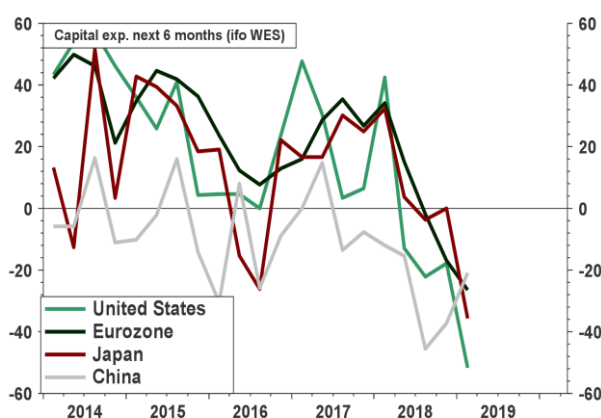


## MACRO ECONOMIC UPDATE

May 2019

### Industrial weakness still weighing on global economic activity with no strong turnaround in sight

- ✓ Global growth currently hovers slightly above 2.5% with confidence indicators still mostly pointing to soft economic growth in the near future. While activity in the services sector holds up rather well, global manufacturing is still feeling the burn. International trade weakness is dragging on and the outlook for investment has weakened.
- ✓ There are glimmers of hope that warrant caution against too much pessimism. These include (1) central banks' willingness to keep their policy stance loose and/or flexible, (2) modest energy prices in combination with a rise in household disposable income, (3) the implementation of Chinese stimulus measures which are starting to have positive effects and (4) more positive signals surrounding the trade discussions between the US and China (although the latter is currently subject to much uncertainty (cfr Trump's latest tweets ; moreover doubts about both the enforcement and the durability of a potential deal would persist).
- ✓ Headline inflation is still somewhat under pressure as a result of base effects linked to the evolution of energy prices. Core inflationary pressures, meanwhile, remain very tame in general.
- ✓ The combination of modest economic activity and inflation implies that central banks are absolutely in no hurry to tighten monetary conditions. On the contrary, both their tone of voice and policy has turned significantly more dovish in recent months.



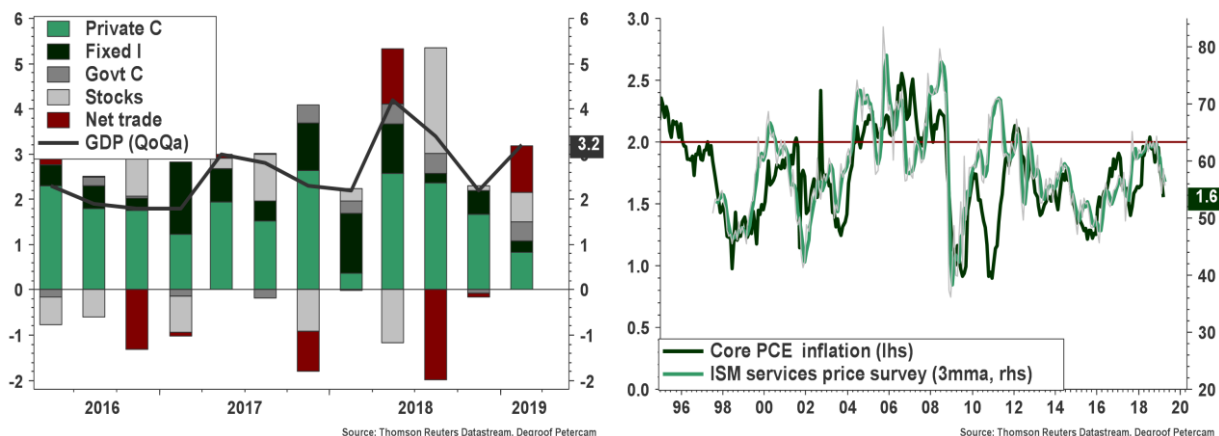
### Strong Q1 growth unlikely to be sustained while core inflation drops below 2% target

- ✓ The US economy saw an unexpectedly strong 3.2% QoQa gain at the start of the year. But that number should be put in perspective as it was boosted by a build-up in inventories (adding 0.7 %-points) and an unusual increase in highway and street construction spending. Furthermore, the big positive contribution from net trade (+1%-point) is unlikely to be repeated.
- ✓ Sluggish global industrial activity in combination with the strong dollar is eroding confidence in the manufacturing industry. Prospects for corporate profits and investments are weakening. What's more, the positive impact of the Trump tax cuts is fading away.

