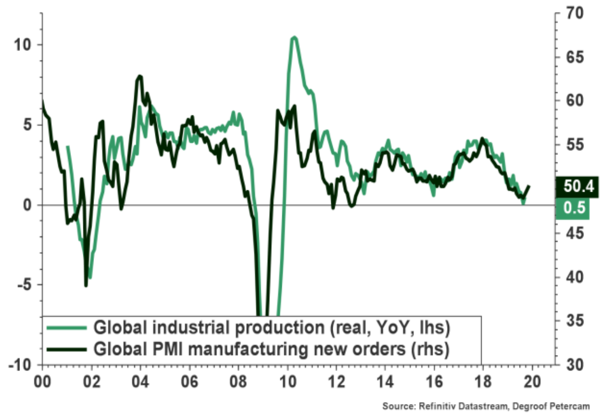
MACRO ECONOMIC UPDATE

December 2019

Any recovery in 2020 looks set to stay rather modest by past standards

- ✓ Global economic confidence continues to point to sluggish activity. That said, there's growing evidence that the downturn in global manufacturing has reached a trough. Indeed, the uptick in confidence actually suggests the global industry is about to turn the corner.
- ✓ Although (geo)political uncertainty remains abundant, the narrative seems to have improved over the past weeks. There are signals that the US and China are on the verge of striking some sort of mini-trade deal (including a partial rollback of tariffs). Meanwhile, chances of an imminent hard Brexit have receded following the Brexit extension to early 2020 and current election polls. What's more, the EU may escape US import taxes on cars.
- ✓ That said, any recovery in 2020 looks set to remain fairly modest by past standards. First, (geo)political tensions are unlikely to disappear going forward. A US-China deal may not happen. And next year's US Presidential race may well add to uncertainty. Second, the automobile sector still faces difficulties on the back of modest demand, high inventories and a challenging transition towards electronic cars. Third, even though the latest figures out of China point to an improving economic environment, a strong rebound in activity seems unlikely. Finally, talk of more expansive Eurozone fiscal policy remains fairly cheap for now.
- ✓ The combination of weakening economic momentum, below target inflation and weakening price pressures has led central banks to become much more dovish throughout 2019. Monetary policy will remain loose in 2020 and both the Fed and the ECB are about to stress the importance of symmetry in their inflation framework. There has been more discussion on fiscal easing but those words look still fairly cheap for now.



US growth slips below 2% while inflation remains below target

- ✓ Confidence surveys in the US still point towards subpar growth (i.e. below the estimated potential growth rate of 2%) with no swift turnaround in sight, at least according to the latest PMI and ISM confidence indicators. Moreover, the positive impact of the Trump tax cuts (boosting growth in 2017-2018) is fading away and the uncertainty surrounding the upcoming 2020 Presidential election campaign in combination with ongoing geopolitical turmoil does not bode particularly well for business investment.

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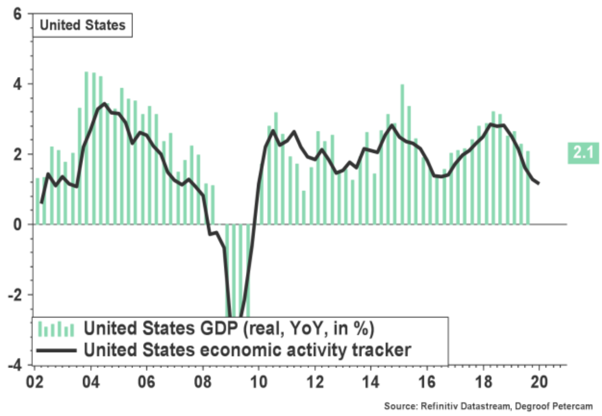
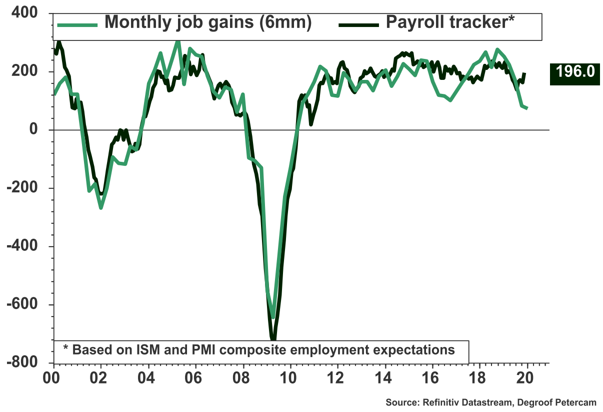
✓ That said, improving housing market data suggest that lower interest rates are playing a supportive role again. Household consumption remains the driving force of the US economy as consumer confidence (despite being over the top), real disposable income growth and labour market dynamics all remain solid. The November payroll report revealed once again strong job gains (+266K versus 156K in October and 193K in August), confirming that the labour market expansion continues. Looking forward, however, confidence indicators suggest it's doubtful that this strong momentum will be sustained in 2020.

