ABN·AMRO

Global Outlook

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Initially weak, then better

This article sketches the outlines of the global economy in 2020. In the coming days and weeks our country and region specialists will produce their views on individual countries or regions from a much more specific angle.

Business confidence: industry contracting

Global manufacturing PMI, index, 50 = neutral

Source: Thomson Reuters Datastream

Global trade vs global industrial output

% y-o-y

Source: Thomson Reuters Datastream

The global economy clearly began to weaken from early 2018 onwards, a development that continued through 2019. Around the start of 2018, global economic growth was above 4%, the highest level since 2011. Since then the pace of growth has slackened. Several factors contributed to this deceleration.

Chinese 'deleveraging'

First of all, the Chinese authorities embarked in 2017 on a policy aimed at reducing the debt ratios. The resulting package of restrictions included a clamp-down on shadow bank lending. From a financial stability perspective, this was no doubt a wise move, and the policy has also proved effective. Around mid-2017 the lending volume through the shadow banking system was still expanding by about 15% y-o-y, compared to about -10% at the end of 2018. One side effect of these measures was undoubtedly a slowdown in economic growth.

China, incidentally, poses a special challenge for global economic analysts. Due to its vast scale, very open economy and powerful growth rate, China's influence on the global economy has greatly increased over the past decades. However, the Chinese economy is less well-documented than the established economies that traditionally set the tone. Identifying, let alone predicting, economic fluctuations in China is far from easy.

China: shadow banking ('social funding') contracting

Source: Bloomberg

China: car sales bottom out

Source: Bloomberg

Trade war inflicting severe damage

A second factor undermining the global economy is the trade war or, more broadly, the series of trade conflicts. The introduction of import tariffs effectively constitutes a tax and is taking a direct toll on the international economy. Even more detrimental, perhaps, is the ensuing uncertainty and the paralysing effect this is having on business sentiment. Growth in business investment has clearly tailed off since early 2018 and it is safe to assume that this has a lot to do with the US-China trade conflict.

Fed policy works with a time lag

A third factor dampening the economy over the past two years is the tightening policy adopted by the Federal Reserve (US central bank, the Fed) in the course of 2018 in the form of four rate hikes and balance sheet reductions. This led to more constrained monetary and financial conditions in the US, but also elsewhere in the world. In the US the higher rates have left their mark on interest-sensitive sectors. Outside the US, the higher dollar-linked interest rates mainly affected emerging countries because of their relatively large dollar-denominated debts. The Fed cut its rates again in 2019, but it takes time for monetary policy to feed through to the real economy.

In addition, various specific factors also contributed to the pull-back in growth in 2018 and 2019, such as the problems in the European automotive sector due to the introduction of new emissions test procedures in September 2018, Brexit and, possibly, some other causes.

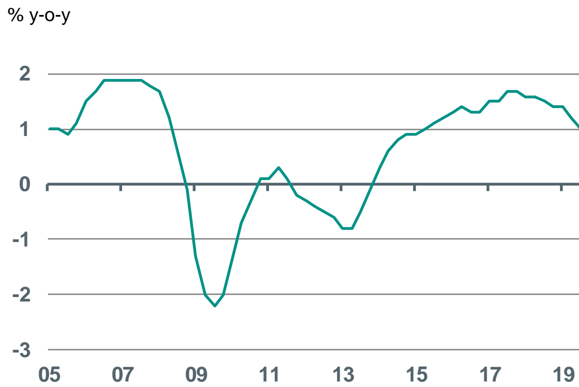
Unemployment will initially rise

The labour market is an economic variable that follows the business cycle with a time lag. In the jargon of economists, it is a lagging variable. Unemployment in the eurozone and the US remains low, but the improving trend in the labour market decelerated in the course of 2019. A deterioration in labour market conditions is to be expected in the coming months due to the recent slowdown in economic growth. This, however, does not imply that the economy is continuing to weaken; it is merely a delayed reaction to the earlier growth deceleration.

The factors determining the economic picture in 2020 differ from the patterns in the period now behind us.

