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Group Economics

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Sandra Phlippen

Head Research Netherlands

Tel: +31 20 628 1368

sandra.phlippen@nl.abnamro.com

Arjen van Dijkhuizen

Senior Economist

Tel: +31 20 628 8052

arjen.van.dijkhuizen@nl.abnamro.com

Trump slump drags the world along

- **US-China tit for tat continues, complicating a deal any time soon**
- **Is it China? Is it the Fed? No, this is ‘the Trump slump’**
- **Supply chains start shifting as US-China trade collapses**
- **German confidence takes a hit, but government has fiscal space to cope**
- **Trump slump causes commotion about what índependence really means**

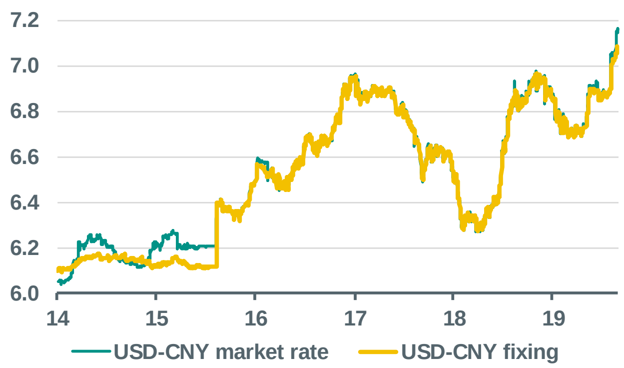
Tit for tat continues …

US-China tensions escalated further a week ago. In response to fresh US tariffs (10%) on USD 300bn of imports from China announced on 1 August (to be implemented in two stages on 1 September and 15 December), China retaliated on 23 August. Beijing presented 5-10% tariffs on USD 75bn of US goods and reintroduced tariffs on US cars and car parts. The US responded immediately by raising existing tariffs over USD 250bn of Chinese goods from 25% to 30% (per 1 October) and by hiking the proposed tariff rates on the remaining USD 300bn from 10% to 15%. Strikingly, in a tweet president Trump ordered US companies to look for alternatives to China, a new element in the US-China conflict that would lead to a further decoupling of the world’s two largest economies.

As a result of these escalating tensions, the Chinese yuan weakened further this week, as the Chinese authorities allow some (primarily market-driven) depreciation to offset the tariff impact on China’s external competitiveness. The yuan recovered a bit after comments from Beijing that it would not immediately retaliate the latest US tariff hikes, but rather preferred discussing the removal of tariffs.

Ongoing yuan depreciation partly offsets tariffs

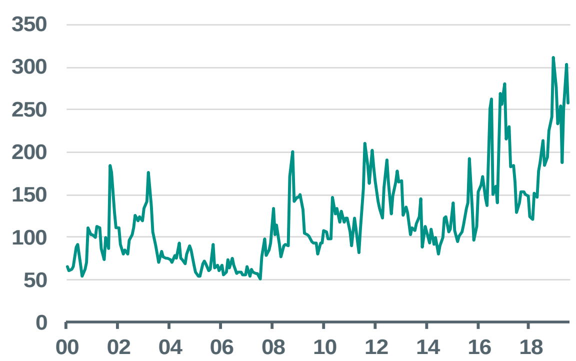
CNY per USD



Source: Bloomberg

Policy uncertainty has risen

Global Economic Policy Uncertainty Index



Source: Bloomberg

Group Economics: ‘Enabling smart decisions’

… complicating a deal any time soon

As stock markets nosedived following the escalation of tensions, president Trump tried to repair the damage by praising Xi. He also stated that Chinese officials had requested to restart negotiations. However, Beijing quickly denied this story.

All this shows that US negotiation tactics are not effective. The Chinese leadership does not seem to be impressed by the building up of threats and seems to have hardened its approach, reducing the likelihood that a deal will be struck in the near term. At home, the Chinese leadership cannot afford being perceived as being weak and bowing to the US. Moreover, it seems that Beijing has taken the view that it can sit out the trade war by accepting some further economic slowdown (mitigated by yuan depreciation and additional targeted stimulus), with US presidential elections looming. The Chinese are quite steadfast in their approach so far, while president Trump seems to shift constantly between the 'let's be tough on China' and the 'let's make a deal' button.