✓ Meanwhile, underlying inflation pressures have softened compared to last year with core PCE inflation (the Fed's preferred inflation metric, now at only 1.6%) staying below target since the start of the year. Both headline inflation and inflation expectations have come down too. There are mixed signals regarding the outlook for inflation. The recent surge in unit labour costs point to an acceleration while surveys suggest ongoing softness.

✓ The combination of soft growth and inflation has resulted in three policy rate cuts in 2019. The economy is not about to fall into recession but given the rather modest outlook for growth and inflation described earlier, and even though the message from both Jerome Powell, the median dot plot and markets suggest otherwise, the Fed may not be completely done yet in terms of loosening monetary policy.





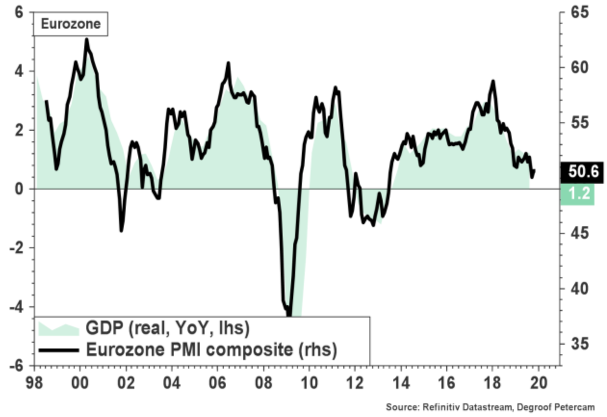
Eurozone industry remains disappointingly weak

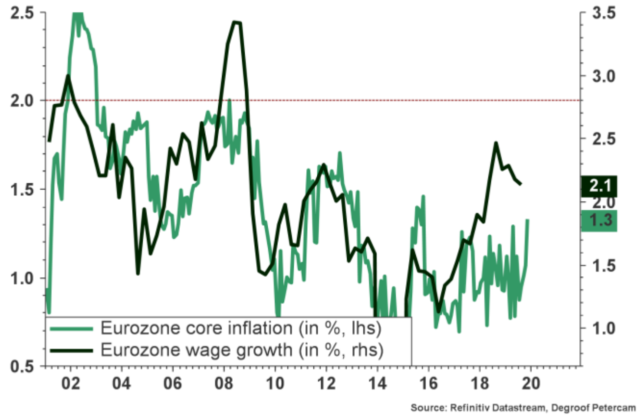
✓ Overall confidence in the Eurozone (as measured by Markit composite PMI data) confirms that economic activity remains sluggish (see graph below). The German industry continues to suffer badly with the downturn showing no signs of an imminent end. True, confidence picked up in November. But with PMI manufacturing confidence at only 44.1 (versus 42.1) conditions still look disappointingly weak.

✓ On the other hand, both service sector and consumer confidence remain quite solid since the start of the year on an aggregate Eurozone level. Household consumption holds up well at around 1% (annualized) as the earlier increase in real wage growth supports spending.

✓ That said, firms' hiring intentions have been softening significantly. And with business surveys also showing that labour shortages are easing, wage growth could soon come under pressure. This would not bode well for inflation prospects (see graph below).

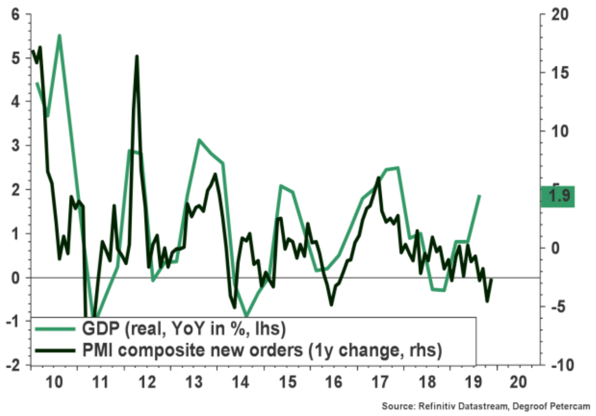
✓ Logically, the soft picture for growth and inflation should increase the pressure on the ECB to do more in 2020. However, given the high degree of controversy surrounding monetary policy these days, the ECB is likely to stay steady for now. Fiscal policy would prove far more efficient when monetary policy is pushing on a string. That said, even though the current fiscal stance is slightly expansionary on a Eurozone level and talk on further fiscal easing gained traction, current plans can still be described as hesitant.





