Macro Outlook & Future of U.S.-China Relation

Michael McDonough
Chief Economist, Financial Products

Email: mmcdonough10@bloomberg.net
Tel: 212-617-6815
@M_McDonough
A complete & dynamic central bank solution.

Click Here
3

U.S. Recession, Boon or Stagnation?  The Future of U.S.-China Relations

China’s Future
DEFINING THE TRUMP RALLY (ATTACK OF THE WASHING MACHINES)

Trump Rally:
1. Gradual Fed Tightening
2. Deregulation & Tax Reform
3. No Major Disruption to Trade

U.S. Presidential Election

Drivers of the Trump Rally:
- Washington Machine Tariffs
- Steel & Aluminum Tariffs
- Statement on $50bn in Tariffs
- Statement on $200bn in Tariffs
- Threat on $267bn in Tariffs
- Trump asks for China Trade Deal Draft
- Trump - Xi G20 Dinner

Rebased to 100 on 11/8/16

Copyright 2019 Bloomberg Finance L.P.
TRUMP ADMINISTRATION SUCCESS (& CURRENT RISK)

Percent of UMich Respondents Making Favorable Comments on News Heard About Government Economic Policy

Source: University of Michigan & Bloomberg

Copyright © 2019 Bloomberg Finance L.P.
ANIMAL SPIRITS COULD BE SLAYED BY RETURN OF UNCERTAINTY

Number of Earnings Calls Mentioning "Tariffs"

Saved: KEYWORDS:"tariff" AND WIRE:BT Story Count: 1704.00
SENTIMENT NOT AS SUPPORTIVE FOR GROWTH

Animal Spirits May Be Headed Toward Hibernation
Bloomberg Economic Surprise Indexes (Survey-Based vs. Hard Economic Data)

- Economic Surprise Index (Excluding Survey Data)
- Economic Surprise Index (Survey Data Only)

Source: Bloomberg

2016 | 2017 | 2018 | 2019
S&P 500 Index: 2834.40
Economic Surprise Index: -0.5571
Economic Surprise Index (Survey Data Only): 0.0921
IS THE U.S. AT RISK FOR RECESSION?

Length of U.S. Economic Expansions (in Months)

June 2009 - ?
November 2001 - December 2007
March 1991 - March 2001
November 1982 - July 1990
July 1980 - July 1981
March 1975 - January 1980
November 1970 - November 1973
February 1961 - December 1969
April 1958 - April 1960
May 1954 - August 1957
October 1949 - July 1953
October 1945 - November 1948
June 1938 - February 1945
March 1933 - May 1937
November 1927 - August 1929
July 1924 - October 1926
July 1921 - May 1923
March 1919 - January 1920
December 1914 - August 1918
January 1912 - January 1913
June 1908 - January 1910
August 1904 - May 1907
December 1900 - September 1902
June 1897 - June 1899
June 1894 - December 1895
May 1891 - January 1893
April 1888 - July 1890
May 1885 - March 1887
March 1879 - March 1882
December 1870 - October 1873
December 1867 - June 1869
June 1861 - April 1865
December 1858 - October 1860
December 1854 - June 1857

Source: NBER
YIELD CURVE POTENTIALLY A WARNING SIGN
BUT, RECESSION STILL NOT A BIG RISK IN NEAR-TERM

Since 1978, there have been an average of 627.2 days between the first inversion of the 2Y10Y spread and the start of the next recession. Applying that average, and assuming the 2Y10Y spread were to invert today, it would imply a recession in December 2020.

Source: Bloomberg
ECONOMY NOT AT IMMINENT RISK OF RECESSION
GROWTH HAS LEGS BUT WILL SLOW
PROOF IS IN THE EARNINGS CALLS

Number of Earnings Calls Mentioning "Artificial Intelligence"

Saved: KEYWORDS:"artificial intelligence" AND WIRE:BT Story Count 619.00
TALK OF “AI” NOT ISOLATED TO TECH COMPANIES

Source: Bloomberg
FROM HIKE TO CUT (MARKET EXPECTATIONS)

Market Implied Probability of Fed Hikes at Meetings Through January 2020

- May '19 Meeting: -8.267
- June '19 Meeting: -26.139
- July '19 Meeting: -11.594
- September '19 Meeting: -37.333
- October '19 Meeting: -12.667
- December '19 Meeting: -29.295
- January '20 Meeting: -21.705

Copyright© 2019 Bloomberg Finance L.P.
FUTURE OF U.S. CHINA RELATIONS

• U.S.-China relations will not normalize

• Worsening economic conditions making both sides more willing to compromise

• Trade deficits are not at the center of the debate, it is intellectual property rights and more direct access to China’s economy

• Major choke point remains the enforcement mechanisms (arbitration, retaliatory tariffs, etc…)

• Outcome of President Trump’s Hanoi summit with North Korea making negotiations more complex

• A deal is much more likely than no deal and a Mar a Lago summit date would likely signify that a deal has been reached
CHINA’S SLOWDOWN WAS NOT TRADE-WAR DRIVEN
BUT, AN ESCALATION WOULDN’T COME WITHOUT COSTS

Tariffs in Place
- $50B
- 25% Tariffs

Tariffs From Sept. 24
- $50B
- 26% Tariffs
- $200B
- 10% Tariffs

Tariffs From Jan. 1
- $250B
- 25% Tariffs

Tariffs on Further Amount (Threatened Over Uncertain Horizon)
- $250B
- 26% Tariffs
- $2675
- 26% Tariffs

Source: Bloomberg Economics; *Assumed tariff level; Bubbles show cumulative impact on annual growth

China
CHINA’S ECONOMY REACHING A TURNING POINT
DELEVERAGING PROCESS A “SUCCESS” FOR NOW...
IN REALITY, THEY ARE KICKING THE CAN

Debt to GDP by Sector

China

Source: Bloomberg Economics; The figures for 2017 are estimates.
SLOWING PROPERTY SECTOR WILL WEIGH ON GROWTH

China Home Prices Rose in 57 of 70 Cities in February

- Cities with Declining MoM Prices
- Cities with Rising MoM Prices
- No Change

Source: Bloomberg
WORRY ABOUT CHINA’S DEMOGRAPHIC SITUATION

Japan's Population Pyramid 2015

China's Population Pyramid 2030

Source: U.S. Census Bureau
DEMOGRAPHICS ARE BETTER FOR OTHER PARTS OF ASIA

*Defined as the period when the pop. under 15Y drops below 30% and the pop. over 65Y is less than 15%*

Source: UN Population to 2030, UN World Population Prospects