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Different leadership

- **Powell's debut balanced**
- **Changing cyclical patterns**
- **Back to emperors, czars and chiefs**

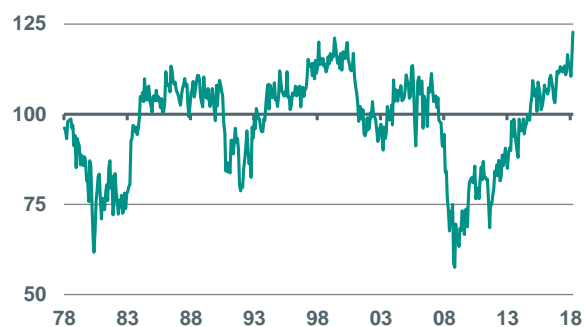
The economies in Europe and China surprised most on the upside last year in terms of economic growth. The US performed in line with expectations. That pattern appears to be changing. Recent indicators show strong confidence in the US, some softening in Europe while the Chinese data is difficult to read due to Chinese New Year.

US confidence data strengthens

Confidence of US small businesses surged to its highest level in March since 1983. Consumer confidence jumped to a new cyclical high in March according to the University of Michigan gauge. While the 'expectations component' eased somewhat, the 'current-conditions component' leaped to its highest level in over 40 years. Last week, the Philly Fed business confidence index and the Empire State index had also shown strength.

US consumer confidence

University of Michigan, current conditions, index



Source: Bloomberg

Many commentators point out that the 'hard data' is less impressive. Perhaps. But industrial production growth was strong in February: +1.1% while manufacturing alone expanded by 1.2%. True, that followed weakness in weather-affected January. But the yoy growth rate now stands at a healthy 4.4%.

Softer in the eurozone

By contrast, the latest industrial production data in Europe was soft. The eurozone's industrial production fell 1.0% mom in January and the yoy rate eased from 5.3% in

December to 2.7%. Perhaps that is a normal fluctuation during the winter months and I have to admit that I am comparing Europe's January data with February data in the US, which may paint a wrong picture. But still. Analysts are becoming a lot more concerned about the eurozone economy. The eurozone ZEW index, which measures analysts optimism about the overall economy fell sharply in March: 13.4 versus 29.3 in February. The German version of this index has two components. The expectations component dropped from 17.8 in February to 5.1 in March. The long term average is 23. The preliminary PMI for the eurozone continues to ease. The manufacturing PMI for Germany fell for the third consecutive time in March.. it is still at a high level, but the recent trend is down. The equivalent for the eurozone as a whole fell a hefty two points: 56.6 in March, versus 58.6 in February and a peak of 60.6 in December.

Industrial production



Source: Bloomberg

Germany: ZEW expectations



Source: Bloomberg

We are not worried about this softening of European confidence indices. Growth is above trend and the manufacturing sector in particular has grown far above trend for a while. It is inevitable for growth and confidence to come down somewhat. It does not mean the economy itself will turn down.

This combination of US and European indicators suggest, however, that the cycle in Europe is probably past its peak and that the Trump policy initiatives are giving the US economy new impetus. Some of the relative developments of confidence indicators may be an overreaction to the rather sudden appearance of protectionism.

China slowdown most likely progressing gradually

Meanwhile, Chinese New Year continues to make it difficult to read the Chinese economy. Chinese retail sales growth eased in February: 9.7% yoy against 10.2% in January. But industrial production growth (year to data) accelerated a little: 7.2% versus 6.6%. That growth rate has suddenly moved away (and up) from what has been an amazingly stable trend. Not sure what it means, but it does not suggest the slowing is getting worse.

A good way to gauge what is going on in the Chinese economy is to look at the trade flows of China's key trade partners. Taiwan's export orders were down 3.8% yoy in February after having been up 19.7% in January. As Chinese New Year is affecting this data, the best thing to do is take an average: growth if just over 8% is not bad, but clearly lower than in the second half of last year.

