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Confusing signals: try to avoid the noise

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- **US business confidence suddenly drops, but economy look fine**
- **Eurozone business confidence falls modestly, but particularly significantly in the Netherlands**
- **UK business confidence bounces back**
- **UK consumer confidence bounces back**
- **Asian data suggests industrial cycle and IT-cycle improving**

Recent economic indicators have thrown up an unexpected and highly confusing picture. Policymakers and investors must decide what to make of it. I think it is important to try and see through the noise. The confusion recent data must be causing among policymakers is bound to make them wait and see before deciding on very drastic action.

Brexit

The general view on Brexit is that the outcome of the referendum has created a confidence shock which will depress spending by consumers and companies. In addition, it creates uncertainty, which will limit companies' investment spending in the medium term, therefore employment and, in turn, income and consumer spending growth. Hence, the Brexit vote is generally expected to push the UK economy into a recession quickly. The first confidence data after the referendum appeared to confirm this view. The UK's PMI plunged from a healthy 52.2 in June to a recession-type 48.3 in July. Consumer confidence also fell sharply in July: -12 from -1 in June. Despite that, July retail sales were actually very strong. But perhaps that was temporary and weather related.

August indicators are highly surprising. Business confidence in the manufacturing sector more than reversed its July decline, coming in at a robust 53.3, the highest level since October last year. Consumer confidence also bounced, though less convincingly, moving back to -7 in August, roughly regaining half of the loss suffered in July.

This could all be a fluke and it is too little evidence for us to change our view that an early brief recession is likely. However, Markit, who compile the PMI data, said the main driver behind the improvement in companies' assessment of orders was the weakening of sterling since the Brexit vote. And that makes some sense. Should the

strong readings in August be sustained in the months ahead, then the gloomy forecasts for the immediate cyclical outlook for the UK must be reviewed.

The European Commission's index of Economic Sentiment for the eurozone weakened somewhat in August: 103.5 versus 104.5 in July. The drop may reflect some Brexit effects but at this level, the index is still indicating modest growth.

The sharp drop in Dutch business confidence (according to the official statistics office) in August was a surprise. The Netherlands have relatively strong trade links with the UK and the fall in business confidence in August may be a delayed response to the July drop in the UK's business confidence. If that is correct, perhaps confidence will bounce next month as it has in the UK. Alternatively, the drop in Dutch business confidence may be caused by the drop of sterling since the Brexit vote. For now, I am banking on the first possibility. The rival index of business confidence, as compiled by NEVI shows a completely opposite development. The August reading of its index actually rose to the second highest level of the year as companies reported buoyant orders inflows.

US ISM falls sharply

We have long argued that the US Federal Reserve would not raise rates this year, though we have indicated recently that one hike this year could not be ruled out. Following relatively hawkish statements by FOMC members, we now think one hike in December is the most likely scenario. There are two reasons not to expect a hike in September. First, inflation continues to be below the Fed's target and really isn't moving quickly to the target of 2%. The Fed preferred measure, core PCE inflation has been remarkably stable at 1.6% for all of this year, including in July, the most recent month for which data is available. Second, the economy continues to show some soft patches. Earlier in the year the labour market seemed to weaken and more recently, the ISM measure of business confidence fell sharply in August: from 52.6 to 49.4. The Fed is likely to want to see whether this is just an aberration or a new trend. I would expect it to become clear in months to come that the August ISM was not a new trend but an incident.

IT and industrial cycle

I have long argued that the global industrial cycle was about to improve somewhat. This is a view that is under pressure, not only from other economists, but also from the data. The above described indices in some European countries (apart from the UK) and the US do not point to an improvement in the global industrial cycle. Yet, I believe there is reason to be cautiously optimistic.

First, the sharp drop in the US ISM seems odd and not really consistent with most other data. Second, the drop in business confidence in some European countries may be Brexit related and may be reversed in the months ahead. Third, disappointing US economic growth in the last couple of quarters is largely due to lower and even negative inventory building. This is bound to reverse before too long, giving a boost to industrial activity. Last, but not least, I think various relevant indicators in Asia and related to the IT sector are improving.

The official manufacturing PMI in China rose to 50.4 in August, the highest since September 2014. The rival Caixin PMI fell in August: 50.0, versus 50.6 in July, but the August reading was the highest since February 2015, apart from July's reading. Our interpretation is that the stimulus measures taken by Chinese policy makers are working.

