

# Macro Weekly

Group Economics

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## A disintegrating world economy is bad news

- **Weakness in Asian trade**
- **Weakness in industrial activity**
- **Some brighter spots**
- **Falling US inflation**

A former boss of mine emailed me recently asking me what I had meant by a remark in last week's weekly when I talked about a disintegrating world. His reading was that I had suggested the world is falling apart and he was wondering how that works. While it was largely a semantic issue he perhaps wasn't the only one wondering. So this is a good opportunity to clarify. Besides, recently published data sheds further light on this process.

During the last 100 years or so (probably even longer), world trade has, on average, grown faster than the world economy. This is even true for most individual years. The exception has been recessions. When the global economy has contracted in the past, world trade has tended to contract even more. You could say that world trade has been a very consistent 'high-beta' play on the global economy.

World trade growth exceeding overall world economic growth implies that the world economy has become ever more integrated. This has been positive for living standards as it is a reflection of an intensifying division of labour that has raised economic efficiency. It has also enabled a large number of countries to grow faster than they otherwise would have as it facilitated their 'catching up'. So I would argue that hundreds of millions of people, if not billions, have benefitted from this phenomenon.

At the micro level, this increasing division of labour has come, among other things, through the development of global value chains.

Recent years have seen a change. Following the 2008/2009 recession there have been several years when global trade growth fell short of overall growth, an unusual phenomenon. Perhaps global value chains had progressed as far as they could, who knows. It is not entirely clear why world trade growth has been relatively weak in recent years.

What is clear, however, is that the trade conflict is doing a lot of damage. It interrupts trade flows and creates huge uncertainty for all companies involved in international trade. It has thus contributed to a contraction of world trade, while the world economy as a whole has continued to grow, albeit only modestly. This combination of contracting world trade and overall growth of the world economy represents a disintegration of the world economy. It has been a negative for all economies involved in international trade and a serious threat to living standards and to the potential for people to raise their living standard in the future.

As international trade has been a strong 'growth enhancer' during the last 100 years or so, the reversal of that process is detrimental.

