Macro Weekly

Group Economics

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It's time to act

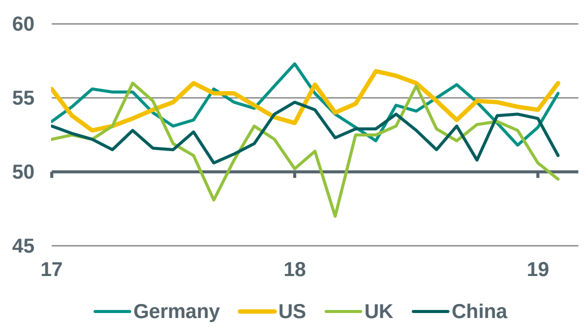
- **The US no longer immune to the global slowdown …**
- **… with US trade deficit widening to historic proportions, …**
- **… President Trump urgently needs a deal, but…**
- **…China's dramatic exports drop indicates China needs it even more**
- **Eurozone growth prospects remain weak**
- **ECB responds to sharply deteriorated outlook**

Will accommodative policies feed through on time? A question that was intended as a cliff-hanger in the previous weekly. This week the ECB took additional accommodative steps. Firstly, by changing its forward guidance to a prolonged period of unchanged policy rates (at least through the end of 2019, but longer if necessary). Secondly, Mr Draghi announced a third round of TLTROs, to stimulate growth through cheap bank lending. We doubt whether this will be enough to re-anchor inflation expectations and expect more measures to follow in the coming months (see here).

Meanwhile, this week's fresh spill of forward looking PMIs show that manufacturing is expected to continue its downward trend, while services prove resilient to most of the global turmoil. In services, British purchasing managers' expectations clearly deviate from this trend, as Brexit still leaves many issues open regarding services provision to European mainland customers. In manufacturing, Germany is leading the way down, falling well below the 50 mark that separates expansion from contraction.

Markit PMI services

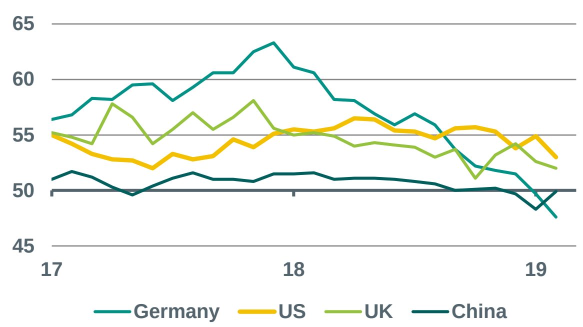
Index, 50=neutral



Source: Thomson Reuters Datastream

Markit PMI manufacturing

Index, 50=neutral



Source: Thomson Reuters Datastream

With US no longer immune..

The December trade data (non-petroleum), which had been delayed by the government shutdown, came out this Wednesday showing exports fell -2.0% (yoy). This widened the trade deficit to its highest level in a decade – a political nightmare for president Trump, as a declining trade deficit was a key election promise.

Combining the export contraction with a sharp - and steeper than we anticipated - decline in the forward looking ISM Manufacturing PMI (54.2), and the negative direct and indirect effects of the shutdown, we have lowered our GDP growth forecast for 2019 from 2.7% to 2.3% (Bill Diviney, see here).

...urgency for a trade deal increases...

The ten year high trade deficit of 621 billion US dollars increases urgency in the White House to close a deal with China to end the trade conflict. While existing and announced tariffs were supposed to discourage imports from China, it seems that importers have absorbed some of the tariff costs, while American consumers' purchasing power has been strong enough to overcome tariff induced price increases. Meanwhile, American producers may also have been front-loading their stocks to prepare for further tariff increases ahead. At the same time, as growth in most other economies has been slowing, exports to those economies declined, adding up to a widening trade deficit.

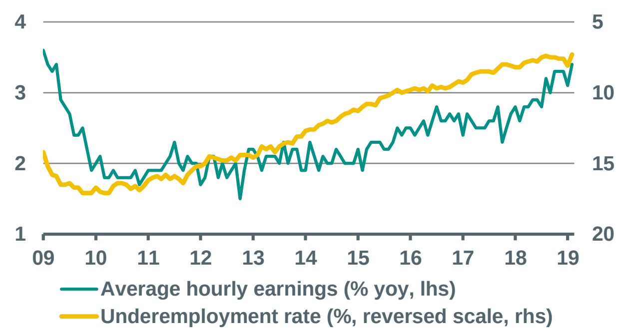
..but enforcing commitment might create new uncertainty

Last week's hints of an upcoming deal in President Trump's Mar-al-Lago resort became a little more concrete this week. US trade representative Robert Lighthizer said that a key hurdle had been overcome, with agreement on a mechanism to enforce commitments made by China. If China does not comply, the deal will be discussed at different levels of government, but eventually enable the US to take punitive action in the form of new tariffs. Whether this agreement creates lasting uncertainty regarding the sudden re-introduction of tariffs should be monitored closely. Much will depend on whether US requests such as a rein in of state-owned enterprises and ending the forced technology transfer is going to be part of the deal. These requests would make a Chinese reluctance to comply more likely, increasing uncertainty around a reintroduction of tariffs.

Meanwhile US consumers still underpin the economy

As long as the US employers keep adding jobs, workers are able to demand higher wages, and consumers are willing and able to spend, the economy will stay resilient. Today's employment data should show that this is indeed the case. While underemployment is bottoming-out, meaning that most of those who want to work more already do so, workers are better positioned to negotiate higher wages. The average hourly earnings (AHE) that come in Friday afternoon, are expected to show a further increase from 3.1 % to 3.3% (yoy). That said, the actual wage increase could very well be higher than the AHE suggests, according to a new study by the Fed. AHE does in fact not only comprise the average of individual wage increases, but includes wage changes that arise from older workers leaving and young workers entering the labour force. Taking this latter composition effect out would result in higher wage increases than previously considered.