Macro Research Contact

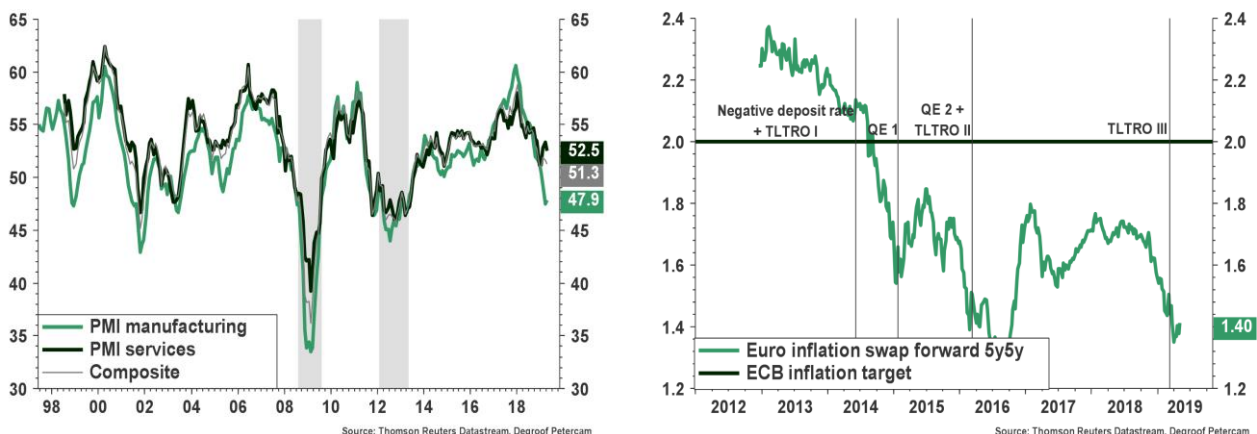
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- ✓ Household consumption, on the other hand, should still see decent growth for now as consumer confidence and real disposable income growth hold up well.
- ✓ April's employment report (headline ~ +263k) still suggests the labour market is in good shape although the drop in hours worked, the continued weakness in the household survey of employment and big fall in the labour force provide important elements for nuance.
- ✓ Meanwhile, underlying inflation pressures have softened in recent months with core PCE inflation (the Fed's preferred inflation metric) now at 1.6% only. In its latest policy meeting, the Fed downplayed this figure by saying that idiosyncratic factors were behind it. The more likely driver, though, is the decline in unit labour cost growth which started earlier. The real question is where productivity growth goes from here following the acceleration witnessed over the last couple of quarters.
- ✓ The upshot is that the combination of moderating growth and underwhelming inflation is keeping the Fed in a fairly dovish and patient wait-and-see-mode for now.



## Weak growth and inflation keep ECB in stimulus mode

- ✓ The rise in growth (from 0.9% QoQa in Q4 2018 to 1.5% in Q1 2019) and the drop in the unemployment rate to 7.7% in March were pretty encouraging. However, the bigger story is that Eurozone economic activity has weakened significantly over the course of 2018. And, even though there are early signs of stabilization, prospects still look rather bleak according to the latest confidence indicators, especially in the manufacturing sector.



