

Macro Weekly

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More good news than bad news

- ▶ **Hong Kong unrest making a US-China deal more difficult**
- ▶ **Eurozone PMI suggests manufacturing past its worst, but confidence in services weakens**
- ▶ **German inflation pressure weakening further**
- ▶ **Asian trade data improves and the electronics sector appear to be bottoming out**

The global economy has weakened since early 2018. Fears that a US recession might be on its way appeared months ago. As the year is drawing to a close the big question for economists and investors is if the cycle will turn (for the better) or not.

The unrest in Hong Kong isn't helping. Hong Kong's economy is not particularly important to the global economy, but developments are now affecting the US-China talks. A truce has become more difficult to achieve as the US has chosen to support the protesters. A continuation of the stand-off, let alone the introduction of new tariffs, will have a negative effect on the global economy.

Lower US mortgage rates helping the housing market

One of the things that have changed this year is Fed policy. Instead of raising rates as the Fed last December expected, the US central bank has cut rates, three times this year. While it takes a while for monetary policy to work its way through the economy, that process starts immediately.

US housing starts

Thousands, 3 months moving average



Source: Bloomberg

The 30-year fixed mortgage rate has fallen over a full percentage point over the last 12 months and the response of the housing market has been swift. Housing starts have been on the rise since earlier in the year. In October, housing starts were 8.5% up yoy, the strongest since August 2018. In February, housing starts yoy hit a cycle low of -10.9%. That is a big swing.

The US labour market, meanwhile, is losing momentum. Initial jobless claims have amounted to 227,000 in the two most recent weeks, above the average for the year. This series is volatile, obviously, but you have to go back to 2017 to see a consistent string of data above 227,000. We expect further slowing of the US economy and it is reasonable to expect some deterioration of the labour market in the quarters ahead. Bear in mind, though, the labour market is a lagging indicator.

The worst is behind us in manufacturing in the eurozone, but not in services

The preliminary November manufacturing PMI for Germany rose from 42.1 to 43.8, much better than expected, although still indicating contraction in the sector. The November reading was the highest in five months and the ‘new orders’ series registered its highest reading since January this year. That is all good news. My guess is that a powerful inventory cycle is partly responsible, although that is always going to be difficult to (dis)prove. As the economy slowed companies probably drew down inventories, pushing production below sales. This, by definition, is temporary. And when inventory reduction changes into inventory build-up the turn in the production numbers can surprise on the upside, at least for a while. PMIs in the low 40s and a decline in industrial production at a rate of 4-5% yoy always looked more negative than the development of final demand would justify.

Germany PMI

Index, 50=neutral



Source: Bloomberg

The services PMI, on the other hand, eased: 51.3 versus 51.6. We have highlighted the unusual gap between the manufacturing and the services PMIs, respectively. A convergence was always likely and we have often argued that the services PMI will follow the manufacturing PMI down at some stage. The strong rise of manufacturing and the modest drop of services narrows the gap between the two.

The French PMI data and the eurozone data show similar trends. It is noticeable though, that the eurozone numbers are weaker than the numbers for Germany and France. The manufacturing PMI is up 1.7 points in Germany, 0.9 points in France, but only 0.7 points in the eurozone. The composite PMI was up on the month in both Germany and France, but down in the eurozone as a whole. It is hard to understand how that fits together.

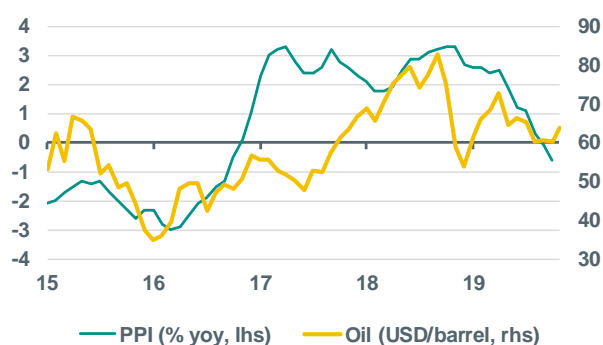
Eurozone car registrations are growing rapidly on a yoy basis: 9.8% yoy in October after +14.8% in September. This sounds much better than it is, really. Car registrations collapsed last year from September on so the yoy comparison is an easy one, against a very low base. Nevertheless, there are news reports of car manufacturers hiring staff.

What the heck is happening to inflation in the eurozone?

Eurozone core inflation has been moving around 1% for several years. Headline inflation has been more volatile, but has averaged 0.9% over the last five years. Late last year, headline inflation had risen to 2.3% but it has now fallen to 0.7%. Oil prices must be the main explanation for the difference between headline and core.

