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Evidence that demands a verdict

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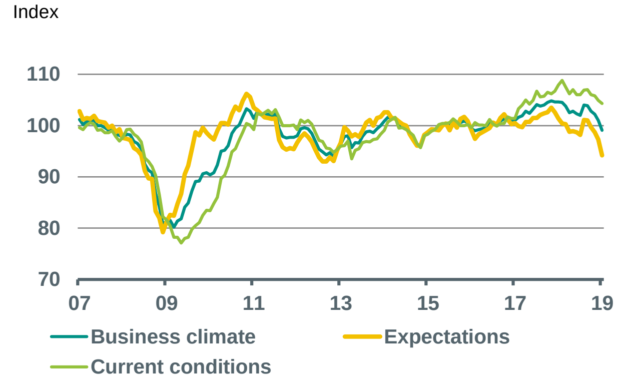
- **Recent data suggests slump in world trade deepening**
- **US appears not to be affected**
- **Uncertainties related to Brexit, the US-China trade conflict and the partial US government shutdown continue to cloud the near-term outlook**

Most, though not all, recent macro data has been poor and suggests that the weakness of world trade growth is intensifying. Actually, the data on world trade as released monthly by the Dutch CPB hasn't been quite as weak as some of the survey data would suggest. But hard data released very recently would be consistent with a material slowing also in the CPB data.

Ifo expectations fall off a cliff

The authoritative German Ifo index of business confidence fell further in January: 99.1, versus 101.0 in December. Analysts generally attach most importance to the 'expectations component'. It fell very sharply, 94.2, versus 97.3, to reach the lowest level since 2012. The 'current conditions component' also softened further, but much less dramatically.

Germany: Ifo index of business confidence

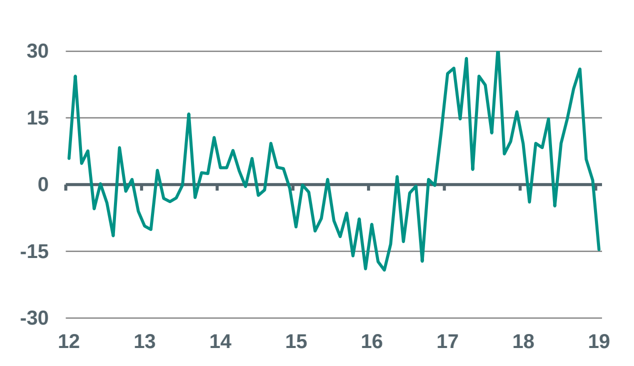


Source: Bloomberg

Asian trade data suggest world-trade growth is falling sharply

Other remarkable weakness was seen in recently published data on trade in some Asian countries. Korea provides the most up-to-date measure of trade. After 20 days each month, the country provides data on trade flows during the first 20 days of that month. The January numbers show a 14.6% yoy decline of exports, against +1.0% in December. Imports also weakened: -9.5% yoy against + 2.2% in December. Taiwan released export orders data for December. They were down 10.5% yoy following a drop of 2.1% in November. A geographical breakdown of this data is interesting. Export orders from the US were up 5.6% yoy; orders from Japan were also up, 2.6% yoy. But export orders from China and Hong Kong were down 10.3% yoy and orders from Europe were down a shocking 28.1% yoy. Admitted, this data can be volatile and base effects can have a big impact on the monthly data.

Korea: exports (first 20 days)



Source: Bloomberg

Taiwan: export orders

Source: Bloomberg

Nevertheless, the data suggests that the US economy is doing OK, that Japan is doing OK-ish and that China and Europe are struggling. As for China, we assume the economy has slowed and probably more than the 'gradual slowdown path' would imply. And we know that Chinese policymakers have taken a range of measures to support growth. I am inclined to think that the policymakers will be successful at bringing growth back to the desired path. The latest data on industrial production in China and retail sales suggest the economy is stabilising.

Divergence in Europe

That leaves Europe. An amazing divergence is occurring in Europe. Italy is very weak, but that isn't really a huge surprise. Spain is actually strong, while France is softening, partly related to the yellow jackets protests. The biggest surprise in Europe is Germany. Industrial production was down almost 5% yoy in November, as reported last week. And the Ifo looks like expectations have fallen off a cliff. The preliminary January reading on the Markit PMI for manufacturing also fell: 49.9, down from 51.5 in December. The same gauge for France rose in January: 51.2, versus 49.7 previously.

The most pressing question is why the German economy is suddenly showing so much weakness and whether or not the economy is sliding into recession. My verdict, at least for now, is that special factors must be affecting Germany.

