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A sudden improvement on Brexit and US-China trade talks?

- **Leo Varadkar sees ‘a pathway to an agreement’**
- **Trump say negotiations with China going ‘very, very well’**
- **Data mixed**

Positive developments can be reported about Brexit and the US-China conflict, two issues that have caused a lot of uncertainty during the last 12 months. In turn this uncertainty has caused a significant amount of damage to the global economy. So any turn for the better regarding these issues is positive for the global economy. But at the time of writing, nothing is definite.

Irish Taoiseach (prime minister) Leo Varadkar met UK PM Boris Johnson on Thursday and said that he sees ‘a pathway to an agreement in the coming weeks’. That is quite remarkable as the Irish had decisively rejected all proposals made by the Johnson government before. We don’t know what Johnson told Varadkar, but it must have the potential to be a major breakthrough. If an agreement is reached, the UK parliament would still have to vote on it. If the deal is rejected, chances are that Boris Johnson achieves a big victory in the then inevitable elections as the electorate is sick of the current ‘Brexit festivities’ and will likely sympathise with the PM. Given the Brexit fatigue, I therefore think parliament will approve the deal. At this stage, however, my position is that I believe it when I see it.

‘Very, very well’

The US and Chinese delegations also met on Thursday to try and hammer out some sort of a deal. On Tuesday 15 October US tariffs will rise from 25% to 30% on USD 250 bn worth of Chinese good unless the rise is postponed. Further increases on another range of goods is scheduled for December. President Trump said that the talks had gone ‘very, very well’, whatever that means. He is set to meet the top Chinese official himself on Friday, a meeting that had not taken place at the time of writing. People say that it is a good sign that the president involves himself personally in the talks. But we have seen hopeful comments before. It must be clear now that the conflict is doing significant damage, including to the US. History suggests that re-election of an incumbent president is more difficult if the economy is deteriorating sharply in the year of the elections. Further escalation of the conflict would risk doing more damage to the US. Logic therefore suggests that it is in the president’s interest to do a deal, even if he intends to rip it up again after the elections. But my logic isn’t Trump’s logic. So it is great to know that talks are going very, very well, but a signed deal is what we want and here, too, I believe it when I see it.

Mixed data, but essentially more of the same

The global economy has slowed markedly since early 2018 and our outlook is for continued sluggish, below-trend growth but no recession. As we share our views, we are challenged on both sides. Why aren't we more optimistic and why aren't we more pessimistic?

What would make me more optimistic is a reasonably convincing deal between the US and China and evidence that business confidence is responding positively to that. That is certainly a possibility, but we have been hopeful in the past only to be disappointed eventually. Bar a US-China deal, we cannot see what should make us much more optimistic.

On the other hand, we do not think a (US) recession is imminent. US consumers are simply too strong. It usually requires consumers to throw in the towel to push the US economy into a recession. But unemployment is very low, income gains reasonable, the savings rate high and the debt service ratio very low. No wonder consumer confidence is high. While we expect things to deteriorate as slower investment spending growth will have an impact on the labour market that will take a while.

Meanwhile, the Fed has eased twice and may ease more. Hawkish critics argue that the Fed's actions are premature and that they should not be easing when unemployment is at record lows. My colleague Bill Diviney tells me that Fed chair Powell has said that the Fed must act more pre-emptively than normal as it hasn't got a lot of ammunition. For many that may seem counter-intuitive. They would argue that you may want to keep your powder dry if you haven't got much powder. I find Powell's logic more appealing. Why wait trying to prevent a downturn allowing the downturn you want to prevent to start? It may take less gun powder to prevent a contraction than to reverse the course of the economy once the downturn is unfolding. Anyway, what I think is not relevant, the Fed is on an easing path. While the most recent minutes may reveal that the FOMC discussed when they should stop easing, deteriorating cyclical conditions are set to force them into more rate cuts, we think.

There wasn't much important data out in recent days. Industrial production rose 0.3% mom in Germany in August after falling 0.4% in July. The yoy rate deteriorated from -3.9% to -4.0%. Industrial orders in Germany fell again in August, by 0.6% mom. The yoy rate deteriorated from -5.6% in July to -6.7%. This is pretty dire. One of the sectors in trouble is the car sector, but some positives are appearing. The automobile sector accounts for some 4% of the German economy. Last year, car production fell by some 10% and this year hasn't been much better so far. While the data is very volatile and one month's data is rather meaningless, the most recent data on German car production is positive. August production was the first yoy increase, albeit marginal. And, admitted, August last year saw a sharp drop in car production, so there was a very positive base effect in August this year. But the improvement continued in September. 415,500 cars produced last month meant a yoy rise of close to 4%. The monthly data on car production and total industrial production do not match very well, but if stronger car production is sustained, the overall industrial production data should also improve somewhat. Other vulnerabilities remain, of course,

such as the dependence on world trade on global capex in general. That implies that Germany is also dependent on the US-China negotiations.