### China exports and imports

Year on year %change



Source: Bloomberg

### China exports and imports

3 months moving average of the YoY change

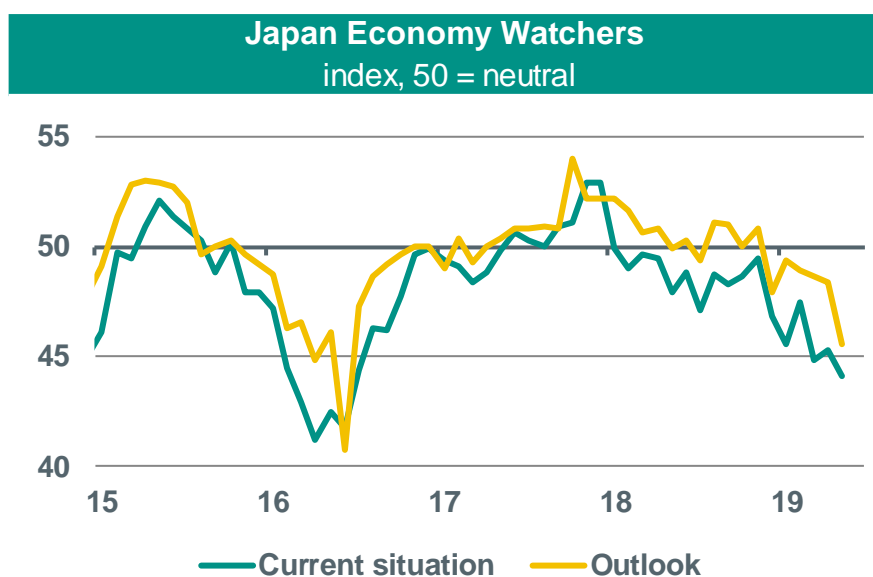


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Recent data isn't particularly pretty. China's industrial production growth slowed to 5.0% yoy in May, the slowest since 1991. Trade data wasn't much better. China's imports were down a disappointing 8.5% yoy in dollar terms (+4.0% in April). As China is a huge importer, that is not nice for the rest of the world. Chinese exports did better, growing 1.1% yoy in May, after falling 2.7% in April. We need to bear in mind that monthly data is volatile and the 3-month moving averages paint a slightly more comforting picture. We must also bear in mind that base effects are now giving rise to distortions that are hard to interpret. Last year saw a strong rise in Chinese imports and exports during this time of the year, probably partly in an effort to get goods in and out before tariffs applied. That has increased the base value and has a negative effect on the growth numbers this year.

Chinese retail sales data was more positive. Retail sales growth amounted to 8.6% yoy in May, up from 7.2% in April. While this is good, it still fits within the normal fluctuation of an otherwise slowing trend. All in all, recently published Chinese data is not particularly encouraging.

Taiwanese trade data did not provide a lot of comfort either. Export growth weakened from -3.3% yoy in April to -4.8% in May. Import growth amounted to +2.6% yoy in April, but fell to -5.9% in May.

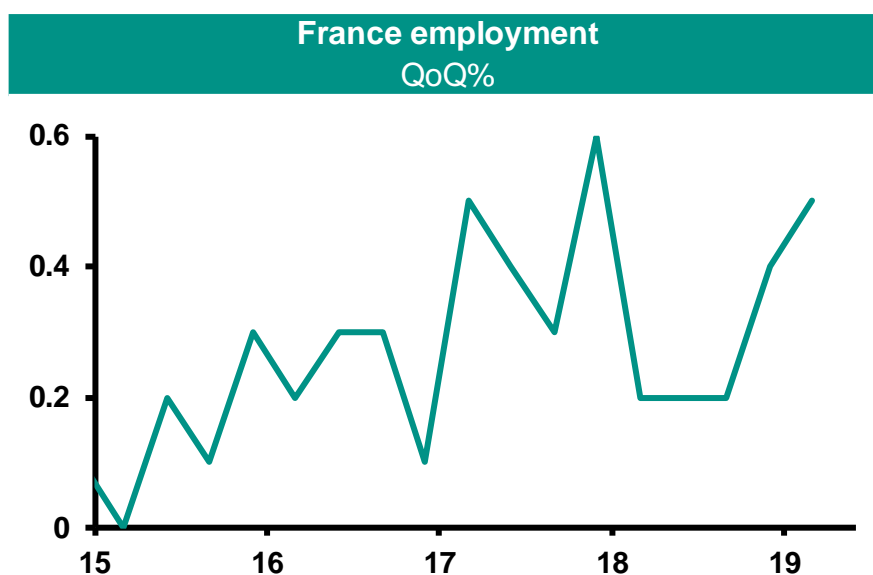


Source: Bloomberg

Japan is another economy strongly integrated in world trade flows and suffering from the trade uncertainty. A monthly survey among economists and analysts showed that these 'eco watchers' have become more negative about the current state of the economy and the outlook. This trend was already ongoing, but the drop in the 'outlook' component in May was particularly pronounced. No doubt this was the result of the unexpected breakdown of talks between the US and China.

Weak industrial production has also been the norm in Europe. Eurozone industrial production fell 0.5% mom in April, after falling 0.4% in the previous month. Nevertheless, the yoy growth rate improved a little: -0.4%, up from -0.7%. This is poor, but at least the downturn in manufacturing does not appear to be intensifying.

There were also some more positive data points in the eurozone. Dutch retail sales strengthened considerably in April, up 4.7% yoy after March' 1.1%. Perhaps more important, employment growth in France picked up in Q1. Private payrolls were up 0.5% qoq. The graph shows that private payrolls growth slowed in the course of 2018, but has strengthened in the most recent quarters. Services and construction were the strongest sectors. Services provide some 60% of private sector employment in France and France is doing remarkably well in high tech and creative services. It is clear that France is less vulnerable to the trade conflict than Germany.



