GREENLEAF TRUST

Perspectives

AUGUST 2019
VOLUME 28, ISSUE 8

Economic Commentary

William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

Current economic data and news seems mostly positive, and yet there are those who are uneasy about the near-term future and seem increasingly convinced that a recession is not far off. Why is there seemingly a disconnect between the current condition and what lies ahead of us? In this month's article, we will try to offer some perspective on the topic.

While it is true that the consumer is employed, labor participation rates are increasing, and wages are growing, many economists would argue that those are at best current data points and at worst lagging indicators. Further, they would suggest that those data points are "rear view mirror" measures that reflect the conditions of previous months and quarters, not predictors of future conditions.

> "So there you have it, economies representing over 73% of the total global economy are producing PMI survey results at or near recessionary levels."

Retail sales increased for the month of June, in large part due to employment and consumer confidence, yet it reflected the first advance since the first quarter of the year; a good number of economists would certainly claim retail sales to be a revelation of what did occur and not what will happen in the future. In fact, of the fifty economic indicators, whose data collection results are released monthly (70%) and quarterly (about 30%), most would reflect results that have occurred and are not predictive about the future.

In essence, most economic analysts would evaluate the current condition of our economy as that of moderate growth as measured by the data sets that we currently have. They would also caution that moderate GDP growth would only continue if the economic conditions that are currently in place continue without change. What signs are economists seeing both globally and domestically that have them concerned?

China

The Chinese government reported that in the second quarter of 2019, China's economy grew at 6.2%. In isolation, a growth rate twice the amount of our expected GDP might look very robust; however, the 6.2% growth rate announced was the slowest rate of growth in twenty-seven years (when the Chinese government began publishing growth numbers). The rate published was within the government's expected range of growth (6.5%) but confirms that their growth rate is slowing.

As our Federal Reserve has turned more dovish (easing rather than increasing rates) so too have many other central banks. The European Central Bank (ECB) signaled an intent to ease monetary policy as have the central banks of Indonesia, South Africa, South Korea, New Zealand, India, the Philippines, and Malaysia, which are all significant trading partners of China. Central banks all utilize the tools on hand to stimulate growth and control inflation, and it is clear that the global move is to assist growth and is therefore an indicator that the risk of recession globally is increasing.

We have stated before that the PMI (purchasing manager index) is a reflection of current manufacturing activity and, therefore, optimism. A recording below 50% on the survey implies contraction and conversely results above 50% demonstrate growth. The current recording for the US PMI in June was 50.6% while the 19 member Eurozone PMI fell to a six-year low of 47.6%. The United Kingdom posted a six year low as well at 48.0%, and China came in at 49.4%. So there you have it, economies representing over 73% of the total global economy are producing PMI survey results at or near recessionary levels.

Brexit

The United Kingdom has a new Prime Minister who must now deliver on promises made to his political party, the Conservative party, and to the citizens of the United Kingdom who voted for the United Kingdom's exit from the European Union over three years ago. Prime Minister Johnson was a vocal leader of the Brexit movement and has stood in stiff opposition to any attempt to exit the European Union under any terms negotiated by the former Prime Minister Theresa May. The United Kingdom has its own Central Bank and is a trading partner with the entire globe, yet the terms of trade between the European Union and the United Kingdom have expired, and the opportunity to continue as is, is quickly coming to an end. The change in leadership will allow Prime Minister Johnson to extend the agreement date until October; however, the expectation of his success by his party and those who voted for Brexit is enormously high, and therefore results must be attained. As a political leader, he stood his ground and gained political capital among the conservatives in the United Kingdom. His negotiation, however, is not with them but with 18 trading partners, which includes the messy and complicated agreement with Northern Ireland. We could write an entire article about the complexity of the needed agreements; however, the real impact for the rest of the globe is the continuation of commerce and trade. Until the resolution is known the economic forecasts are more clouded than clear and add an element of concern for global GDP.

Anti-Growth Policies

There are many surveys of CFOs among large global consulting companies and in last month's article I referenced McKinsey as one of them. Another survey that is gaining traction for thought leadership is the Duke CFO survey produced by Duke's Fuqua School of Business. The survey has concentrated on the forward focus of CFOs of the largest US companies. On the question of recession, the survey is clear. Two thirds of the survey respondents feel that we will enter a recession in 2020 with the undercurrent of thought being in three main categories: Current US trade disputes with significant trading partners; Tariff policy and Brexit uncertainty; and lastly, there was significant mention of the length of our current expansive business cycle at 121 months.

Geopolitical

We have endured over six decades of tensions and wars in the Middle East in the post-World War II era and the present escalation of tension between the US and Iran adds to the uncertainty of the continuation of global trade and commerce.

> "... the present escalation of tension between the US and Iran adds to the uncertainty of the continuation of global trade and commerce."

The conflict is, at its core, the perception among the Shi'a sect of Islam that the US supports the Sunni sect of Islam (representing approximately 85% of all Muslims) even though within both the Shi'a and Sunni sects there are many smaller sects. The historical legacy of conflict between Iran and the US is long and amplified by the US backing of the Shah of Iran, prior to the Iranian Revolution, which was followed by Iranian hostage taking during the Carter administration and now failed denuclearization. There is a difference between political tension and war when it comes to global economic activity, but the increasing military buildup has elevated a long-standing political conflict to the top of the economic concern list.

So the essence of thoughts among mainstream economists seems to land around the acceptance of an economy that is growing moderately yet facing some stronger headwinds that could slow growth in the future months. Events that change the condition that we are in are not easily predictable with respect to probability, but are always easy to identify as "increases in risk," and I think that is a fair place to land.