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Han de Jong
Chief Economist

 Tel: +31 20 628 4201
 han.de.jong@nl.abnamro.com

How does it all add up?

- **Gilets jaunes and car trouble affect Europe,**
- **But don't extrapolate recent very poor data**
- **US data flow reduced, but households respond to lower mortgage rates**
- **Chinese trade data shows particular weakness in imports from the US**

Economic data from the eurozone continues to show weakness. The European Commission's index of Economic Sentiment fell again: 107.3, versus 109.5 in November. It was the 12th consecutive monthly decline. Having said that, a level of 107.3 is still well above long-term averages.

Eurozone: economic sentiment



Source: Bloomberg

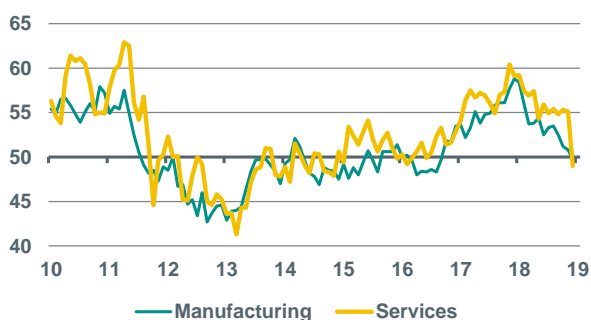
The two largest economies in the eurozone are struggling with what one would assume are temporary factors. The French economy is experiencing significant disruption from the "gilets jaunes". Take a look, for example, at the PMI in the services sector in France. It tumbled from a good 55.1 in November to 49.0 in December. That is a huge drop. It pulled the composite PMI down as well, while the manufacturing PMI also fell, but much less.

Germany is struggling with problems in the car industry. These are partly related to new emission testing procedures, but may also be more fundamental. German industry produced poor numbers for November. Industrial orders were down 1.0% mom and down 4.3% yoy (-3.0% in October). These numbers may actually overstate the weakness a little. Apparently, weak orders from Airbus in France had a big impact. Orders from elsewhere were actually not bad. Nevertheless, industrial production in November was also weak: -1.9% mom and -4.7% yoy (+0.5% in October). German car production continued to

struggle in December. Only 296,000 cars were produced that month, down 18% yoy, although this series is very volatile.

France: PMI

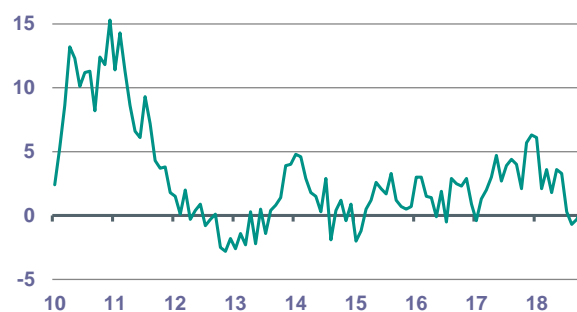
Index, 50=neutral



Source: Thomson Reuters Datastream

Germany: industrial production

% yoy



Source: Bloomberg

Recession or not?

Looking at the French PMIs and the German industrial data raises the question whether or not the eurozone is sliding into a recession (or has already done so). My answer continues to be no. The caveat I would add is that special factors (the disruptions in France and perhaps the Brexit process) can pose a serious threat. But it seems to me that the domestic side of the economy is fundamentally OK and I think recent poor data is exaggerating the problems for the economy as specific, but presumably temporary factors are at play. Add to that that the US economy appears to be fairly robust and that Chinese policymakers are taking a range of measures to boost activity. I would warn against extrapolating recent trends. Having said that, recent weak data has forced us to lower our growth estimates for this year.

The shutdown reduces the US dataflow, while households respond to lower mortgage rates

The flow of economic data from the US is currently reduced as the statisticians from the Bureau of Economic Analysis are not in work. They are among the 800,000 or so government workers affected by the shutdown. The statisticians elsewhere (the Fed, the Bureau of Labour Statistics and private data gatherers) are not affected, so some data is still being produced. Recent days have seen the ISM for the non-manufacturing sector decline from 60.7 in November to 57.6 in December. That is quite a drop, but still a decent level. Business confidence among SMEs eased a little, but is still robust (104.4 in December, down from 104.8). Perhaps the most interesting piece of economic US data of the last couple of days relates to mortgage applications. This is a weekly series and can be volatile. Mortgage applications rose 23.5% in the week to 4 January, after a 8.5% drop in the previous week. These numbers may be affected by calendar effects. But what is interesting is that the subindex of 'refinancings' was the main driver. The sharp increase in the latest week is still modest in a historical perspective, but it suggests that households are very alert and respond quickly to lower mortgage rates. This improves their financial situation which isn't bad to begin with.