German PPI data, not something I look at a lot, is confirming the downward trend seen in headline CPI. PPI was down 0.6% yoy in October. But a breakdown suggests there is more to this than energy prices. The PPI excluding energy has eased from 1.3% yoy in April to 0.3% in October. Inflation has been extremely muted in recent years. In fact, many economists are wondering if the behaviour of inflation has changed fundamentally. If these recent trends were to continue, that would bring the ECB into an interesting situation. A somewhat improving growth outlook, coinciding with a further drop of inflation does not make the ECB's life much easier.

Germany PPI vs oil price



Source: Bloomberg

In her first speech about policy, ECB president Lagarde, did not give any clues about what we should expect next. We will have to wait for her press conference following the December policy meeting.

Better news about global trade and the tech cycle

The trade conflicts have played a big role in the contraction of world trade this year. But the most recent data in some of the early-cyclical Asian economies is improving. Taiwanese export orders were down 3.5% yoy, better than the previous two months (-4.9% and -8.3%) and the second best number in the last 12 months. Electronics exports are some 25-30% of total Taiwanese exports and they are clearly bouncing. The yoy rate stood at 1.7% in October, the first positive number in 12 months.

Singapore's electronics exports were down 16.4% yoy in October. That is clearly a bad number, but it was still the highest in five months and the trend has been improving since June.

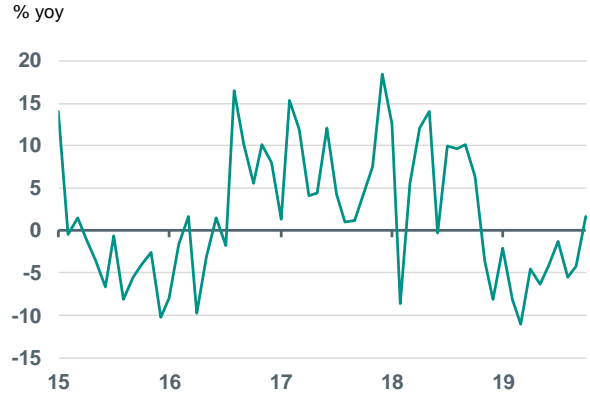
All this suggests, I think and hope, that this data suggests that the technology cycle in the world is turning up. The roll-out of 5G should be playing an important role here.

Singapore electronics exports



Source: Bloomberg

Taiwan export orders electronics



Source: Bloomberg

Korea's exports also appear to be improving, although they still firmly remain in contraction. Nevertheless, exports during the first 20 days of the month were down 9.6% yoy in November, an improvement from October's -19.5% and the best since April.

Taiwan export orders



Source: Bloomberg

Overall

Overall, it looks like the global business cycle is bottoming out. It is hard to see a significant strengthening of momentum any time soon, but positive surprises could come from a US-China deal, the inventory cycle and perhaps some pent-up demand as uncertainty over the trade conflict eases somewhat. Any upturn remains fragile, at least for now.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	14/11/2019	21/11/2019	+3M	2019e	2020e
United States	2.4	2.9	2.2	1.3	United States	1.90	1.90	1.43	1.43	1.55
Eurozone	2.7	1.9	0.8	0.6	Eurozone	-0.40	-0.41	-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	0.79	0.80	0.80	0.80	0.80
China	6.8	6.6	6.2	5.8						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	14/11/2019	21/11/2019	+3M	2019e	2020e
United States	2.1	2.4	1.8	2.0	US Treasury	1.82	1.77	1.5	1.50	1.50
Eurozone	1.5	1.7	1.1	0.9	German Bund	-0.35	-0.32	-0.8	-0.80	-0.80
Japan	0.5	0.9	1.1	1.6	Japanese gov. bonds	-0.07	-0.11	-0.1	-0.10	0.00
United Kingdom	2.7	2.5	1.9	1.8	UK gilts	0.71	0.76	0.3	0.30	0.30
China	1.6	2.1	2.5	2.5						
Key policy rate	21/11/2019	+3M	2019e	2020e	Currencies	14/11/2019	21/11/2019	+3M	2019e	2020e
Federal Reserve	1.75	1.50	1.50	1.50	EUR/USD	1.10	1.11	1.12	1.12	1.15
European Central Bank	-0.50	-0.60	-0.60	-0.60	USD/JPY	108.4	108.6	104	104	100
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.29	1.29	1.24	1.24	1.30
Bank of England	0.75	0.75	0.75	0.75	EUR/GBP	0.86	0.86	0.90	0.90	0.88
People's Bank of China	4.15	4.10	4.10	3.85	USD/CNY	7.02	7.04	7.20	7.20	7.50

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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