

# Macro Weekly

Group Economics

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## Playing with fire

- **Further escalation trade conflict is big risk to the global economy**
- **Eurozone GDP growth halves**
- **Chinese PMIs up a little...**
- **...while manufacturing globally remains under pressure**

US president Trump announced further tariffs on imports from China. As of 1 September a new 10% will be levied on goods representing USD 300bn worth of annual US imports with smart phones and laptops being the biggest categories. This is an enormous blow to people like me who had thought that Trump would hold his fire in order not to do damage to the US economy with the elections being just over a year away. But the frustration of the president over the lack of progress in the negotiations obviously got the better of him and he judged that increasing the pressure on China would be the best way forward. It is not likely China will bow. Instead, they are likely to retaliate. It is hard to see anything positive coming out of all this any time soon.

The newest escalation of the trade conflict comes while the global economy has been weakening for a year or even more. So the risks are now higher than last year. The manufacturing sector worldwide is under pressure and contracting in many countries. The services sector is generally doing better, but there are strong links between the two and it is unlikely the services sector can stay strong if weakness in manufacturing persists or intensifies.

The trade war affects the real economy in several ways. Of course, the tariffs make goods more expensive and the producers must either absorb the cost or lose market share as the cost of their product increases for the buyers. If they choose to do the latter, at least in theory, inflation will go up in the importing country, reducing spending power of consumers. It must be said that the evidence so far is that US inflation has not materially risen as a consequence of the tariffs. But the most important effect the trade conflict has is through its impact on confidence. How can companies plan for the future and make investment decisions given the uncertainty the twists and turns in the conflict are causing? So the effect on capital spending by companies is significant.

President Trump is playing with fire in my opinion as he is risking bringing a new US recession much closer than is necessary, apart from the damage he is inflicting on other economies, whether they are his targets or fairly innocent bystanders. The Chinese are more long-term thinkers. Not losing face is also important to them and they are more willing than Western nations to suffer pain in the short term. So they are not going to make significant concessions any time soon, I would imagine.

### Recent revision US national accounts suggests recession risk bigger than previously thought

The recent revision of the US national accounts did not rewrite history for the economy as a whole. However, there was a significant downward revision to corporate profits. Before the revision corporate profits had grown in line with GDP in recent years. But according to the new data profits have grown more slowly, leading to a decline of the profit share in GDP. That is relevant to the debate about whether or not the US is heading for a recession in the not-too-distant future. Many commentators have made the point recently that the yield curve is suggesting a recession is on the horizon. We have rejected that idea as corporate profits have also been a good warning signal for approaching recessions in the past and they had remained robust. As profits have now turned out to have been weaker than originally reported, this reduces the weight of our argument against the idea that a US recession is on the horizon. It doesn't mean we are expecting a recession to occur in the near future, though. What it means is that the recession risk between now and the end of next year has gone up somewhat, but remains a risk scenario, not our base case. The consumer is still in good shape and low interest rates will provide stimulus to construction. That should be enough to prevent a downturn.

#### US: Corporate profits

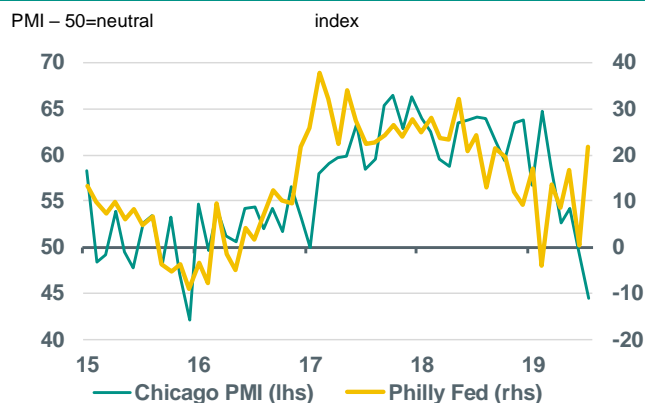


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

### Manufacturing under pressure, virtually everywhere

Recent days have seen the release of many business-confidence indices related to manufacturing. The important ISM index in the US fell further in July: 51.2, down from June's 51.7. That still suggests the US industrial sector is expanding, but momentum has eased very significantly in the last 12 months or so. The ISM stood at 60.8 in August last year. The Chicago PMI, one of the more important regional indices of business confidence, fell in July to 44.4, from 49.7 in June. That is a massive monthly drop and was much worse than expected. Intriguingly, the huge drop in the Chicago PMI is a sharp contrast to the big jump registered by the Philly Fed index, also one of the more important regional indices of business confidence. I am not sure what to make of that contrast, I am flabbergasted. This amazing divergence can't and won't last.

