

Macro Weekly

Group Economics

07 June 2019

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Historic visit to Germany

- We have shifted to a more negative scenario concerning the trade conflict and its consequences
- Poor German production and trade data in April
- Central bankers are making a statement
- My unique experience in Germany

I spent the last couple of days in Germany, visiting five cities meeting with my colleagues of the Bethmann Bank talking to and doing presentations to our German clients. I have done such German tours for the last ten years or so. In my presentations I always include some multiple-choice questions which I ask clients to answer by raising their hands. That way we get a good impression of what the majority thinks. One of the questions I had included this time was what people thought of inflation. And one option was that inflation would rise considerably. For the first time during those ten years of Germany tours not one single client thought that inflation would rise appreciably. Ten years ago, when central banks started aggressive monetary policy, the majority of our German clients thought high inflation was likely. Those fears got another boost when the ECB started its bond-buying programme in 2015. But the experience of the last couple of years appears to have killed the deep-rooted inflation fears in Germany. A vast majority of the people I asked had, nevertheless, a strong preference for Bundesbank president Jens Weidmann as Mario Draghi's successor at the helm of the ECB.

Meanwhile, eurozone inflation data showed that, as we had thought, the recent rise in inflation did not reflect an underlying trend towards the ECB's target. Headline inflation fell from 1.7% yoy in April to 1.2% in May, while core inflation fell from 1.3% yoy to 0.8%.

Moving to a more negative trade-conflict scenario

Following the US threats against Mexico and the apparent hardening of the tone in the US-China conflict, we have moved to a more negative scenario. Our old main scenario was that the US-China conflict would be resolved within the next couple of months. But the Mexico threat cast a new light on the US-China relationship also as the Chinese might conclude that president Trump cannot be trusted and there is no point doing a deal with him (as the Mexicans had done in the new NAFTA deal) if he is willing to negate such a new deal at any time and for any reason.

We always considered alternative scenarios with a more negative outcome possible with a non-negligible probability. We have now raised the probability of a

more negative scenario, making that our main scenario. The implication is that we have lowered our forecasts for economic growth in most regions, lowered our projections for interest rates and bond yields and are now assuming various easing actions by central banks. For an overview of forecast changes, [see here](#).

I think at the end of the day, we must make up our minds as to whether or not we are dealing with a decisive phase in the quest for global economic, political and technological leadership or not. If the leaders of the countries involved think we are in such a decisive phase then they will be willing to accept economic pain and even be willing to inflict pain on their own economy if they feel it is hurting even more on the other side. That would lead to severe damage to the global business cycle. It would also lead to a disintegration of the world economy. But if the current controversy is 'just' one of the likely many battles in this quest for global leadership, there is still every chance that it will be resolved, at least for some time. I, for one, still think that president Trump will do a deal this time as he cannot afford a very weak economy ahead of next year's elections. Also, he does not like falling stockmarkets and a further escalation on the conflict could do serious harm there. But there is no rush for Trum, there is time yet and it is hard to see President Trump wanting to compromise any time soon.

If one assumes that his possible re-election will have a big impact on president Trump's behaviour, then one must wonder what might happen during his next term (should he be re-elected) when he does not have to worry about his political future...

US ISM and ISM new orders



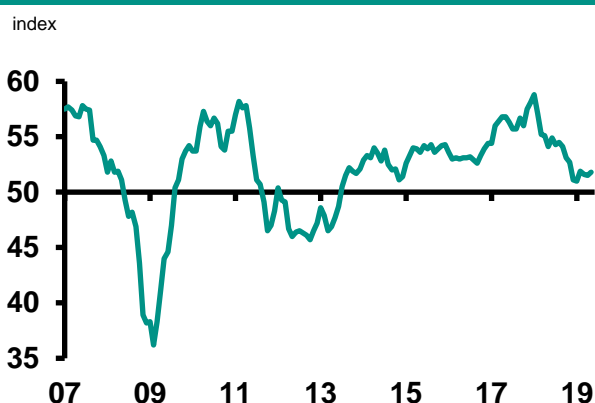
Source: Bloomberg

Soft economies, but no recession

Meanwhile, global business confidence indicators continue to be soft. The US authoritative ISM manufacturing index fell to 52.1 in May, down from 52.8 in April. While this was the lowest reading since 2016, the graph going back to 2007 shows that the index is still at a pretty reasonable level, quite far from recession territory. The important sub-series for new orders actually improved a little in May.

