Economic Snapshot: USA

US Factory Activity Slumps

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Factory activity in the US, as measured by the ISM Manufacturing PMI, dropped to 47.8 in September from 49.1 in the previous month, and missed market expectations of 50.1. The latest reading points to the steepest month of contraction in the manufacturing sector since June 2009, amid ongoing trade tensions with China. All key components of the index fell, including production (47.3), employment (46.3), inventories (46.9), new orders (47.3) and prices paid (49.7). Numbers below 50 represent a contraction, while numbers above 50 indicate expansion.

Figure 1. US ISM Manufacturing PMI

Source: Forsyth Barr analysis, Trading Economics

Trade disputes and weaker macro momentum in China

Global trade remains the most significant issue for manufacturers. The demand for new orders has been contracting since July, with this downside momentum increasing the cautionary views regarding near-term growth.

China has been less willing to prop up domestic demand via stimulus, the impact of which may have been underestimated by the markets. Beijing's more tailored easing measures are designed to put a floor under China's economic activity, rather than boost it significantly via credit fueled growth.

China's slowing growth profile is reverberating around Asia, Europe, and now the US. Electronic exports from Singapore and Taiwan have fallen as have machinery exports from Japan. The demand for new cars has weakened considerably, tourism has slowed, and the next cycle in tech componentry is yet to take off.

Factory weakness may spread to services

Services have so far been relatively shielded from the industrial downswing that has spread around the world. But this sector is not entirely immune. Services activity has continued to expand in most developed markets while employment growth, modest wage increases and low interest rates prevail. But the rate of expansion has been slowing.

The rate of growth in employment is also cooling, as one would expect at this stage of the cycle. The employment indicators in the US are dropping, in-line with declining business optimism. With job creation slowing and business profits under pressure, wage growth is also likely to slow. This will weigh on household earnings growth over the next 12 months and may contribute to a softer services sector and weaker consumption.

Key economic data (as at 2 October 2019)

Figure 2. Key economic data

Country	GDP ($b)	GDP (yoy)%	GDP (qoq)%	Cash Rate %	CPI %	Jobless rate %	Gov. budget %	Debt/GDP %
United States	20,494	2.3	2.0	2.0	1.7	3.7%	-3.8%	106.1%

Source: Forsyth Barr analysis, Trading Economics

Recent economic releases — employment strength belies manufacturing weakness

- US economy expands at an annualised +2.0% in Q2, down from +3.1% in Q1
- US factory activity shrinks the most in a decade in September
- US consumer sentiment revised higher in September
- US personal spending below forecasts in August.

Economic outlook — US inflation nudges higher

US CPI headline inflation hit +1.7% in August, with the core CPI rising to +2.4%. The Fed is more interested in the personal consumption expenditure deflator (PCED) as a broader measure of consumer inflation. The core PCED rose to +1.8% in August, still below the 2.0% target but with an upward bias. US inflation is trending at a higher rate compared to the Euro area and Japan. Trend economic growth has been stronger in the US, which is one explanation. But the key difference is most likely that the US includes a far higher 'rent-of-shelter' component in its inflation measure, than do the other two regions.

Wage growth continues to pick up in the US, so unless productivity trends higher as well overall inflation may continue to rise. The recent up-tick in consumer prices coincides with an increase in tariffs and a reduction in interest rates as the Fed moves into an easing mode. If the services sector remains strong due to lower interest rates (unlike our front page scenario) then consumer inflation is likely to continue picking up.

With more rate cuts expected and potentially higher domestic inflation (CPI), real rates in the US look likely to fall. This should set the scene for a weaker USD.

Strong USD has contributed to the trade downturn

The purchasing power of the USD has been increasing in line with its appreciation. But the stronger currency has eroded the competitiveness of US exporters and has been an earnings headwind for US multinationals, where most of their revenue is sourced outside the US. The stronger USD has also eroded the financial position of many emerging economies that rely on USD funding, and raised the debt servicing costs for global companies who have borrowed in dollars. In summary, the strong USD has acted as a handbrake on the global economy. Two years ago, when the USD was declining, global manufacturing was expanding strongly, US exports rose strongly, and factory activity in many economies hit cyclical highs.