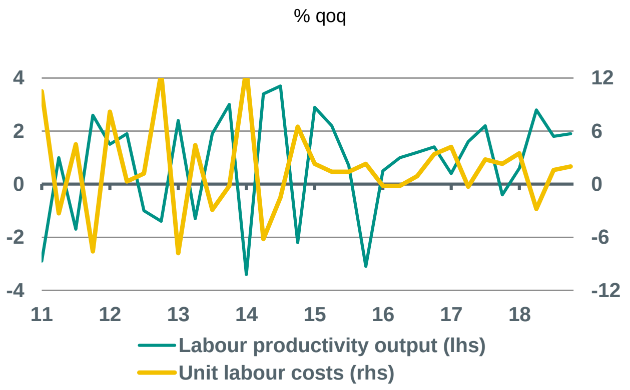
US: employment



Source: Bloomberg

Friday's productivity growth figures add to the good news. Labour productivity is growing at a solid 1.9% (qoq annualised), keeping unit labour cost growth in check even as wage growth accelerates. Ultimately, as labour's bargaining power continues to increase, we expect the downward trending labour share of income to start to turn upward again.

US: productivity and costs



Source: Bloomberg

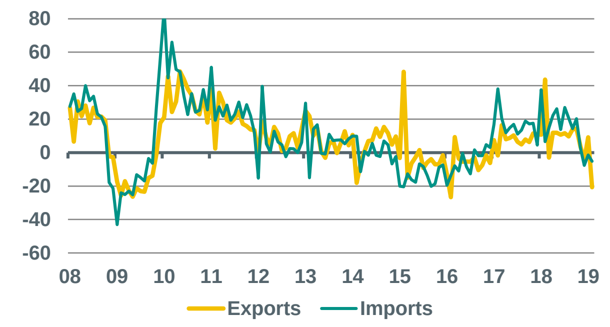
On the other side of the trade spectrum: China's spectacular exports drop

In China, the annual National People's Congress that started this week confirmed once more that the Chinese government currently prioritizes macro-economic stabilisation over deleveraging. Beijing will continue with piecemeal fiscal and monetary easing. In line with our expectations, Prime Minister Li Keqiang announced a growth target of 6.0-6.5% for 2019 (our 2019 growth forecast of 6.3% is in the middle of that range.

China's trade figures published on Friday are to be interpreted cautiously given Chinese New Year effects, as the difference in year-to-year timings of the large holiday break add to volatility of monthly trade figures. That said, the figures reveal a sharp narrowing in the trade surplus from USD 39.2 bn to USD 4.1 bn. Export growth (yoy) dropped sharply (-20.7% yoy). This is a much steeper drop than was expected (consensus -5%). Imports also contracted more than was anticipated (-5.2%; consensus -0.6%). Processing imports – that serve exports - made up the bulk of the decline. Unsurprisingly, exports to the US have been hardest hit (-28.6% yoy), but exports to Europe also contracted sharply (-13.2%

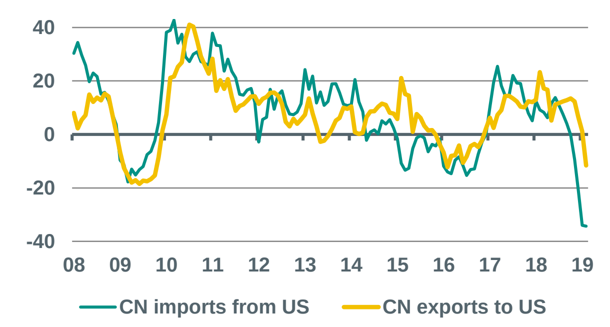
yoy). Imports from the US declined further (-26% yoy). Imports from the EU also fell, but in annual growth terms were relatively positive (+2.5% yoy).

Chinese export/import growth down since late 2018



Source: Bloomberg

US-China trade slows sharply



Source: Bloomberg

China's sharp loss of momentum in trade makes a deal with the US even more urgent. Whether such a deal would bring down the existing 10 % US tariffs on China is uncertain, however. US trade representatives might want to keep them in place as a commitment device.

Main economic/financial forecasts

GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	28/02/2019	07/03/2019	+3M	2019e	2020e
United States	2.2	2.9	2.3 ↓	1.9 ↑	United States	2.62	2.60	2.60	2.60	2.50
Eurozone	2.5	1.8	0.8	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.20
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	1.1	1.8	United Kingdom	0.85	0.84	0.80	1.00	1.25
China	6.9	6.6	6.3	6.0						
World	3.8	3.6	3.4	3.3						
Inflation (%)	**2017**	**2018e**	**2019e**	**2020e**	**10Y interest rate**	**28/02/2019**	**07/03/2019**	**+3M**	**2019e**	**2020e**
United States	2.1	2.4	1.6	2.0	US Treasury	2.71	2.64	2.6	2.60	2.50
Eurozone	1.5	1.7	1.0	1.3	German Bund	0.19	0.07	0.0	0.20	0.50
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.71	0.60	0.6	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.02	-0.01	0.0	0.10	0.30
China	1.6	2.1	2.5	2.5	UK gilts	1.30	1.17	1.5	1.50	1.80
World	3.0	3.5	3.8	3.3						
Key policy rate	**07/03/2019**	**+3M**	**2019e**	**2020e**	**Currencies**	**28/02/2019**	**07/03/2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.14	1.12	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	111.4	111.6	111	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.33	1.31	1.28	1.35	1.45
Bank of England	0.75	0.75	0.75	1.00	EUR/GBP	0.86	0.86	0.86	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.69	6.72	6.70	6.60	6.60

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.