Macro Weekly

Group Economics

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Industrial downturn deepens

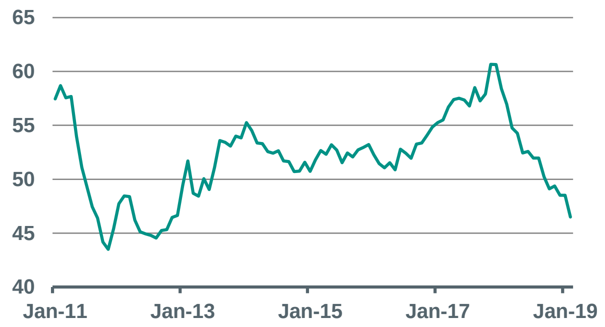
- **A string of data around the world related to exports and industry weakened further**
- **The past tightening of financial conditions combined with uncertainty related to trade policy is probably still feeding through**
- **Some of these forces are turning for the better, but not yet sufficiently so to be a strong tailwind**
- **The good news comes in the shape of signs of resilience of domestic demand in a number of key economies**
- **On balance, we expect the global economy to regain some traction later in the year, but a strong rebound, as we saw in 2016-17, is unlikely**

Reports on industry and trade…not for the faint hearted

Reports released this week related to the industrial sector and trade from countries across the world took another turn down. The export orders balance of the eurozone PMI survey fell deeper into contraction territory in February. Indeed, the last time order books were contracting at this pace was when the eurozone economy was emerging from the euro crisis at the end of 2012. The weakness is particularly acute in Germany, which is a bellwether for trends in global industry and trade. Indeed, Germany's Ifo expectations index fell further in February and is consistent with contraction in the economy as a whole.

Eurozone manufacturing - export orders

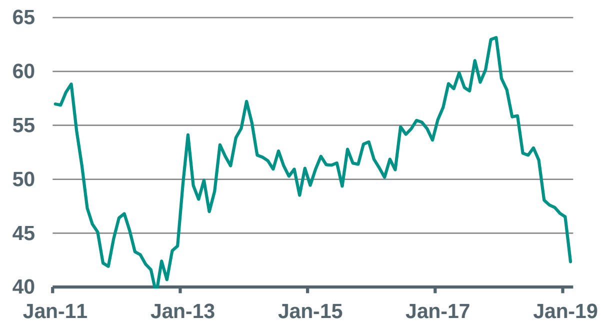
Manufacturing PMI – new export orders index



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Germany manufacturing - export orders

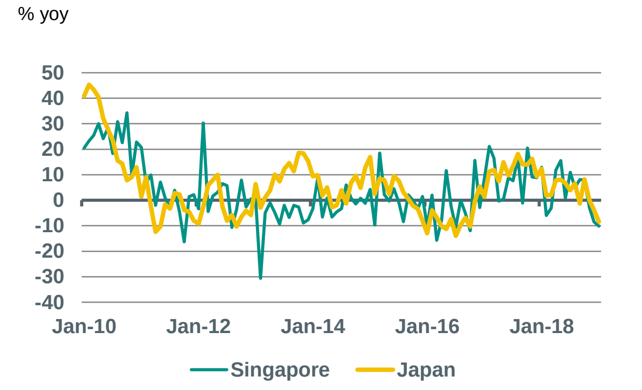
Manufacturing PMI – new export orders index



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

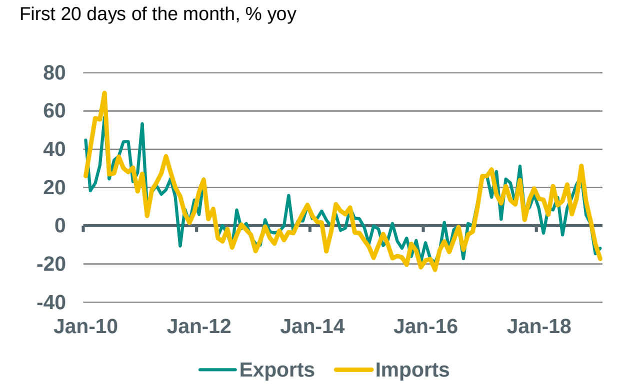
Hard data for January also point in the same direction. For instance, Japanese exports are now shrinking at a rate of more than 8% yoy, while Italian industrial sales fell by more than 7% yoy in December. Early data showed exports in South Korea shrinking at a slower pace in February, though they are still down by more than 11% yoy, while the slump in imports deepened, with a contraction of more than 17%. Other export-orientated Asian economies also reported weakness in trade. Singapore's non-oil exports were down by around 10% yoy in January, with electronic exports falling by almost 16%. An important outlier in this narrative is the rebound in China's exports in January (published last week) though reports at this time of year from the country can be unreliable due to the New Year holidays.