A weaker USD could boost growth and equities

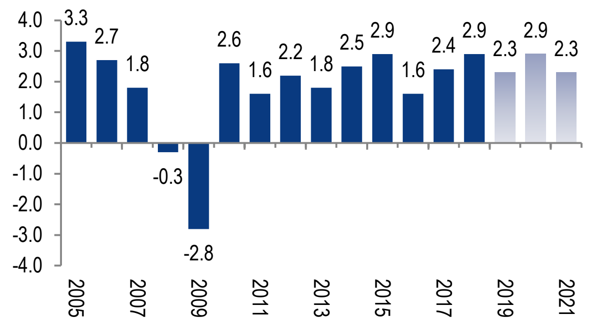
The Q3 earnings season is shaping up to be reasonably weak. The average decline in Q3 EPS for the S&P 500 is forecast to be ~-4.0%. The strength of the USD has been noted as a key headwind for US earnings growth. A receding USD would ease some of this pressure.

As a historical precedent, the Plaza Accord in the mid 1980s was effective in lowering the USD. The subsequent two years saw a shoring up of US growth and a strong run up in equity markets. The negative impact of a weaker US dollar was translated through a spike in Treasury yields, which eventually led to the "Black Monday" shock in October 1987. The Dow fell -22% in a single day. So while a weaker USD is desirable from an earnings and growth perspective, it won't come without disruption — particularly to interest rates and credit markets.

Lower real rates is the key to a lower USD

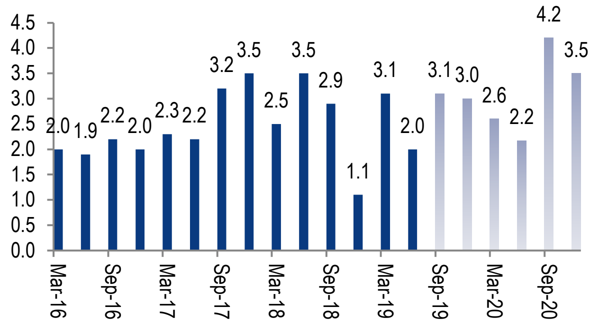
The Fed is easing but so too are other major central banks. However, most other economies do not have much more room to go — while the US does. If the Fed continues to cut rates and inflation stabilises or moves higher, US real rates will fall. This will be the catalyst for investors to dump the USD and move back into the EUR and JPY.

Figure 3. Real GDP (annual YoY %)



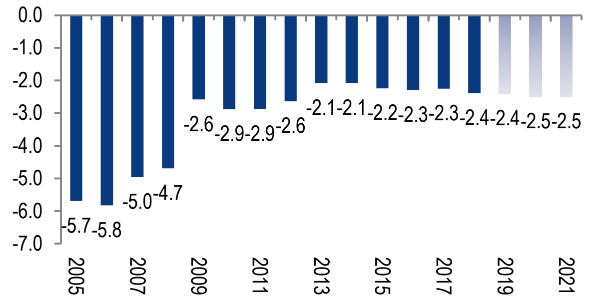
Source: Bloomberg, Forsyth Barr analysis

Figure 4. Real GDP (annualised QoQ % SAAR)



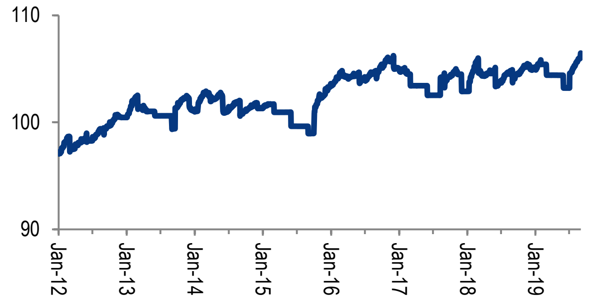
Source: Bloomberg, Forsyth Barr analysis

Figure 5. Current account balance (% of GDP)



