QNB Economics
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Cyclical indicators suggest that the global economy is slowing further

At this time over the last two years, despite existing and rising political risks, the global economy was benefiting from splashes of optimism as growth was accelerating in a synchronized way across different countries and regions. At the time of writing, in the first week of 2019, political risks persist and previous optimism has been mostly washed out by material negative changes in key equity markets, as corrections take place and US stock benchmarks slip into bear market territory. But market sentiments are notoriously volatile and can often be misleading. As we start a new year in 2019, what is the cyclical evidence for the state of the global economy?

While GDP is the most important measure to gauge economic performance, it is not very timely or even accurate, as official estimates are only released quarterly with a lag and the initial readings are often revised at a later stage. Hence, other key indicators have to be waged in order to provide a reliable snapshot of the global economy in a timely fashion. In other words, as official GDP numbers are only released with a lag or after the economic cycle already moved forward, coincident and leading indicators present signals for current and even short-term future conditions. Our analysis builds a picture of the global economic momentum based on manufacturing Purchasing Managers' Indices (PMIs) and trade volumes of early-reporting countries.

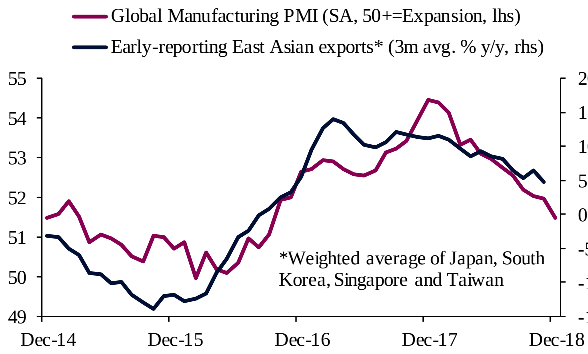
Manufacturing PMIs are diffusion indexes based on monthly business surveys in which respondents point whether variables such as output and employment have improved or deteriorated in relation to the previous month. Readings above 50 signal to expansions and below 50 to contractions. PMIs are the most accurate timely indicators of the state of global demand, and manufacturing PMIs have been the best gauge for global activity in recent years.

According to the IHS Markit Global Manufacturing PMI, economic activity has been slowing down since the beginning of 2018 and further weakness is estimated to have taken place in Q4 2018 and to continue in Q1 2019. While global manufacturing PMI numbers for December 2018 are still comfortably within expansion territory at 51.5, it is considerably below the 54.5 reading of December 2017.

Importantly, country and region-based manufacturing PMIs are pointing to a continuation of the recent trend of global economic growth divergence, i.e., different economies with similar income per capita growing at markedly different paces. Indeed, while the US manufacturing PMI numbers remain strong, hovering below but near the recent peak, Euro area numbers have fallen markedly to close to 3-year lows. In the case of the US, subcomponents of the PMI are still pointing to strong new orders and relatively low inventories, which suggests that activity should continue to run at a reasonable pace over the short-term.

Japan's manufacturing PMI has also been softening considerably throughout the year and especially over recent months. EM's and China's PMIs are similarly pointing to a deterioration in demand with readings breaching the 50 threshould.

Monthly cyclical indicators for global growth



Sources: Haver Analytics, QNB Economics analysis

Exports of early-reporting and highly-open economies of East Asia (Japan, South Korea, Singapore and Taiwan) are also an important and reliable gauge of global demand. When it comes to this indicator, a slowdown is also being signalled as 3-month average y/y export growth softens from two digits in February 2017-February 2018 to 4.8% in November 2018. In addition, forward-looking surveys of firms' export orders have been falling further, implying even slower y/y trade growth in the coming months.

Timely South Korean export data, consistently reported on the first day of each month for the previous period, was down in December 2018, suggesting further weakness on world trade and activity. Of particular relevance was the fact that exports to China have contracted markedly (13.9% y/y) last month, which does not bode well in terms of expectations for activity in the second largest economy of the world or of sentiment associated with the still ongoing trade disputes between the US and China. South Korea is a major exporter of intermediary industrial inputs to China's export sector and is indirectly affected by US-China trade jitters.

In short, these cyclical indicators demonstrate that the global economy has already peaked and is now slowing further into 2019.

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