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Group Economics

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Are policymakers doing enough?

- The global economy continued to slow at the turn of the year and the weakness is likely to persist for a while longer
- We are seeing a reaction from central banks around the world to the slowdown in economic growth
- Financial conditions have eased and, perhaps helped by some lifting of policy uncertainty, momentum will improve later in the year
- We doubt economic growth will improve sharply given that the actions by central banks have been relatively modest so far
- The improvement in financial conditions will take time to feed through into demand

Global economic slowdown continues

Economic data this week was generally downbeat and points to an ongoing loss of global economic momentum. Most of the reports released came out of Europe and the German data was noticeably weak. German factory orders fell by 1.6% mom in December, taking the annual contraction to 7% yoy. Orders data can be volatile, but that pace of contraction has previously been consistent with a recession in the German economy. Industrial production looked 'better', falling by 0.4% on the month and 3.9% over the last year. Weakness was also seen in industrial production in Italy (-5.5% yoy), Spain (-6.2% yoy), and the Netherlands (-4.2% yoy), while there was surprising resilience in France (-1.4% yoy) against this background. The weakness in Europe's industrial sector is consistent with the global manufacturing PMI survey at the end of last week. Global export orders fell further (to 49.4 in January from 49.7 in December). This indicator leads world trade growth, which also weakened considerably at the end of last year.

German factory orders and GDP

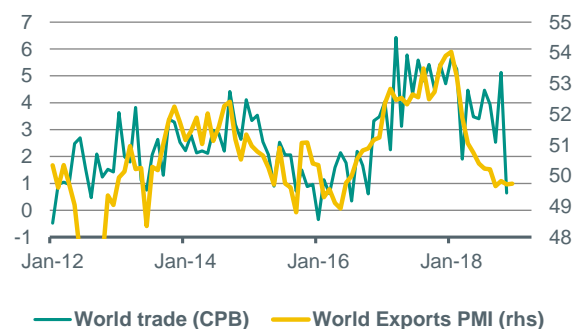
% yoy



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

World trade and PMI export orders

% yoy



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

The downgrades are rolling in

Official institutions in Europe announced downgrades to their economic growth outlook. The European Commission got the ball rolling for countries across the EU, while the BoE followed afterwards. Indeed, the European Commission heavily downgraded its growth forecasts for 2019 in its Winter interim update. Eurozone economic growth is now seen at 1.3% this year (previously: 1.9%) on the back of weaker global demand, uncertainty hitting confidence, as well as some specific temporary domestic factors. The biggest downward revisions were for Germany (1.1% from 1.8%), Italy (0.2% from 1.2%) and the Netherlands (1.7% from 2.4%). Meanwhile, the BoE downgraded UK economic growth as well (1.2% from 1.7%).

Further revisions ahead

We think there are a number of important take-aways. First of all, despite the large downgrade in economic growth forecasts, they probably do not go far enough, and further revisions are likely. For instance, the EC still projects economic growth of 0.3% qoq in the current quarter and 0.4% in Q2, while business surveys are consistent with a much weaker trajectory in the near term. Our own forecast for eurozone GDP growth is 1.1%, while we are reviewing the outlook, with a view of reducing our projection lower. Second, the central bank will likely follow the EC. The ECB currently expects growth of 1.7% for this year and we are likely to see a significant revision to this number. This will also have knock on effects to its views on inflation. The EC did not publish forecasts for core inflation, but it suggested in the written text that core inflation would not embark on an upward trend until 2020. These macro downgrades should see the ECB signalling that rates will be on hold for even longer, while it will probably also introduce another programme of long-term loans to banks (TLTRO).

Italy versus the Commission – round 2

Third, the downgrade to Italy's growth forecast points to worse public finance outcomes, which will trigger renewed tensions with the European authorities. The country's recession looks likely to extend in to the first quarter at least and our view is that Italy's budget deficit will more likely be closer to 3% this year on the current path for the economy and fiscal policy. This prospect led to a sell-off in the Italian government bond market this week, as investors priced in more credit risk.

