

# Macro Weekly

Group Economics

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## For better, for worse

- **Germany escapes recession, that's not bad**
- **Very poor Chinese trade data**
- **US housing and mortgages responding to lower mortgage rates**
- **Fed patient**
- **Brexit mess**
- **Light at the end of the trade-conflict-tunnel**

According to preliminary data the German economy grew at a modest 1.5% rate last year, after 2.2% in 2018. While a separate Q4 number has not yet been published, the data suggests that growth resumed in Q4 after a 0.2% qoq contraction in Q3. My colleague Aline Schuiling [calculates](#) that Q4 growth may have amounted to 0.3%. Even if it is a little lower, I would still argue that that is pretty decent. I have written before about the decline of car production in Europe and Germany in particular. According to data from the VDA (the German association of the automotive industry) car production was almost 13% down yoy in Q4. Admitted, this data is not seasonally or work-day adjusted. But still, the car production data does not look great at all. For the overall economy to register growth nonetheless, suggests that other parts of the economy are doing reasonably well.

### Germany: car production

Thousands, 12 months moving average



Source: Bloomberg

The data on German car production, actually, looks so bad that you have to think that the downturn as revealed by the numbers must be overstating underlying dynamics. Demand for German cars has not fallen off a cliff on a sustained basis, or has it? So it is time to start to look for signs of improvement. The monthly Ifo survey of business confidence includes a series on the assessment of new orders in the auto industry. The most recent reading (December) is the highest in six months. Does this provide a glimmer of hope? I

think so, but then, I want to think so... Given that so many commentators are currently pessimistic, I think chances of positive surprises are increasing rapidly.

### Germany: Ifo – assessment of new orders in the car industry



Source: Bloomberg

### Very poor Chinese trade data, but they may overstate underlying dynamics

Chinese trade data took a decisive turn for the worse in December. I wrote about Chinese trade last week, showing that imports had generally continued to grow for most of 2018 and that Chinese imports from Germany were still up yoy in November. This all changed in December and I am repeating several graphs I used last week (except they look worse now). The value of Chinese imports in USD was down 7.6% yoy in December, the first negative number since mid-2016. It must be borne in mind, this data is about values, so the drop in oil and other commodity prices plays a role here. There may also be base effects and currency effects. In addition, Chinese importers may have tried to beat tariffs imposed on US products, which may have boosted the numbers when that happened, but which inevitably leads to a drop when it is over. The point is, however, that such a drop is temporary and overstates the underlying dynamics. Another point to make is that a big chunk of Chinese imports are inputs to export products. So any slowdown of exports will translate in slower imports and is not necessarily a reflection of slower growth of the domestic economy.

### China: imports

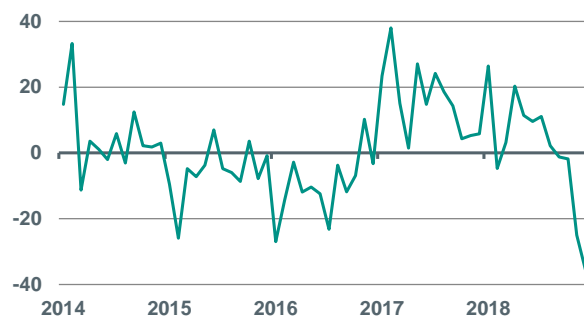
In USD, % yoy



Source: Bloomberg

### China: imports from the US

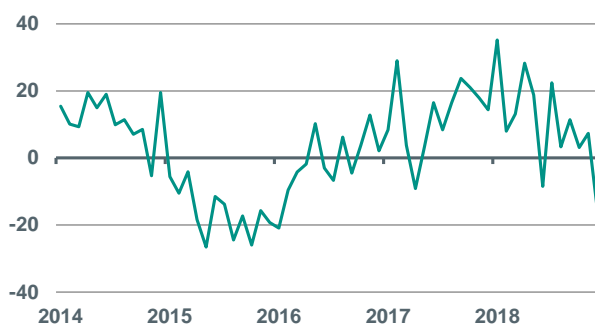
In USD, % yoy



Source: Bloomberg

**China: imports from Germany**

In USD, % yoy



Source: Bloomberg

Regardless of all these qualifications, the December data was weak and must be at least partly reflection either of slowing growth in China or resulting from the trade war. It is probably a bit of both. Having said that, the longer I look at this data, the more I am inclined to think they must be exaggerating the downturn. The growth rate of the value of imports has collapsed from +20.3% yoy in October to -7.6% in December. It simply is unlikely that actual activity would have fallen off a cliff in such a dramatic way. Therefore, I am inclined to think that there is at least a glimmer of hope. Given that so many commentators are currently pessimistic, I think chances of positive surprises are increasing rapidly.

