



# Monthly Cyclical Update - Mature Economies

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MacroFinance Research – February 2018

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## United States

*Despite disappointed cyclical indicators, the US economic activity remains fundamentally robust, as the latest fiscal plan boosted confidence, with potential upward economic effects in the short term. The recent concern over inflation surge reflects market adjustment rather than a shift in fundamental.*

- The 2017Q4 GDP was revised from 2.6% q/q saar to 2.5% q/q saar on 2<sup>nd</sup> estimate. The adjustment was minimal. GDP decomposition illustrated robust private demand: consumption expenditures and fixed investment contributed by +3.9pp, while net exports and inventories subtracted respectively -1.13 pp and -0.7pp.
- Two trends emerged in February: concerns over cyclical indicators deceleration and resurgence of inflation risk. On the first point, while recent indicators surprised to the downside (-0.3% m/m on retail sales, -0.1% m/m industrial production, -3.7% m/m on durable goods orders in Jan.18), their trend remained consistent with our growth projections. The recent surge in confidence (both consumer and industrial) supported private demand expansion. Indeed, interestingly, the recent equity markets reversal did not affect it, and perceptions of positive outcome from the fiscal plan dominated the sentiment index. On the second point, the resurgence of inflation risk might be interpreted more like an adjustment of financial markets, than a shift in the global scenario. Inflationary pressures will remain gradual. The January CPI figure (+2.1% y/y) was driven by transitory factors and may be slightly reversed in the months ahead.
- The FOMC minutes showed that members expect a more favorable outlook supporting gradual rate hikes. The combination of fiscal stimulus, strong labor market and rise in inflation might cause the Fed to continue its firming path, with expected March rate hike (+25bp) and potentially shift from three to four hikes in 2018 in the dot plots figures.

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## Euro Zone

*Despite deceleration in Eurozone confidence surveys and two political events in March, figures are still consistent with our GDP growth acceleration scenario. ECB will remain cautious in its forward guidance approach, especially as inflation remains subdued.*

- In February, business and consumer surveys have moderated from their recent highs (-2 pts to 112 for INSEE French Survey, -2.2 pts to 115.4 for German IFO Survey, -1.3 pts to 57.5 for the Eurozone Composite PMI). A slight decline in elevated figures is rather “normal” and the current levels are still consistent with activity expansion. Our GDP growth scenario is unchanged, around 2.8% y/y in 2018H1, against 2.7% in 2017H2.
- Two political elements are worth noting in March: the outcome of the SPD Party member vote to approve Germany Grand Coalition and the Italian General election, both on March 4<sup>th</sup>. On the first element, a “no” vote would suggest a German minority government or a new election. On the second element, latest Italian polls signaled no outright majority, with potential hung parliament or center-right majority outcome. Similar recent political events have been unable to derail the current growth momentum, as long as confidence is unaffected.
- Headline inflation decelerated from +1.3% y/y to +1.2% y/y in February. After fading effects of lower annual energy/food prices, inflation is likely to accelerate with volatile components, but core prices remained muted. The accounts of the ECB (equivalent to the central bank’s Minutes) confirmed the key message delivered during the January 25<sup>th</sup> policy meeting: improvement of the economic activity, but subdued inflation outlook which still necessitate monetary policy stimulus. The message should be interpreted as preparing markets for a gradual change in forward guidance without creating speculation of a significant change.

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## United Kingdom

*Recent cyclical indicators suggest a more nuanced picture than the expressed BoE upward economic outlook. However, persistent inflationary pressure remains a concern and is likely to push the Monetary Policy Committee to further increase its policy rate in 2018H1.*

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- The BoE revised upward economic outlook in the Feb.18 Inflation Report, at 1.7% for 2018 and 1.8% for 2019 (from respectively 1.5% and 1.7% in the Nov.17 report). However, recent data indicate a more negative view. The second estimates of 2017Q4 GDP growth was revised downward, at 1.6% q/q saar (from a first estimate at 2.0% q/q saar), reflecting a slower growth in production industries. A zero-growth industrial production was observed in December 2017 while the unemployment rate started increasing (at 4.4% in Dec.17). Despite robust global demand and the past depreciation of sterling, net trade contribution to GDP was negative in 2017Q4.
  - Household consumption growth remains sluggish with retail sales registering lower than expected growth, at 0.1% m/m in January (from -1.4% in December 2017) and the GfK consumer confidence index remained in negative territory (-10 in February). Sustained above-target inflation (core CPI inflation at +2.7% in January), due to the effects of higher import prices (following sterling's past depreciation) and firming wage growth (in line with the tightening labor market), could motivate the Bank of England to raise interest rate as soon as May in order to rein in inflationary pressures.
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## Japan

