

# Macro Weekly

Group Economics

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## Turn in the cycle

- **Mixed data as you would expect around the turn of the cycle**
- **Eurozone industrial sector remains in the doldrums**
- **Canary in the coal mine: Korean exports improving**
- **US productivity gains accelerating**

Growth momentum in the global economy has softened for a year or so. The question for the remainder of the year (and beyond) is whether the softening continues and some economies end up in recession or not. The alternative route is a strengthening of growth. I am a believer in the latter view. If the economy is going to improve, we must be close to what you could call a turning point in the cycle. Around these turning points one should expect very mixed data as some economies lead the cycle while others lag. And that is exactly what recent data shows.

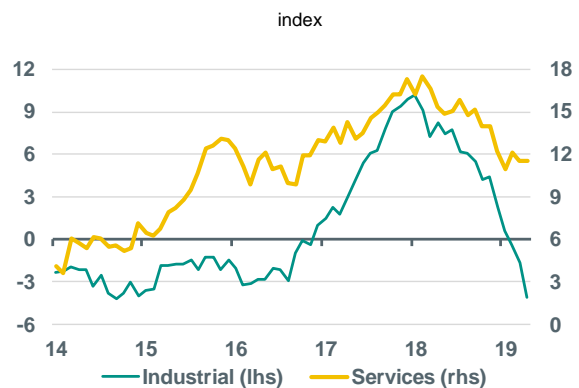
The eurozone is a laggard in the cycle. Nothing wrong with that, it is just a statement of fact. The data shows that in the good old days, before China had such a big impact on the global economy, the eurozone business cycle was usually lagging the US cycle by some three to nine months. In the brave new world where China plays a key role, the eurozone is most likely still lagging, but perhaps less clearly just lagging the US. It is no surprise then that the eurozone is not showing much sign of improving momentum. The European Commission's index for Economic Sentiment weakened again in April and fell short of not overly optimistic expectations. The data confirms that the problems are mainly in the industrial sector. Industrial confidence fell to -4.1, the lowest since 2014. Confidence in the services sector and consumer confidence have held up considerably better.

**Eurozone economic confidence**



Source: Bloomberg

**Eurozone sector confidence**



Source: Bloomberg

Eurozone GDP surprised on the positive side in Q1 by growing 0.4% qoq and 1.2% yoy. We know very few details yet, but it is likely that domestic demand made the most important contribution. It is also likely that the 0.4% growth rate is flattering what is really going on, just like the US Q1 GDP growth rate of 3.2% annualised also flattered what was going on in that economy.

The key point for me is that any fundamental improvement in economic momentum in the eurozone depends to a large extent on global economic conditions.

### Higher eurozone inflation, but is this a distortion?

Eurozone inflation picked up in April. Headline inflation accelerated to 1.7% yoy, up from 1.4% in March, while core inflation jumped from 0.8% yoy to 1.2%. Does that suggest that inflation has finally started to move towards the ECB's target? Perhaps, but let's not get carried away. The German data showed a similar rise, but may have been distorted due to Easter being very late this year. Prices of package holidays contributed significantly to the rise in German inflation. That component is volatile. We need to wait for the May data to get this clarified. Most other countries showed much more modest inflation. We think core inflation will remain around the 1.0% mark this year and only creep up next year.

### US: is productivity on the rise?

The US economy has grown faster than the eurozone's in recent quarters. That is partly the result of the expansionary budget of the Trump administration. But industrial confidence in the US has also weakened. This is a global phenomenon. The authoritative ISM index for the manufacturing sector tumbled in April, 52.4, down from 57.5 in March, reaching its lowest level since 2016. The rival Markit PMI had weakened in previous months and edged higher in April, but is close to the ISM in absolute terms: 52.6 against 52.4 in March. It looks like the ISM may have 'overshot' in recent months and has now come down to a level better reflecting what is actually going on. But a level of just over 52 is not a problem. The US looks pretty good to me from a cyclical point of view. Although personal income only increased by 0.1% mom in March, personal spending rose 0.9% mom. This gap suggests a drop in the savings rate, but that is not a problem as the savings rate is relatively high and household finances look healthy. Corporate earnings also look fine.

#### US: Producer confidence

index



Source: Bloomberg

#### US: Labour productivity

% yoy, 8q ma



Source: Bloomberg

Perhaps the most impressive piece of recently published US data was the 3.6% qoq annualised increase in labour productivity in Q1. We must bear in mind, however, that productivity is highly volatile, one quarter's data means very little. The measure of productivity gains is simply the result of the increase in total output and the increase in hours worked. Hours worked did not rise much in Q1. But output did. As mentioned earlier, the strong growth of Q1 GDP overstated underlying strength and therefore, by definition, the productivity data also provided an unrealistic positive picture. When you look at productivity data, you really should look at the trend, which can be done by taking a moving average of a longer period. When you do that, the picture is less upbeat than just looking at the Q1 data, but an improving trend is, nevertheless, starting to appear. That is hugely positive. Economists have been at great pains in recent years trying to explain why productivity growth was very weak. The advances made in the ICT sector had fed hopes that economy-wide implementation of new techniques would contribute to stronger, not weaker productivity growth. But the improvements did not show up in the data. It could be that the improvement has finally arrived. Fingers crossed.

