Marketing Material

ENDING 2019 ON A STRONG FOOTING?

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IN A NUTSHELL

- We still believe in lower growth rates in 2020 despite a phase-one trade deal between the United States and China as we do not anticipate another fiscal impulse.
- There is still muted wage growth despite unemployment being at cyclical lows. This could be caused by low investments and productivity.

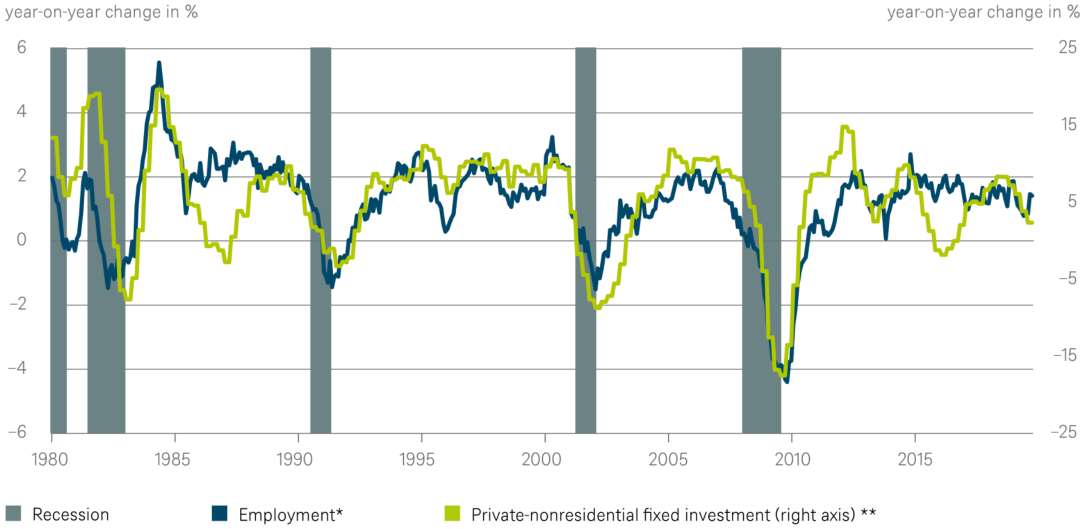
The chairman of the U.S. Federal Reserve (Fed), Powell, communicated a very clear message after the last Federal-Open-Market-Committee (FOMC) meeting this year. Despite weak exports and business investments, the economy remains in what some might call a 'sweet spot' – especially when measured by the latest encouraging labor-market developments. Supported by sound monetary and financial-market conditions, the strong labor market should ensure that the growth engine – consumption – will run smoothly. And while inflation currently remains sluggish, it is expected to converge toward the Fed's target of two percent in the course of the next twelve months. Only a development that commands a "material change" to the Fed's outlook is likely to lead them to alter their monetary-policy stance.

While we are still optimistic, we are not as cheerful for the mid- to long-term.[1] Labor markets surprised to the upside in November as the negative impact from strikes in the automotive sector reversed almost entirely. However, we do not observe a change in the overarching momentum. The trend of job gains in the goods-producing sector remains muted. The main driver has once again been the service sector. And with the unemployment rate back to a cyclical low of 3.5%, we still miss higher gains in wage growth – the main driver for future consumption. Wage growth tends to behave as we would expect it in the goods-producing sector, e.g. it is currently increasing, service-sector-wage growth exhibits an atypical behavior as growth rates declined slightly in the course of 2019.

There are several theories on how wages are determined in an economy. The explanation is: wages should reflect at least the marginal productivity of a worker. The measurement of productivity in services is pretty tricky, and gets even more difficult when one considers the impact of the ongoing digital transformation is the usually well-defined concept of economic output. While that impact cannot be observed directly, we instead can track the inputs to overall productivity. We find it striking that the decline of productivity in the third quarter was driven by a jump of hours worked of unincorporated self-employed people. This jump could have been caused by the so called gig-economy, e.g. ride-sharing and delivery services. While representing only a smaller fraction of overall employment, by excluding this effect, productivity would have increased by 1.5% quarter-over-quarter annualized instead of falling by 0.2%. It remains to be seen how the measurement puzzle will be solved by the statistical number crunchers, our take would be that current gig-economy jobs cannot keep up with classic jobs in terms of productivity and wage growth.