US: mortgage applications - refinancings

Source: Bloomberg

The Fed is done

Apart from economic data, of course, the communication by Fed officials has been noticeable in recent weeks. They have clearly shifted to a more dovish stance, insisting that they can be 'patient'. And that is right. We have concluded that a March hike, which we had pencilled in, is therefore no more likely. As we expect US growth to slow in the course of the year, we now think that rate hikes will not occur in 2019. The Fed is done.

The adding up problem of the European slowdown in 2018

While 2017 was a year of surprisingly strong global growth, 2018 was a year of disappointment as growth slowed down. As I have regularly written here, I am still a little puzzled about what exactly happened. When I compare our growth forecasts for 2018 at the beginning of the year to what we now think, the most significant disappointment has occurred in Europe. When you dig into the data, it turns out that international trade made the biggest negative contribution to eurozone growth while domestic demand remained relatively robust. Digging into the trade data tells you that trade with Asia was particularly weak. So far, so good. I would then expect Asian overall growth numbers to also have disappointed materially. Somehow, that is not the case.

Chinese trade data suggests: Trump is shooting himself in the foot

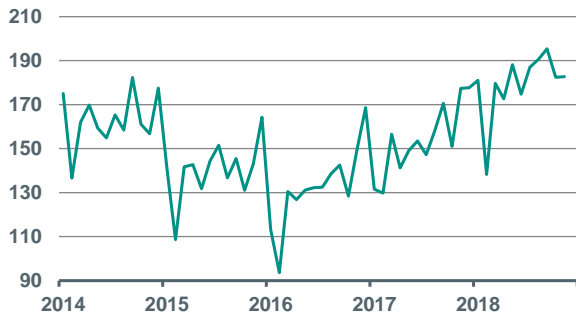
I think one of the key problems is that data about the largest Asian economy may not provide a good insight into the short-term fluctuations of the business cycle. It looks to me as though Chinese policy measures to deleverage the Chinese economy have slowed growth, which is what one would expect. And perhaps this effect has been a little stronger than the authorities counted on. On top of that came the trade conflict, which has affected confidence and may also have affected trade flows. But the Chinese data remain puzzling. I like to look at the trade data as they show the most direct link between the various economies and I think Chinese data in this area are actually very reliable. Chinese imports were weak in 2015 and 2016 as we experienced the 'Chinese growth scare'. Import growth (nominal in USD) then improved strongly and amounted to 16.8% in 2017. In the first 11 months of 2018, the growth rate was 18.8%. So much for the slowdown... It must be said that the November number was a mere 3%, although this may be due to base effects.

What is surprising in the Chinese trade data is that imports from the US have weakened in the course of the year while imports from other countries have not. In addition to base

effects in November that has led to a contraction of imports from the US by no less than 25% (!) yoy in November. Imports from Germany have held up much better. Imports from other countries like Japan have also not shown any particular weakness. This data does not shed much light on why the eurozone economy disappointed. What it does show is that it looks like President Trump is shooting himself in the foot with his trade war.