The combination of reasonable overall growth and improving productivity gains should lead to a deceleration of inflation. Admitted, the tight and tightening labour market has pushed up wage increases, but this can be compensated for by higher productivity growth so that inflation does not rise. Recent inflation data is consistent with this line of argument. The Fed's favourite inflation measure is the 'core PCE deflator'. It was up 0.1% mom in March. The yoy rate fell to 1.6%. This measure reached a peak in July last year at 2.0%. It shows, once again, that the inflation scare we have seen at times over the past 12 months is totally unnecessary. The implication is that there is even less reason for the Fed to tighten monetary policy.

The Fed left its key rates unchanged at its most recent policy meeting (apart from a small technically driven cut in the IOER). Chairman Powell sounded a little less dovish than market participants had, apparently, hoped, but I would not read too much into that. Markets are pricing in a reasonable chance of a rate cut near the end of the year. That is too far away for Powell to provide hints about at this stage. The US economy is likely to lose some momentum when the fiscal stimulus abates in the course of this year, but whether that will be enough to ease monetary policy is a moot point. Events in recent months do throw up an intriguing question: could president Trump's intuition about the economy and required monetary policy be more correct than all the Fed's PhD economists together?

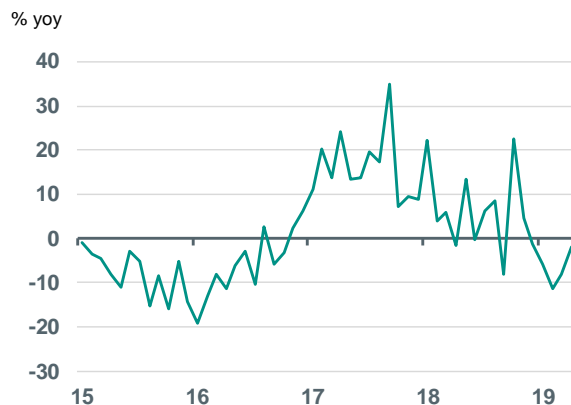
The president's attempt to fill vacancies at the Fed board with like-minded people has failed so far as both candidates he had proposed, Herman Cain and Stephen Moore, have withdrawn their candidacy. Republic senators had made it clear they would not confirm Cain or Moore as they considered them unsuitable. To be continued...

#### **Global trade improving?**

The early-cyclical economies in Asia which are also very open always provide interesting information about the state and prospects of global trade. A significant deterioration of global trade occurred in the last couple of months of last year and the first months of the current year. The escalation of the trade conflict between the US and China and to a lesser extent between the US and other countries may have played a role. In addition,

slower growth in China must have been an important driver as must have been the global IT cycle.

#### Korea exports



Source: Bloomberg

I am looking for some improvement in the months ahead. As reported last week, there has been a clear improvement in some Chinese data. But before getting overly enthusiastic, one must bear in mind that the Chinese data are not extremely reliable and can be volatile. So you would like to see confirmation in the months ahead in the Chinese data, but also confirmation in the data of countries with strong economic ties with China. Taiwan's PMI improved strongly in March, but lost some ground again in April. I would say that the evidence for a turning point in the Taiwanese PMI is inconclusive. Korean data was better. The country's PMI had also risen in March and continued its rise in April: 50.2, against 48.8 in March and 47.2 in February. New export orders were particularly strong according to the PMI survey. Actual Korean exports were down 2.0% yoy in April. That does not sound impressive, of course, but it is a lot better than the -8.2% in March and the -11.4% in February. Korean exports to China were down 4.5% yoy in April, following -15.6% in March, -17.3% in February and a trough of -19.0% in January. This data makes me hopeful, if not confident that the worst is behind us and that global trade growth is in the process of bottoming out.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	25/04/2019	02/05/2019	+3M	2019e	2020e
United States	2.2	2.9	2.3	1.9	United States	2.58	2.57	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	0.8	1.7	United Kingdom	0.83	0.81	1.00	1.00	1.25
China	6.9	6.6	6.3	6.0						
World	3.7	3.6	3.3	3.4						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	25/04/2019	02/05/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.53	2.55	2.6	2.60	2.50
Eurozone	1.5	1.7	1.2	1.2	German Bund	-0.01	0.02	0.0	0.20	0.50
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.50	0.52	0.6	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.03	-0.04	0.1	0.10	0.30
China	1.6	2.1	2.5	2.5	UK gilts	1.16	1.19	1.7	1.50	1.80
World	3.0	3.5	↓ 3.7	3.2						
Key policy rate	02/05/2019	+3M	2019e	2020e	Currencies	25/04/2019	02/05/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.11	1.12	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	111.6	111.5	110	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.29	1.30	1.30	1.35	1.45
Bank of England	0.75	0.75	0.75	1.00	EUR/GBP	0.86	0.86	0.85	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.73	6.74	6.65	6.60	6.60

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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