[1] Strategic outlook (up to one year)

EMPLOYMENT TENDS TO FOLLOW INVESTMENTS – MOST OF THE TIME…



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, National Bureau of Economic Research, DWS Investment GmbH as of 12/17/19
* seasonally adjusted
** seasonally adjusted, in U.S. dollar

Another economic rule of thumb is that business investments increase productivity, which in turn increases (potential) output, corporate profits [DWS U.S. Economic Outlook as of 11/19/19], employment and eventually wages. The chart suggests that the relatively close-fitting relationship between the year-on-year change of overall employment and business investments broke down in early 2015 – just as it did in the mid-80s. Back then oil prices experienced a similar price drop as they did in 2015. This also caused concerns whether the world economy is at the brink of a downturn. In the 80s, as in recent history, a fiscal stimulus kept the cycle alive and people employed, at least for a while, so that the outlook might not be as gloomy.

Another interpretation of stable employment with declining investments evolved in the course of another trade-related crisis: Brexit. The hypothesis goes: corporations simply substitute less business investments with more hiring. In times of high uncertainty about future economic regimes as in the United States, business investments would be a too serious commitment. Employment on the other hand can be adjusted relatively quickly. Neither UK nor U.S. data yet backs this hypothesis. However, anecdotal evidence like the often cited shortage of skilled labor gives a strong hint to follow these thoughts – higher investments could mitigate such shortcomings.[2]

For the time being we follow the sweet-spot narrative, especially for the labor market. We again highlight that much of the positive momentum in the economy was rooted in the last fiscal package – momentum which is fading out. Another significant boost from fiscal policy is not expected in an election year. Admittedly, the reversal of at least some tariffs could potentially yield some minor upward revisions in the growth outlook, but it still does not resolve uncertainty to a point where larger committed business investments get attractive again. We stick to our view of an ongoing moderation of the economy and lower growth rates in 2020.

In the short run[3], especially while heading into a politically challenging election year, the Fed does well to step to the sidelines. Recent economic data supports this decision. Also there are other topics which should keep the Fed busy in the very near term. To name a few: the U.S. repo market or simply to maintain the credibility to be independent from politics ahead of the elections.

OVERVIEW: KEY ECONOMIC INDICATORS

	2018		2019				2020			
	Q3	Q4	Q1	Q2	Q3	Q4F**	Q1F	Q2F	Q3F	Q4F
GDP (% qoq, annualized)	2.9	1.1	3.1	2.0	1.9	1.2	1.8	1.6	1.6	1.2
Core inflation (% yoy)*	1.9	1.9	1.6	1.6	1.7	1.8	1.9	1.9	1.9	1.9
Headline inflation (% yoy)*	2.0	1.9	1.4	1.4	1.4	1.6	1.6	1.4	1.3	1.4
Unemployment rate (%)	3.7	3.8	3.9	3.6	3.6	3.6	3.7	3.8	3.9	4.0
Fiscal balance (% of GDP)	-3.8	-4.2	-4.1	-4.3	-4.6	-4.6	-4.8	-4.6	-4.8	-4.6
Federal funds rate (%)	2.00-2.25	2.25-2.50	2.25-2.50	2.25-2.50	1.75-2.00	1.50-1.75	1.50-1.75	1.50-1.75	1.50-1.75	1.50-1.75

* PCE Price Index
** Forecast

[2] https://www.federalreserve.gov/monetarypolicy/beigebook201911.htm
[3] One to three month(s)

GLOSSARY

Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

Cyclical is something that moves with the cycle.

The Federal Open Market Committee (FOMC) is the committee that oversees the open-market operations (purchases and sales of securities that are intended to steer interest rates and market liquidity) of the U.S. Federal Reserve.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

A repurchase agreement (repo) is a form of short-term borrowing, whereby a dealer commits to repurchase the security shortly after it is sold. The dealer pays the repo interest as remuneration.

The U.S. dollar (USD) is the official currency of the United States and its overseas territories.

The U.S. Federal Reserve, often referred to as "the Fed", is the central bank of the United States.

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IMPORTANT INFORMATION – APAC

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