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Group Economics

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Growth concerns mount, despite tariff delay

- **More twists in trade war: US delays part of fresh China tariffs**
- **US recession fears rise, as 2-10 yr yield curve inverts; consumer holds up**
- **Eurozone slows: Germany close to a recession, Netherlands outperforms**
- **China: Activity data dip in July, after jump in June; more support likely**
- **EM: yuan depreciation 'controlled', Argentine peso in freefall**

More twists and turns in the US-China trade war

It has not been a big surprise to us that the US would become more protectionist and mercantilist under a Trump presidency. It also has not been a big surprise that China would be the main target of this turn in US policy. What has been more difficult to predict is the way this protectionist card would be played. And what has been almost impossible to predict, but what keeps on having a substantial impact on financial markets, are the many twists and turns that we have seen in the US-China trade/tech war so far.

In late June, Trump and Xi agreed on a second truce in Osaka. But whereas the first truce agreed in Buenos Aires in late 2018 lasted for about five months, the Osaka truce was already broken within a month or so. On 31 July, US president Trump announced new 10% tariffs on the remaining USD 300bn of imports from China. And last Tuesday, within two weeks since the truce was broken, the US announced to delay part of these new tariffs (for about half of the goods concerned) until 15 December. The argumentation for this delay is that the US consumer would not feel the impact of higher tariffs during the holiday shoppings at the end of this year. Later this week, one of Trump's tweets also made a connection between the ongoing protests in Hong Kong and the trade conflict. He also hinted at a possible next meeting or call with Xi.

Global business confidence down on trade conflict ...

Purchasing managers' indices, 50 = 'neutral mark'



Source: Thomson Reuters Datastream

... and so are global trade and industrial production

% yoy



Source: Thomson Reuters Datastream, CPB

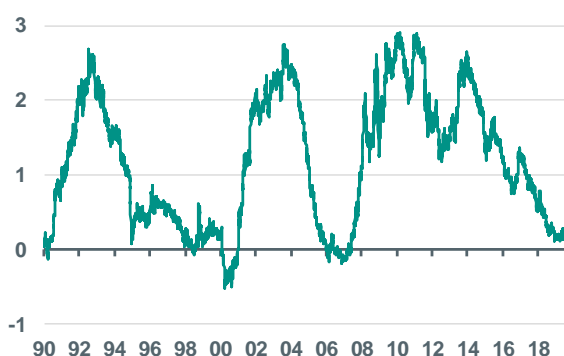
Stock markets reacted positively to the delay, but the joy was short-lived as global growth concerns quickly took over again, troubles brewed in Hong Kong, Argentina and other places and China stated it would retaliate fresh US tariffs despite the delay (although stronger US retail sales brought some respite). Despite all the uncertainties and turns and twists on the trade front, what is sure is that the escalation of the trade/tech war between the world's two largest economies has become a key headwind for global industrial activity, (cross-border) investment and global trade. The drag from these trade tensions have become so serious, that business confidence and GDP growth have slowed almost everywhere. As a result, following downward adjustments made in June for many countries, we recently lowered our growth forecasts further for the US, the eurozone and several emerging markets (see an overview [here](#)). We have also changed our central bank forecasts and expect even more easing in the US and the eurozone, and have revised our forecasts for interest rates, currencies and several commodities as well.

US: Recession fears flare up as 2-10 yr yield curve inverts; consumer holds up

In the US, recession fears flared up in the course of this week, as the spread between the two and ten year government bond yields dropped briefly below zero for the first time since the start of the global financial crisis in 2007. This caused sharp corrections in US stock markets as well. As we have written about recently (see for instance [here](#)), the yield curve has a strong predictive track record, and is likely signalling the heightened, late cycle vulnerability to a recession. However, history suggests expansions do not die of old age, but due to a combination of capacity constraints and shocks. Although the US economy is approaching full capacity, it is not quite there yet. While wage growth has picked up, so has productivity, which has grown on average 3.1% annualised year-to-date, according to data released yesterday – well above the post-crisis average of 1.0%. This is dampening the pass-through of higher wage growth to profit margins, highlights our US economist Bill Diviney.