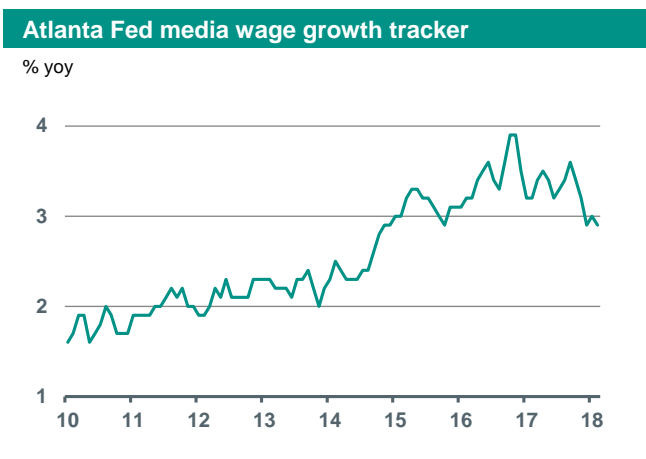
South Korean exports during the first 20 days of March were up 9.3% yoy, after -3.9% in February. The average for Q1 stands at 4.9%. This confirms the picture from the Taiwanese data: not bad, but certainly weaker than in the last part of 2017.

Powell balanced

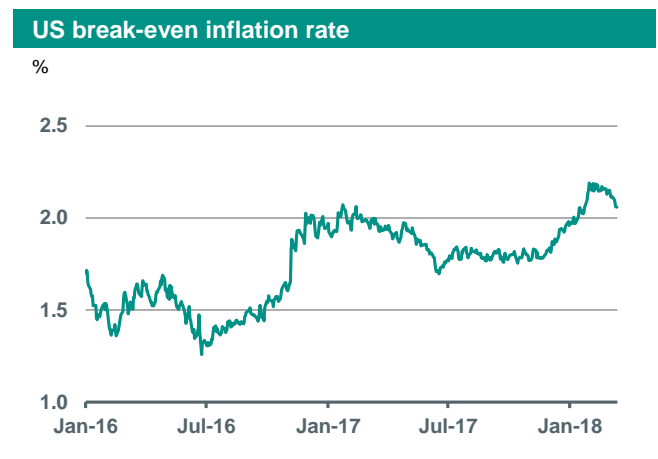
As expected the Fed raised official rates at their most recent policy meeting. But that really wasn't the thing market participants had been anxious about. Their interest was with the communication. At his earlier congressional testimony chairman Powell had sounded somewhat hawkish, so market participants were keen to see if he continued that and whether or not there would be changes to the median view on future policy among the FOMC members.

As it happened, Powell and the FOMC were extremely balanced. The median view remained that this year would bring three hikes. It would have been possible for the FOMC to move to four projected hikes. So that was a little dovish. On the other hand the projection for rate hikes beyond 2018 was raised as were the growth forecasts for the economy.

Chairman Powell does not have an academic economic background and it is said that he is less likely than his predecessors to be led by econometric models. Perhaps. I have always thought that a good dose of common sense goes a long way and I liked Powell's observation that there is, as yet 'no sense in the data that we are on the cusp of an acceleration' of inflation. That is right! Core CPI stood at 1.8% yoy in February against 2.2% in February 2017. Average hourly earnings stood at 2.6% yoy against 2.7% a year earlier. The Atlanta Fed median wage growth tracker was up 2.9% yoy in January, down from the 3.2% it reached in January 2017. Last, inflation expectations have stopped rising. The so called 5yr-5yr forward break even inflation rate peaked early February and has moved lower since.



Source: Bloomberg



Source: Bloomberg

Something will have to give, but not yet

I think it is reasonable to expect the Fed to continue its gradual policy of tightening. how far that will go remains to be seen. The market does not think that the Fed will actually deliver all the rate hikes they are projecting. The median projection for Fed Funds by the end of

2020 is just under 3.5%. If the market believed that, the yield on 10yr Treasuries would not be just below 3% and the curve would not have been flattening recently. Something will have to give, but not for quite some time.

New leadership style

I am an old-fashioned sort of guy. I like and respect traditions and find it difficult to cope with a lot of change. So you can imagine that I am happy to see recent developments in politics in a number of countries. It is back to the good old times in several key countries.

The Chinese have an emperor again. Excellent!

The Russians have their czar again. Thrilling!

The Americans have a 71 year old leader who does not really seem to like democracy if it isn't working in his favour and who demands respect from his underlings the way Indian chiefs probably did for centuries before the Europeans came. Super!

Don't you just love such traditions?

