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Baltic Dry Index, Trade war and Coronavirus
Coming this week (Feb.3 – Feb.9)
and
Brexit and weak business cycle
What to keep in mind from last week (Jan. 27 – Feb.2)

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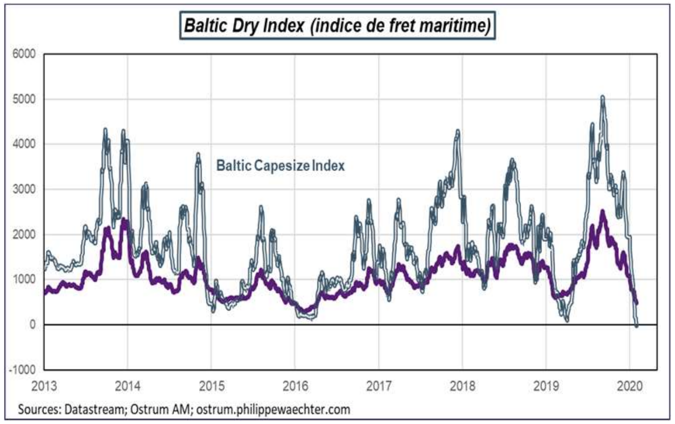
HIGHLIGHTS

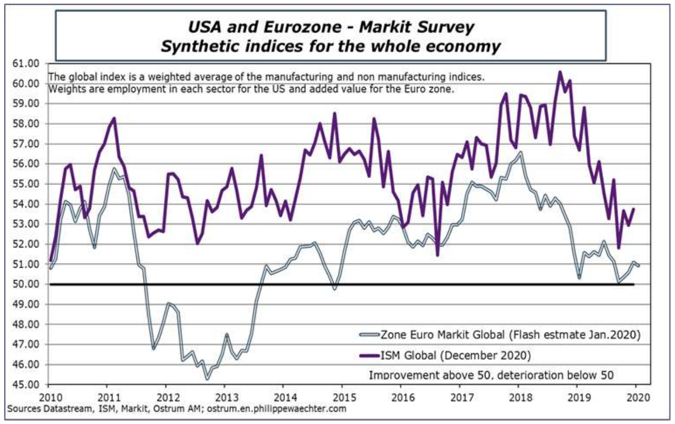
- **World trade is at risk with the Coronavirus**
  Day to day measures of the world trade momentum are on the downside. This reflects the impact of the coronavirus leading to a sudden stop in trade.
  The global economic outlook is at risk. One source of concern is the absence of help from the US. The White House doesn't want to postpone the trade agreement and the White House that the epidemic will encourage US companies to repatriate their activity in the US. That's a new side of the trade war.
- **ISM and Eurozone Markit global indices (February 5)**
  Recent data suggest that a stabilization is nigh. This will start with the manufacturing indices (as show by the ISM). But risks are still on the downside as corporate investment is weak everywhere, showing that non one is able to reduce the uncertainty.
- **Productivity in the US for the fourth quarter (February 6)**
  The US productivity trend is the lowest since WWII. This weakness explains the low trend on GDP growth. As immigration is limited now and in the future, the capacity to grow for the US economy is lower than in the past (Growth is productivity plus employment)
- **Employment report for January in the US (February 7)**
  Data on jobs will remain robust in the short run but this will not push wages on the upside. That will allow the Fed to drop its rate if necessary
- **US external trade for December and for the whole year (February 5)**
  Recent improvement came from the rapid and deep contraction of US imports. .
- **German industrial orders for December (Feb.6) and external trade and industrial production (7)**
  The last 12 month drop in industrial orders is probably over. The strong rebound on the Markit new orders index is good news on this front.
- **Other statistics**:
  Retail sales in the Euro Area for December (Feb.5), industrial production indices in France and in Spain (7). French employment for the 4th quarter (Feb.7), Chinese external trade for January (7). This latter will show how the Chinese trade has been affected by the epidemic.

