

Macro Weekly

Group Economics

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It ain't over yet: recession fears in the eurozone

- **Eurozone recession still not most likely, but risks are tilting to the downside**
 - 10-year German Bund turned negative
 - Corporate lending less favorable than it seems
 - German manufacturing employment shrinks for the first time since the slowdown
- **ECB will do all it can, but fiscal aid is possible and would be helpful**
- **While Brexit negotiations are come to a deadlock**

Reawakening recession fears

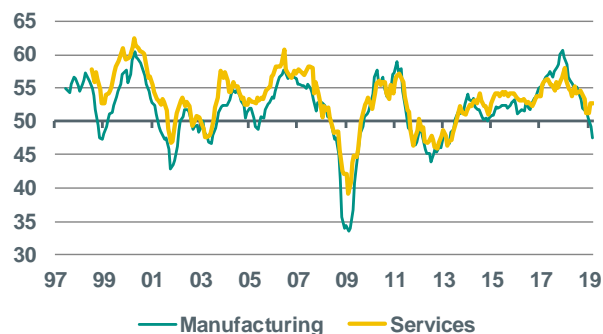
On Wednesday, 10-year German debt was auctioned with a negative yield for the first time since the autumn of 2016. The willingness of investors to receive negative yields reflects a flight to safety in assets that are perceived to be "risk free". This flight for safe haven assets could be driven by a number of developments. Rising concerns about the ongoing slowdown in Germany and globally, combined with ongoing political uncertainty has moved investors into haven assets already for weeks. Their concerns prove not unjustified. Thursdays release of the manufacturing confidence index from the European Commission (from -0.4 to -1.7), reminded us of the fear that the slowdown may not have bottomed out just yet.

However, other factors play a role as well. Such as investor concerns arising from the latest dovish shift by the Fed last week when it put off any rate hike for the rest of the year. But yields eventually turned negative on Wednesdays auction when Mr. Draghi hinted that the bank's governing council could tweak its negative interest rate policy to zero in order to limit its impact on banks (see [here](#) for our view on hiking rates back to zero).

While we do see risks tilting to the downside - with below consensus GDP growth expectations of 0.8% in 2019 -, we still do not expect a recession in our baseline scenario. We expect global industrial production to recover somewhat in the second half of this year, which will pull industrial production in the Eurozone along. Another factor of resilience is the service industry. While the forward looking services PMI tend to follow manufacturing PMI, it has shown remarkable resilience since the end of 2018.

Eurozone: PMI

Index, 50=neutral



Source: Thomson Reuters Datastream

Corporate lending sparks could reflect mere volatility

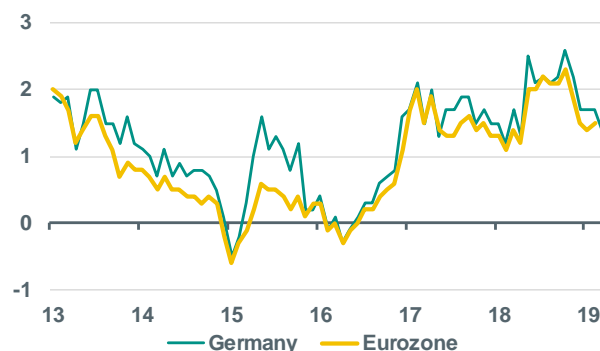
With each economic data point being closely monitored to assess whether the slowdown is coming to a halt, Thursdays hopeful news on bank lending to non-financial businesses might not be more than a month's data point. In February banks provided loans worth 17 billion euros, a growth of 3,7 % vis-à-vis the same month a year before. The less volatile 3-month moving average shows a continuing decline from its peak at 17 bn euro in the summer of 2018 to 8.6 bn in the last three months. Moreover underlying country data show that lending growth figures were rather skewed. In Germany and France, non-financial business lending grew around 6% compared to the same month a year earlier, while Italy and Spain, countries that were the main beneficiaries of previous ECB measures for favourable lending conditions (TLTROs), barely saw a lending increase.

Insufficient inflationary pressures

While Eurozone headline inflation for March is coming through on Monday, individual countries' inflation figures show a mixed picture. Germany is down from 1.7 to at 1.4% (HICP), while others such as Spain or Belgium are up. On aggregate we expect eurozone headline inflation to stay at 1.5% on Monday.

Inflation

% yoy



Source: Bloomberg

Both cyclical factors and structural drivers are in our view weighing on inflation (see [here](#) for more details). With inflation expectations persistently below target, wage setting in negotiations is suppressed to levels below than what could have been achieved given the current tightness of the labour market. That said, another question is whether labour markets really are as tight as they seem.

German unemployment is bottoming out, while manufacturing jobs are expected to get hit for the first time

Today's release of German unemployment figures, show a further decrease to 4.9%. This is a low that hasn't been achieved since the reunification of East- and West Germany. But it was less of a decline than expected, given some receding economic tailwind lately.

