

Macro Weekly

Group Economics

21 June 2019

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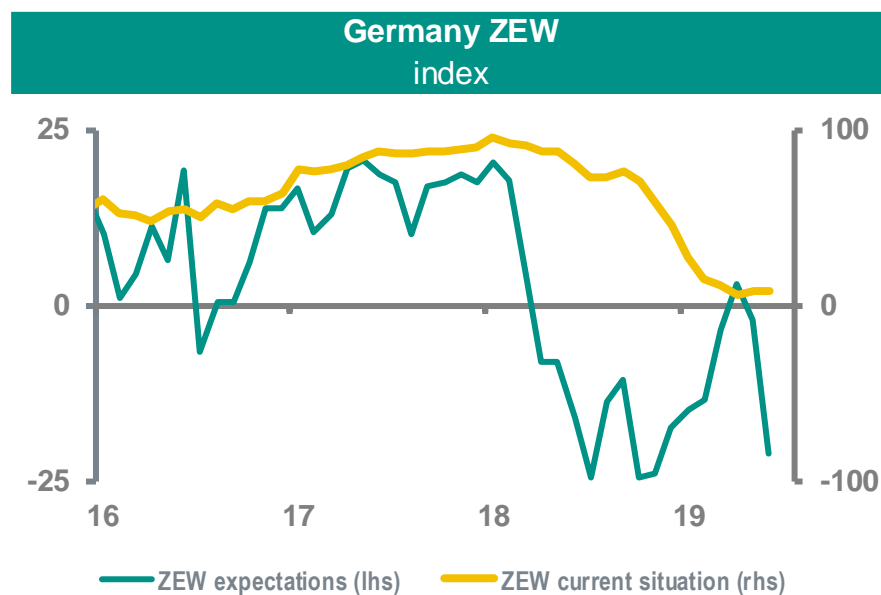
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Knee jerk reaction

- First reaction to re-escalating trade war visible
- Korea hit by more than the trade war?
- Central bankers promising (much) more easing

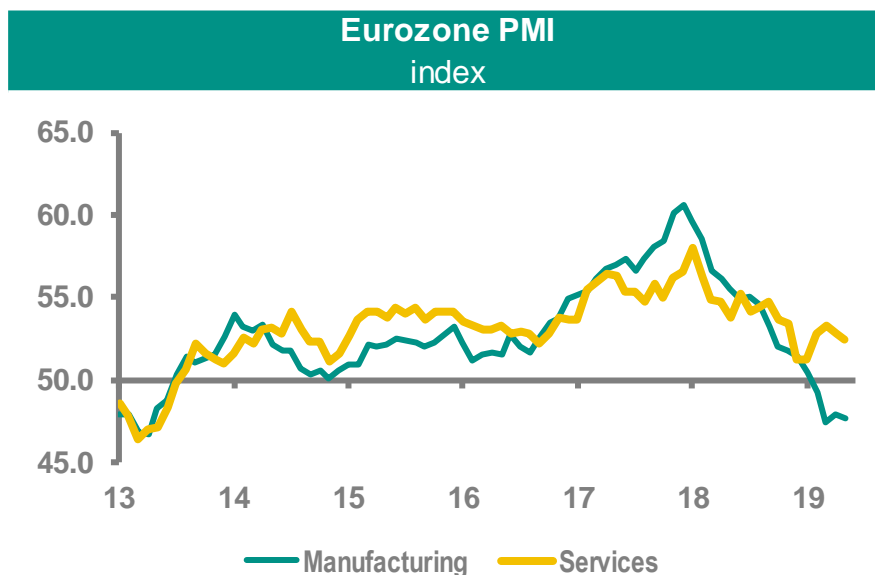
Previous weeks had already shown that the unexpected re-escalation of the conflict between the US and China has had an immediate impact on economic variables, or better, on confidence, particularly of companies. Some, though certainly not all data shows what can best be described as a knee jerk reaction to the unfortunate events in May. The ZEW index, a measure of confidence among analysts, dropped sharply in the eurozone in June: -20.2 versus -1.6 in May. On this measure, the eurozone's largest economy, Germany was hit hard.



Source: Bloomberg

The details show, however, there is perhaps some hope yet. The 'expectations' component of the ZEW index for Germany tumbled from -2.1 in May to -21.1 in June. But the 'current conditions' component fared considerably better, falling only from +8.2 to +7.8. Typically, the expectations component is seen as a leading indicator for current conditions. But the combination seen in June also suggests that the re-escalation of the Sino-US conflict has scared the hell out of people but not actually hit the real economy yet. Should some sort of a truce be reached soon, perhaps the damage to the real economy can remain limited. It may not lead, though, to a rapid reversal in confidence as companies will not make the same mistake (assuming all is fine) twice.

