OCTOBER 2019
ECONOMIC OUTLOOK

EVALUATING GLOBAL GROWTH VIA BELLWETHERS

Alex Bellefleur, M.Ec., CFA
Chief Economist & Strategist, Mackenzie Multi-Asset Strategies Team

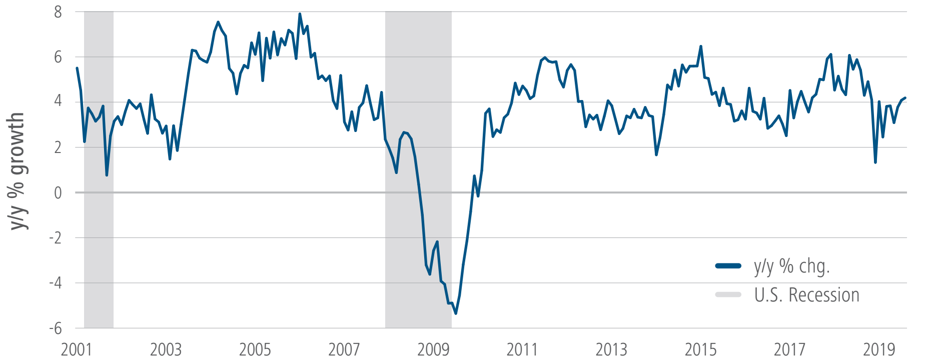
Much of this year's market focus has centered around not only the U.S.-China trade war, but also on the negative impacts on third-party countries, some of which are sometimes heavily dependent on global trade. This is the case of Germany, which has suffered from the slowdown in global trade, idiosyncratic elements playing out in its automobile industry (see last month's comment, *We Need to Talk About Germany*) and its own lack of domestic demand.

Against this tense trade war backdrop, 'bellwether' data points can help to inform our views on the extent to which global growth is suffering from the disruptions to global trade. Let's look at some of these data points to assess the current state of global growth.

The United States: Slowing, but Chugging Along

Much of current slowdown is trade- and manufacturing-centric. Indeed, most of the current weakness in U.S. data stems from these areas and is especially visible in factory surveys. However, we have not yet seen a significant slowdown in U.S. personal consumption expenditures. With the U.S. consumer being mostly driven by domestic factors, the recent acceleration in retail sales growth suggests that the more domestically-focused elements of the U.S. economy remain in reasonably good shape. We are watching closely for signs of a potential deceleration in U.S. consumption expenditures, but so far, the U.S. appears resilient.

U.S. Retail Sales Growth



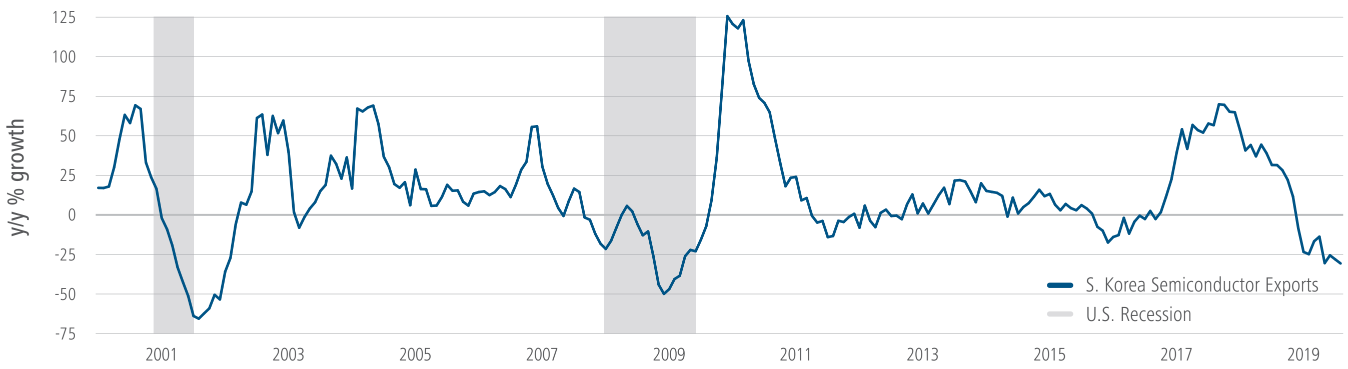
Mackenzie Investments (U.S. Census Bureau data via Bloomberg)

Moreover, recent U.S. housing data has been encouraging. New home sales appear to be increasing, probably on the back of lower mortgage rates, and the inventory of unsold homes is falling. Given the large impact the housing market usually has on the broader U.S. economy, this is another encouraging sign. Our base case for now remains that while the U.S. manufacturing has entered slight contraction territory, consumers and the housing sector will be able to provide a buffer to these more negative trends, allowing the U.S. economy to avoid recession.