China: imports

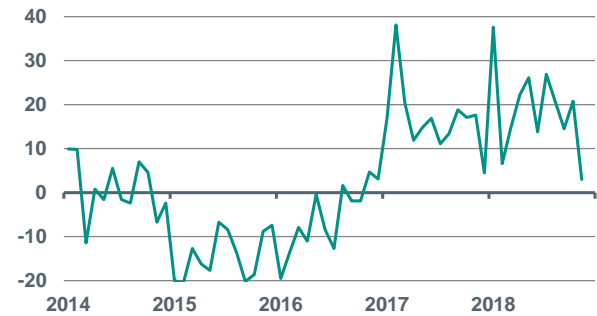
In USD bn



Source: Bloomberg

China: imports

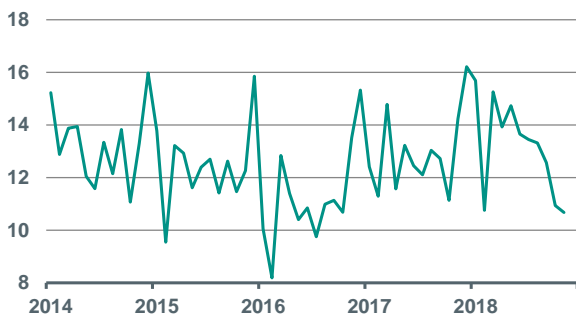
% yoy



Source: Bloomberg

China: imports from US

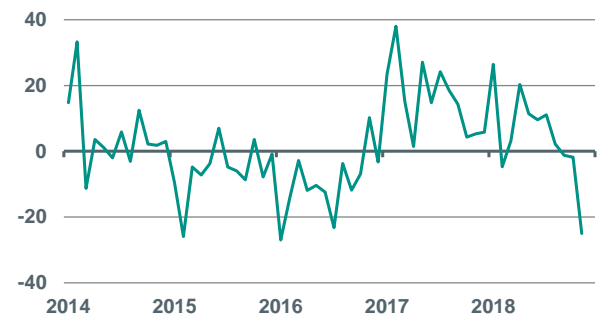
In USD bn



Source: Bloomberg

China: imports from US

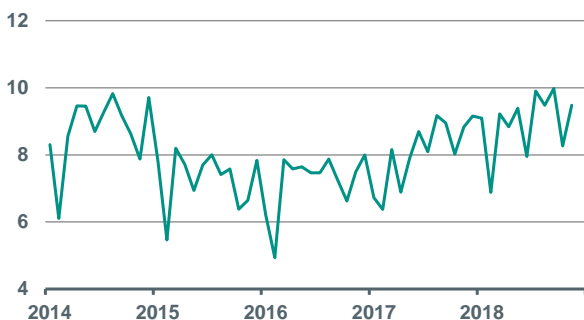
In USD, % yoy



Source: Bloomberg

China: imports from Germany

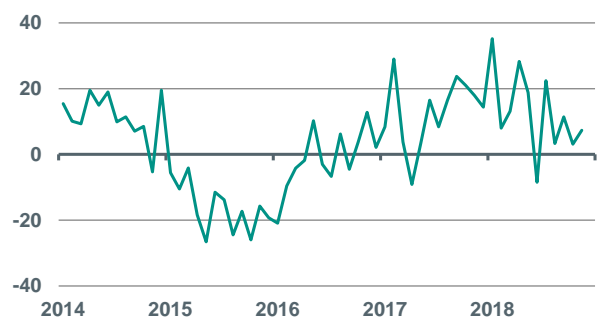
In USD bn



Source: Bloomberg

China: imports from Germany

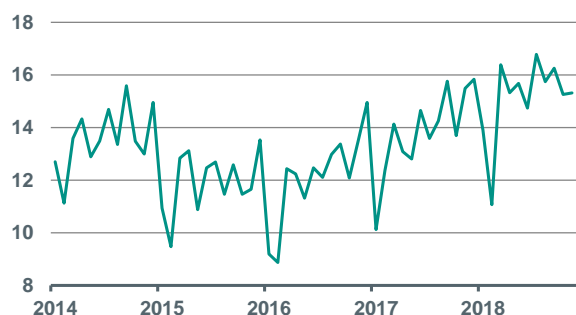
In USD, % yoy



Source: Bloomberg

China: imports from Japan

In USD bn



Source: Bloomberg

Main economic/financial forecasts

GDP growth (%)	2017	2018e	2019e	2020e	3M interbank rate	03/01/2019	10/01/2019	+3M	2019e	2020e
United States	2.2	3.0	2.7	1.7	United States	2.80	2.80	2.90	2.80	2.70
Eurozone	2.5	1.9	1.4	1.3	Eurozone	-0.31	-0.31	-0.33	-0.33	-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	0.91	0.90	0.80	1.20	1.45
China	6.9	6.6	6.3	6.0						
World	3.8	3.7	3.5	3.3						
Inflation (%)	2017	2018e	2019e	2020e	10Y interest rate	03/01/2019	10/01/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.55	2.73	3.1	2.70	2.60
Eurozone	1.5	1.8	1.2	1.5	German Bund	0.15	0.20	0.3	0.50	0.80
Japan	0.5	1.0	1.1	1.6	Euro swap rate	0.76	0.82	1.1	1.25	
United Kingdom	2.7	2.4	1.4	1.8	Japanese gov. bonds	0.00	0.03	0.0	0.30	0.50
China	2.1	2.2	2.5	2.5	UK gilts	1.20	1.28	1.5	1.80	2.10
World	3.0	3.6	3.9	3.3						
Key policy rate	10/01/2019	+3M	2019e	2020e	Currencies	03/01/2019	10/01/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.75	2.75	2.75	EUR/USD	1.14	1.15	1.17	1.25	1.30
European Central Bank	-0.40	-0.40	-0.40	-0.20	USD/JPY	107.7	108.4	111	105	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.26	1.28	1.36	1.45	1.50
Bank of England	0.75	0.75	1.00	1.25	EUR/GBP	0.90	0.90	0.86	0.86	0.87
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.87	6.79	6.85	6.70	6.70

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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