Japan and Singapore - exports



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

South Korea - trade

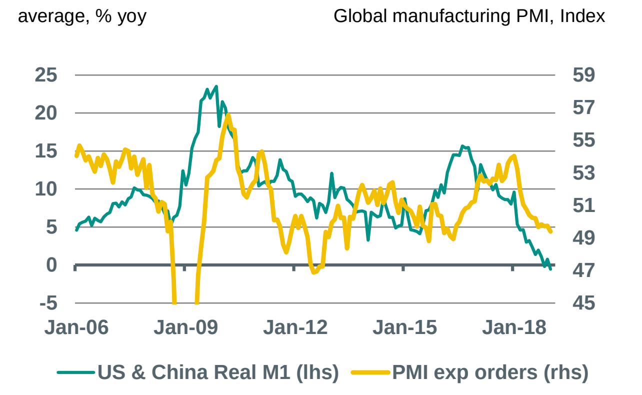


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Impact of drags still feeding through

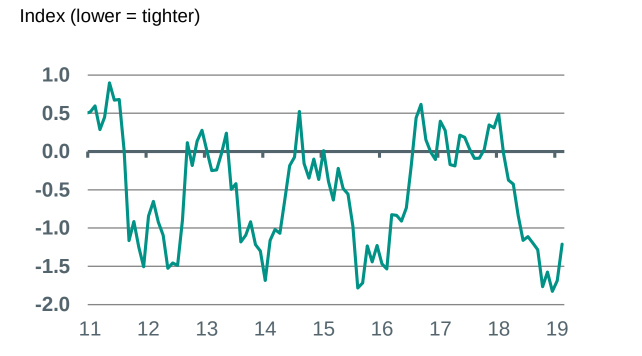
Financial conditions tightened in Asia during 2018 driven by more restrictive policy by the Chinese authorities and by Fed rate hikes and balance sheet reduction. The relationship between real M1 money supply growth and global trade suggests that there are lags in this process. So these drags may still be feeding through and may continue to weigh for a time. In addition, uncertainty related to trade policy – the US-China trade dispute and to a lesser extent Brexit – may also be hurting business confidence.

Money supply growth and global trade



Source: Bloomberg, ABN AMRO Group Economics

Asian financial conditions ex-Japan



Source: Bloomberg, ABN AMRO Group Economics

A turn for the better

Although real M1 growth in China and the US has not turned yet, there are indications of improved financial conditions in the pipeline. The Chinese authorities shifted towards an easing policy in the latter part of 2018. Aggregate financing to the real economy jumped in January. Although it is always strong in that month, the rise was particularly significant. In addition, the Fed appears to have ended its rate hike cycle and has signalled that balance sheet reduction will also cease later in the year. Financial conditions in Asia have eased. There are also dovish shifts at other central banks around the world. For instance, the ECB is likely to keep interest rates on hold for even longer, while it seems to be considering a new programme of long-term loans to banks.

Trade tensions may ease

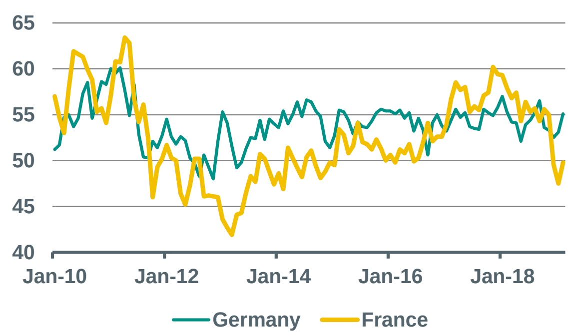
Meanwhile, there are some positive noises emanating from the US-China trade talks, which could at least lead to a truce and a freeze of further tariffs. The mood music from the Brexit discussions is far from positive. Though our judgement remains that a no-deal UK withdrawal from the EU is unlikely. It seems that this is the one thing there is a majority view about among UK parliamentarians. The current stalemate could well see parliament pushing the government to negotiate a delay of the Article 50 deadline next week.