US 2-10 year yield curve close to inversion

US government bond yields, spread 2-10 yrs, %-points



Source: Bloomberg

Retail sales still highlight strength of US consumer

US core retail sales, annualised, 3m/3m



Source: Thomson Reuters Datastream

Sure, we can identify several potential recession triggers, including fall-out from the trade war, and elevated corporate debt leading to a round of deleveraging and retrenchment. However, we expect consumption – which makes up 70% of the US economy – to remain a key support for growth. Indeed, the July retail sales figures provided further evidence that the US consumer is in good shape, with both headline and core (ex-autos/gas) readings beating economists' expectations, rising 0.7% and 0.9% mom respectively. As of

July, core retail sales are rising 8.6% 3m/3m annualised – the fastest pace since June 2014. As such, while we expect weakness in manufacturing to drive a significant slowdown in the US during our 2019-20 forecast horizon (and recently cut our growth forecasts a bit further), we do not expect a recession.

Eurozone slows: Germany heading for recession, ...

The highly export oriented eurozone is one of the victims of global trade conflicts and the global slowdown in manufacturing and trade. Over the past few weeks, Q2 GDP growth numbers were published for individual eurozone countries and for the eurozone as a whole. As expected, quarterly growth in the eurozone fell to 0.2% qoq, from 0.4% qoq in Q1. Meanwhile in Germany, quarterly growth dropped back into negative territory (-0.1% qoq) for the first time since Q3-18. Moreover, the leading ZEW index came in much weaker than expected and dropped back to multi-year lows. As explained [here](#), German weakness is concentrated in exports and industry. Germany is heading for a recession, as Q3 numbers point to a contraction as well. We expect the German economy to remain weaker than the eurozone aggregate, which should be close to stagnation in the second half of this year but not in recession.

German ZEW nosedives

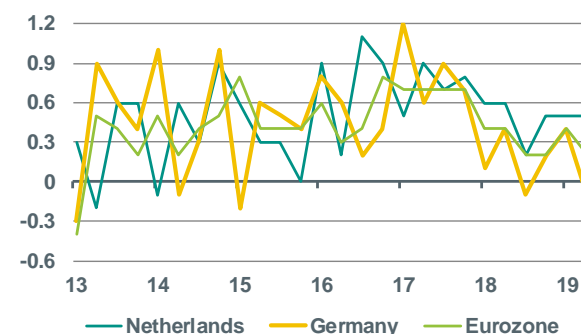
Index



Source: Bloomberg

Germany underperforms, Netherlands outperforms

GDP growth, % qoq



Source: Bloomberg

... while the Netherlands still outperforms

Meanwhile, economic growth in the Netherlands held up well at 0.5% qoq in the second quarter. This was similar to Q1's pace, better than the consensus expectation of 0.3% qoq and still clearly above the eurozone's average. Net exports contributed positively to growth in Q2, as exports accelerated and imports slowed (see [here](#) for more background). The Netherlands is also highly export oriented, but less dependent on the export of capital goods than Germany is. We now expect a bit higher growth this year. Still, we do not expect the Dutch economy to continue to grow at this rate, as the international environment is worsening and the US-China conflict has re-escalated. We have cut our 2020 growth forecast a bit further recently.

Weak Chinese data for July build the case for more support

China's activity data for July published this week were weak. Industrial production slowed to 4.8% yoy (June: 6.3%, consensus: 6.0%), the lowest pace in 17 years. Retail sales slowed to 7.6% yoy (June: 9.8%, consensus: 8.6%). Fixed investment growth was marginally lower in July (5.7% yoy ytd) compared to June. Lending data for July published early last week were also weaker than expected. Bloomberg's monthly GDP estimate



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dropped to a post global financial crisis low of 6.0% yoy, from June's spike of 7.1%. While part of the weakness in July's data seems to relate to payback from the surprisingly strong June data, the picture emerges that the Chinese economy is not out of the woods yet, with headwinds from the trade/tech conflict with the US having risen over the past months. We expect the authorities to step up fiscal and monetary easing (including RRR and interest rate cuts) to keep China's growth slowdown measured.

