Talking Points

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Global Trade is Falling Down, Falling Down

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Following a crackling six-week surge, global equities took a step back this week on a wave of soft economic data—especially from Europe—and renewed concerns over prospects for the U.S./China trade talks. After brushing up against the 200-day moving average earlier this week, the S&P 500 dipped through the back-half amid trade jitters. In tandem, longer-term Treasury yields revisited levels not seen since the opening days of the year (the 30-year fell below 3%). While the rally in North American bonds has been impressive, it can't hold a candle to the move in German bunds, where the 10-year yield has careened down to just 8 bps (yes, 0.08%) from a peak of 77 bps almost exactly a year ago. Completing the risk-off move this week, the U.S. dollar took a small step forward and oil prices sagged somewhat.

The main driver for this week's moderate market angst was not the State of the Union, it was the **State of the Global Economy**. A suddenly much more subdued tone around the negotiations with China—which resume in Beijing on February 14, at a "high level"—rattled the cozy consensus that a half-loaf deal could be reached by the March 1 deadline. It turns out that the Presidents are not going to meet before then, suggesting that an extension of talks may be the best possible outcome at this point.

Suffice it to say that **we have long been sceptics on a successful conclusion on the U.S./China file**. Consider, for example, the painful NAFTA negotiations: In that case, we had a perfectly good agreement to begin with, a moderate bilateral imbalance (between the U.S. and Mexico), and generally positive relationships between the three, and it took more than a year of hard bargaining. In this case, we have no current deal, a massive bilateral imbalance, the U.S. aiming for structural changes, and two adversaries at the table. Simply, there is no way that a full-meal deal can be reached in a short period of time. Whatever unfolds in the next three weeks, one would suspect that this issue will hover over markets for many, many months to come.

As a brief sidebar on NAFTA/USMCA, note that even this—seemingly uncontroversial—deal is going to face tough sledding in Congress (see this week's *Focus* for some of the procedural details). A piece this week in the New York Times indicated that the USMCA faces serious resistance on both sides of the aisle, and of course it arrives at a time of a Grand Canyon-style political divide. The fact that a number of Republican Senators are warning the President not to terminate NAFTA (in order to force the House's hand on USMCA) is cold comfort; it's a positive that they are prodding him, it's a negative that they feel the need to do so. From Canada's perspective (and Mexico's), the prospect of many more months of uncertainty on the trade file is about as welcome as endless replays of the Super Bowl half-time show. But at least the two NAFTA partners may be spared some of the worst possible protectionist measures, since they won't be responsible for any delays in the new pact.

On top of ongoing concerns about the outlook for trade, we saw a wave of weak trade and production data looking backwards this week. Recall that it was only in late

September that the U.S. imposed the latest round of big tariffs on China (10% on $200 billion of imports), and the global data may now only be catching up with the resulting chill in activity. **Germany, in particular, has been harshly sideswiped by the cooldown in trade**, and in China's economy specifically. As one wag put it, *"another day, another piece of terrible German data"*. The stand-out was a fourth consecutive monthly drop in industrial production in December, leaving it down a hefty 3.9% y/y. That's weaker than in the depths of the Euro crisis, and cannot be explained away by any special factor as many sectors are flagging. This coming week will bring Q4 GDP results for Germany and the Euro Area on Thursday, and we look for gains of just 0.1% and 0.2%, respectively.

To highlight **just some of the other sickly figures pointing to a notable slowdown in global trade**:

- The Baltic Dry Index fell to its lowest level in almost three years this week and is now down 44% y/y.
- U.S. imports tumbled 2.9% in the (delayed) November trade figures.
- A measure of global trade volumes (from CPB) sagged 1.3% in the three months to November, its biggest slide since mid-2015.

In this environment, there was a wave of downgrades to the 2019 growth outlook in the industrial world, which, in some cases, took an end run around our already subdued forecasts. Most notably, the EU carved its call for GDP this year to 1.3% (from 1.9% as recently as November), while the BoE cut the U.K. call to 1.2% (from 1.7%, also in November). Even the lucky country got into the act, with the RBA slicing its GDP outlook half a point (albeit to a still solid 2.75%—this is, after all, the country that hasn't had a recession since pre-internet days, or around the time the wheel was discovered). While none of the revised forecasts are especially controversial or surprising, the synchronicity of the sudden downgrades is telling, and simply reinforces the point that **we are in a very long pause for interest rate hikes globally**.

The Bank of Canada was arguably at the forefront of the global growth downgrades, having chopped its 2019 call way back in the first full week of the year. At that time, the MPR sliced the GDP outlook to 1.7% (a snick below our current call of 1.8%) and down from the previous 2.1% projection. And recent results such as the 0.1% drop in November GDP and ongoing softness in domestic auto sales (-7.3% y/y in January) seemed to fully reinforce the more subdued outlook.

Of course, in oh-so-typical Canadian fashion, this week's run of data suddenly turned perky, highlighted by a powerful 66,800 jump in January jobs (replete with a record 111,500 surge in private sector positions), as well as solid readings on permits and starts. While we wouldn't call employment a lagging indicator—it's actually a very good co-incident indicator, historically—Canada's jobs figures are about as consistent as the Rams' offence (but the punting, wow). Beyond that unreliability, headline job gains are flattered by the fact that the working age population is soaring as well, up a record 432,000 in the past year (or 36,000 a month). In other words, Canada requires a steady stream of employment gains that appear strong on the surface, just to keep the unemployment rate steady. It's striking that even after just reeling off the strongest five-month run of job gains since 2002, Canada's 5.8% unemployment rate is now unchanged from last year's average.

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