A similar message is reflected by the Composite PMI index for the eurozone. That index of business confidence in manufacturing and services inched a fraction higher in May: 51.8, versus 51.6 in April. The more important message, however, is that having fallen from a very high level at the beginning of 2018, the index has been remarkably stable since the beginning of the year. And the index is far higher than one would associate with recession. The same is true for the Italian Composite PMI, only that it has stabilised since October last year.

Eurozone composite PMI



Source: Bloomberg

Italian composite PMI



Source: Bloomberg

Poor German data

German factory orders rose 0.3% mom in April, a little better than expected while the March data was revised from +0.6% to +0.8%. That is positive, but optimism was quickly killed when industrial production data showed a drop of 1.9% mom in April after +0.5% in March. The yoy rate has now fallen to -1.8%. While German manufacturers are positive about the state of their order books, these are not very good numbers. They were corroborated by trade data showing a monthly decline of exports of no less than 3.7%. Now, these series are volatile and the April data may have been affected by Easter being late this year, but still...

Germany Industrial production



Source: Bloomberg

Central bankers are making a statement

Recent days have seen a range of central bankers all making similar statements. Following the re-escalation of the trade conflict and the new Mexico threats by the US, and perhaps also in response to softish economic and confidence data as well as the poor performance of the stockmarket in May Fed officials suggested that they may lower interest rates. We think a lowering of US interest rates during the next couple of months is, indeed, now the most likely scenario.

The ECB followed suit. At his press conference Mr Draghi not only explained why the ECB had decided to extend their forward guidance of 'no rate hike' until the end of 2019 to the middle of 2020. More remarkably, however, he told journalists that the Governing Council had discussed easing measures they could consider. Indeed, we think that the ECB will likely restart asset purchases later this year in response to weak growth and persistently low inflation against a background of falling inflation expectations.

Last, the governor of China's central bank, Yi Gang, stated that the PBoC and the Chinese government have plenty of policy options should it be necessary to provide much more stimulus to the economy. I think that is right.

Overall then, economic growth globally is soft and the re-escalation of the trade conflict is bad news for the near-term outlook. It is therefore not hard to understand why people are becoming more negative. However, I would say that there is no reason to become overly negative. Recessions still do not look likely within the next couple of quarters. And recessions are the real danger.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	30/05/2019	06/06/2019	+3M	2019e	2020e
United States	2.2	2.9	2.2	1.5	United States	2.52	2.45	2.20	1.90	1.80
Eurozone	2.5	1.9	0.7	0.9	Eurozone	-0.32	-0.32	-0.33	-0.33	-0.33
Japan	1.9	0.8	0.7	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	0.80	0.79	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	3.7	3.6	3.2	3.3						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	30/05/2019	06/06/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.23	2.12	2.0	1.90	2.00
Eurozone	1.5	1.7	1.1	1.0	German Bund	-0.17	-0.23	-0.3	-0.35	-0.20
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.37	0.28	0.7	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.08	-0.12	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.90	0.83	0.8	0.80	1.00
World	3.0	3.5	3.7	3.2						
Key policy rate	06/06/2019	+3M	2019e	2020e	Currencies	30/05/2019	06/06/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.25	2.00	1.75	EUR/USD	1.11	1.13	1.12	1.12	1.20
European Central Bank	-0.40	-0.40	-0.40	-0.40	USD/JPY	109.6	108.4	104	100	95
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.26	1.27	1.24	1.24	1.40
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.88	0.89	0.90	0.90	0.86
People's Bank of China	4.35	4.10	4.10	3.85	USD/CNY	6.90	6.91	6.90	6.90	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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