Does this mean that some kind of deal is completely impossible now? Not necessarily, but in our view it would require a material change of political calculus (primarily in Washington, but also in Beijing).

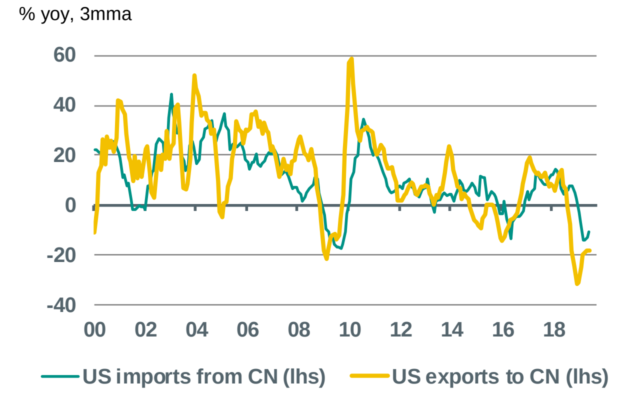
It is China? Is it the Fed? No, this is the 'Trump slump'

Our base case for a further escalation of the trade/tech war, and consequently a further weakening of economic growth thus remains intact. Our 2020 growth forecasts for the US, the eurozone and China have all been below consensus for a while, mainly for this reason. In our view, the escalation of US-China tensions (and the US-driven tendency to challenge the notion that 'globalisation is always good') is the main factor behind the weakening in global manufacturing. Despite all twists and turns in this conflict, the situation has become worse since last year and has contributed to policy worldwide uncertainty, a loss of business confidence and a slowdown in corporate investment spending and global trade. The weakness started in manufacturing, but there are increasing signs that other parts of the economy are infected as well. This is also illustrated by lower GDP growth figures, particularly for highly export oriented economies in Europe (with Germany heading for recession in Q3) and Asia. Not surprisingly, at the Biarritz summit last weekend G7 leaders urged president Trump to calm down on China.

Supply chains start shifting as US-China bilateral trade collapses

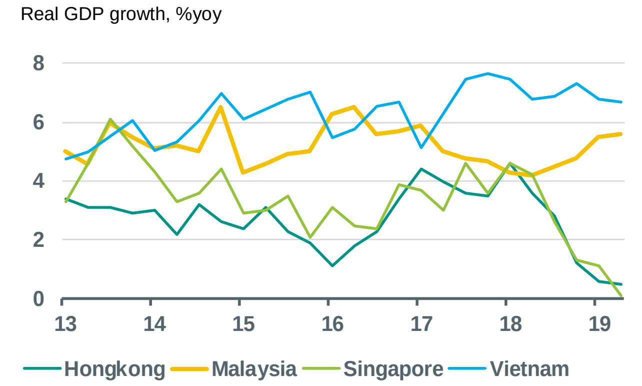
Meanwhile, the are several indications that the decoupling between the US and China has already started. Bilateral trade between the two countries has collapsed in the course of this year and will be dragged down further by the stepping up of tariffs. This is indicative of US-China centered global supply chains being disrupted. This disruptive process could be accelerated by president Trump's recent orders to US companies to withdraw from China. Even though the legal base of such an order is not clear, and US firms are objecting to it, the mere launching of the order will likely make US firms even more hesitant to do business in/with China. Some other evidence for these shifts of supply chains can be found from the growth rates of various Asian countries. Growth of global bellwethers Hong Kong and Singapore (typically exposed to US-China centered supply chains) has slowed sharply since last year. By contrast, growth in countries such as Vietnam and Malaysia – that seem to profit from the US-China trade war – is holding up quite well, despite the weakening global business cycle.