Asia: More Difficult

At the other end of the spectrum, the economic data in small, open and trade-oriented economies is not faring quite as well. South Korea is a perfect bellwether for these types of economies due to its large openness to trade and its proximity to China, acting as a hub for global manufacturing and technology exports. As such, semiconductor exports from South Korea are considered to represent a useful gauge of global growth. The decline of the past several months is somewhat concerning, suggesting that the global trade headwinds remain very real, hurting trade-dependent economies.

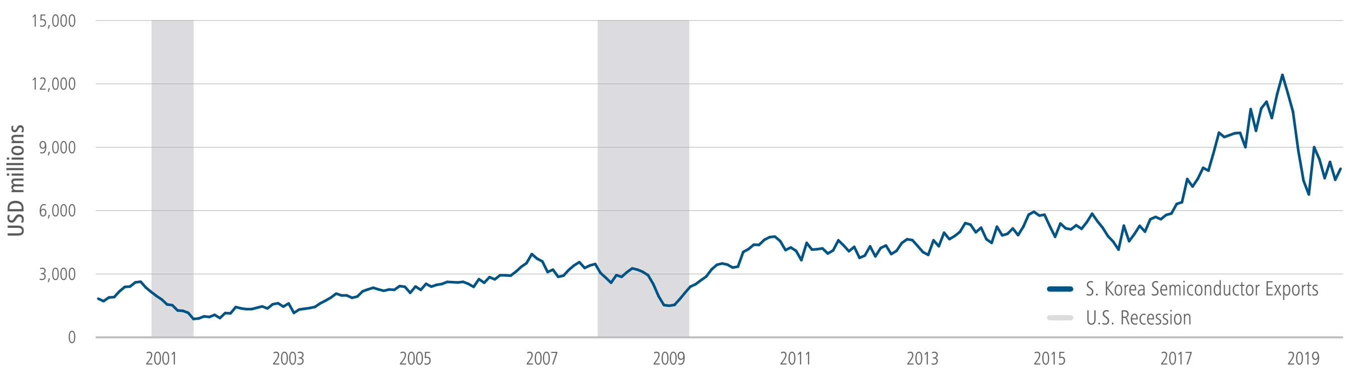
South Korea: Annual Growth in Semiconductor Exports



Mackenzie Investments (U.S. Census Bureau data via Bloomberg)

A 30% annual contraction in semiconductor exports certainly is an eye-catching number. However, it is important to put this data point in its broader context. When considering the longer-term picture *in level terms*, we note that the current slowdown corresponds more to a return to long-term trends after a significant and unsustainable acceleration in 2017. Moreover, most of the contraction took place toward the end of 2018; semiconductor exports have so far stabilized during 2019. Therefore, while it is obvious that this points to a global slowdown, it does not suggest a broader implosion of global trade.

South Korea: Semiconductor Exports



Mackenzie Investments (U.S. Census Bureau data via Bloomberg)

China: Still Slowing

Another interesting bellwether of underlying global growth and inflationary pressures can be found in commodity prices. While real commodity prices tend to decline in the long run, short-to-medium-term fluctuations can provide useful information about underlying pressures of growth and inflation experienced in the world's largest economies. Moreover, given China's significant weight in global commodity consumption, this can help provide useful indirect information on the state of China's economy.

Currently, commodity prices such as copper or crude oil are relatively weak. In the event of an acceleration in Chinese growth and a push towards large monetary or fiscal stimulus, we would tend to see a rally in these economically-sensitive commodity prices. This has not been the case so far in the last few months. In our view, this suggests that Chinese policy makers are so far resisting calls to step up economic stimulus to counter the slowdown from the trade war.

Spot Copper and Brent Crude Oil Prices

Mackenzie Investments (data via Datastream)

Investment Implications

Overall, these bellwether data points suggest that while the U.S. economy remains relatively resilient, global weakness persists. In our view, economies which are more trade-dependent and more exposed to the global slowdown will continue to underperform the United States. The weak global outlook is likely to remain of concern to several members of the Federal Reserve Open Market Committee. For this reason, we think that easy monetary policy from the Fed will continue in the coming months, despite signs of domestic resilience. This continues to justify the tactical overweight position we have in long-duration U.S. Treasuries. This position is also an effective way to manage the risk that the slowdown spreads over to the United States. This is not our central scenario, but it is a risk that we think is important to manage.

Finally, the resilient U.S./weak rest-of-the-world combination continues to support our underweight position in the euro. Without a significant re-acceleration of growth outside the U.S., we think Euro area growth will continue to struggle, forcing the European Central Bank to maintain ultra-easy monetary policy, with negative rates and quantitative easing in place for a long time. Over time, we think this will continue to push investors out of the euro and into other currencies.

1102809 10/19