*The recent volatile data, partly reflecting seasonal factors, make cyclical analysis more complex but latest GDP components confirms the expansionary cycle, related to favorable trade environment. The reappointment of Kuroda as BoJ Governor and the subdued inflation outlook, suggest that the BoJ monetary policy will remain unchanged.*

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- 2017Q4 GDP growth sharply decelerated to +0.5% q/q saar (after 2.5% in 2017Q2 and 2.2% in 2017Q3). This slowdown might be tempered by the growth components: domestic demand and exports are still supportive. Households consumption increased by +1.9% q/q saar while non-residential investment grew by +2.8% q/q saar. Negative contribution to GDP growth came from changes in inventories and net exports (higher imports at +12% q/q saar than exports at +10% q/q saar).
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- Due at least partly to seasonal factors (based effects, cold weather, Lunar New Year), recent cyclical indicators surprised to the downside. For instance, January retail sales contracted by -1.8% m/m and core machinery orders decreased by -11.9% m/m. The January drop in industrial production (-6.6% m/m) is inconsistent with the robust capex and exports dynamics, thus making the assertion of the cyclical activity more complex. In this context, the focus on trends rather than “month over month” adjustments is more appropriate in the short term.
  - While short term risks are tilted to the downside, the current context is still appropriate for activity expansion. External demand remained robust and labor market shortage create gradual pressures for wages adjustments. It confirmed our GDP growth scenario of Japan's moderate expansion with large oscillation in quarterly performances and no clear acceleration or deceleration trend. Some raised concerns from the negative impact of the recent JPY appreciation (110.4 USD/JPY on February 2<sup>nd</sup> to 106.7 on February 28<sup>th</sup>) on corporate profits. Our USD/JPY econometric model does not project a sustainable JPY appreciation.
  - BoJ Governor Kuroda was officially nominated for reappointment. Its nomination prolonged the current balance of views within the BoJ Committee. With raising concerns of JPY appreciation and risks still skewed to the downside regarding the inflation outlook (still primarily driven by oil prices), a monetary policy adjustment in this context appeared unlikely.
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## Exchange rates and oil prices

- Our “new” EUR/USD regime supported the past month EUR/USD appreciation toward 1.25 on February 16<sup>th</sup>. So far, our scenario remained unchanged, even with the slight EUR depreciation toward 1.22 on February 28<sup>th</sup>. One of the key indicator of our model, the European Economic Sentiment Index, is still above the 113 level (114.1 in February) suggesting EURUSD will remain on an appreciation trend toward 1.25/1.30 in the coming months.
  - The update of our models does not suggest the oil price increase to continue in 2018, with an estimated range close to 65\$/bl in 2018H1 with potential of decline towards 60\$/bl during the summer before reaching again levels around 65\$/bl end-2018. This means that strong demand and OPEC discipline would compensate increasing US tight oil and persistently large inventories.
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## Economic Indicators Dashboard

Short term data for the United States, Euro Zone, United Kingdom and Japan

### United States

#### Monthly economic data

	2017 M05	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01
Industrial Production (y/y, %)	2.3	2.1	1.7	1.4	1.8	3.3	3.8	3.4	3.7
Consumer prices (y/y, %)	1.9	1.6	1.7	1.9	2.2	2.0	2.2	2.1	2.1
Producer Prices* (y/y, %)	2.3	1.9	2.0	2.4	2.6	2.8	3.1	2.6	2.7
Interest Rate - ST (Fed Funds, %)	0.9	1.0	1.2	1.2	1.2	1.2	1.2	1.3	1.4
Interest Rate - LT (10 years, %)	2.3	2.2	2.3	2.2	2.2	2.4	2.4	2.4	2.6
M2 (y/y, %)	5.9	5.6	5.6	5.3	5.1	5.0	4.6	4.7	4.2

\* PPI for finished goods

Sources: BLS, FRB

#### Survey data

	2017 M05	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01
ISM - Manufacturing PMI	55.5	56.7	56.5	59.3	60.2	58.5	58.2	59.3	59.1
ISM - Employment (% positive)	53.3	56.3	55.8	59.8	58.7	59.8	59.2	58.1	54.2
ISM - Production (% positive)	57.5	60.9	60.4	62.0	61.9	61.0	64.3	65.2	64.5
ISM - Prices (% positive)	60.5	55.0	62.0	62.0	71.5	68.5	65.5	69.0	72.7
ISM - New Orders (% positive)	60.0	61.3	61.0	61.8	64.4	63.5	63.9	67.4	65.4

Source: ISM (Institute for Supply Management)