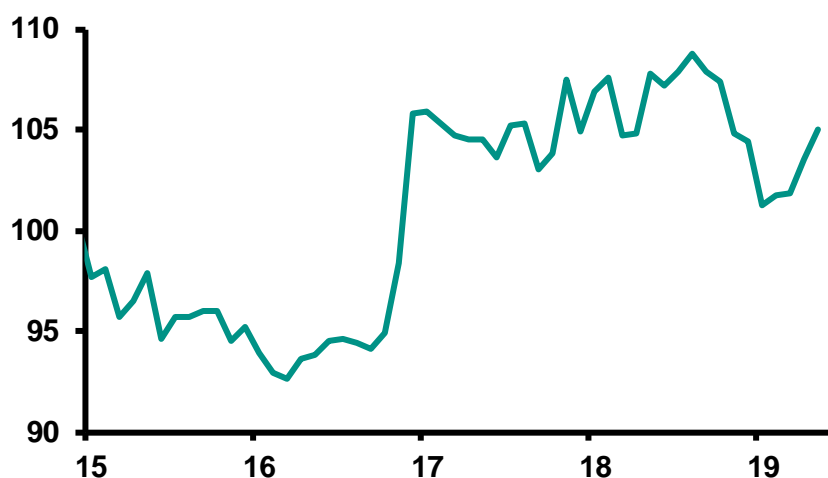
Source: Bloomberg

US industrial activity has weakened in line with, though not as much as this sector elsewhere. Industrial production advanced 0.4% mom in May after falling that much in April. Manufacturing output was up 0.2% mom after falling 0.5% in April. The yoy rate for overall industrial production went up to 2.0% against 0.9% in April. Manufacturing output was up 0.7% yoy after a marginal decline in April.

Business confidence among US SMEs, or 'small businesses' as it is labelled in the US, improved in May as the NFIB index rose from 103.5 in April to 105.0. This sector is the backbone of the US economy. Confidence fell noticeably between August last year and January, but has been on the rise since. That rise was very modest in February and March but accelerated in April and May. I realise there is a lot of talk about the bond market signalling an approaching recession in the US. While a recession will no doubt happen at some stage, this sort of indicator suggests it is not exactly imminent.

US retail sales grew 0.5% mom in May. This is a sign that the US consumer is not breaking down. To get the US economy into recession, a fall in consumer spending is more or less necessary given the weight of consumption in GDP. A deterioration of the labour market or another shock to consumers can, of course, lead to a contraction of consumption, but at least we can say that is not happening yet. April retail sales were revised up from a fall of 0.2% mom to a plus of 0.3% underscoring my previous observation, while also highlighting that this can be a volatile series. Retail sales ex-autos were up 0.5% mom in May, after also 0.5% in April (originally reported as a more modest rise of 0.1%).

