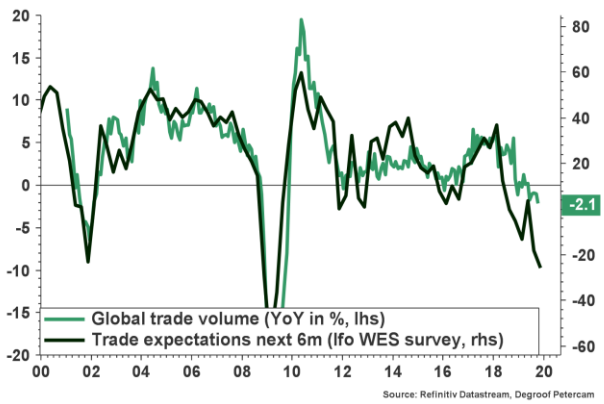
Degroof Petercam

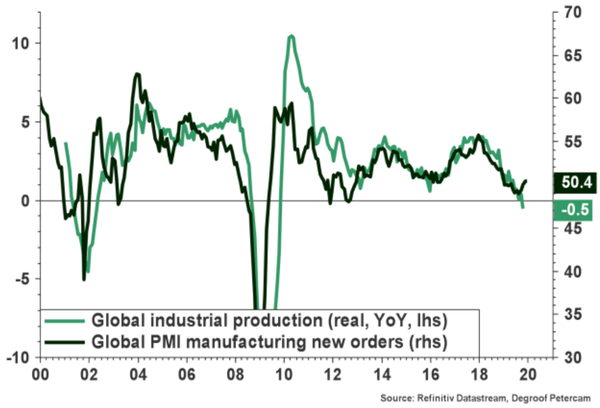
MACRO ECONOMIC UPDATE

January 2020

More signs of improvement but a strong synchronized global recovery is not in the cards

- ✓ Global economic confidence still points to fairly sluggish activity. The manufacturing sector remains in the doldrums and global trade volumes are contracting (see graph below). The good news, however, is that activity in the services sector continues to do well. Moreover, there's evidence that the industrial downturn will soon reach a trough. Indeed, confidence indicators suggest the global industry is about to turn the corner (see graph below).
- ✓ All in all, however, a strong synchronized global economic upturn (similar to what we've seen in 2016-18) looks unlikely. First, geopolitical uncertainty will continue to weigh on firms' investment plans. 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. Fourth, talk of more expansive Eurozone fiscal policy remains fairly cheap for now. And fifth, despite ultra-low interest rates, bank standards for lending have tightened.
- ✓ Rising US-Iran tensions keep the Middle East in a permanent state of alarm. The latest developments point to dangerous situation but a major escalation is not our base case scenario. The US and China are about to sign a mini-deal (including a partial rollback of tariffs) in January but underlying tensions will likely remain high. Meanwhile, chances of an imminent hard Brexit have gone down following the Brexit extension to early 2020 and the December election results. However, uncertainty with regard to the future EU-UK relationship will linger on.
- ✓ 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 looks set to remain loose in 2020 on the back of both modest economic growth and underlying inflation expectations. That said, headline inflation will increase from current levels as earlier base effects fade and oil prices move higher as a result of the US-Iran conflict. More strategically, both the Fed and the ECB are about to stress the importance of symmetry in their inflation framework.





US consumer trumps weak industry

- ✓ 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. Moreover, the positive impact of the Trump tax cuts (boosting growth in

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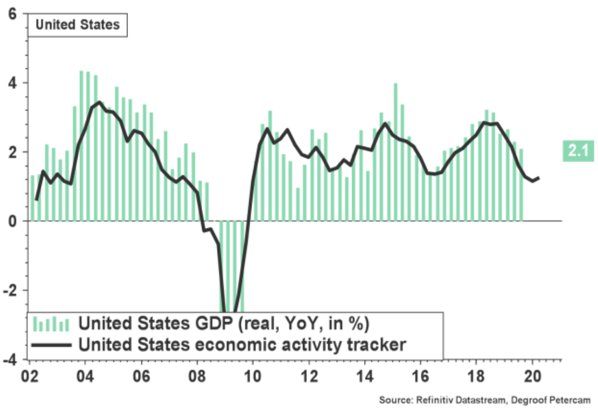
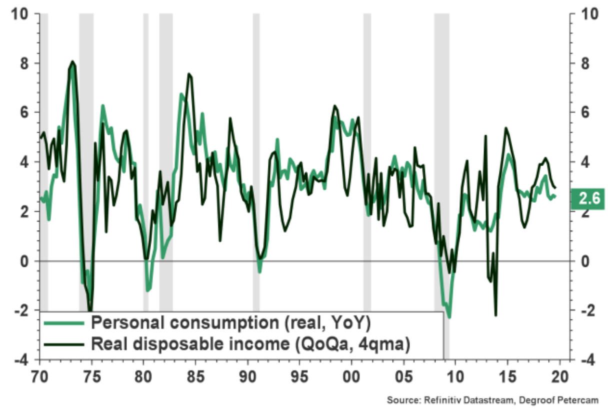
2017-2018) is fading away and the uncertainty surrounding the upcoming 2020 Presidential election campaign in combination with ongoing geopolitical turmoil does not bode particularly well for business investment. The manufacturing sector is still struggling (ISM at 47.2 in December). What's more, more forward leading indicators (such as the Conference Board's CEO confidence and Ifo economic expectations) point to a sustained growth deceleration.

