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Group Economics

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World trade and manufacturing remain under pressure

- **Global manufacturing business confidence improves a touch**
- **But world trade remains under pressure**
- **Hard to see where material improvement will come from**

Global manufacturing PMI

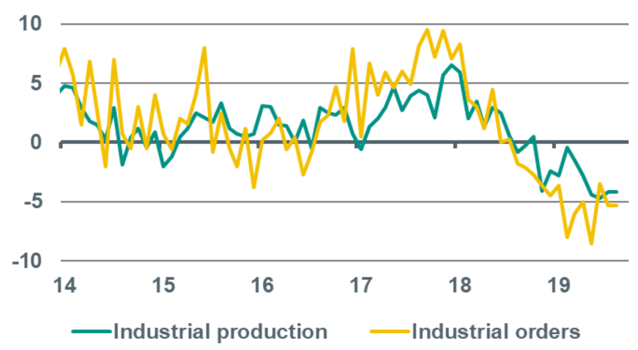
Source: Bloomberg

Business confidence in manufacturing globally, as measured by the global PMI manufacturing improved a little in August but remains weak: 49.5 versus 49.2. This was partly thanks to an improvement in China's Caixin index (50.4, up from 49.9). But the sector remains in the doldrums globally. The sub-series on new export orders was the weakest since 2012.

Germany's manufacturing is particularly weak. Recent data indicate continued problems in Germany. Industrial production fell 0.6% mom in July, weaker than expected, after a 1.5% drop in June. The year-over -year pace of change amounted to -4.2%, a little better than June's -5.2%, but clearly in recession territory. Industrial orders were even worse: -2.7% mom, reversing June's 2.7% gain. Orders were down 5.6% yoy after -3.5% in June. Orders from outside the eurozone were particularly weak: -6.7% mom.

Germany Industrial orders and production

% yoy

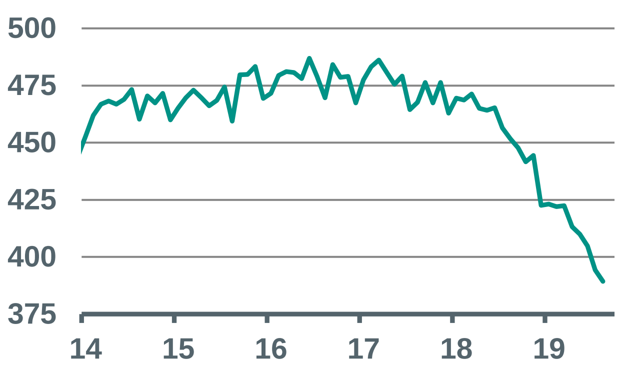


Source: Bloomberg

German industry remains under pressure from various directions. Global corporate investment activity has weakened significantly. As Germany is a big producer of capital goods, this hurts. In addition, German car production remains under pressure. Problems with car production started last year when emission testing procedures changed. I thought that these problems would be overcome in the course of this year, but that does not appear to be happening. Weakness in car sales in China may be one explanation. The slow response by German car manufacturers to the growth of electric cars may be another. A third factor is that German car manufacturers are moving production increasingly to other countries. This may be in response to the trade conflict. Whatever the reasons behind depressed car production, it is hard to see a significant improvement coming any time soon.

Germany car production

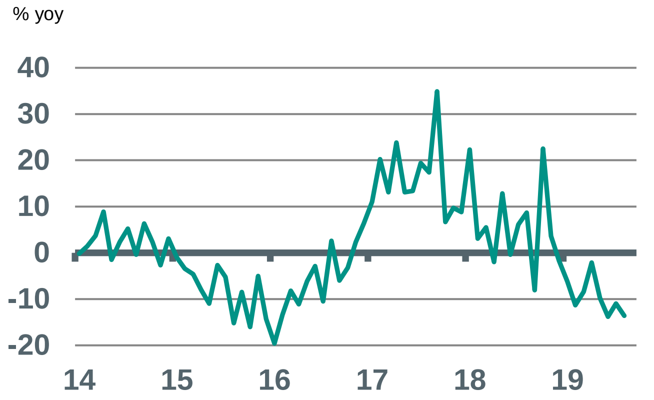
Thousands, 12mma



Source: Bloomberg

While the saga of the US-China trade conflict continues, hard data on global trade remain poor. According to CPB data global trade is contracting on a year-over-year basis. This hurts open economies obviously more than others. Germany is one of those. South Korea is another. Korean exports were down 13.6% yoy in August after falling 11.0% yoy in July. Semiconductor exports were particularly weak: -30.7% yoy, marginally worse than in the previous couple of months. All this data is pointing at weakness in China. Korean exports to China were down 21.3% yoy in August. Hong Kong's PMI report registered a record low for 'new business from China'. The riots in Hong Kong were cited as one of the reasons, but the US-China trade conflict and the depreciation of the Chinese currency were also mentioned.