Bilateral US-China trade has collapsed



Source: Thomson Reuters Datastream, US Census Bureau, ABN AMRO

Not everyone loses

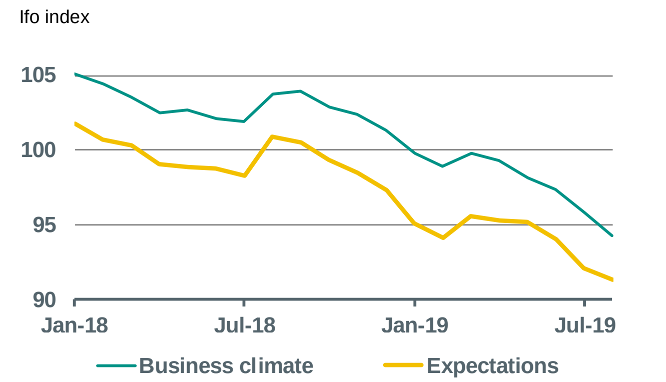


Source: Bloomberg

Trump slump drags German confidence down

In the Eurozone, all eyes are on German manufacturing exports, as this has appeared to be the epicentre connecting the trade war to the economy of the Eurozone. This week's Ifo indicators of the current German business climate in manufacturing, trade and construction recorded a meagre 94.3, well below the already increasingly gloomy analysists expectations (95.1). As if that were not enough, the forward looking expectations component tumbled to 91.3 (surveys indicated a 91.8)

Germany: future expectations even worse than current

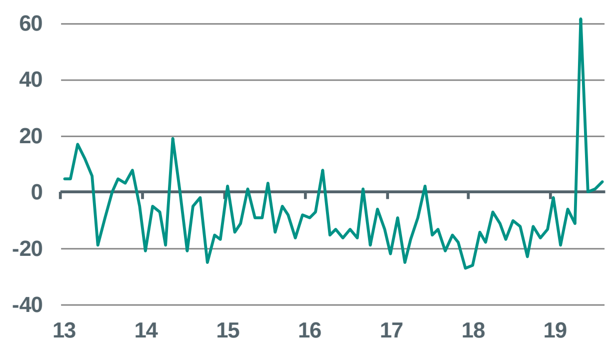


Source: Bloomberg

These figures quickly ended hopes that anyone might have gotten from last weeks uptick in Germany's manufacturing PMI. Unemployment figures also add to the gloom this Thursday, with a jump in the number of unemployed in August. In line with the Ifo business indicators, we expect the German economy to officially enter recession in the third quarter, bringing our annual growth expectation for 2019 to 0.4 percent.

Unemployment spike could justify government to act

Germany: unemployment change in thousands



Source: Bloomberg

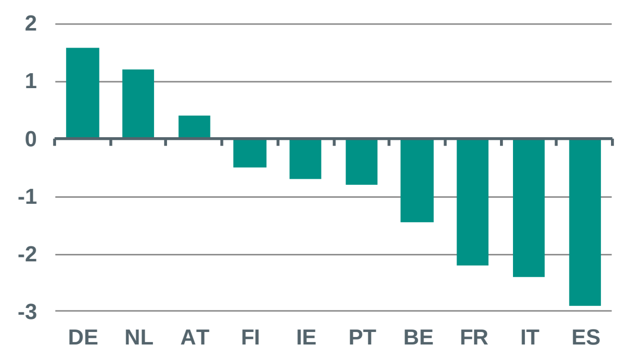
Germans are most able to counteract with fiscal stimulus

The pressure on the German government to let go of its traditional 'Schwartze Null' (budget balance) policy is mounting. Not only is the German economy most hit by the trade conflict, as pointed out above, it's tendency to hold onto budget balance and current account surpluses is increasingly considered unnecessary and even damaging to the German and other European member states. Also, implementing the stimulus should not be that hard in Germany. The infrastructure is widely considered outdated, there is an ambitious agenda on climate policies coming up next month.

In a thematic publication by Aline Schuiling this week, we show that the German Government could spend some EUR 54 bn on fiscal stimulus, while still remain safely within the margins of the medium term structural deficit requirements by the European Commission. If one assesses Germany's fiscal room in terms of keeping current debt levels sustainable, it would even have double fiscal space. While Germany's finance Minister, Olaf Scholz has indeed confirmed the fiscal spending potential, Chancellor Merkel has up to now commented that she sees no need for it. Yesterdays unemployment spike could give Chancellor Merkel the justification to act.