- ✓ That said, for now at least, the picture doesn't look too bad. Overall confidence indicators are showing signs of stabilization (see graph below). And more importantly, the US consumer remains in good shape. Household confidence is still upbeat. Moreover, ongoing gains in real incomes (see graph below) and employment as well as low interest rates are supporting private consumption and residential construction.
- ✓ Meanwhile, underlying inflation pressures have softened throughout 2019 with core PCE inflation (the Fed's preferred inflation metric, now at only 1.6%) staying below target. Underlying inflation pressure are likely to remain muted in the near future as price surveys signal ongoing softness. Headline inflation, on the other hand, will see upward pressure (for reasons explained above).
- ✓ The combination of soft growth and inflation has resulted in three policy rate cuts in 2019. As things stand, the Fed will probably stay on the sidelines and adopt a wait-and-see approach for now. That said, a batch of disappointing data would most likely trigger an immediate rate cut.

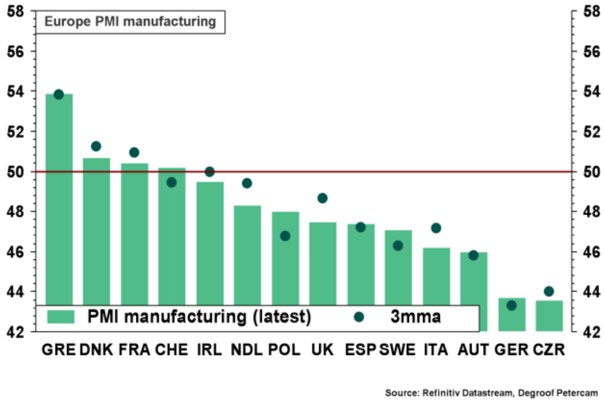


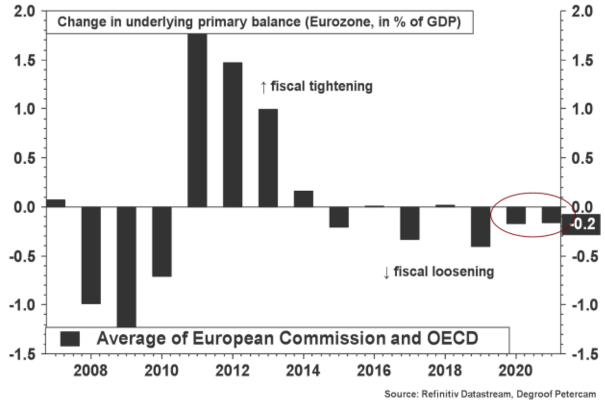


The service sector is weathering the storm in the industry

- ✓ All in all, leading indicators point to sluggish economic growth overall. Among the biggest economies, Germany and Italy continue to struggle while Spain and France are doing relatively well.
- ✓ The Eurozone (and especially the German) manufacturing sector continues to suffer badly with the downturn showing no signs of an imminent end (see graph below). On the other hand, both service sector confidence (with PMI level picking up to 52.8 in December from 51.9 in November) and consumer confidence remain quite solid 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, labour market dynamics have become somewhat less vigorous last year. While the Eurozone unemployment rate stays relatively (versus its own history) low at 7.5%, hiring intentions have been softening. And with business surveys also showing that labour shortages are easing, wage growth is unlikely to accelerate further (in fact it has decelerated lately). Core inflation (now at 1.3%, a modest pickup from the average of 1% over the last five years) will continue to come in significantly below target. That said, energy effects will push up the headline inflation rate (now at 1.0%).
- ✓ 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