**Mixed US data while housing is responding to lower mortgage rates**

The US data flow has been reduced by the shutdown which is keeping staff of the bureau of Economic Analysis away from their desks. The US data that was released recently has a clear message: economic growth is past its peak, but not collapsing while the housing and mortgage sectors are responding to the drop in mortgage rates. The first regional business surveys for January are currently being released. The Empire State index (New York state) eased from 11.5 to 3.5, the second considerable monthly decline. This index had moved around 20 for most of 2018, the average since 2002 is 8.8. It is not clear if and to what extent this index has been affected by the shutdown. In any event, the data suggests that growth has come off the boil. The Philly Fed index of business confidence, on the other hand, improved in January: 17, against 9.1 in December. The trend of this index remains downward, however.

Last week I highlighted the sharp rise in mortgage refinancings. The US Mortgage Bankers Association provides data on a weekly basis. Their index of mortgage applications rose 13.5% in the most recent week, after +23.5% in the week before. I do not know if there are changes in the regulatory or tax background playing a role. But it looks to me as though mortgage demand is responding strongly to mortgage rates. The rate on a 30-year mortgage has come down by some 50bp since November, in line with the decline of Treasury yields. Against that background, it was good to see that the confidence index of home builders also improved in January after a couple of months of decline. This could be supporting evidence that the housing sector is responding to lower borrowing costs. One should expect the US economy to slow in the course of the year as investment spending slows and the fiscal stimulus wears off. However, with the housing sector showing a new

lease of life I think there is more than a glimmer of hope that the slowdown will not be too bad. Given that so many commentators are currently pessimistic, I think chances of positive surprises are increasing rapidly.

#### **Fed hawks turning dovish**

I have highlighted this before, but the tone of Fed officials continues to shift. Esther George, President of the Kansas City Fed is known as one of the most hawkish FOMC members. In recent days she has said that the Fed can be patient, meaning that the Fed can afford to take a wait-and-see approach as inflation is very tame. As my colleague Bill Diviney has [pointed](#) out, Ms George has gone a considerable step further in an interview with the Wall Street Journal when she suggested that the Fed might reconsider its policy of shortening its balance sheet. This policy is currently essentially on auto pilot. Our conclusion is that we were right when we took out the rate hike we had pencilled in for March. In fact, we feel comfortable with our view of no changes to interest rates by the Fed this year.

#### **The mess called Brexit**

I must admit I enjoyed watching the voting procedure on Brexit and on PM May in the UK's House of Commons. That does not mean I have a clear idea of how this will end. Our view is that a no-deal Brexit is unacceptable to so many MPs, that it will disappear as an option. We now think that a second referendum, resulting in the UK staying in the EU has become a lot more likely. But anything can happen.

#### **US-China trade conflict hopes**

China has announced that their vice PM will lead their delegation at the next round of trade talks. That must be a good sign. The more senior people tend only to come if their underlings have made sufficient progress. I also think both sides are aware of the risk of doing significant damage to their own economies by escalating the conflict. US president Trump will be starting to think of next year's elections. The last thing he needs is an economy in trouble or an extended bear market in equities. The best way for him to reduce such risks is to do a trade deal. He is a master at selling any deal as a victory, so it really doesn't matter what the deal includes. The Wall Street Journal article claiming that US Treasury Secretary Steve Mnuchin would favour rolling back the tariffs imposed on imports from China (not confirmed) may also be a positive signal.

Main economic/financial forecasts										
GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	10/01/2019	17/01/2019	+3M	2019e	2020e
United States	2.2	3.0	2.7	1.7	United States	2.80	2.78	↓	2.75	↓ 2.60
Eurozone	2.5	1.8	↓ 1.1	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.05
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	1.7	1.9	United Kingdom	0.92	0.93	0.80	1.20	1.45
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	10/01/2019	17/01/2019	+3M	2019e	2020e
United States	2.4	2.4	1.6	2.0	US Treasury	2.73	2.75	3.1	2.70	2.60
Eurozone	1.5	1.7	↓ 1.0	1.3	German Bund	0.20	0.24	0.3	0.50	0.80
Japan	0.9	1.0	1.1	1.6	Euro swap rate	0.82	0.80	1.1	1.25	
United Kingdom	2.5	2.4	1.4	1.8	Japanese gov. bonds	0.03	0.01	0.0	0.30	0.50
China	2.1	2.1	2.5	2.5	UK gilts	1.28	1.34	1.5	1.80	2.10
World	3.0	3.6	↓ 3.9	3.3						
Key policy rate	17/01/2019	+3M	2019e	2020e	Currencies	10/01/2019	17/01/2019	+3M	2019e	2020e
Federal Reserve	2.50	↓ 2.50	↓ 2.50	2.50	EUR/USD	1.15	1.14	1.17	1.25	1.30
European Central Bank	-0.40	-0.40	-0.40	-0.20	USD/JPY	108.4	109.2	111	105	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.28	1.29	1.36	1.45	1.50
Bank of England	0.75	0.75	1.00	1.25	EUR/GBP	0.90	0.88	0.86	0.86	0.87
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.79	6.78	6.85	6.70	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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