NEXT WEEK'S MAIN DATA AND EVENTS PAGE 1

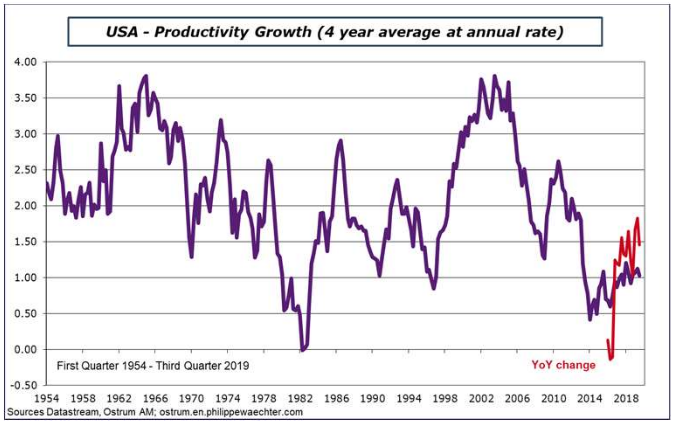
- **World trade is at risk with the Coronavirus**
  The epidemic has had a strong impact on trade as shown by the graph. The Baltic Dry Index is an assessment of the average price to ship raw materials on a number of shipping routes and by ship size. It's considered as a leading indicator of the global economic activity. It's the average of 4 sub-indices. The Capezize shown on the graph is the most volatile of the four but also the most liquid contract of the four. Since the peak of January the 4th, the Capesize index has plunged to 0. The Baltic is down -69% since this date and other sub-indices are down between -34 and -56%.
  It suggests that the world trade momentum will decrease again. It was at -1.3% on a year last November but it can contract more in coming weeks depending on the contagion of the epidemic. The risk on the global economy is high and worrisome.



- **ISM and Eurozone Markit global indices (February 5)**
  Surveys from ISM in the US and Markit for many countries will be available this week. The manufacturing indices for both types of surveys will be available on Monday 3 and the services and composite indices will be released on February the 5th.
  The relative stability in the manufacturing sector indices and the robustness of the services indices suggest that the perception of the world economy is more positive at the beginning of the year. It's not yet at a level that will persuade central banks to change their strategies.
  In February and March the contagion effect of the coronavirus (see above) will be higher than in January. It may lead to a new and deeper recession in the manufacturing sector.

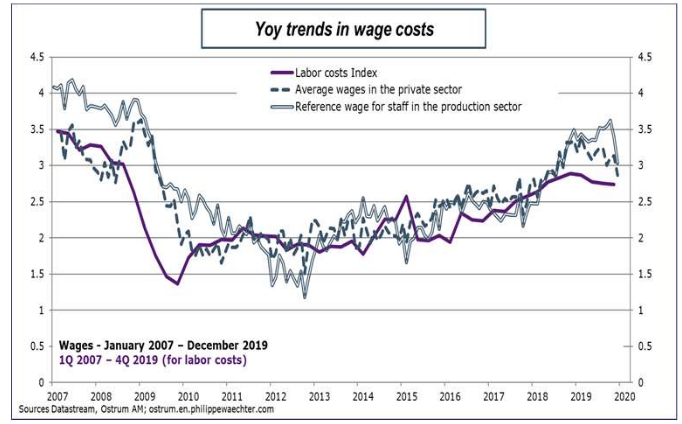


- **Productivity in the US for the fourth quarter (February 6)**
  As shown on the graph, the US productivity trend is very weak in this business cycle. It is not comparable to any episode of the past (at least since WWII). This is a source of lower GDP growth where strong employment growth doesn't balance the low productivity momentum. The interesting point is that it is not associated with high Unit Labor Costs contrary to what theory suggests. This means that there is no inflationary bias in the US economy.

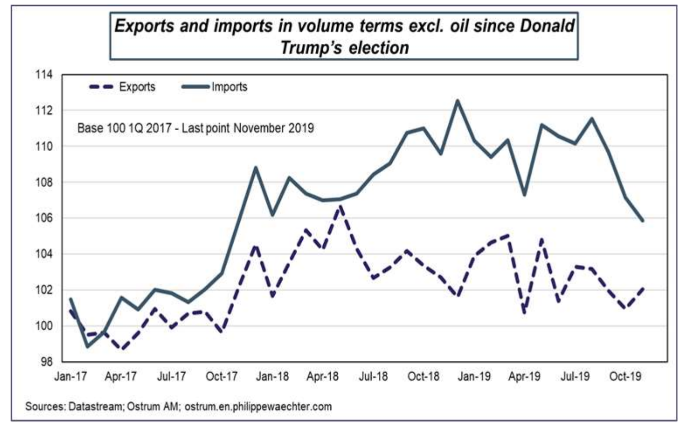


NEXT WEEK'S MAIN DATA AND EVENTS PAGE 2

- **Employment report for January in the US (February 7)**
  The employment dynamics was robust in 2019 with a net 176 000 new jobs every month on average. It should continue more or less on this trend at least in the short run.
  The main question is still on the wage profile. It was down at the end of last year and larger measures as the Employment Cost Index or the Unit Labor Cost do not suggest that these measures are wrong. This will be a topic to look at with attention this year as the Fed is expected to lower its rate. The probability of two moves on the downside is quite high. This strategy would be in question in the case of higher wages and the risk of a higher inflation rate.