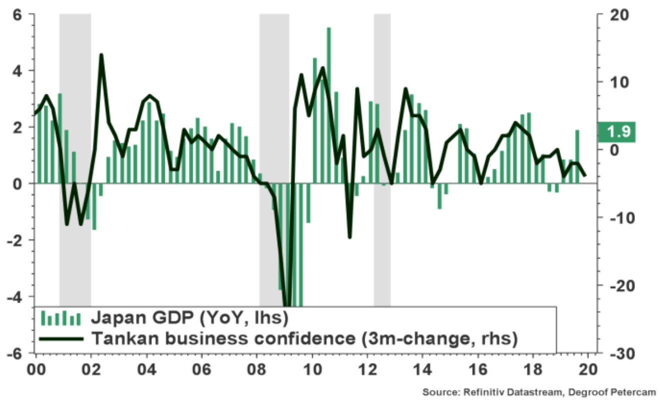
though the current fiscal stance is slightly expansionary on a Eurozone level and talk on further fiscal easing gained traction, current plans can still be described as hesitant at best (see graph below).

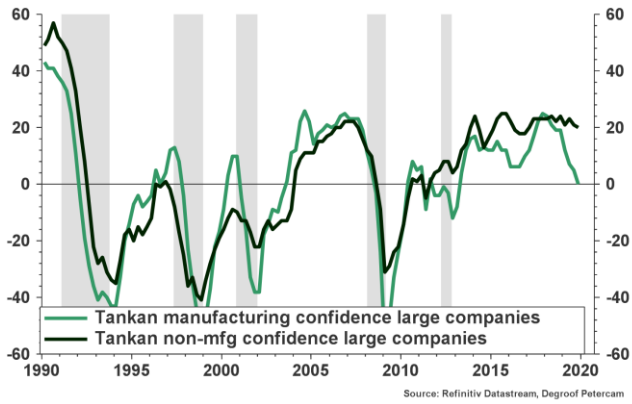




Weak growth and below target inflation keep BoJ in stimulus mode

- ✓ Confidence indicators point to stagnating economic activity (see graph below). Industrial production is contracting and manufacturing confidence remains downbeat. Services sector confidence, meanwhile, is holding up much better (see graph below). That said, household consumption likely fell last quarter following the sales tax hike from 8 to 10% implemented at the start of October and household confidence suggest consumption will remain weak. Meanwhile, 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.
- ✓ Core inflation (at 0.8% in November versus 0.6% in October) has been creeping higher but remains well below the BoJ's inflation target. At the same time, household inflation expectations have come down as of late. Unsurprisingly, 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).

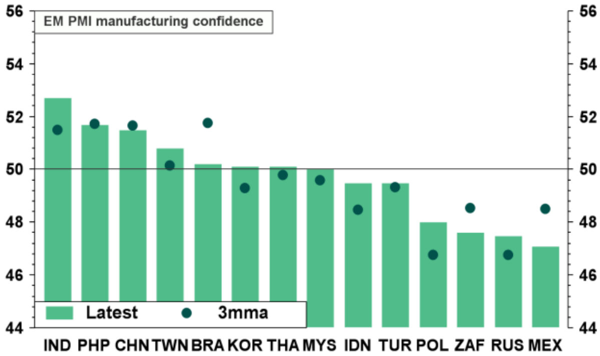




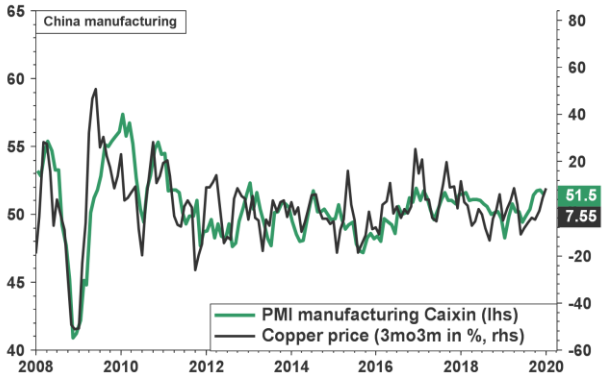
EM are likely to see a modest pickup in growth next year

- ✓ 2019 was not a particularly good year for EM, as growth likely slowed to its lowest level in 4 years. PMI data for December suggests that overall EM manufacturing fared better at the end of 2019, especially in emerging Asia.

Confidence in Emerging Europe picked up (but remains in recessionary territory) while Brazil and Mexico saw sharp declines. All in all, the outlook for 2020 is more positive with stronger growth expected in several big EM economies including Brazil, India, and Turkey.