Eurozone: less employment growth

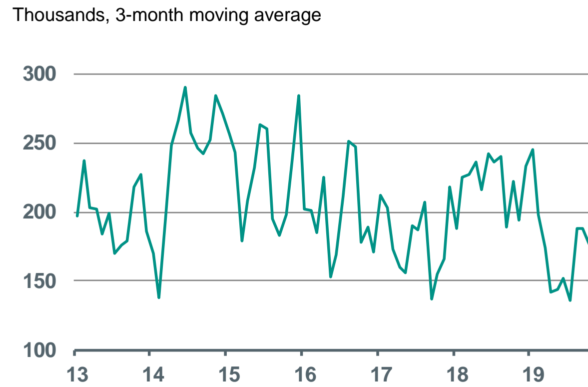
% y-o-y



Source: Bloomberg

US: change in employment set to weaken

Thousands, 3-month moving average



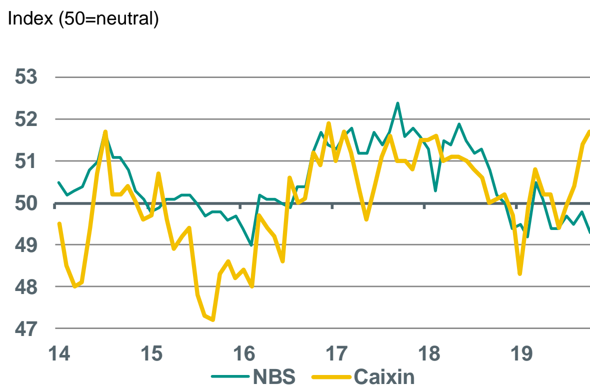
Source: Bloomberg

Chinese stimulus seems to be effective

First of all, the Chinese authorities have somewhat shifted their policy approach. Evidently, the economic weakening had gone further than they were prepared to tolerate, possibly because of additional fall-out from the trade conflict.

China: Diverging manufacturing PMIs

Index (50=neutral)



Source: Thomson Reuters Datastream

China: clear GDP deceleration from early 2018

% y-o-y

Source: Thomson Reuters Datastream

For some time now, they have been taking relatively small, targeted measures to boost business activity. It is not very clear how successful these measures are. Looking for signs of improvement, I found a remarkable divergence between China's two leading business confidence indices, the NBS and the Caixin. The latter has clearly risen in recent months, while the former has shown no noteworthy change. The Chinese government's measures to stimulate the economy have focused on the private sector and private companies are more strongly represented in the Caixin than in the NBS. The divergence of both indicators may signify that the policy has had some success.

China-US relationship crucial

The outcome of the US-China conflict is hard to predict. Earlier this year, I was convinced that a deal would be reached, but then the talks turned ugly, sparking a series of additional retaliatory tariffs. History tells us that an ailing economy seriously impairs a US president's chances of re-election. And the risk of economic weakness is greater if the conflict is allowed to fester or even escalate further. In this light, it seems reasonable to assume that further escalation will be avoided, with the parties eventually agreeing on a truce. The Chinese, too, would prefer this outcome as their economy is

definitely suffering. But honesty compels us to add that what we see as reasonable, logical and rational is not necessarily how President Trump sees it…

A truce in the conflict would have a positive effect on sentiment. If this is accompanied by a reduction or cancellation of the introduced tariffs, the reaction could be very positive indeed. The conflict has caused many companies to postpone capital spending. Some of this capital spending will get the go-ahead if an agreement is reached. This kind of pent-up demand could give the economy an unexpected tailwind.

Continuing effect from Fed U-turn

One of the key developments in 2019 was undoubtedly the Fed's change of direction. In December 2018 the Fed was still hinting at several rate increases in 2019. But in January 2019 Fed chief Powell already dramatically changed his tone, saying that the Fed could be 'patient'. Ultimately, the Fed cut its official rates three times. The explanation was that this was a kind of insurance against economic weakening. In one sense, the rate cuts of 2019 can also be termed a historical first. Never before was monetary policy loosened when unemployment was at an all-time low. That the Fed was able to do this was entirely down to the persistent low inflation. In the past, such low unemployment numbers pushed up prices, forcing the Fed to raise rates to keep inflation in check. The rate cuts of 2019 will undoubtedly help to keep the US economy on a growth track for the time being, thus extending what is already its longest run of uninterrupted expansion since records began (1854).

The effects of the Fed's easing are clear. For a start, interest-sensitive sectors are enjoying the benefits. Construction, for instance, is picking up. The positive consequences of the lower interest rates for the economy will gradually spread to the wider economy. The US interest rate cuts have also led to more relaxed monetary and financial conditions around the world.