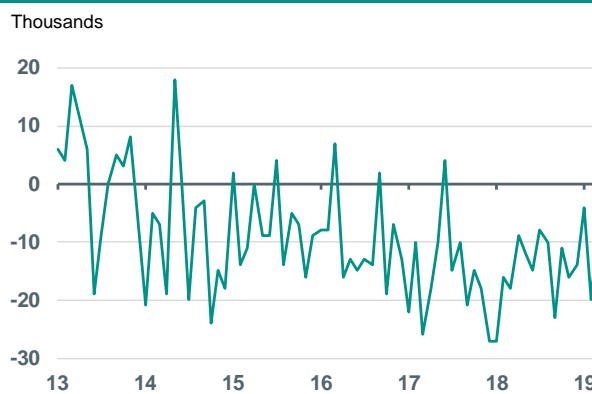
The Ifo employment barometer that came out on Thursday shows cracks appearing in the so far highly resilient German labour market. Manufacturing employers are for the first time, since the export demand shock hit their businesses, expecting their hiring intentions for the coming three months to shrink

Germany: Ifo unemployment expectations



Source: Thomson Reuters Datastream

Germany: change in unemployment



Source: Bloomberg

Expected ECB reactions (by Nick Kounis)

Our base case is that the ECB will further push out its forward guidance on the period of unchanged policy rates and ongoing reinvestments. The modest trajectory for economic growth will not be sufficient for underlying inflationary pressures to build. We think that ECB forecasts for growth and inflation remain too high despite recent downgrades. Our base case is that ECB policy interest rates will remain on hold through to the end of 2020 and reinvestments will continue to end of 2021. However, the risks are to the downside. The probability is rising that the ECB will need to step up stimulus and restart QE.

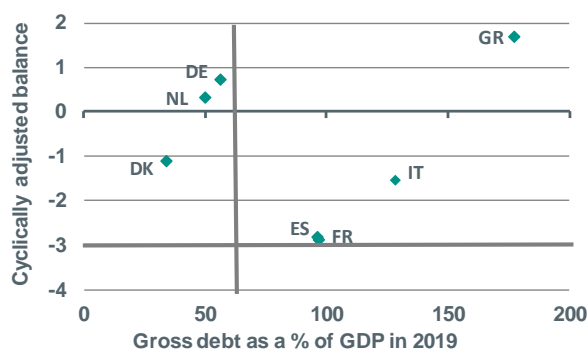
What to expect in the fiscal sphere?

As the Eurozone economies are still struggling to recover from global slowdown, monetary policies could use some help on the fiscal side. Moreover, one might even say that monetary policies are nearing the end of their abilities and require fiscal measures to be successful.

This month the OECD estimates that if governments that run a surplus invest 0.5 per cent of GDP for the next three years (and start some necessary structural reforms), they could increase long-term eurozone GDP by 1 per cent.

Especially German fiscal spending would prove highly effective, according to the OECD.

Debt and deficit as % of GDP



Source: IMF, 2018, Bloomberg

Fiscal plans 2019

Change in primary balance as a % of GDP



Source: IMF, 2018, Bloomberg

Budget plans in countries with fiscal room to manoeuvre

Though it is only a small step, as the German government applies its own balanced budget rule, plans for increasing investments have been announced last week in the midterm federal budget.

In the Netherlands the budget surplus turned out to be 1.5% of GDP this week. This was higher than expected, bringing the debt-to-GDP ratio down to 52,4%. The Government plans to use its additional income to further reduce its debt.

In France, some increase in fiscal spending is announced to ease tensions with the *gilletts jaunes* but it is insufficient to count as countercyclical fiscal spending.

Finally, countercyclical fiscal aid could have come from Mr. Macron, who had proposed a Eurozone budget that would have been a fiscal bazooka worth several points of eurozone GDP. But European governments minimized the budget to 22bn euro spread over seven years.

Taken together, one can safely conclude that governments are not yet helping monetary policy succeed in enhancing economic growth.

Brexit still as uncertain as ever

Today was the day Brexit was supposed to set in. While in fact, there is hardly any more clarity today on Britain's future than there was on June 23 2016, when the decision to leave was made.

This week, British politics took two diverging paths. The first is the attempts by PM May to move Tory MPs toward backing her deal. With three highly outspoken brexiteers that made the turn, that seemed promising until Tuesday. Tuesday, DUB declined the request.

As things stand on Thursday evening, May's chances of getting the deal approved are rather small, despite her offering her own resignation in return for support. In addition, if this kamikaze gesture would get the withdrawal agreement through, it will make subsequent negotiations with the EU much harder, as Tory MPs will slip into election mode.

The second path that was taken this week looks more promising. Parliament has begun debating the various Brexit options before holding indicative votes to find out with alternatives are most likely to build a compromise deal on. While no option received majority support, the customs union and the referendum on the peoples vote were almost support by a majority in Parliament. The debates showed that certain trade-offs around Brexit, such as the notion that restricting immigration from Europe means leaving the single market or that maintaining open borders to Northern Ireland does not go with an independent trade policy.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	21/03/2019	28/03/2019	+3M	2019e	2020e
United States	2.2	2.9	2.3	1.9	United States	2.60	2.59	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	1.1	1.8	United Kingdom	0.84	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	21/03/2019	28/03/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.54	2.39	2.6	2.60	2.50
Eurozone	1.5	1.7	1.2	1.2	German Bund	0.04	-0.07	0.0	0.20	0.50
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.56	0.47	0.6	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.04	-0.10	0.1	0.10	0.30
China	1.6	2.1	2.5	2.5	UK gilts	1.06	1.00	1.7	1.50	1.80
World	3.0	3.5	3.8	3.2						
Key policy rate	28/03/2019	+3M	2019e	2020e	Currencies	21/03/2019	28/03/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.14	1.12	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	110.8	110.6	110	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.31	1.31	1.30	1.35	1.45
Bank of England	0.75	0.75	0.75	1.00	EUR/GBP	0.87	0.86	0.85	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.70	6.74	6.65	6.60	6.60

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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