

Macro Weekly

Group Economics

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Returned to the office with hope

- **When I left for my sabbatical the global economy was stumbling along. It still is.**
- **But here is hope as...**
- **...the Fed has done a U-turn,...**
- **...the trade conflict has eased...**
- **...and Chinese policy stimulus appears to be having effects**

Early February I started a sabbatical until Easter. It was a great experience. We travelled extensively and, most important, my marriage survived. In fact, it has flourished. What more do you want?

In my last weekly commentary early February, I listed five things I expected to happen during my sabbatical.

First, I expected a US-China trade deal to be signed. I was wrong. It hasn't been signed, but neither have talks collapsed. It seems to me that the last point is key. If a deal wasn't going to happen, talks would have been broken off. I therefore still expect a deal to be completed before too long.

Second, I expected a Brexit deal. I was wrong. However, I added that a hard Brexit would be avoided and, so far, it has. So I stick to the view that a deal will eventually be done that will not do the economic damage that a hard Brexit might do.

Third, I expected cyclical indicators to bounce back. You can argue whether that has happened or is happening as we speak or not. I will address this issue below.

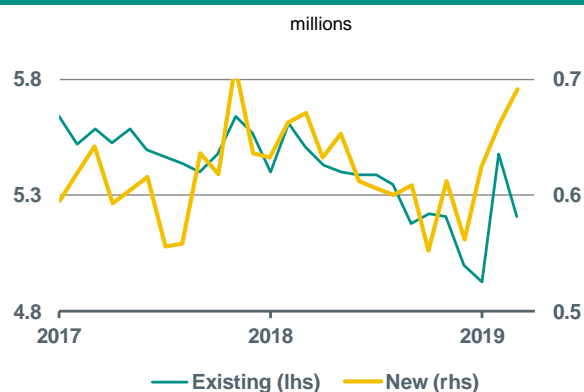
Fourth, I expected inflation to stay low despite tight labour markets leading to some acceleration of wage increases. I was right. In fact, inflation indicators during my absence have come in slightly lower than expected. As oil prices have risen considerably since the start of the year, headline inflation may rise a little in the short term. But underlying inflation pressures remain in check.

Fifth, I expected central banks to stay put as I saw no reason for them to tighten policy. I was right here, although it now looks a little funny to see I was considering tightening of monetary policy more likely than loosening policy.

Where do we stand now?

Growth in the global economy is still very soft. Are we heading for a contraction in key economies or will growth accelerate from here? The US seems all right to me. The economy is benefitting from an expansionary fiscal policy and the drop in bond yields is also having an impact. Home sales, for example, weakened in the course of 2018, but are now bouncing back, most likely as a result of fallen mortgage rates. Growth of corporate investment has been solid in recent years, but has also weakened during the last couple of quarters. We don't expect a dramatic turnaround, but recently released data on durable goods orders offers some hope that things are developing in a slightly more favourable direction. Orders for capital goods, excluding defence and excluding aircraft are on the rise, measured in dollars. The year-on-year growth rate has fallen and may continue to fall for some months to come, but I am not worried about that as the most recent trend in the underlying data is actually up.

US: home sales



Source: Bloomberg

US: Capital goods orders ex defense, ex air



Source: Bloomberg

Germany: Ifo index



Source: Bloomberg

Germany: Ifo export expectations



Source: Bloomberg

Europe does not look great. The German economy is close to stagnation. It registered one negative growth quarter last year and may do so again this year. Any contraction will be modest, though. I had thought that the weakness in Germany would be temporary as it was affected by problems in the car industry, which I expected to be overcome, and by low water levels in key rivers. But things have not improved in Germany. Car production has stabilised, but has not rebounded. The April Ifo data was disappointing. Have perked up in

March, the index fell again in April. The sub series on German companies' expectations concerning exports has continued to fall and is already at very low levels.

The eurozone economy appears to be particularly vulnerable to the contraction of world trade. As the eurozone economy is more open than the US economy, it is hardly surprising that fluctuations in world trade have a bigger impact in Europe than in the US, but the current difference is remarkable. What can the Europeans do? The ECB's policy stance is already very loose and it is unlikely they will take further aggressive actions other than committing to keep rates very low for a long time yet and making sure sufficient liquidity is provided to the banking system. Some countries (particularly Germany and Holland) have ample room for fiscal stimulus, but these countries appear unlikely to use that room. What's left then is hoping for a recovery of world trade growth.