That is all great so far. The missing link is Europe. We have been brought up with the belief that market economies are the best economic system to raise living standards and that it will bring liberal democracy which is the ultimate peak of human civilisation. We must count ourselves lucky that we have reached this state of nirvana just when we are alive. It does not matter that democratic choices sometimes seem highly irrational. It doesn't matter that that a few percentage points of British voters decided radically to change the destiny of their economy even though most (on either side of the debate) of them had no clue what the issues at stake were. Yeah, democracy is great for making that possible. Unfortunately, developments elsewhere (and in some European countries, too, for that matter) are challenging our core beliefs. I am now starting to wonder if our 200 years or so experiment with democracy has actually failed and is coming to an end...

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| Main economic/financial forecasts | | | | | | | | | | | | | |
|-----------------------------------|--|------------|-------|-------|-------|---------------------|--|------------|------------|-------|-------|--------|-------|
| GDP growth (%) | | 2016 | 2017 | 2018e | 2019e | 3M interbank rate | | 14/03/2018 | 21/03/2018 | +3M | 2018e | +12M | 2019e |
| United States | | 1.5 | 2.3 | 3.0 | 2.7 | United States | | 2.15 | 2.27 | 1.90 | 2.40 | 2.40 | 2.80 |
| Eurozone | | 1.8 | 2.5 | 2.8 | 2.3 | Eurozone | | -0.33 | -0.33 | -0.33 | -0.33 | -0.33 | -0.13 |
| Japan | | 0.9 | 1.7 | 1.7 | 1.3 | Japan | | 0.07 | 0.07 | -0.10 | -0.02 | -0.10 | -0.10 |
| United Kingdom | | 1.9 | 1.7 | 1.4 | 1.7 | United Kingdom | | 0.60 | 0.64 | 0.80 | 1.00 | 1.10 | 1.60 |
| China | | 6.7 | 6.9 | 6.5 | 6.0 | | | | | | | | |
| World | | 3.2 | 3.7 | 3.9 | 3.7 | | | | | | | | |
| Inflation (%) | | 2016 | 2017 | 2018e | 2019e | 10Y interest rate | | 14/03/2018 | 21/03/2018 | +3M | 2018e | +12M | 2019e |
| United States | | 1.3 | 2.1 | 2.1 | 2.0 | US Treasury | | 2.82 | 2.91 | 2.9 | 3.00 | 2.70 | 2.85 |
| Eurozone | | 0.2 | 1.5 | 1.7 | 1.4 | German Bund | | 0.59 | 0.59 | 0.8 | 0.90 | 1.00 | 1.20 |
| Japan | | -0.1 | 0.5 | 1.0 | 0.8 | Euro sw ap rate | | 1.04 | 1.05 | 0.9 | 1.10 | 1.10 | 1.25 |
| United Kingdom | | 0.7 | 2.7 | 2.3 | 1.9 | Japanese gov. bonds | | 0.03 | 0.03 | 0.0 | 0.00 | 0.00 | 0.20 |
| China | | 2.0 | 1.6 | 2.5 | 2.5 | UK gilts | | 1.44 | 1.53 | 1.4 | 1.50 | 1.50 | 1.80 |
| World | | 3.0 | 3.0 | 3.4 | 3.1 | | | | | | | | |
| Key policy rate | | 21/03/2018 | +3M | 2018e | 2019e | Currencies | | 14/03/2018 | 21/03/2018 | +3M | 2018e | +12M | 2019e |
| Federal Reserve | | 1.50 | 2.00 | 2.25 | 2.75 | EUR/USD | | 1.24 | 1.23 | 1.21 | 1.20 | 1.22 ↑ | 1.30 |
| European Central Bank | | -0.40 | -0.40 | -0.40 | -0.20 | USD/JPY | | 106.3 | 106.1 | 109 | 110 | 108 | 100 |
| Bank of Japan | | -0.10 | -0.10 | -0.10 | -0.10 | GBP/USD | | 1.39 | 1.41 | 1.39 | 1.42 | 1.46 | 1.52 |
| Bank of England | | 0.50 | 0.75 | 1.00 | 1.50 | EUR/GBP | | 0.89 | 0.87 | 0.87 | 0.85 | 0.84 | 0.86 |
| People's Bank of China | | 4.35 | 4.35 | 4.35 | 4.35 | USD/CNY | | 6.32 | 6.33 | 6.45 | 6.50 | 6.55 | 6.70 |

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.