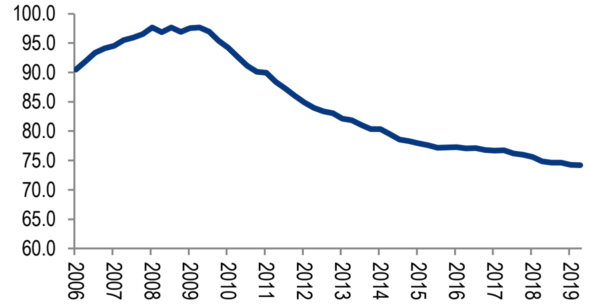
Source: Bloomberg, Forsyth Barr analysis

Figure 6. Government debt (% of GDP)



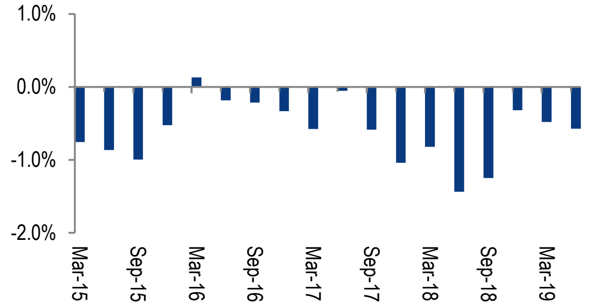
Source: Bloomberg, Forsyth Barr analysis

Figure 7. Household debt (% of GDP)



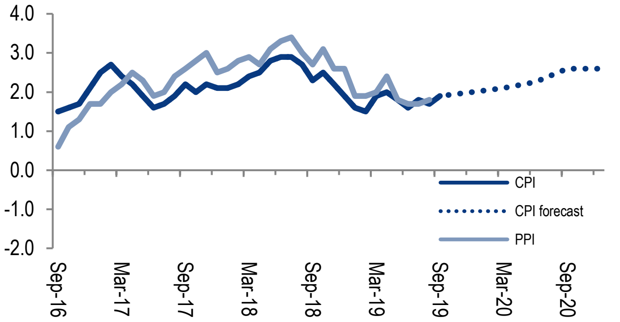
Source: Bloomberg, Forsyth Barr analysis

Figure 8. Change in household debt to GDP (rolling six months)



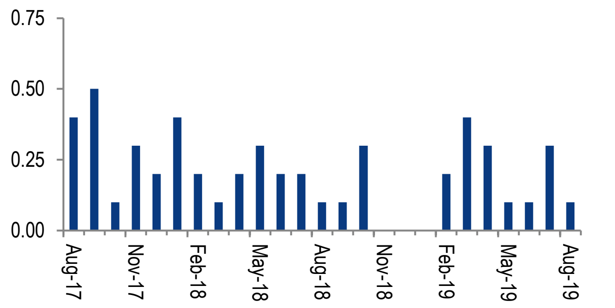
Source: Bloomberg, Forsyth Barr analysis

Figure 9. CPI and PPI (YoY %)



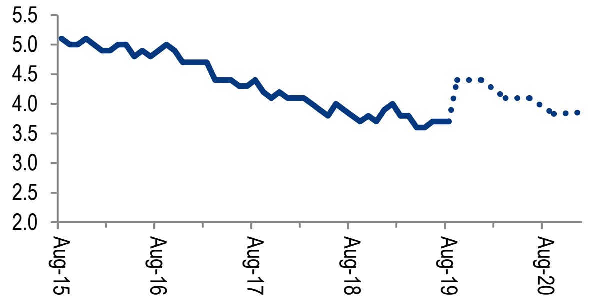
Source: Bloomberg, Forsyth Barr analysis

Figure 10. CPI momentum (MoM%)