South Korea exports



Source: Bloomberg

US data was, generally, a little better, but here too, signs of weakness in the industrial sector are becoming clearer. The ISM manufacturing, a gauge that measures business confidence in that sector dropped to 49.1 in August, down from 51.2 in July. This was the lowest reading since January 2016. Such a reading does not signal an imminent recession for the US as a whole. In the past, US recessions did not start with the ISM at around current levels. For the ISM to signal a recession it would have to fall to the low 40s.

US durable goods orders were up 2.0% mom in July after a rise of 2.1% mom in June. That is good. Some sub-series of the durable goods report are used as an indication for corporate capital spending. Shipments of capital goods, excluding defence and aircraft feed into the national accounts as data on investment spending. These shipments were down 0.6% mom in July after registering -0.7% mom in June. The yoy rate improved a touch: from 1.1% in June to 2.0% in July. That is not bad, but not great either as the data shows a clear deceleration of growth of corporate capital spending since late 2017 when these shipments were growing at a pace of 11.6%.

US shipments

Source: Bloomberg

It is hard to see where a meaningful improvement is going to come from any time soon. Sure, the services sector is holding up a lot better. For example, while the US ISM manufacturing fell below 50 in August, the same gauge for the 'non-manufacturing' sector rose from 53.7 In June to a robust 54.4 in August. But history shows that the more cyclical industrial sector leads the services sector in the cycle.

The Fed and the ECB are set to cut rates and the ECB is set to restart QE. This will provide some stimulus, but it is hard to see this having a decisive influence.

Perhaps the inventory cycle can come to the rescue. Companies are often surprised by falling demand ending up with increasing inventory levels. They then respond by cutting production. They usually cut production to a level lower than actual demand in order to run down inventories. This causes exaggerated weakness on the production side. Once inventories have been brought to desired levels, production improves again. It is hard to get a clear view on the level of inventories, but perhaps some improvement will come from the inventory cycle.

Welcome as that may be, the US-China trade conflict continues to be a major problem. The two countries have announced that they will return to the negotiating table before too long. That is positive and financial markets responded positively. However, this is something we have seen before. A return to the negotiating table does not guarantee that a deal will be done.

The Brexit saga also continues. As the UK parliament has now adopted legislation forbidding a no-deal Brexit PM Boris Johnson finds himself in an ever-tighter corner. Any forecast as to where this is going runs the risk of proven wrong before the ink with which it is written has dried. So perhaps I should just say let's wait and see.

Main economic/financial forecasts

GDP growth (%)	**2017**	**2018**	**2019e**	**2020e**	**3M interbank rate**	**29-8-2019**	**5-9-2019**	**+3M**	**2019e**	**2020e**
United States	2,4	2,9	2,2	1,3	United States	2,13	2,11	1,43	1,43	1,55
Eurozone	2,7	1,9	0,8	0,6	Eurozone	-0,42	-0,44	-0,55	-0,55	-0,55
Japan	1,9	0,8	1,0	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	0,75	0,76	0,80	0,80	0,80
China	6,9	6,6	6,2	5,8						
World	3,8	3,6	2,9	2,9						
Inflation (%)	**2017**	**2018**	**2019e**	**2020e**	**10Y interest rate**	**29-8-2019**	**5-9-2019**	**+3M**	**2019e**	**2020e**
United States	2,1	2,4	1,8	2,0	US Treasury	1,52	1,57	1,5	1,50	1,50
Eurozone	1,5	1,7	1,1	0,9	German Bund	-0,69	-0,59	-0,8	-0,80	-0,80
Japan	0,5	0,9	1,1	1,6	Euro swap rate	-0,29	-0,16	0,2	0,20	0,35
United Kingdom	2,7	2,5	1,9	1,8	Japanese gov. bonds	-0,29	-0,27	-0,1	-0,10	0,00
China	1,6	2,1	2,5	2,5	UK gilts	0,44	0,60	0,3	0,30	0,30
World	3,0	3,4	3,7	3,3						
Key policy rate	**5-9-2019**	**+3M**	**2019e**	**2020e**	**Currencies**	**29-8-2019**	**5-9-2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2,25	1,50	1,50	1,50	EUR/USD	1,11	1,10	1,12	1,12	1,15
European Central Bank	-0,40	-0,60	-0,60	-0,60	USD/JPY	106,5	106,9	104	104	100
Bank of Japan	-0,10	-0,10	-0,10	-0,10	GBP/USD	1,22	1,23	1,24	1,24	1,30
Bank of England	0,75	0,75	0,75	0,75	EUR/GBP	0,91	0,90	0,90	0,90	0,88
People's Bank of China	4,35	4,10	4,10	3,85	USD/CNY	7,15	7,16	7,20	7,20	7,50

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.