### Euro Zone

#### Monthly economic data

	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01	2018 M01
Industrial Production (y/y, %)	3.4	3.9	3.4	3.6	3.3	4.0	--	--	--
Industrial Production excl. construction (y/y, %)	2.8	3.8	3.7	3.4	4.0	3.6	5.2	--	--
Consumer Prices (y/y, %)	1.3	1.3	1.5	1.5	1.4	1.5	1.4	1.3	1.3
Producer prices* (y/y, %)	2.1	2.2	2.7	2.9	2.6	3.0	2.1	--	--
Interest Rate - ST (EURIBOR 3 months, %)	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Interest Rate - LT (Euroland aggr. 10 years, %)	1.1	1.2	1.0	1.1	1.1	0.9	0.9	1.0	1.0
Interest Rate - LT (Germany Gvt Bond 10 year, %)	0.3	0.5	0.3	0.4	0.4	0.4	0.4	0.4	0.5
M2 (y/y, %)	5.2	5.0	5.4	5.4	5.4	5.3	5.1	5.3	5.3

\* PPI for manufactured goods

Sources: ECB

#### Survey data

	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01	2018 M02
ECS – Consumer Confidence	-1.3	-1.7	-1.5	-1.2	-1.1	0.0	0.5	1.4	0.1
ECS – Industrial Confidence	4.5	4.5	5.0	6.7	8.0	8.1	8.8	9.0	8.0
ECS - Employment	5.2	6.2	7.3	7.4	9.1	10.3	12.3	10.4	9.9
ECS - Production	13.6	13.9	15.7	18.0	17.6	18.0	18.9	19.0	16.0
ECS - Prices	7.1	7.5	8.1	10.5	8.7	11.1	13.0	12.4	12.6
ECS – New Orders	2.4	2.3	1.6	4.4	7.4	7.7	7.8	9.1	9.0

Source: European Commission (ECS: European Commission Survey)

## United Kingdom

### Monthly economic data

	2017 M05	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01
Industrial Production (y/y, %)	0.7	1.8	2.0	2.5	3.4	4.5	2.5	0.0	--
Consumer Prices (y/y, %)	2.9	2.6	2.6	2.9	3.0	3.0	3.1	3.0	3.0
Producer Prices* (y/y, %)	3.6	3.3	3.3	3.4	3.3	2.9	3.1	3.3	2.8
Interest Rate - ST (3 months, %)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.3
Interest Rate - LT (10 years, %)	1.1	1.1	1.3	1.1	1.3	1.4	1.3	1.3	1.4
M4 (y/y, %)	7.2	5.6	4.6	4.7	5.7	5.1	4.8	4.8	--

\* PPI for manufactured goods

Sources: Bank of England, UK Office for National Statistics

### Survey data

	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01	2018 M02
ECS – Consumer Confidence	-7.4	-6.5	-7.2	-5.2	-5.5	-5.2	-7.0	-4.8	-4.1
ECS – Industrial Confidence	12.9	16.2	12.3	10.3	10.5	11.5	13.2	13.0	6.4
ECS - Employment	8.3	12.2	14.7	15.4	18.2	18.2	13.1	7.1	13.9
ECS - Production	25.7	30.7	30.4	25.4	26.2	21.6	21.7	24.6	14.2
ECS - Prices	29.5	17.9	27.2	26.3	26.8	19.6	21.0	35.1	20.3
ECS – New Orders	14.5	12.8	11.9	10.5	10.6	17.4	15.5	15.5	10.2

Source: European Commission (ECS: European Commission Survey)

## Japan

### Monthly economic data

	2017 M05	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01
Industrial Production (y/y, %)	4.7	5.5	4.6	5.3	4.0	4.1	3.6	5.7	--
Consumer Prices (y/y, %)	0.4	0.3	0.5	0.6	0.7	0.2	0.5	1.1	1.3
Producer Prices* (y/y, %)	2.1	2.2	2.6	2.9	3.1	3.4	3.6	3.0	2.7
Interest Rate - ST (3 months, %)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest Rate - LT (10 years, %)	0.0	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.1
M2 (y/y, %)	3.8	3.9	4.0	4.0	4.0	4.1	4.0	3.6	3.4

\* PPI for manufactured goods

Sources: Bank of Japan, Statistics Bureau

### Survey data

	2017 M06	2017 M07	2017 M08	2017 M09	2017 M10	2017 M11	2017 M12	2018 M01	2018 M02
Consumer Confidence	43.3	43.8	43.3	43.9	44.5	44.9	44.7	44.7	--
Industrial Confidence (Nikkei PMI)	52.4	52.1	52.2	52.9	52.8	53.6	54.0	54.8	54.0
Industrial Conf. (Reuters Tankan)	26.0	26.0	27.0	25.0	31.0	27.0	27.0	35.0	29.0

Source: Statistics Bureau

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