Policymakers are reacting...but is it enough?

The bad news is that the global economy has lost a lot of momentum and there is no convincing sign of a bottom yet. The weakness appears to reflect the lagged impact of a tightening of financial conditions last year. The interest rate increases by the Federal Reserve and the Chinese authorities' targeted tightening campaign led to tighter financial conditions in emerging markets, and Chinese demand in particular has slowed. The particular weakness in the eurozone and specifically Germany is a reflection of their dependence on exports and the global capital goods cycle. Weak exports are having knock-on effects on business investment. While some one-off factors have also depressed eurozone economic growth, the impact of these should not be exaggerated. For instance, the weakness of German industry in December came despite a rebound in car orders and output. A final factor driving slower growth is the uncertainty caused by the trade dispute between the US and China, and the rocky negotiations between the UK and the EU relating to the former's exit from the union.

The good news is that policymakers have been reacting over the last few months. The Federal Reserve and the BoE have signalled that further policy rate hikes for this year are being put on the shelf, while the ECB will soon very likely do the same. The US central bank has also made it clear that it is open to end the run-down of its balance sheet if necessary, while the ECB appears to be mulling a new programme of long-term loans to banks. Finally, the Chinese authorities have started to ease fiscal and monetary policy over the last few months. These steps have arrested the tightening of financial conditions and we have seen some easing.

Financial conditions in Asia

Financial Conditions Index Asia ex-Japan (higher = easier)



Source: Bloomberg, ABN AMRO Group Economics

Expectations for US policy rates

Implied interest rate from December 2019 Fed funds future, %



Source: Bloomberg, ABN AMRO Group Economics

While positive, there are a couple of points of caution. First of all, changes in financial conditions take time to have an impact on demand. Second, the steps we have seen are likely to improve economic momentum over time, but what we have seen is not yet enough to foster a strong rebound in economic activity. To use an analogy, advanced economy central banks might be taking their foot off the breaks, but they are not (yet at least) stepping on the gas. While the Chinese authorities have moved towards stimulus, they are doing less than in previous rounds. For instance, in 2014-2015 the PBOC cut its policy rate by more than 150bp. On this occasion it has not reduced policy rates at all, though it has reduced reserve requirements for banks.

Overall, our sense is that the global economy will pick up moderately during the course of this year. For the eurozone, we think growth will be very weak in the near term, probably close to stagnation in the first half, but will return to trend growth rates in the second half of the year. Policymakers appear to be doing enough to stabilise the ship, but not enough to foster strong tailwinds so far.

Main economic/financial forecasts										
GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	31/01/2019	07/02/2019	+3M	2019e	2020e
United States	2.2	3.0	2.7	1.7	United States	2.74	2.70	2.75	2.70	2.60
Eurozone	2.5	1.8	1.1	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.05
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	1.7	1.9	United Kingdom	0.91	0.90	0.80	1.20	1.45
China	6.9	6.6	6.3	6.0						
World	3.7	3.6	3.4	3.3						
Inflation (%)	2017	2018e	2019e	2020e	10Y interest rate	31/01/2019	07/02/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.64	2.65	2.7	2.70	2.60
Eurozone	1.5	1.7	1.0	1.3	German Bund	0.16	0.17	0.2	0.50	0.80
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.67	0.65	0.8	1.10	1.40
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	0.00	-0.01	0.0	0.30	0.50
China	1.6	2.1	2.5	2.5	UK gilts	1.22	1.18	1.5	1.80	2.10
World	3.0	3.5	3.8	3.3						
Key policy rate	07/02/2019	+3M	2019e	2020e	Currencies	31/01/2019	07/02/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.15	1.14	1.17	1.25	1.30
European Central Bank	-0.40	-0.40	-0.40	-0.20	USD/JPY	108.9	109.8	111	105	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.32	1.30	1.36	1.45	1.50
Bank of England	0.75	0.75	1.00	1.25	EUR/GBP	0.87	0.88	0.86	0.86	0.87
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.75	6.74	6.85	6.70	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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