Recessions are caused by something and rarely restricted to individual economies

When economies fall into recession, there is usually a clear reason for that. For example, some sort of shock, monetary conditions that are too tight or enormous negative wealth effects resulting from bursting asset bubbles. In addition, economies generally do not fall into recession on their own while others are continuing to grow. The world economy is highly integrated and different economies are affected by the same factors.

I simply do not see any of the traditional factors pushing economies into contraction doing so in Germany currently. In addition, the divergence between Germany on the one hand and other economies on the other suggest that Germany is affected by special factors. I think there are three.

Germany's three special factors

First, as I have highlighted many times, German car manufacturers have experienced huge problems around the new emission-testing procedures. Car production has slumped as a result. Some survey data suggests orders are rebounding. Second, China is an important export market for Germany. The slowdown in China resulting from the deleveraging strategy of the Chinese policymakers has undoubtedly affected German exports of machinery to China. And, third, the drought over the summer has led to low water levels in Germany's rivers, such as the Rhine. Shipping has been restricted as a result, which has caused problems for companies to shift their products and get their inputs.

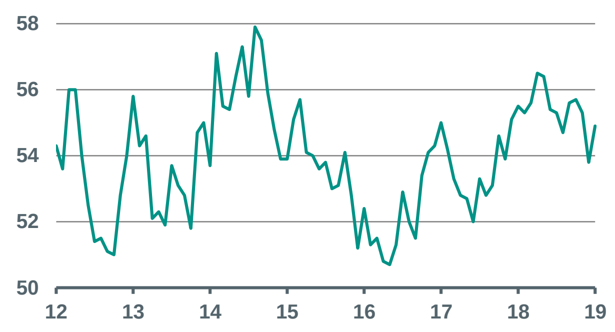
I think German car manufacturers will overcome their problems and production will bounce back. I also think that Chinese policy measures to support activity will be successful and that German exporters will benefit. Last, my understanding is that water levels in rivers are now back to normal so that normal supply service can resume. Even if that were not the case, one would expect companies to find other solutions.

My verdict, therefore, remains that a recession is highly unlikely and that some improvement in the data must come about some time during the next couple of months. But I must admit, this is a big call.

US data has been scarce in recent weeks, due to the shutdown of the US Bureau of Economic Analysis. In the latest week, initial jobless claims fell to 199,000, the first sub-200K reading I can remember, underscoring the strength of the labour market. Business confidence improved in the manufacturing sector, as already referred to above: 54.9 in January, after 53.8 in December, suggesting the US economy isn't affected strongly by the weakness elsewhere.

US: Markit PMI manufacturing

Index, 50=neutral



Source: Thomson Reuters Datastream

Main economic/financial forecasts

GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	17/01/2019	24/01/2019	+3M	2019e	2020e
United States	2.2	3.0	2.7	1.7	United States	2.78	2.77	2.75	2.70	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	0.93	0.92	0.80	1.20	1.45
China	6.6	6.6	6.3	6.0						
World	3.8	3.6	3.4	3.3						
Inflation (%)	**2017**	**2018e**	**2019e**	**2020e**	**10Y interest rate**	**17/01/2019**	**24/01/2019**	**+3M**	**2019e**	**2020e**
United States	2.4	2.4	1.6	2.0	US Treasury	2.75	2.71	3.1	2.70	2.60
Eurozone	1.5	1.7	1.0	1.3	German Bund	0.24	0.18	0.2	0.50	0.80
Japan	0.9	1.0	1.1	1.6	Euro swap rate	0.80	0.73	0.8	1.10	1.40
United Kingdom	2.5	2.4	1.4	1.8	Japanese gov. bonds	0.01	0.01	0.0	0.30	0.50
China	2.1	2.1	2.5	2.5	UK gilts	1.34	1.27	1.5	1.80	2.10
World	3.0	3.6	3.9	3.3						
Key policy rate	**24/01/2019**	**+3M**	**2019e**	**2020e**	**Currencies**	**17/01/2019**	**24/01/2019**	**+3M**	**2019e**	**2020e**
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.14	1.14	1.17	1.25	1.30
European Central Bank	-0.40	-0.40	-0.40	-0.20	USD/JPY	109.2	109.6	111	105	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.29	1.30	1.36	1.45	1.50
Bank of England	0.75	0.75	1.00	1.25	EUR/GBP	0.88	0.87	0.86	0.86	0.87
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.78	6.79	6.85	6.70	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.