Meanwhile, fears of an early recession in the US have abated. The divergence in the US between consumer and manufacturing confidence is remarkable. The upbeat mood among consumers is hardly surprising. There are plenty of jobs, incomes are growing and household finances are solid. As long as consumers keep spending – and what's to stop them? – a recession in the US is unlikely.

US: consumers more optimistic than producers

Index, 50=neutral index

Source: Bloomberg

US: housing starts increase

Thousands, 3-month moving average

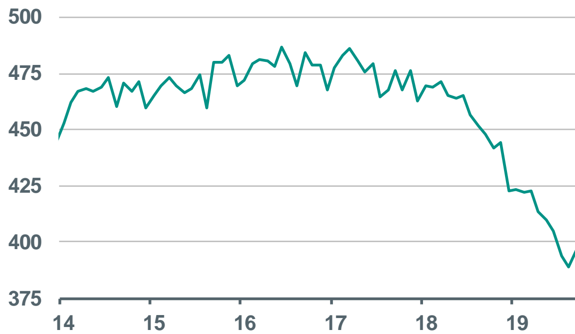
Source: Bloomberg

It can't get worse, so it must get better

Automotive manufacturers will (eventually) turn the corner. That is particularly important for Germany, where the sector accounts for about 4% of the economy. The fall in output since mid-2018 amounts to some 15-20%, cutting German GDP by over half a per cent. How much worse can it get? After such a severe slump, a clear upturn is all the more likely. First of all, car sales in China have moved up a gear in recent months. Secondly, German car companies are on the eve of the launch of an impressive array of electric cars. Even more important, perhaps, is that there seems to have been a sharp correction in inventories. The production of German cars may have decreased by 15-20%, but demand has fallen less. The process of running down inventories has had a negative impact on the economy. But the good news is that this cannot last forever. At a certain point, industry shifts from destocking to restocking mode. This, in turn, gives the economy an impulse. This is the scenario that is likely to play out in Germany in 2020.

Germany: slump in car production almost over?

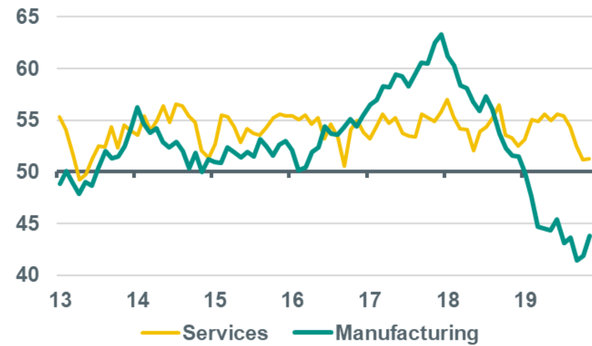
Thousands, 12-month moving average



Source: Bloomberg

Germany: manufacturer confidence

PMI, index, 50=neutral



Source: Bloomberg

This shift from destocking to restocking may also extend to sectors other than the car industry. Industrial output in Germany has been decelerating by 4-5% for some time now. Figures about inventory movements are notoriously unreliable, but it is unlikely that total demand for German goods has shrunk 4-5%. The only logical conclusion is that stocks have been run down. That, as noted, is a finite process.

Germany: inventory movements

In current prices, EUR billion

Source: Bloomberg

Eurozone: divergence in business confidence

PMI, index, 50=neutral

Source: Bloomberg

5G increasingly vital to the economy

One remarkable development in 2019 was the extremely powerful price surge of IT equities. The IT sector far outstripped the wider equity market in 2019. Until the time of writing, the S&P500 had gained 25% year to date, whereas the SOX index of semi-conductor firms had soared 50%. Suppliers of equipment that is essential for the construction of 5G did particularly well. This signals the market's expectation that the roll-out of 5G is set to continue apace in the coming period, insofar as it has not already taken place. Both the construction and future usage of 5G will stimulate business activity, with undoubted knock-on effects for the global economy in 2020. In a certain sense, the struggle between the US and China for technological supremacy will further galvanise this development. Europe must face up to the bitter and regrettable reality that it only has a modest role in this field of cutting-edge technology. One tell-tale sign of the quickening global IT cycle is the increase in Taiwanese electronics export orders. Another interesting consideration as we look to the future is that productivity growth has been remarkably low in most countries in the past ten years. More recently, a certain improvement has been noticeable in the US. And the launch of 5G may give productivity a fresh impulse.