Germany: car production

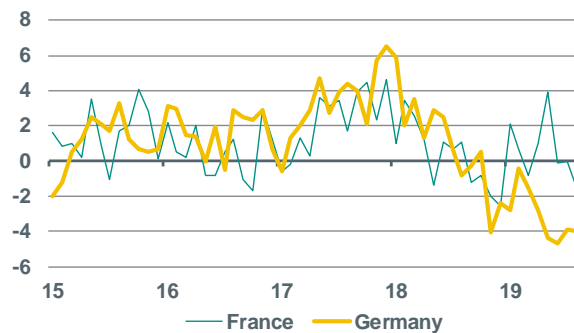
Thousands, 12 month moving average



Source: Bloomberg

Industrial production

% yoy



Source: Bloomberg

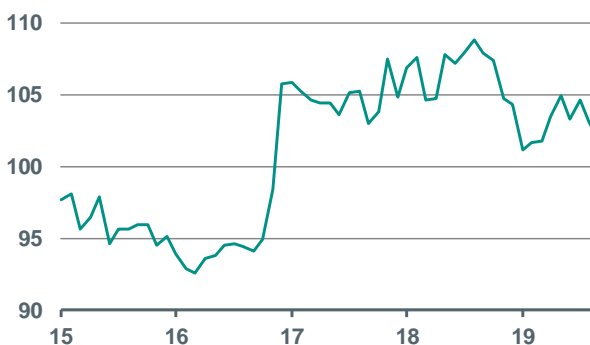
French industrial performance has been more positive than Germany's in recent months. However, August was a poor month for France. Industrial production fell 0.9% mom and 1.4% yoy. This is still better than Germany but it is heading in the same direction.

US SME business confidence

Business confidence among what Americans call small businesses, but what I would call SMEs, fell in September to 101.8, down from 103.1, the second monthly decline. Confidence in this sector is still at relatively high levels, but is close to the lows this year. This could be noise or it could point at a modest weakening of the overall economy. The latter would be consistent with the overall economic trends and with our expectations. US CPI data showed surprisingly little inflation still, despite the very tight labour market. That gives the Fed the scope to act more forcefully than they otherwise might consider.

US: business confidence small businesses

index



Source: Bloomberg

Japan's outlook murky

I do not often cover a lot of Japanese data, but today I will cover some. The importance of Japan to the world as a whole has been reduced by its relative decline and, of course, the meteoric rise of China. But Japan is still the third largest economy in the world, so it

actually matters. Recent data is not hugely positive. Japan's leading index fell from 93.7 in August to 91.8 in September. This indicator has more or less fallen in a straight line since early 2018. Its highest reading of recent years was 102.9 in July 2017. The Eco Watchers indices were a little mixed. The assessment of current conditions was up: 46.7 in September against 42.8 in August. But the assessment of the outlook fell further: 36.9, versus 39.7, the lowest since 2014.

Japan: Eco Watchers Survey: Expectations



Source: Bloomberg

Trade data from Taiwan did not do much to improve my mood either. These reached a low in terms of year-over-year changes in February (-8.3%) and had improved to +2.8% yoy in August. However, the September data came in at -4.6%. China (including Hong Kong) is by far the most important export destination, taking some two thirds of Taiwan's exports. But these exports to China were down 6.4% yoy in September, the worst since May. This is most likely the result of China's slowdown and the downturn in the electronics sector worldwide.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	03/10/2019	10/10/2019	+3M	2019e	2020e
United States	2.4	2.9	2.2	1.3	United States	2.04	1.99	1.43	1.43	1.55
Eurozone	2.7	1.9	0.8	0.6	Eurozone	-0.43	-0.42	-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	1.9	1.4	1.2	1.2	United Kingdom	0.76	0.77	0.80	0.80	0.80
China	6.9	6.6	6.2	5.8						
World	3.8	3.5	2.9	2.9						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	03/10/2019	10/10/2019	+3M	2019e	2020e
United States	2.1	2.4	1.8	2.0	US Treasury	1.54	1.66	1.5	1.50	1.50
Eurozone	1.5	1.7	1.1	0.9	German Bund	-0.58	-0.49	-0.8	-0.80	-0.80
Japan	0.5	0.9	1.1	1.6	Euro swap rate	-0.17	-0.06	0.2	0.20	0.35
United Kingdom	2.7	2.5	1.9	1.8	Japanese gov. bonds	-0.22	-0.23	-0.1	-0.10	0.00
China	1.6	2.1	2.5	2.5	UK gilts	0.47	0.58	0.3	0.30	0.30
World	3.0	3.4	3.6	3.3						
Key policy rate	10/10/2019	+3M	2019e	2020e	Currencies	03/10/2019	10/10/2019	+3M	2019e	2020e
Federal Reserve	2.00	1.50	1.50	1.50	EUR/USD	1.10	1.10	1.12	1.12	1.15
European Central Bank	-0.50	-0.60	-0.60	-0.60	USD/JPY	106.9	108.0	104	104	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.24	1.23	1.24	1.24	1.30
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.89	0.90	0.90	0.90	0.88
People's Bank of China	4.35	4.10	4.10	3.85	USD/CNY	7.15	7.12	7.20	7.20	7.50

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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