Recent indicators in Asia are mixed. Export orders in Taiwan contracted by 9.0% yoy in March, after contracting 10.9% in February. Taiwanese industrial production was down 9.9% yoy in March, after a drop of 2.0% in February. These series can be volatile and are hard to interpret in the early months of the year due to Chinese New Year. However, these sort of numbers are clearly very poor. Korea reported a 0.3% qoq contraction of GDP in Q1, considerably weaker than expected. More worrying even is that exports in the first 20 days of the month of April were down 8.7% yoy, following -4.9% in March.

Green shoots in China

Despite the remarkably poor recent data in Korea and Taiwan, I am optimistic that things are set to improve in a meaningful way before too long. My colleague Arjen van Dijkhuizen wrote about [green shoots in China](#) recently, and he is right. Arjen referred to Chinese Q1 GDP surprising positively as did industrial production in March and retail sales and imports also. We need to be careful with these indicators as they, as well, can be affected by the timing of Chinese New Year. Having said that, stronger activity data in China makes sense given the stimulus Chinese policymakers started to provide in the course of last year. The standard series on business confidence surprised positively in March.

The CKGSB business conditions index showing a V-shaped recovery

During my sabbatical I discovered an interesting series published by the CKGSB business school (a Chinese school). They carry out a monthly survey among corporates comparable to the PMI. More clearly than many other Chinese economic indicators, the CKGSB business conditions index showed a remarkable drop in confidence in the second half of 2018, which seems to be a good reflection of what was actually going on and of the impact it had on global trade. But since early this year, the CKGSB business conditions index is showing a V-shaped recovery. According to the commentary accompanying the data, the improvement is driven by a strong improvement of financial conditions. This ties in perfectly with the policy measures taken by the authorities.

The CKGSB has just published the April data. Their overall index rose further in April. An interpretation is a little difficult as English language commentary is not available yet, as far as I can see. Nevertheless, the rise in April is important as the improvement in February, and particularly March could have been caused by calendar effects. So confirmation of the improving trend in April suggests that the Chinese economy is actually experiencing a short-term acceleration of growth. Hopefully, this will have a similar effect on the global

economy as the slowdown did last year, but on the positive side this time, obviously. It is dangerous to get carried away, but stronger growth in China should lead to stronger global trade growth during the next couple of quarters. The rest of Asia and Europe should benefit from that. Fingers crossed, but cyclical conditions should be expected to improve in the quarters ahead.

China: CKGSB business conditions

Index (CKGSB = Cheung Kong Graduate School of Business)



Source: Bloomberg

Three key differences between 2018 and 2019

The global economy slowed markedly in the course of 2018 and by more than most people expected, including ourselves. It always remains a bit of a guess as to what causes these fluctuations. Generally, tighter monetary policy in the US leading to tighter financial conditions around the globe, Chinese policies aimed at deleveraging and the erupting and escalating trade conflict are seen as important drivers of the slowdown in 2018.

All three negative factors have now turned! The Fed is firmly on hold as they have removed expected rate hikes. The lower mortgage rates that were partly the result from that change are already boosting the housing sector. The Chinese policymakers did a U-turn by providing stimulus and giving deleveraging a lower priority. The first positive effects on growth can be seen in recent macro data and, particularly, in the V-shaped recovery of some business confidence indicators in recent months. And last, the trade conflict appears to be easing, although a conflict between the US and Europe could develop and escalate.

My hope that global growth will strengthen in the course of this year is based on the fact that the three main negatives of 2018 have all been reversed.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	18/04/2019	25/04/2019	+3M	2019e	2020e
United States	2.2	2.9	2.3	1.9	United States	2.58	2.58	2.60	2.60	2.50
Eurozone	2.5	1.8	0.8	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.20
Japan	1.9	0.8	0.9	0.7	Japan	0.07	0.07	-0.10	-0.10	-0.10
United Kingdom	1.8	1.4	↓ 0.8	↓ 1.7	United Kingdom	0.82	0.83	1.00	1.00	1.25
China	6.9	6.6	6.3	6.0						
World	3.7	3.6	3.3	3.4						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	18/04/2019	25/04/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.56	2.53	2.6	2.60	2.50
Eurozone	1.5	1.7	1.2	1.2	German Bund	0.02	-0.01	0.0	0.20	0.50
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.53	0.50	0.6	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.03	-0.03	0.1	0.10	0.30
China	1.6	2.1	2.5	2.5	UK gilts	1.20	1.16	1.7	1.50	1.80
World	3.0	3.5	3.8	3.2						
Key policy rate	25/04/2019	+3M	2019e	2020e	Currencies	18/04/2019	25/04/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.12	1.11	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	112.0	111.6	110	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.30	1.29	1.30	1.35	1.45
Bank of England	0.75	0.75	0.75	1.00	EUR/GBP	0.86	0.86	0.85	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.71	6.75	6.65	6.60	6.60

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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