Macro Weekly

Group Economics

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US consumers down but not out

- **Retail sales data were weak raising concerns about the US consumer, one of the few bright spots in the global economy**
- **Although consumer spending growth looks to have lost momentum real income growth is still healthy, while confidence is still elevated**
- **We still judge that consumer spending will grow at a decent pace, albeit slowing compared to the buoyant pace we saw for much of last year**
- **We have revised down our eurozone GDP forecast to take it further below consensus on the weakness in exports and capital spending**
- **The ECB looks likely to keep policy easy for even longer**
- **Spanish elections add to European political risk**
- **Chances of a trade truce between the US and China look to be rising**

US retail sales fell sharply in December

Perhaps the most important macro report of the last few days was US retail sales, which was much weaker than expected. Retail sales fell by 1.2% mom in December, the biggest drop since 2009 (which of course was not a great year for the global economy). Meanwhile, excluding autos and gas, sales were even worse, declining by 1.4%, taking annualised growth to just 0.6% in Q4, compared to 5.3% in Q3.

Against the background of slowing world trade and global capex spending, this has raised worries about one of the bright spots in the global economy. Indeed, the resilience and health of consumers is often used as one of the arguments not to expect recession.

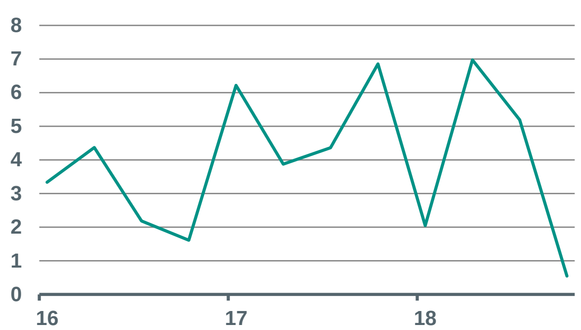
US consumer spending

Personal consumption expenditure national accounts, % yoy

Source: Thomson Reuters Datastream, ABN AMRO Group Economics

US retail sales

Ex-autos and gas, % qoq annualised



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

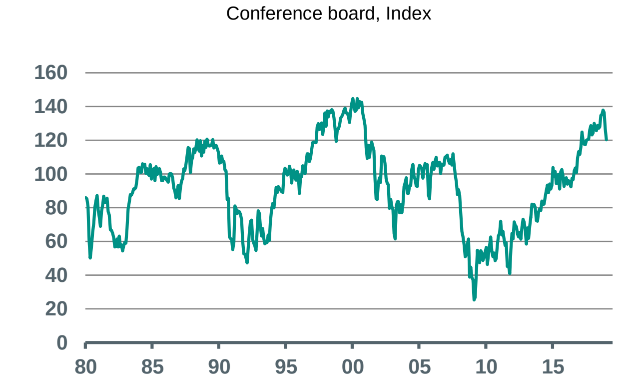
Time to worry about consumers?

So is it time for concern? Let's start with the data. The first point to make is that retail sales are volatile even on a quarterly basis. As the chart on top right shows, they bounce up and down even at the best of times. Secondly, consumer fundamentals still look good. In the private sector, hourly wage growth is running at 3.2% yoy in January. While, employment continues to grow strongly. Non-farm payrolls were up by 2.1% in the same month. With CPI inflation at 1.6%, that means that real aggregate incomes were up by 3.7% yoy last month. Meanwhile, consumer confidence is down from its peak, but remains historically high. Finally, household balance sheets look healthy.

US private real aggregate wages

Source: Thomson Reuters Datastream, ABN AMRO Group Economics

US consumer confidence



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Down but not out

We do expect consumer spending to slow on a trend basis to average around 2% in the coming quarters. The overall slowdown that we see coming in the economy – driven by weaker investment and exports – should also leave its mark on job growth. In addition, the slowdown in the housing market should lead to less spending related to moving house, such as on furniture. Indeed, this was visible in December's retail sales report. Finally, the impact of last year's interest rates should continue to feed through. However, the positives we outline above should keep consumer spending growing at around a trend pace.

Downgrades to eurozone outlook

Turning to Europe, we made downward revisions to our eurozone GDP forecast for this year, with implications for our ECB, bond yield and currency forecasts. We have lowered our GDP growth forecast for 2019 to 0.8% from 1.1% previously, taking us further below consensus forecast (1.4% according to the Bloomberg survey). Indeed, our projection is for a growth rate less than half of the ECB's current forecast. The change stems from the recent and ongoing weakness in eurozone and global economic data that suggest the period of weaker economic growth will be more protracted.

The weakness in global trade and production looks set to persist as the tightening of global financial conditions that we saw last year will continue to feed through. The downturn in eurozone exports is also leading to a slowdown in fixed investment growth. The economy will probably see sub-trend growth rates in the first half of this year, before a return to trend rates in the second half of the year. This is based on the relative resilience of domestic demand combined with an improvement in the global economy. Domestic demand should be underpinned by easy financial conditions, lower headline inflation and some fiscal stimulus. The improvement in global growth should be supported by the dovish shift by global central banks, which is arresting the tightening of financial conditions. However, central banks have are far from stepping on the gas, so we do not expect a sharp recovery in global growth.

