Synchronized global slowdown? Weak ISM manufacturing data.

The latest ISM manufacturing number declined sharply from 59.3 to 54.1, a disappointing number, but not an unexpected one. Manufacturing is global whereas non-manufacturing is more domestic. Given the weakness in manufacturing PMIs in Europe and Asia, it was surprising that the US manufacturing PMI was so resilient. A decline was to be expected.

In the US and China, non-manufacturing PMIs remain robust, even as manufacturing PMIs decline, recalling the period 2010 – 2015, where global trade as a proportion of GDP was declining. This period might be regarded as a period of Cold War in Trade; a first salvo. The current situation is an escalation in this conflict and evokes comparisons with that period.

Corroborating this is the base metals index which fell from 2011 through 2015. Manufacturing recessions correlate with materials recessions. 2016 – 2017 was a reprieve in world trade where trade as a percentage of GDP rose. It coincided with a recovery in materials.

The USD strengthened in the periods of trade, manufacturing and materials recession. As the largest net importer in the world, and with the world's most important trading currency, this is to be expected.

There is a difference today. Whereas from 2010 – 2015, central banks were accommodative almost universally, today the US Fed is raising rates and shrinking its balance sheet. This could threaten the general economy and cause non-manufacturing PMIs to decline in sympathy with manufacturing. Given where interest rates are, the risk remains low but will increase with each rate hike and as the Fed's holdings of US treasuries dwindles. The impact on the USD could be further to the upside.

Early 2018 saw synchronized global expansion, but also saw the peak of it. Early 2019 is seeing the beginnings of global synchronized slowdown. The question is when it peaks and where does it peak first? In Q1, or Q2, or longer? In China, or the US, or Europe?

The US is latest into the slowdown. Europe and China were first. Should we expect Europe and China to lead in peak slowdown? Central bank policy will play a part. The ECB may not be able to be as hawkish as it has represented. It has already backtracked on economic forecasts. The PBOC has been tightening since early 2018 and has already had to backtrack on actual policy with reserve ratio cuts and increased credit facilities to the banking system. Will the Fed reverse course on its rate hikes and normalization? On current data, there is no need, but it may do so if the economic data weakens. This weakness could be delayed. Non-manufacturing, the larger portion of the US economy could prop up the economy for longer. However, we are now seeing data suggesting an incipient slowdown, in more equivocal labour statistics.