The eurozone PMI was more upbeat, in the sense that PMIs were slightly higher in June, but at low levels. These series suggest that the economy is actually stabilising. It will be interesting to see if these indicators will deteriorate further in the months ahead should the Sino-US conflict were to deepen.



Source: Bloomberg

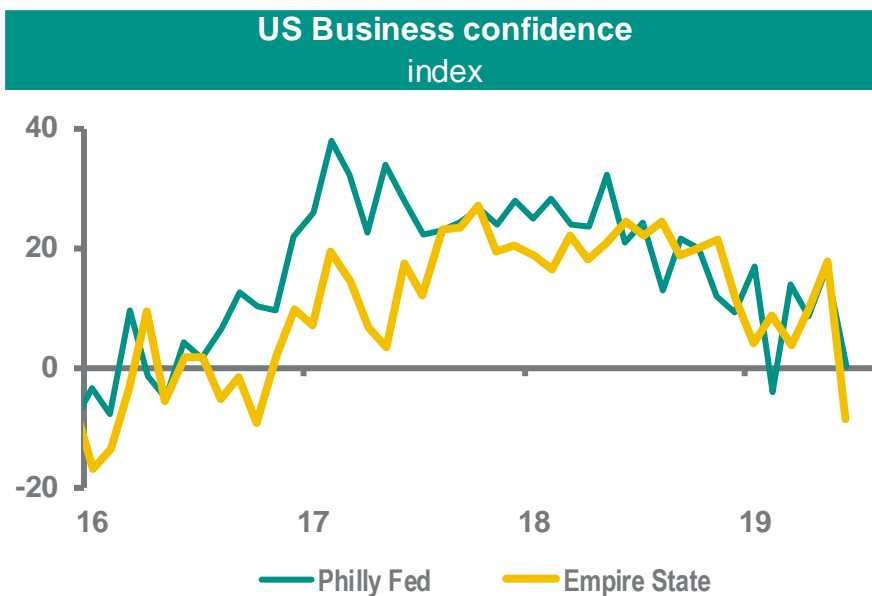
A sudden stop?

Business confidence indices in the US show a similar pattern. The Empire State survey of the New York Fed got hammered in June, falling from a respectable 17.8 to -8.6. That was the lowest reading since October 2016 and the monthly drop must have been one of the largest monthly drops on record (though I have not checked all the data for this). It is very unlikely that this hammering is an accurate reflection of actual economic developments. The economy in the region covered surely did not fall off a cliff. The detail of this report shows clearly what is happening. Companies have been taken by surprise and their knee jerk reaction is to 'put everything on hold'. New orders were down from 9.7 in May to -12.0 in June. Such a drop may indicate that companies have put their capital spending on hold. The capex plan series in this survey dropped from 26.2 to 10.5. It is probably totally exaggerated, but it looks a little like what economists refer to as a 'sudden stop' (although the sudden stop literature focusses most on international capital flows). I am not a guy for pessimism, but the last time I saw a sudden stop in economic variables was towards the end of 2008 when the seizure of the money markets forced companies to cancel all their orders for lack of working capital. We know what happened after that. The situation is clearly a lot less dramatic now, but the survey evidence shows the risks if the uncertainty over trade continues. On the positive side the Empire State index of business confidence shows that companies are much more benign about the outlook further down the road. The assessment of business conditions 6 months ahead weakened modestly in June: 25.7 versus 30.6 in May. The June reading was more or less on par with the average for the year. My conclusion is that companies appear to have put investment decisions on hold. If the conflict lingers on, this could have a seriously negative impact on the economy (in the US and elsewhere). If, on the other hand, some sort of truce can be found, there may be a reversal and pent-up demand might provide a short term positive surprise. The Philly Fed index,

measuring business confidence in the district of the Philadelphia Fed showed the same picture. The headline series tumbled from 16.6 in May to 0.3 in June as new orders fell sharply: 8.3, down from 38.2.

Quiet spots

Not all recently published data is showing such drama. Dutch consumer confidence, for example, strengthened in June: 0, versus -3 in May. You wonder if Dutch consumers don't read newspapers. Or maybe they are distracted by the women's football World Cup.



Source: Bloomberg

Car registrations in the eurozone seem to be stabilising after much turbulence last year. In fact car registrations in April and May rose substantially: +4.8% mom in April and +2.8% mom in May. Obviously, car registrations are highly seasonal and affected by special measures such as tax changes. But the year-on-year comparison is also improving: -0.1% yoy in April, +1.1% in May.

The US housing market is also an area showing no reaction to the trade conflict escalation. Indeed, you would not expect it to do so at this stage. Confidence among estate agents, as measured by the NAHB, fell back marginally in June, 64, down from 66 in the previous month, but it is clear that the housing market is benefitting from fallen mortgage rates.