Fiscal room to manoeuvre

% GDP



Source: European Commission, ECB, ABN AMRO Group Economics

Together with the Dutch

Whilst Dutch GDP growth has been remarkably solid amidst the shrinking neighbouring economies of Germany and the UK, we expect that more downturn will eventually bring economic growth in the Netherlands further down to 0.9% in 2020 (prior expectation 1.1%). In light of these risks from abroad, the Dutch government is currently considering to initiate a structural investment fund of several billion euros to counterweigh a potential downturn. Details of the investment fund will be presented alongside the 2020 budget plans, on 17 September. This week's Brexit developments have reduced the probability of avoiding a no-deal Brexit (see here), and with that, increased the downside risks to the Dutch economy.

Trump slump confused central bankers about 'what entails independence?'

Against the backdrop of the global downturn, central bankers at their annual meeting in Jackson Hole revealed a growing awareness that they cannot safeguard the global economies on their own. With a shrinking room to manoeuvre and surprise market participants (see also here) in a way that convinces them to step up their spending and reduce their savings, political boldness to loosen the debt brakes is increasingly seen as a prerequisite to stay effective in the future.

In a remarkable public statement this week, the former vice-chairman of the Fed Mr Dudley, urged the Fed to not cushion the economic backlashes of president Trump's aggressive trade policies. In this Bloomberg column, he explained that ignoring the administration's trade policies as being outside the realm of the Fed's mandate, could actually imply being drawn into Mr Trump's political agenda. Mr Dudley suggested that "the Fed's accommodation encourages the president to escalate the trade war further, increasing the risk of a recession". Mr Dudley suggested that the Fed could consider 'refusing to play along' as a way to achieve longer term price stability. The Federal Reserve quickly rejected this suggestion, although Fed chairman Mr Powell had raised concerns on how the Fed responds to uncertainties around the trade war just days earlier.

Main economic/financial forecasts

GDP growth (%)	**2017**	**2018**	**2019e**	**2020e**	**3M interbank rate**	**22/08/2019**	**29/08/2019**	**+3M**	**2019e**	**2020e**
United States	2.4	2.9	2.2	1.3	United States	2.13	2.12	1.43	1.43	1.55
Eurozone	2.6	1.9	0.8	0.6	Eurozone	-0.42	-0.42	-0.55	-0.55	-0.55
Japan	1.9	0.8	1.0	0.3	Japan	0.07	0.07	-0.10	-0.10	-0.10
United Kingdom	1.8	1.4	1.2	1.2	United Kingdom	0.76	0.76	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	3.8	3.6	2.9	2.9						
Inflation (%)	**2017**	**2018**	**2019e**	**2020e**	**10Y interest rate**	**22/08/2019**	**29/08/2019**	**+3M**	**2019e**	**2020e**
United States	2.1	2.4	1.8	2.0	US Treasury	1.61	1.52	1.5	1.50	1.50
Eurozone	1.5	1.7	1.1 ↓	0.9	German Bund	-0.64	-0.69	-0.8	-0.80	-0.80
Japan	0.5	0.9	1.1	1.6	Euro swap rate	-0.20	-0.29	0.2	0.20	0.35
United Kingdom	2.7	2.5	1.9	1.8	Japanese gov. bonds	-0.25	-0.29	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.52	0.44	0.3	0.30	0.30
World	3.0	3.4	3.7	3.3						
Key policy rate	**29/08/2019**	**+3M**	**2019e**	**2020e**	**Currencies**	**22/08/2019**	**29/08/2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2.50	1.50	1.50	1.50	EUR/USD	1.11	1.11	1.12	1.12	1.15
European Central Bank	-0.40	-0.60	-0.60	-0.60	USD/JPY	106.4	106.5	104	104	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.23	1.22	1.24	1.24	1.30
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.90	0.91	0.90	0.90	0.88
People's Bank of China	4.35	4.10	4.10	3.85	USD/CNY	7.09	7.15	7.20	7.20	7.50

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.