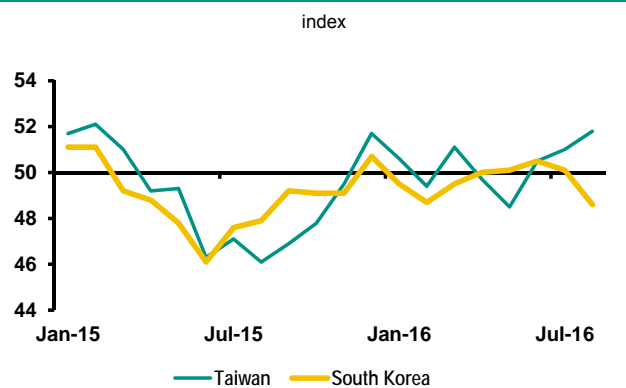
China PMI manufacturing



Source: Bloomberg

A strange divergence is occurring between the PMIs in Taiwan and Korea. I look at those as both economies are early cyclical and often their indices for business confidence move in line. Taiwan's PMI has risen in three consecutive months, whereas Korea's PMI dropped sharply in August. What can explain the difference? Taiwan's economy is more dependent on the IT cycle than Korea's, while the shipping sector is more important to Korea. Shipping is under pressure and some Korean shipping companies are experiencing significant difficulties.

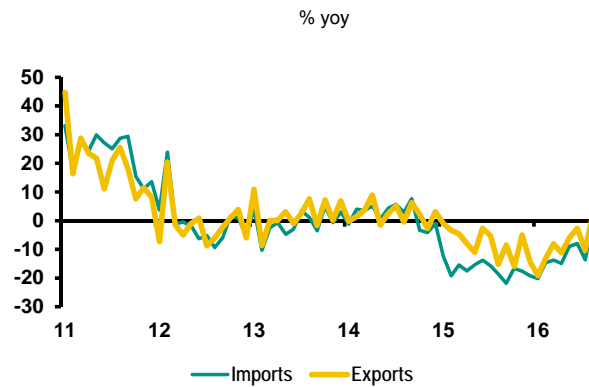
Taiwan and Korea PMI manufacturing



Source: Bloomberg

This explanation for the divergence between Taiwan's and Korea's business confidence indices appears to be supported by Korea's import and export data. The country's exports and imports troughed early this year, but have been improving since. Export growth on a year-over-year basis moved back into positive territory in August (+2.6%), the first time since December 2014.

Korea imports and exports



Source: Bloomberg

Another sign of improvement of the IT-cycle is the performance of the shares of companies in the semiconductors business, the SOX index. That index has risen steadily in recent months.

SOX index (Philadelphia semiconductors stock index)



Source: Bloomberg

Overall

Overall then, recent data does not paint a clear picture of the global economy as some data has surprised negatively, while other data has been more positive. Weighing it all up, I see no reason to change my cautious optimism for the period ahead.

Main economic/financial forecasts

GDP growth (%)		2014	2015	2016e	2017e	3M interbank rate		25/08/2016	01/09/2016	+3M	2016e	+12M	2017e
United States		2.4	2.6	↓ 1.5	↑ 1.9	United States		0.83	0.84	↑ 0.8	↑ 0.80	↑ 1.20	↓ 1.4
Eurozone		0.9	1.6	↑ 1.5	1.0	Eurozone		-0.30	-0.30	-0.35	-0.35	-0.35	-0.35
Japan		-0.1	0.6	0.6	0.7	Japan		0.06	0.06	-0.1	-0.10	-0.10	-0.1
United Kingdom		3.1	2.2	1.5	0.5	United Kingdom		0.39	0.39	0.3	↓ 0.20	↓ 0.20	0.3
China		7.3	6.9	6.5	6.0								
World		3.4	3.2	2.9	3.1								
Inflation (%)		2014	2015	2016e	2017e	10Y interest rate		25/08/2016	01/09/2016	+3M	2016e	+12M	2017e
United States		1.6	0.1	1.4	1.9	US Treasury		1.58	1.57	↑ 1.6	↑ 1.60	↑ 1.70	1.8
Eurozone		0.4	0.0	0.3	1.5	German Bund		-0.07	-0.07	-0.2	-0.20	-0.10	0.1
Japan		2.7	0.8	0.0	1.0	Euro sw ap rate		0.28	0.28	0.4	0.35	0.55	0.6
United Kingdom		1.5	0.0	0.5	2.3	Japanese gov. bonds		-0.08	-0.05	-0.2	-0.30	0.20	0.0
China		2.0	1.4	2.0	2.0	UK gilts		0.58	0.67	↓ 0.6	0.50	0.50	0.2
World		3.5	2.9	3.1	3.2								
Key policy rate		01/09/2016	+3M	2016e	2017e	Currencies		25/08/2016	01/09/2016	+3M	2016e	+12M	2017e
Federal Reserve		0.50	0.50	↑ 0.75	1.25	EUR/USD		1.13	1.12	1.10	1.10	1.10	1.10
European Central Bank		-0.40	-0.40	-0.40	-0.40	USD/JPY		100.5	103.2	100.0	103.0	105.0	110
Bank of Japan		-0.10	-0.30	-0.30	-0.30	GBP/USD		1.32	1.33	1.27	1.20	1.25	1.35
Bank of England		0.25	↓ 0.05	↓ 0.05	0.25	EUR/GBP		0.86	0.84	0.87	0.92	0.88	0.81
People's Bank of China		4.35	4.35	4.10	3.85	USD/CNY		6.66	6.68	6.70	6.80	6.90	7.00