## US: Chicago PMI and Philly Fed

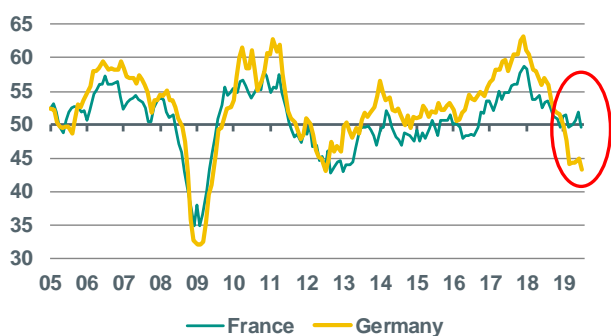


Source: Bloomberg

Eurozone Q2 GDP growth amounted to 0.2% qoq, after 0.4% in Q1. We knew that Q1 had benefitted from special factors that were reversed in Q2. Taken together, the first half of the year wasn't too bad, but momentum is weakening. German GDP data for the second quarter hasn't been released yet and the Bundesbank is saying that the German economy may have contracted fractionally. Our eurozone economist Aline Schuiling agrees. A remarkable development in the eurozone is the divergence (of business confidence) in manufacturing in Germany on the one hand and France on the other. The growing gap between the two conveys some important messages. First, Germany is more dependent on world trade than France. Second, Germany is more important on the investment cycle in the world as its emphasis is much more on producing (high-quality) machinery and equipment. But third, it may also say something about 'home-grown' problems in Germany and specific sectors and companies in particular. The evidence is crying out for fiscal stimulus in Germany.

## Markit PMI manufacturing

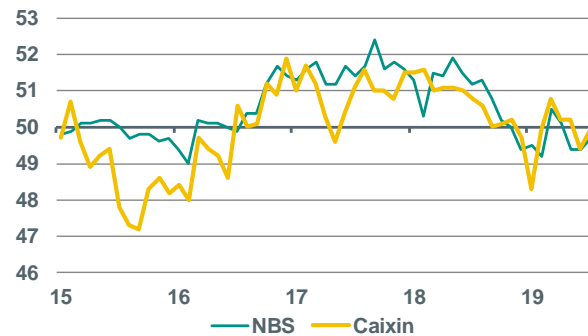
Index, 50=neutral



Source: Thomson Reuters Datastream

## China: PMI manufacturing

Index, 50=neutral



Source: Bloomberg, Thomson Reuters Datastream

China's manufacturing PMIs for July were actually up a touch. The NBS measure rose from 49.4 to 49.7 while the Caixin measure went up from 49.4 to 49.9. Perhaps this is the result of policy stimulus. Taiwan's manufacturing PMI rose quite sharply in July, which may be confirmation of an improvement in China. However, the absolute level of the Taiwanese gauge (48.1, versus 45.5 in June) is hardly cause for euphoria. South Korea remains weak as its national measure of business confidence in manufacturing fell from 75 in June to 71



in July. Japan's industrial production was down 4.1% yoy in June, the second lowest monthly reading since 2016. Japanese consumers are getting more pessimistic as indicated by consumer confidence, which has come down in a straight line since early 2018, although it must be said that confidence was exceptionally strong back then.

#### Japan: consumer confidence



Source: Bloomberg

#### Fed cuts as expected

The Federal Reserve cut official rates by 25bp as expected. The FOMC also decided to stop its policy of shortening its balance sheet by way of not reinvesting monies coming in from maturing bonds. The plan was to stop that shortening of the balance sheet, sometimes referred to as quantitative tightening, in two months' time. The decision to stop straight away is more symbolic than particularly material. Two FOMC members dissented and voted against the rate cut. Dissenting votes occur relatively often, but it is unusual to have two dissenters. It shows there are clear differences of opinion within the FOMC. Nevertheless, we think economic developments will lead the Fed to cut two more times between now and the end of Q1 2020. And to be honest, I think it is the right thing to do. The further escalation of the trade war probably implies that more aggressive easing is likelier than less aggressive easing.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	25/07/2019	01/08/2019	+3M	2019e	2020e
United States	2.4	2.9	2.2	1.5	United States	2.26	2.29	2.20	1.90	1.80
Eurozone	2.6	1.9	0.7	0.9	Eurozone	-0.38	-0.38	-0.45	-0.45	-0.52
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	0.78	0.77	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	3.8	3.5	2.9	3.0						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	25/07/2019	01/08/2019	+3M	2019e	2020e
United States	2.1	2.4	1.8	2.0	US Treasury	2.07	1.89	2.0	1.90	2.00
Eurozone	1.5	1.7	1.1	1.0	German Bund	-0.36	-0.45	-0.4	-0.50	-0.30
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.05	-0.02	0.3	0.20	0.35
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.15	-0.13	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.71	0.59	0.8	0.80	1.00
World	3.0	3.4	3.9	3.4						
Key policy rate	30/08/2019	+3M	2019e	2020e	Currencies	25/07/2019	01/08/2019	+3M	2019e	2020e
Federal Reserve	2.25	2.25	2.00	1.75	EUR/USD	1.12	1.11	1.12	1.12	1.20
European Central Bank	-0.40	-0.50	-0.50	-0.60	USD/JPY	108.6	107.3	104	100	95
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.25	1.21	1.24	1.24	1.40
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.89	0.91	0.90	0.90	0.86
People's Bank of China	4.35	4.10	4.10	3.85	USD/CNY	6.87	6.90	6.90	6.90	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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