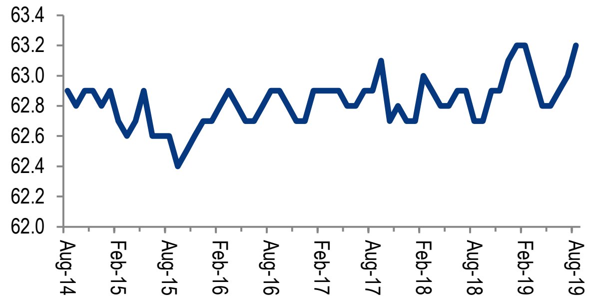
Source: Bloomberg, Forsyth Barr analysis

Figure 11. Unemployment rate (%)



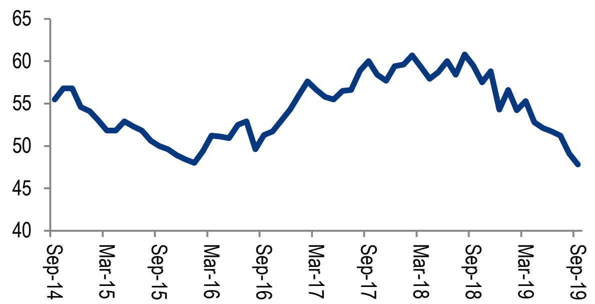
Source: Bloomberg, Forsyth Barr analysis

Figure 12. Labour force participation rate (%)



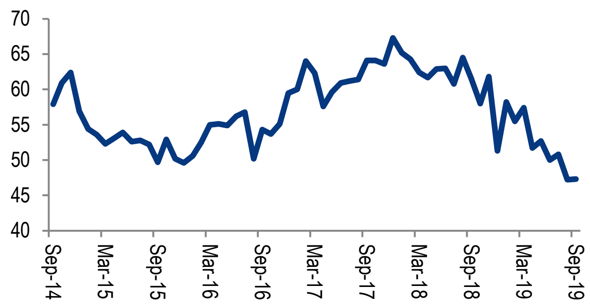
Source: Bloomberg, Forsyth Barr analysis

Figure 13. Manufacturing PMI



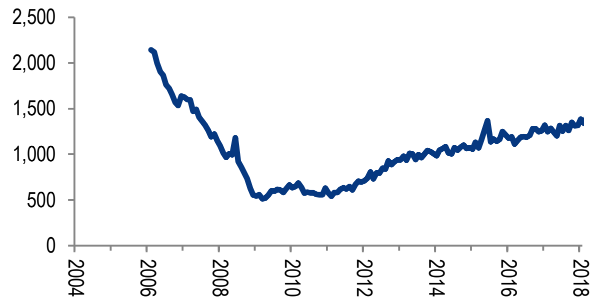
Source: Bloomberg, Forsyth Barr analysis

Figure 14. PMI new orders



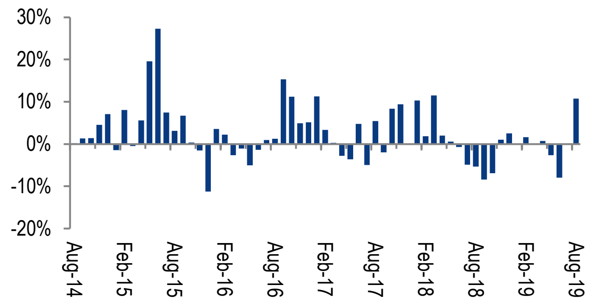
Source: Bloomberg, Forsyth Barr analysis

Figure 15. Private housing building permits (thousands of units)



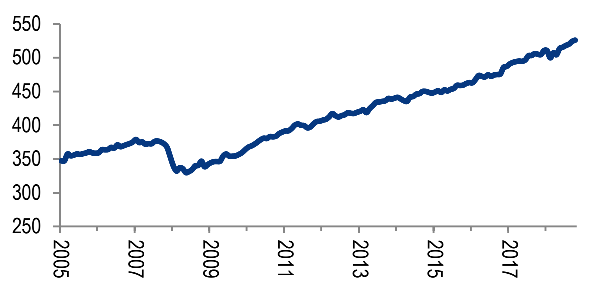
Source: Bloomberg, Forsyth Barr analysis

Figure 16. Change in building permits (rolling six months)