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

Day	Date	Time	Country	Key Economic Indicators and Events	Period	Latest outcome	Consensus	ABN AMRO
Monday	05/09/2016	03:45:00	CN	PMI services - index (Caixin)	Aug	51.7		
Monday	05/09/2016	03:45:00	CN	PMI composite - index (Caixin)	Aug	51.9		
Monday	05/09/2016	10:00:00	EC	Composite PMI output	Aug F	53.3	53.3	
Monday	05/09/2016	10:00:00	EC	PMI services - index	Aug F	53.1	53.1	
Monday	05/09/2016	10:30:00	GB	PMI services - index	Aug	47.4	49.1	
Monday	05/09/2016	11:00:00	EC	Retail sales - % mom	Jul	0.0	0.4	0.3
Tuesday	06/09/2016	08:00:00	DE	Manufacturing orders - % mom	Jul	-0.4	0.5	0.1
Tuesday	06/09/2016	11:00:00	EC	GDP - % qoq	2Q F	0.3	0.3	
Tuesday	06/09/2016	16:00:00	US	ISM non-manufacturing, index	Aug	55.5	55.3	
Wednesday	07/09/2016		CN	Foreign Reserves - USD bn	Aug	3201.1	3192.0	
Wednesday	07/09/2016	03:15:00	US	Fed's Williams on Outlook, Nevada				
Wednesday	07/09/2016	08:00:00	DE	Industrial production - % mom	Jul	0.8	0.2	-0.5
Wednesday	07/09/2016	09:00:00	CH	Foreign currency reserves - CHF mln	Aug	615550.1		
Wednesday	07/09/2016	09:30:00	SE	Policy rate - %	Sep 7	-0.5	-0.5	-0.5
Wednesday	07/09/2016		US	US Job Openings by Industry	Jul	5624		
Wednesday	07/09/2016	16:00:00	CA	Policy rate - %	Sep 7	0.5	0.5	
Wednesday	07/09/2016		PL	Reference rate - %	Sep 7	1.5	1.5	
Wednesday	07/09/2016	20:00:00	US	US Federal Reserve Releases Beige Book				
Thursday	08/09/2016	01:50:00	JP	GDP - % qoq	2Q F	0	0	
Thursday	08/09/2016		CN	Imports - % yoy	Aug	-12.5	-4.8	
Thursday	08/09/2016		CN	Exports - % yoy	Aug	-4.4	-4.0	
Thursday	08/09/2016	06:30:00	NL	CPI - % yoy	Aug	-0.3		0.0
Thursday	08/09/2016	13:45:00	EC	Policy rate - %	Sep 8	0.0	0.0	0.0
Thursday	08/09/2016	13:45:00	EC	ECB Deposit rate - %	Sep 8	-0.4	-0.4	-0.4
Thursday	08/09/2016	21:00:00	US	Fed Reserve consumer credit - USD bn	Jul	12.3	15.6	
Friday	09/09/2016	03:30:00	CN	CPI - % yoy	Aug	1.8	1.7	
Friday	09/09/2016	03:30:00	CN	PPI - % yoy	Aug	-1.7	-1.0	
Friday	09/09/2016	10:30:00	GB	Trade balance - GDP mln	Jul	-5084	-4900	
Friday	09/09/2016	13:45:00	US	Fed's Rosengren Economic Forecast Boston				
Friday	09/09/2016		KR	Policy rate - %	Sep 9	1.25	1.25	1.25
Friday	09/09/2016		RU	GDP - % yoy	2Q P	-0.6	-0.6	

Source: Bloomberg, Reuters, ABN AMRO Group Economics (we provide own forecasts only for selected key variables and events)

FOM C (v) voting; (nv) non voting

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