- **US external trade for December and for the whole year (February 5)**
  In the US GDP analysis for the last quarter of last year, the main source of weakness was the slide in imports.
  The graph shows that in real terms and excluding oil, imports have declined by -13.5% at annual rate between the third and the fourth quarter (at the end of November). It's the cost of Trump trade policy. It's quite expensive and it will continue as the White House doesn't expect to change it rapidly.
  Therefore the recent improvement in the US external trade comes from lower imports rather than higher exports. Clearly not a virtuous behavior.



- **German industrial orders for December (Feb.6) and external trade and industrial production (7)**
  Industrial orders have a good chance to rebound at the beginning of this year if they follow the Markit index for new orders in the manufacturing sector.
  The question will be on its geographical composition (Domestic orders have been weak recently) and by type of goods (Capital goods are important for global investment)

- **Other statistics**
  Retail sales in the Euro Area for December (Feb.5), industrial production indices in France and in Spain (7). French employment for the 4th quarter (Feb.7), Chinese external trade for January (7). This latter will show how the Chinese trade has been affected by the epidemic.

WHAT TO KEEP IN MIND FROM LAST WEEK (JANUARY 27 – FEBRUARY 2)

- **The Brexit is done**
  The main question after the launch of the Brexit, last Friday, is to know how things will change and at which speed. In a recent post on my blog I said that political polarization was the most important point. It says that in a heterogenous society, economic decisions will be depend mainly on political choices. It means that the most rational choices are necessarily those to be chosen.
  It also means that excess will probably be seen in the coming weeks and months. The strong political support for Brexit may lead some Brexiters to anticipate what they expect after the effective and definitive exit at the end of the year. For the moment, it's just anecdotal as Guernsey that doesn't allow French boats in its fishing perimeter.
  The starts of negotiations has shown that Michel Barnier for the European Commission and Boris Johnson do not share the same vision of the expected agreement. On the one side, Michel Barnier wants the UK to respect rules to have access to the single market, rules that are rejected by Boris Johnson. It's too early to have a judgement on this negotiation but a long lasting disagreement would allow many Brexiters to expect that the divorce could be without agreement. In that case, the real Brexit would start before the end of the year. The smooth transition will no longer exist and the hard Brexit will be the real story.
- **On the Coronavirus**
  Two issues here: one is associated with the risk on the world trade momentum as seen with the Baltic Dry Index. The other point is the Chinese central bank reaction to limit risks on the economy and on financial markets. The Pobc has added huge amounts of liquidity (USD bn175) and dropped its main rate by 10bp. At the same time, the Chinese government try to contain the epidemic.
- **US GDP growth was at just 2.1% in the fourth quarter (annual rate) and at 2.3% for the whole year (vs 2.9% in 2018)**
  The contribution from domestic demand is weaker at 1.7% (vs 2.3% in Q3 and 3.7% in Q2. Consumption expenditures have had a lower momentum but the main source of concern is non residential investment which now has been down for the third consecutive quarters. After the fiscal boost in 2018 that pushed the economic activity on the upside, the domestic demand is converging to a low trajectory as large uncertainty constraints behavior. Most of this uncertainty comes from the US trade policy and its consequences. The recent epidemic could push the economy on a lower profile.
  The carryover for 2020 at the end of 2019 is 0.8% comparable to last year carry over.
- **Euro Area GDP: weak almost everywhere even in Spain**
  The Euro area growth was just 0.4% in Q4 (at annual rate) and will be 1.2% for 2019 while it was -0.33% in France (1.2% in 2019); -1.35% in Italy (0.2% in 2019) and +2.1% in Spain (2% for 2019). But in Spain the main contribution is external trade with positive exports but very negative imports. At the same time consumption expenditures dropped to 0 and investment was negative. The internal demand contribution was negative. In France, the internal demand was lower on lower investment and the global figure was negative as inventories' contribution was deeply negative. It means that a rebound can be expected in the first quarter. Nevertheless growth for 2020 will probably be lower than 1% while the government expectations are at 1.3%. It will have a cost on budget (EUR bn7)

ADDITIONAL NOTES

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