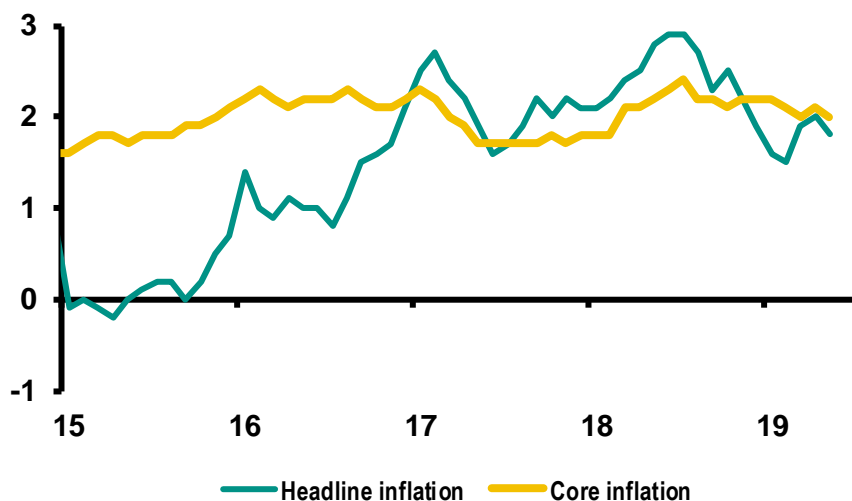
### US Small business confidence index



Source: Bloomberg

US inflation data is showing a further easing of inflation pressures. The CPI and the core CPI both increased 0.1% mom in May. The yoy rates fell from 2.0% in April to 1.8% for the headline number and from 2.1% to 2.0% for the core rate. Producer price inflation was also very modest and import prices actually fell, suggesting that any inflation pressure in the pipeline is easing. It is clear that inflation is not a hindrance to the Fed cutting rates soon as an 'insurance' against a further slowdown of overall economic growth.

### US inflation and core inflation % yoy



Source: Bloomberg

| Main economic/financial forecasts |            |       |       |       |                     |            |            |       |       |       |
|-----------------------------------|------------|-------|-------|-------|---------------------|------------|------------|-------|-------|-------|
| GDP growth (%)                    | 2017       | 2018  | 2019e | 2020e | 3M interbank rate   | 06/06/2019 | 13/06/2019 | +3M   | 2019e | 2020e |
| United States                     | 2.2        | 2.9   | 2.2   | 1.5   | United States       | 2.45       | 2.43       | 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      | 0.79       | 0.79       | 0.80  | 0.80  | 0.80  |
| China                             | 6.9        | 6.6   | 6.2   | 5.8   |                     |            |            |       |       |       |
| World                             | 3.7        | 3.6   | 3.1   | 3.1   |                     |            |            |       |       |       |
| Inflation (%)                     | 2017       | 2018  | 2019e | 2020e | 10Y interest rate   | 06/06/2019 | 13/06/2019 | +3M   | 2019e | 2020e |
| United States                     | 2.1        | 2.4   | 1.6   | 2.0   | US Treasury         | 2.12       | 2.09       | 2.0   | 1.90  | 2.00  |
| Eurozone                          | 1.5        | 1.7   | 1.1   | 1.0   | German Bund         | -0.23      | -0.24      | -0.3  | -0.35 | -0.20 |
| Japan                             | 0.5        | 0.9   | 1.1   | 1.6   | Euro sw ap rate     | 0.28       | 0.26       | 0.7   | 0.80  | 1.10  |
| United Kingdom                    | 2.7        | 2.5   | 1.4   | 1.8   | Japanese gov. bonds | -0.12      | -0.11      | -0.1  | -0.10 | 0.00  |
| China                             | 1.6        | 2.1   | 2.5   | 2.5   | UK gilts            | 0.83       | 0.84       | 0.8   | 0.80  | 1.00  |
| World                             | 3.0        | 3.5   | 3.7   | 3.3   |                     |            |            |       |       |       |
| Key policy rate                   | 13/06/2019 | +3M   | 2019e | 2020e | Currencies          | 06/06/2019 | 13/06/2019 | +3M   | 2019e | 2020e |
| Federal Reserve                   | 2.50       | 2.25  | 2.00  | 1.75  | EUR/USD             | 1.13       | 1.13       | 1.12  | 1.12  | 1.20  |
| European Central Bank             | -0.40      | -0.40 | -0.40 | -0.40 | USD/JPY             | 108.4      | 108.4      | 104   | 100   | 95    |
| Bank of Japan                     | -0.10      | -0.10 | -0.10 | -0.10 | GBP/USD             | 1.27       | 1.27       | 1.24  | 1.24  | 1.40  |
| Bank of England                   | 0.75       | 0.75  | 0.75  | 0.75  | EUR/GBP             | 0.89       | 0.89       | 0.90  | 0.90  | 0.86  |
| People's Bank of China            | 4.35       | 4.10  | 4.10  | 3.85  | USD/CNY             | 6.91       | 6.92       | 6.90  | 6.90  | 6.70  |

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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