Source: Refinitiv Datastream, Degroof Petercam



Source: Refinitiv Datastream, Degroof Petercam

- ✓ That said, a sharp economic upturn is probably not in the cards. **China** is an important reason why we think overall EM activity will remain contained. True, economic figures at the end of 2019 were pretty good and the "phase-one" deal (which should be signed on January 15th) should bring further relief. However, challenges remain. The deal definitely doesn't bring an end to the trade war. Consequently, even though the outlook for the Chinese manufacturing (see graph above) and export sector has improved in recent months, external headwinds are likely to remain present. In addition, high pork prices undermine household spending power (even though the peak of the African Swine Fever is behind us) and real estate activity (a driving force of the economy in recent years) looks set to weaken on the back of ongoing property regulation. The PBoC's stance remains accommodative. It recently decreased the reserve requirement ratio for commercial lenders and cut its 14-day reverse repo rate by 5bp, the first time it has altered that rate since it was brought up in April 2018. Further rate cuts are in the pipeline. That said, a major loosening of financial conditions should not be expected as the overall debt level in the economy remains uncomfortably high.
- ✓ In **India**, the latest data shows the manufacturing sector is recovering as the latest PMI rose to a seven-month high of 52.7. This is good news as India is in its longest period of growth deceleration on record and this has largely contributed to the EM slowdown experienced in 2019. On a less positive note, protests against the new citizenship law continue, adding to the long list of downside risks plaguing the Indian economy. Other risks, external and domestic, remain strong for India in 2020 and more monetary and fiscal easing, as well as structural measures, will be necessary to put the economy back on track. In **Vietnam**, exporters are still benefiting from US tariffs on Chinese goods and this led to strong economic growth at the end of 2019. In **Indonesia**, Bank of Indonesia kept interest rates on hold in December but possible rate cuts in 2020 are likely as inflation remains within the Bank's target range. In **Thailand**, the Baht keeps on soaring, continuing to weigh on exports and economic growth. The outlook for the medium term remains bleak, with a level of growth that is among the slowest in south-east Asia. To fight the strong currency, the central bank cut rates again by 50bp in November, bringing interest rates to their lowest level on record.
- ✓ In **Brazil**, inflation shot up in the first half of December due to a spike in the price of beef but this should be a temporary event. On another note, unemployment fell more than expected in November and real wages continued to rise. The central bank's forecasts for inflation remain low through 2021 while the bank also expects activity and credit growth to pick up further. The ongoing protests in Chile and the crisis in Argentina have hit Brazilian exports and December's PMI, at 50.2, was much lower than the 52.9 index seen in November. **Argentina** left recession in Q3 with GDP growth of 0.9% q/q but worries remain as the boost in growth only came thanks to a

strongly performing month of July. We expect growth to turn negative again in Q4. On top of that, large debt repayments are due in the first half of 2020, repayments that will be difficult for the government to pay. To try to reduce the burden of debt, the government decided to postpone payments on around $9bn of US Treasuring Bills until August. The new PM's "grow first, pay later" approach alongside a new bill sent to Congress to increase public spending indicates that defaults in the coming months remain a strong possibility. Growth and inflation in **Mexico** continue to disappoint and in response, the central bank cut interest rates from 7.5% to 7.25%, its fourth 25bp cut in a row. The weakness in economic growth continued in the last quarter as the latest PMI data suggests (it dropped to 47, its lowest level on record). **Chile's** economy continues to feel the downward pressure created by protests and the Banco Central de Chile continues to intervene in the foreign exchange market in an effort to reduce the Peso's volatility, a measure they should end in March. In **Colombia**, Congress has passed a fiscal reform bill that lowers corporate taxes and offers VAT rebates for low-income Colombians while slightly raising taxes on the wealthy. Through this bill, the government hopes to use fiscal easing to appease the ongoing protests and boost growth. On the monetary front, BanRep left its policy rate unchanged at 4.25% for the thirteenth consecutive time.

Forecasts for 2020-21

	GDP				Inflation		
	2019	2020	2021		2019	2020	2021
US	*2.3*	**1.9**	**1.7**		*1.8*	**2.1**	**1.8**
		1.8	*1.8*			*2.0*	*2.1*
Eurozone	*1.2*	**0.8**	**1.0**		*1.2*	**1.5**	**1.3**
		1.0	*1.2*			*1.2*	*1.4*
Belgium	*1.2*	**0.8**	**1.0**		1.4	**1.6**	**1.6**
		1.1	*1.1*			*1.4*	*1.6*
Japan	*1.0*	**0.1**	**0.5**		*0.7*	**0.8**	**0.7**
		0.3	*0.8*			*0.6*	*0.7*
China	*6.1*	**5.5**	**5.0**		*2.6*	**3.3**	**2.2**
		5.8	*5.8*			*2.9*	*2.1*

Update January 2020, *Consensus forecasts*