Signs of domestic resilience

Another positive, is that there are signs of domestic resilience in advanced economies. The weakness in exports is feeding through into weaker business investment spending. Though labour market conditions are still positive, which should support consumer demand, and we are also seeing fiscal stimulus in the US and a number of eurozone member states. It was encouraging that the service sector PMI improved in both the US and eurozone in February.

Service sector PMI

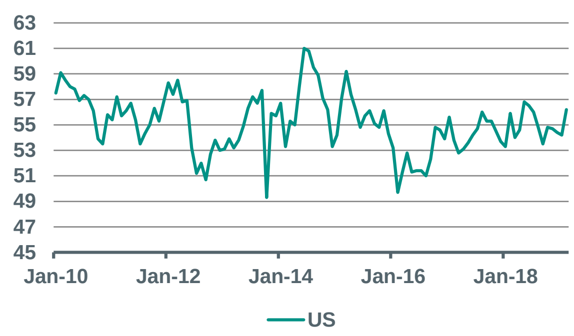
Business activity index



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Service sector PMI

Business activity index



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Shift in policy settings not sufficiently strong to be a strong tailwind

The more accommodative policy stance at central banks is not (yet at least) a significant enough shift (see here) to be a strong tailwind for the global economy over the coming quarters. We still characterise the situation as being one of policymakers taking their foot off the breaks rather than stepping on the gas. The Chinese authorities do not appear to be open to moving towards large-scale stimulus, as there is concern about a further building up of debt. Indeed, this week, Premier Li Keqiang expressed concern about the jump in credit in January, saying it could involve 'potential risks'. He asserted that the 'fundamental path to solving China's long-term development problems' was structural reform. On balance, we expect the global economy to regain some traction later in the year, but the improvement is likely to be gradual and moderate. The shift in the stance of monetary policy is not sufficient to trigger the kind of rebound that we saw in 2016-17.

Main economic/financial forecasts

GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	14/02/2019	21/02/2019	+3M	2019e	2020e
United States	2.2	3.0	2.7	1.7	United States	2.69	2.65	↓ 2.60	↓ 2.60	↓ 2.50
Eurozone	1.8	1.8	0.8	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.20
Japan	0.7	0.8	0.9	0.7	Japan	0.07	0.07	-0.10	-0.10	-0.10
United Kingdom	1.4	1.4	↓ 1.1	↓ 1.8	United Kingdom	0.87	0.86	0.80	↓ 1.00	↓ 1.25
China	6.6	6.6	6.3	6.0						
World	3.8	3.6	3.4	3.3						
Inflation (%)	**2017**	**2018e**	**2019e**	**2020e**	**10Y interest rate**	**14/02/2019**	**21/02/2019**	**+3M**	**2019e**	**2020e**
United States	2.4	2.4	1.6	2.0	US Treasury	2.66	2.69	↓ 2.6	↓ 2.60	↓ 2.50
Eurozone	1.7	1.7	1.0	1.3	German Bund	0.10	0.13	0.0	0.20	0.50
Japan	0.9	1.0	1.1	1.6	Euro swap rate	0.66	0.66	0.6	0.80	1.10
United Kingdom	2.5	2.4	1.4	1.8	Japanese gov. bonds	-0.01	-0.04	0.0	↓ 0.10	↓ 0.30
China	2.1	2.1	2.5	2.5	UK gilts	1.15	1.20	1.5	↓ 1.50	↓ 1.80
World	3.0	3.5	3.8	3.3						
Key policy rate	**21/02/2019**	**+3M**	**2019e**	**2020e**	**Currencies**	**14/02/2019**	**21/02/2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.13	1.13	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	110.5	110.7	111	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.28	1.31	1.28	1.35	1.45
Bank of England	0.75	0.75	↓ 0.75	↓ 1.00	EUR/GBP	0.88	0.87	0.86	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.77	6.72	6.70	6.60	6.60

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