More dovish ECB

We now expect the ECB to remain on hold until the very end of next year (we are pencilling in a 10bp hike in December 2020). We previously expected a 10bp increase in March 2020 and one in September of next year. At the June Governing Council meeting, we expect the ECB to change its forward guidance to rule out rate hikes for this year as well as announcing another programme of long-term loans to banks. The downward revision to our economic growth forecast means that we will see four consecutive quarters of economic growth comfortably below trend. The consequence is that underlying inflationary pressures will build even more slowly.

Lower bond yields and euro

Our new forecasts imply further macro downgrades and an additional re-pricing of ECB expectations. This should lead to a further decline core bond yields from current levels (see table below). We think the decline will be concentrated in 5y and 10y yields. For instance, we now see 10y Bund yields at 0% in Q1 and Q2 (previously 0.15%). Given that the short-end will be more stable, we see the 2s5s and 2s10s segment of core government bond yield curves flattening over the next 3-6 months. This will be followed by a more moderate recovery in the second half of the year as economic growth regains some traction. We see 10y Bund yields at 0.2% by year end (previously: 0.5%). Finally, given weaker macroeconomic data and the longer period of unchanged ECB policy rates we have lowered our EUR/USD forecast (to 1.16 end of this year from 1.25).

Spanish elections to add to European political risk this year

After Spain's parliament voted down the government's 2019 Budget earlier this week, early elections in Spain will be held on 28 April. This adds to the number of elections this year (Belgium, Portugal, Greece and the European parliament will all hold elections), pointing to further political risk in Europe. Opinion polls do not suggest there is any chance of a populist government, as in Italy, but they do suggest that forming a government will again be very difficult.

And now for some good news…

In recent times, the news flow on the macro, political and policy front has often been downbeat. Some may even say depressing. So it is great to be able to finish with some good news. High level talks have been taking place this week between US and Chinese officials to try and find a resolution on trade. There will be further meetings next week. The US had been threatening to impose a new round of tariffs on Chinese imports on 1 March if trade agreement is not reached. Commentary from various sources suggest that progress has been made and that the truce may well be extended, with the 'tariff deadline' delayed' while talks continue. Such an outcome would ease worries about a further escalation of the trade war, while not removing this risk completely.

Main economic/financial forecasts

GDP growth (%)	2017	2018e	2019e	2020e
United States	2.2	3.0	2.7	1.7
Eurozone	1.8	1.8	↓ 0.8	1.3
Japan	0.7	0.8	0.9	0.7
United Kingdom	1.4	1.4	1.7	1.9
China	6.6	6.6	6.3	6.0
World	3.8	3.6	3.4	3.3
Inflation (%)	**2017**	**2018e**	**2019e**	**2020e**
United States	2.4	2.4	1.6	2.0
Eurozone	1.5	1.7	1.0	1.3
Japan	0.9	1.0	1.1	1.6
United Kingdom	2.5	2.4	1.4	1.8
China	2.1	2.1	2.5	2.5
World	3.0	3.5	↓ 3.8	3.3
Key policy rate	**14/02/2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2.50	2.50	2.50	2.50
European Central Bank	-0.40	-0.40	-0.40	↓ -0.30
Bank of Japan	-0.10	-0.10	-0.10	-0.10
Bank of England	0.75	0.75	1.00	1.25
People's Bank of China	4.35	4.35	4.35	4.35

3M interbank rate	07/02/2019	14/02/2019	+3M	2019e	2020e
United States	2.70	2.69	2.75	2.70	2.60
Eurozone	-0.31	-0.31	-0.30	-0.30	↓ -0.20
Japan	0.07	0.07	-0.10	-0.10	-0.10
United Kingdom	0.90	0.87	0.80	1.20	1.45
10Y interest rate	**07/02/2019**	**14/02/2019**	**+3M**	**2019e**	**2020e**
US Treasury	2.65	2.66	2.7	2.70	2.60
German Bund	0.11	0.10	↓ 0.0	↓ 0.20	↓ 0.50
Euro swap rate	0.65	0.66	↓ 0.6	↓ 0.80	↓ 1.10
Japanese gov. bonds	-0.01	-0.01	0.0	0.30	0.50
UK gilts	1.18	1.15	1.5	1.80	2.10
Currencies	**07/02/2019**	**14/02/2019**	**+3M**	**2019e**	**2020e**
EUR/USD	1.14	1.13	↓ 1.10	↓ 1.16	↓ 1.25
USD/JPY	109.8	110.5	111	105	100
GBP/USD	1.30	1.28	1.36	1.45	1.50
EUR/GBP	0.88	0.88	↓ 0.81	↓ 0.80	↓ 0.83
USD/CNY	6.74	6.77	6.85	6.70	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.