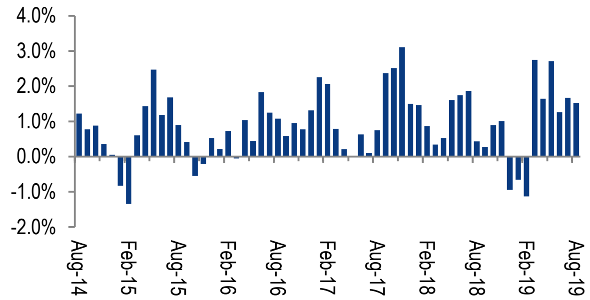
Source: Bloomberg, Forsyth Barr analysis

Figure 17. Adjusted retail & food services sales (US$ bn)



Source: Bloomberg, Forsyth Barr analysis

Figure 18. Change in retail spending (rolling three months)



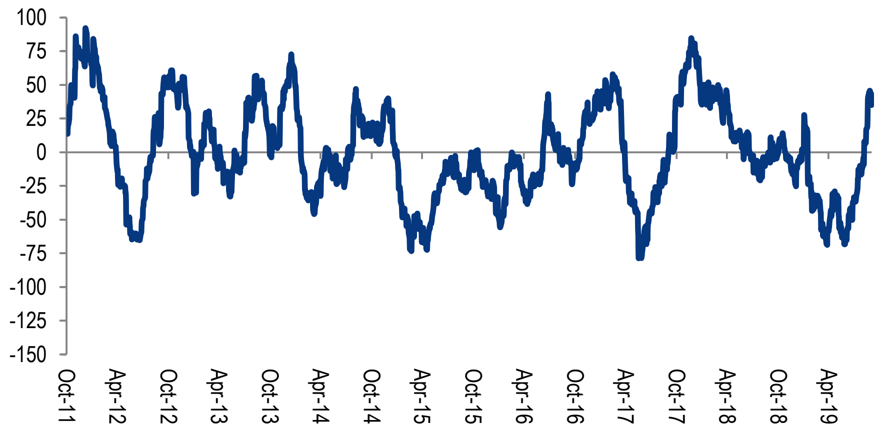
Source: Bloomberg, Forsyth Barr analysis

Figure 19. Economic data

	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Annual GDP: Nominal ($b)	14,560	14,628	15,241	15,796	16,359	17,083	17,850	18,351	18,992	19,919	20,898		
Annual GDP: Real ($b)	15,328	15,356	15,751	16,004	16,239	16,664	17,143	17,469	17,824	18,323	18,784		
YoY GDP Growth	-0.3%	-2.8%	+2.6%	+1.6%	+2.2%	+1.8%	+2.5%	+2.9%	+1.6%	+2.4%	+2.9%	*+2.3%*	*+2.9%*
Current Account % of GDP	-4.7%	-2.6%	-2.9%	-2.9%	-2.6%	-2.1%	-2.1%	-2.2%	-2.3%	-2.3%	*-2.4%*	*-2.4%*	*-2.5%*
Inflation (YoY)	+3.9%	-0.4%	+1.6%	+3.2%	+2.1%	+1.5%	+1.6%	+0.1%	+1.3%	+2.1%	+2.5%	*+2.1%*	*+2.4%*
Unemployment Rate	+7.3%	+9.9%	+9.3%	+8.5%	+7.9%	+6.7%	+5.6%	+5.0%	+4.7%	+4.1%	+3.9%	*+4.4%*	*+3.9%*
Retail Sales Growth YoY	-11.3%	+4.2%	+6.7%	+6.1%	+4.3%	+3.4%	+3.8%	+2.8%	+3.7%	+5.4%	+1.4%		
New Housing Starts	560	581	539	694	976	1,010	1,081	1,138	1,268	1,210	1,142		
Manufacturing PMI	34.5	55.8	56.6	53.0	49.8	55.9	54.6	48.4	54.3	59.4	54.3		

Source: Bloomberg, Forsyth Barr analysis

Figure 20. Citigroup economic surprise index



Source: Forsyth Barr analysis, Citigroup Global Markets