Korean trade data showing what's going on

Asian trade data is important to watch, not only because these economies are early-cyclical, the data from the various countries also reflect developments in China. Japan's trade data for May were weak. Exports were down 7.8% yoy after April's -2.4%. The regional breakdown in volumes provides an interesting picture. Exports to China were down 9.4% yoy, but that was in line with previous months (-9.6% in April and -15.2% in March). So no sign there yet of an effect of the re-escalation of the trade conflict and its impact on China. Japanese export volumes to the EU were down 8.0% yoy, against -3.0% in April. The US remains the strongest export market for Japan, although here also a deterioration took place: -1.0% yoy following +5.1% in April.

Taiwanese export orders were down 5.8% yoy in May, a little worse than April's -3.7%. The May number does not really deviate from the recent trend. It is going to be interesting to see if the June numbers show the same knee jerk reaction to the re-escalation of the trade conflict seen in survey based evidence for June.

The most recent data on international trade comes from Korea. That country produces export and import data on the first 20 days of each month, released on the 21st day of the month. Don't ask me how they do that, but they do it. Total Korean exports (values) were down 10.0% yoy in the first 20 days of June. That was slightly better than the -11.7% registered in May and roughly in line with most months so far this year. The detail is showing some interesting trends. First, exports of semiconductors were down 24%. This is at least partly a reflection of weakness in the sector. Samsung has said it does not expect a meaningful improvement this year for semiconductors. Looking at the geographical breakdown, exports to China were down 21% yoy. This is a reflection of a number of factors. First, in the course of last year, China appears to have stepped up imports, presumably, trying to beat tariffs. Somehow, that has also affected Chinese imports from other countries than the US. So the recent weakness may be a pay-back now. Second, the slowdown in China may have had an impact here. And last, the re-escalation of the Sino-US conflict may have had an impact. While Korean exports to China were down sharply in the first 20 days of June, exports to the US were actually up by 3.3% yoy.

All in all, I don't want to sound alarmist. However, we cannot ignore that a number of indicators, mostly related to confidence, have weakened sharply following the events in May. If the conflict were to deepen, that would be bad news for the global economy. While I have no superior knowledge of what goes on in president Trump's head, I am still assuming he has an incentive not to let things go out of hand completely as that would reduce his chances to be re-elected.

Central banks sounding relatively aggressive

ECB president Draghi spoke at the annual ECB conference in Sintra in Portugal last Tuesday. He signalled that the ECB will provide more stimulus. We had assumed that the ECB will restart purchasing assets. But we had also presumed they would leave the already negative deposit rate unchanged. Mr Draghi said explicitly that cutting rates further is a policy option that is on the table. He also discussed why negative rates have been successful and why the differences between the US and the eurozone imply that negative rates are a less attractive policy option in the US. Now why would he discuss all this at some length if he thought that further rate cuts would not occur. We are in the process of adjusting our ECB call to include some further lowering of the official rates.

Mr Draghi's opposite number at the US Federal Reserve, Jay Powell, spoke at the press conference following the Fed's policy meeting last Wednesday. He also signalled easing and we are confident that the Fed will cut rates at their next meeting on the last two days of July. What surprised us a little, or even more than a little, is that Powell appeared to keep open the option of cutting by 50 bp. The market has been pricing in some rate cuts for some time. Most people worry that the market has gotten a little ahead of itself. If the Fed cuts rates, but by less or fewer times than the market is pricing in, then there could be a negative market reaction. I would have thought that there was no need to be egging the market on in terms of

their rate-cut expectations. Yet, that is effectively what Powell did. Markets responded positively. He'd better deliver.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	13/06/2019	20/06/2019	+3M	2019e	2020e
United States	2.2	2.9	2.2	1.5	United States	2.41	2.34	2.20	1.90	1.80
Eurozone	2.5	1.9	0.7	0.9	Eurozone	-0.32	-0.34	-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	0.78	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	3.7	3.6	3.2	3.3						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	13/06/2019	20/06/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.09	2.00	2.0	1.90	2.00
Eurozone	1.5	1.7	1.1	1.0	German Bund	-0.24	-0.32	-0.3	-0.35	-0.20
Japan	0.5	0.9	1.1	1.6	Euro sw ap rate	0.26	0.20	0.7	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.11	-0.17	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.84	0.81	0.8	0.80	1.00
World	3.0	3.5	3.7	3.2						
Key policy rate	20/06/2019	+3M	2019e	2020e	Currencies	13/06/2019	20/06/2019	+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	107.3	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	6.92	6.85	6.90	6.90	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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