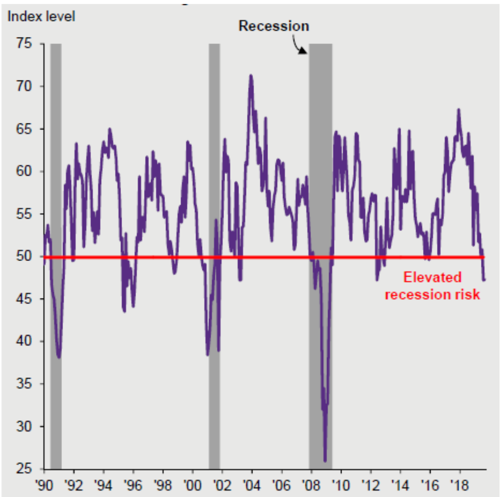
IS A RECESSION LOOMING?

In previous weekly comments and numerous alternate financial commentaries alike, the perceived correlation between an inversion of a country's sovereign yield curve and the prospect of an imminent recession have been highlighted. In this weekly comment I want to avoid making judgments based on this indicator alone, as its reliability in isolation has been questioned and instead look at additional signals that may be evident.

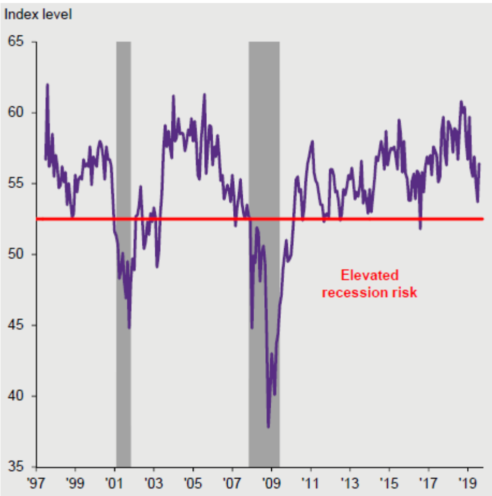
Historically, manufacturing has been an important bellwether of the health of a country's economy and one way in which this is measured is through the Manufacturing Purchasing Managers' Index (PMI). Compiled by the Institute for Supply Management, this expresses the output from a monthly survey of a country's manufacturing firms in numerical form, with a reading above 50 indicating growth and below 50 indicating contraction within the sector.

As a consequence of US policies on trade and subsequent responses from Chinese authorities, global manufacturing readings are showing signs of a widespread downturn. In the US, the PMI is at its lowest levels in over a decade at 47.8, the Eurozone readings having shown contraction since February of this year (current 45.7), the UK is just coming off of a six-and-a-half year low rising from 47.4 to 48.3. Among the major economies, the only bright spot is that Chinese data has surprised on the upside in August with a reading of 51.4, after readings of 49.4 in June and 49.7 in July. Based on these figures, it could be argued that manufacturing data points to the potential of a forthcoming global recession.

US ISM manufacturing: New orders



US ISM non-manufacturing



Source: JP Morgan

However, the manufacturing component of the largest global economies is far less significant than has historically been the case, particularly within the developed market world, where the service sector now contributes the majority of most countries' GDP. Taking the US as an (albeit extreme) example, manufacturing contributed only 12% to GDP in 2018; moreover, even China's GDP composition is now more reliant on services than manufacturing, with the services sector contributing 52.2% of GDP.

Whilst services remain resilient, a global contraction and subsequent recession is unlikely. The US continues to expand its service sector, with the latest reading of the Services PMI confirmed at 50.9 and along with China, whose reading also indicated expansion, at 51.3 (the weakest reading since February however), meaning the world's two largest economies should stimulate growth in the broader global economy.

Other data also suggests that US economy remains, arguably, in a relatively healthy state, particularly in respect of consumer activity and GDP is forecast to increase (consumer spending makes up 70% of the US's GDP print). Commentators point to the latest jobs and wage data as further evidence, with the headline unemployment rate falling to 3.5% and incomes modestly rising. On the flip side of that, others would contend the rate of consumer spending is slowing, climbing only 0.1% in August, its weakest increase in 6 months, and companies are spending less on capital equipment.

Elsewhere, the latest UK services PMI of 49.5 indicated the sector is in decline, which, when combined with the manufacturing Index release indicates the economy contracted 0.1% over the 3rd quarter after shrinking 0.2% in Q2. Elsewhere, the Flash Eurozone Services PMI Activity Index came in at 52, coupled with the manufacturing equivalent this leaves the Eurozone Composite PMI on the brink of falling below 50, currently at 50.4: a 75-month low. The region's largest economy, Germany, after shrinking 0.1% in Q2, will hope the increase in industrial production in August will alleviate fears of falling into recession.

As the foregoing comments suggest, the global economy is in a precarious position and a lot, as ever, is reliant on the US and China to provide the engine for growth and stimulate demand. Meanwhile, the likes of the UK, Germany, Italy, parts of Latin America, South Korea and Russia, amongst others are in, or on the verge of, recession. The credit rating agency, Fitch, is predicting global growth to fall to 8-year lows in 2020 citing the US-China trade tensions as the main catalyst. The PMI data would perhaps support this forecast.

Blair Campbell
Portfolio Manager (Guernsey)

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