Yuan depreciation remains 'orderly'

A new element in the re-escalation of the trade war has been the USD-CNY exchange rate breaking the 7 level, for the first time since 2008. Last week, that added to investors fears of more deflationary forces joining the picture and on potential spill-overs to EM currencies and commodity markets. We have adjusted our USD-CNY forecasts down (for 2019 from 6.90 to 7.20 and for 2020 from 6.70 to 7.50). However, we have maintained our view that the People's Bank of China (PBoC) would not tolerate a free fall of the yuan, as it learned lessons the hard way during the turbulence back in 2015-16. In that episode, capital outflows surged on sharp CNY depreciation expectations and Chinese FX reserves dropped by 25%. All told, we now expect the PBoC will tolerate some more yuan weakness to preserve China's competitiveness in the wake of higher tariffs, but will act to keep the depreciation modest. Developments over the past week lend support to this view.

China's July activity data disappoint



Source: Thomson Reuters Datastream

Argentine peso in free fall



Source: Bloomberg

Emerging markets: dó cry for me, Argentina

The deterioration in risk sentiment and the renewed depreciation of the Chinese yuan has an effect on emerging markets, with most EM currencies weakening versus the US dollar again. Last year, we singled out Turkey and Argentina as the weakest links among emerging markets, mainly due to their external and political fragilities. This time around, Argentina is left over as the weakest link. The Argentine peso had already been under pressure in the run-up to the October presidential elections. However, the situation has changed dramatically after the primaries on 11 August, which resulted in a strong victory for the left leaning candidates (Fernandez + Fernandez). A free fall of the peso and sharp corrections on Argentine asset markets resulted. External payment risks are also rising again for Argentina, that defaulted eight times on its debt in the past 200 years. Meanwhile, Turkey has become more resilient to a shift in sentiment compared to last year (see our recent [Turkey Watch](#)), with the Turkish lira outperforming recently after big hits last year.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	08/08/2019	15/08/2019	+3M	2019e	2020e
United States	2.4	2.9	2.2	1.3	United States	2.18	2.17	1.43	1.43	1.55
Eurozone	2.6	1.9	0.8	0.6	Eurozone	-0.39	-0.41	-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	0.77	0.77	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	4.0	3.8	2.9	2.9						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	08/08/2019	15/08/2019	+3M	2019e	2020e
United States	2.1	2.4	1.8	2.0	US Treasury	1.72	1.53	1.5	1.50	1.50
Eurozone	1.5	1.7	1.1	1.0	German Bund	-0.56	-0.70	-0.8	-0.80	-0.80
Japan	0.5	0.9	1.1	1.6	Euro sw ap rate	-0.14	-0.35	0.2	0.20	0.35
United Kingdom	2.7	2.5	1.9	1.8	Japanese gov. bonds	-0.19	-0.24	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.52	0.41	0.3	0.30	0.30
World	3.1	3.5	3.7	3.3						
Key policy rate	30/08/2019	+3M	2019e	2020e	Currencies	08/08/2019	15/08/2019	+3M	2019e	2020e
Federal Reserve	2.25	1.50	1.50	1.50	EUR/USD	1.12	1.11	1.12	1.12	1.15
European Central Bank	-0.40	-0.60	-0.60	-0.60	USD/JPY	106.1	106.1	104	104	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.21	1.21	1.24	1.24	1.30
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.92	0.92	0.90	0.90	0.88
People's Bank of China	4.35	4.10	4.10	3.85	USD/CNY	7.05	7.04	7.20	7.20	7.50

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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