Fiscal easing measures unlikely to strongly boost activity

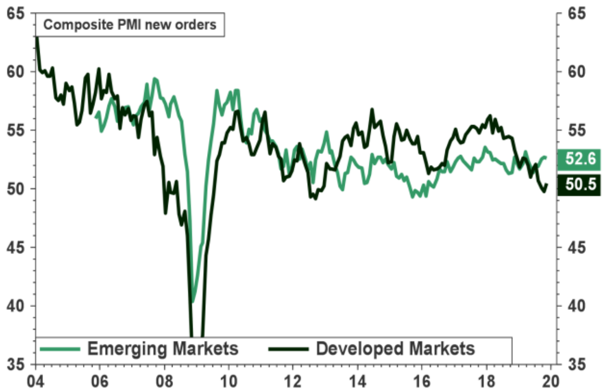
- Confidence indicators point to a weakening growth momentum (see graph below) while core inflation (now at 0.6%, see graph below) fails to pick up meaningfully despite still tight labour market conditions. Consumption is likely to fall in Q4 following the sales tax hike from 8 to 10% implemented at the start of October. The newly introduced fiscal stimulus package (of around 5% of GDP) is unlikely to translate into much stronger growth as the headline figure is strongly inflated and the government has a reputation of spending less than announced.
- The Bank of Japan continues to strike a dovish tone. Given the subdued outlook for growth and inflation, the BoJ stated it will keep both short- and long-term interest rates at present or lower levels for as long as the momentum towards hitting its 2% inflation is weak. At the same time, the BoJ continues to emphasize the risk of unwelcome side effects of its policy (i.e. financial stability concerns).



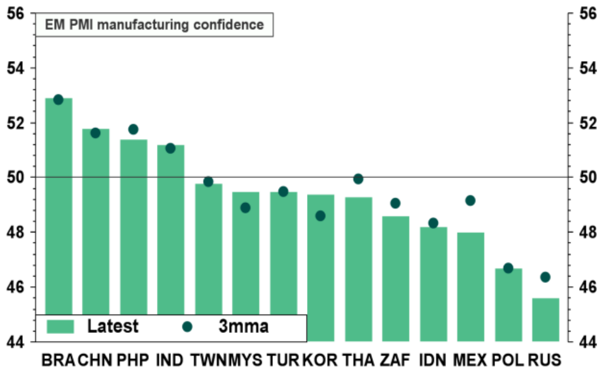
EM are likely to see a modest pickup in growth next year

- Economic growth across EM's will continue to feel the external headwinds coming from the US-China trade war as well as structural domestic challenges coming to the surface in major EM's such as India (banking crisis), Chile (social unrest) or Mexico (recession). A slight pickup in EM growth is expected in 2020, mainly driven by Latin America and Emerging Europe. Inflation will remain under upward pressure due to rising food prices coming from the pork swine flu crisis. However, core inflation remains subdued in most EM's, giving a decent amount of monetary space to boost economic growth. Public and private debt levels are starting to reach alarming levels in certain EM's, such as China, giving a tough job for governments, who wish to contain credit growth and debt while also support growth.

- In Latin America, Brazil's GDP grew by 2.5% y/y in the third quarter (following 1.6% growth in Q2), supported by growth in private consumption and investment, showing that the recovery in Latin America's largest economy is gaining some momentum and that the worst is behind us. The Brazilian economy grew faster than expected in Q3. Meanwhile, inflation is largely under control (except in Argentina and Venezuela) providing central banks with room to ease monetary policy a bit further. Ongoing street protests, for example in Chile, suggest the political climate will likely remain fragile.
- Economic Sentiment Indicators suggest that GDP growth for the CEE region picked up from 3.6% in Q3 to 4% at the beginning of Q4. However, manufacturing indicators remain disappointing. In Russia, the PMI fell to 45.6 in November, is lowest level since May 2009. PMI data were also disappointing in the Czech Republic and in Poland, leading to signs of a contraction in the manufacturing sector for CEE as a whole. Fiscal policy will likely continue to be eased in CEE in the next few months as countries try to fight external headwinds and support growth.
- Despite the fact that confidence indicators have been going higher in recent months, growth in China has remained sluggish. The prospect of ongoing geopolitical tensions implies the external climate will remain challenging going forward. Policymakers limit stimulus to what's necessary to keep the economy on the rails. China will continue to use fiscal stimulus to boost its economy through special bond issuance intended for infrastructure projects. And monetary conditions will likely ease on the margin (to limit financial stress and facilitate a modest fiscal boost) as the appetite for more aggressive measures is limited. All in all, this is unlikely to set off a broad-based and sustained upturn in activity.



Source: Refinitiv Datastream, Degroof Petercam



Source: Refinitiv Datastream, Degroof Petercam

Forecasts for 2019-2020

	GDP 2018	GDP 2019	GDP 2020	Inflation 2018	Inflation 2019	Inflation 2020
US	*2.9*	**2.3**	**1.6**	*2.4*	**1.7**	**1.8**
		2.3	*1.8*		*1.8*	*2.0*
Eurozone	*1.9*	**1.2**	**0.9**	*1.7*	**1.2**	**1.3**
		1.1	*1.0*		*1.2*	*1.2*
Belgium	*1.4*	**1.3**	**0.9**	2.2	**1.5**	**1.3**
		1.1	*1.1*		*1.4*	*1.2*
Japan	*0.8*	**1.3**	**0.6**	*1.0*	**0.6**	**0.7**
		1.0	*0.2*		*0.6*	*0.7*
China	*6.6*	**5.5**	**5.0**	*2.1*	**2.6**	**2.6**
		6.1	*5.8*		*2.7*	*2.7*

Update December 2019, *Consensus forecasts*