Taiwan: electronics export orders

% y-o-y

Source: Bloomberg

US: labour productivity

% y-o-y; 8 quarters moving average

Source: Bloomberg

As well as the above favourable factors, the lower oil price and the slightly more accommodative budget policy in Europe may give the economy some support in 2020.

Annual figures conceal the underlying trend

An exclusive focus on year-on-year economic growth figures can blind the observer to the underlying economic trend. The deceleration in 2019 entails that this year will probably end on a weak note. 2020 will then also get off to a slow start, making a strong recovery necessary to push the 2020 'full-year figure' above that of 2019. For many countries, we are forecasting slightly lower growth for 2020 than in 2019. It is important to stress that this conceals our expectation that underlying growth will strengthen in the course of 2020.

However, with growth remaining subdued for the time being, we foresee one more Fed rate cut, somewhere in the first quarter. And with growth at a low ebb and inflation remaining stagnant, more relaxation by the ECB is also on the cards.

On balance

On balance we look ahead to 2020 with some optimism. The global economy has weakened significantly in the past two years. But there is reason to assume that 2020 will bring an acceleration in global growth. One crucial factor is the (temporary) termination of the conflict between China and the US. If that conflict is allowed to drag on or escalate further,

the global economy will suffer badly in 2020. We assume that the antagonists will reach an agreement some time soon, even if an agreement is torn up again after the US elections. Other positive factors for 2020 are the Chinese stimulus measures, the effects of monetary relaxation in the US, the probable upturn in fortunes for (German) car companies, the roll-out of 5G, the slightly lower oil price, the moderately expansive budget policy in Europe, the onset of catch-up demand as the current uncertainties recede and the inventory cycle in several important sectors. At the moment, we already see a broad-based uplift in confidence indicators, albeit from low levels. Though conditions remain fragile, this development does point to an improvement in the global economy in the course of 2020.

As ever, risks and uncertainties abound around the world. The US elections will cast a shadow as the year unfolds. Brexit appears to have moved into calmer waters, though new and unpleasant surprises cannot be excluded. Nor is it clear whether the ECB will change its course under new leadership. The same applies to the European Commission. There are also risks concerning government policy. Many governments face mounting pressure to step up their efforts to achieve the Paris Climate objectives. This could easily lead to knee-jerk measures that may have abrupt and negative effects on business activity in the short term.

Key and financial indicator estimates

3-12-2019	GDP (% yoy)			Inflation (% yoy)		
	2019e	2020e	2021e	2019e	2020e	2021e
US	2,2	1,3	2,0	1,8	1,9	1,9
Japan	1,0	0,4	1,0	1,1	1,6	1,0
Eurozone	1,0	0,8	1,3	1,0	0,8	1,0
UK	1,2	1,2	2,0	1,8	1,7	2,0
Emerging Markets						
China	6,2	5,8	5,6	2,8	2,5	2,0
Asia	5,5	5,4	5,5	2,9	2,9	2,8
Em. Europe	1,4	2,4	2,4	6,6	4,9	4,7
Latam	-0,1	1,5	2,3	9,3	8,1	6,3
World trade	0,0	1,0	2,0			

3-12-2019	Official policy rate (%, eop)			3m interbank rate (%, eop)		
	2019e	2020e	2021e	2019e	2020e	2021e
US	1,75	1,50	1,50	1,7	1,4	1,4
Japan	-0,10	-0,10	-0,10	-0,1	-0,1	-0,1
Eurozone	-0,50	-0,60	-0,60	-0,4	-0,6	-0,5
UK	0,75	0,75	0,75	0,8	0,8	0,8

	10y government bond yields (%, eop)		
	2019e	2020e	2021e
US	1,7	1,9	1,9
Japan	-0,1	0,0	0,0
Eurozone (Bunds)	-0,4	-0,4	-0,4
UK	0,3	0,3	0,7

	Exchange rates (versus USD, eop)*			Exchange rates (versus EUR, eop)*			
	2019e	2020e	2021e	2019e	2020e	2021e	
				1,12	1,16	1,20	EUR/USD
USD/JPY	108	112	116	121	130	139	EUR/JPY
USD/EUR	0,89	0,86	0,83				
GBP/USD	1,30	1,35	1,42	0,86	0,86	0,85	EUR/GBP

Source: Thomson Reuters Datastream, EIU, ABN AMRO Group Economics

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