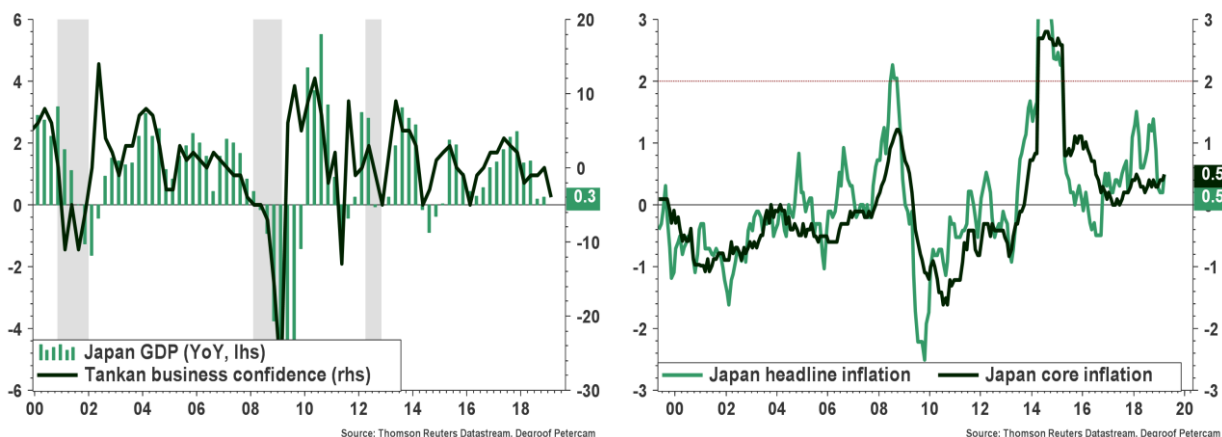
- ✓ Industrial production growth has stalled on the back of a slump in car manufacturing, weaker external demand and ongoing political uncertainty. Meanwhile, the outlook for both investment and exports has deteriorated.
- ✓ Consumer confidence has come down too, albeit from elevated levels. All in all, household consumption should

hold up as the increase in real wage growth should help to support spending.

- ✓ Underlying inflation remains uncomfortably and stubbornly low. Core CPI increased to 1.2% in April (from 0.8% in March) but that was mostly due to the timing of Easter. In addition inflation expectations have come down aggressively more recently.
- ✓ Logically, the combination of downbeat growth prospects and undershooting inflation figures has led the ECB to become much more cautious in recent months. June's ECB meeting is likely to see more details on the terms of the TLTRO-III programme and perhaps also on the possible introduction of 'tiering' (although the latter is controversial for the time being).
- ✓ All attention is now shifting to the upcoming European elections where populist parties will benefit from rising support. But the bigger worry is that lasting political fragmentation and structural economic differences within Europe are standing in the way of meaningful institutional reforms over time.

### 🇯🇵 **Bank of Japan stands put as growth remains downbeat**

- ✓ Output and survey data suggest that the economy stalled (or even contracted) during the first months of the year. Moreover, the outlook for industrial production and consumption remains downbeat, reinforcing rumours that the planned consumption tax hike to 10% (from 8%) could be postponed. The base case, however, remains that the headline rate will be raised in October.
- ✓ Despite tight labour market conditions, wage growth and inflation remain tepid. As a result, even though the BoJ has been emphasizing the risk of unwelcome side effects of its policy, monetary policy remains firmly in easing mode.



### 🇨🇳 **Chinese stimulus measures start to bear fruit but a strong and sustainable upturn looks unlikely**

- ✓ The situation in the emerging world is very different from region to region and from country to country. While the Brazilian, Indian and Russian manufacturing sector are recording fairly positive figures, countries such as Turkey, Poland, S. Korea, Malaysia and S. Africa are facing (strong) headwinds. On aggregate, though, EM manufacturing confidence is holding up at rather decent levels, suggesting the trough in industrial production is behind us.
- ✓ Of course China attracts the most attention as it represents no less than 40% of all economic activity in the developing and emerging world. Budgetary and monetary policymakers in China have been stepping up efforts to arrest the slowdown. And there is growing hope that China and the US will soon reach an agreement (even

though the underlying nature of the bilateral relationship has changed forever and the durability of the upcoming trade deal is very much in doubt).

- ✓ Lower interbank interest rates, targeted RRR cuts, tax cuts (mostly directed towards families and SME's) and some extra investment spending should produce stabilizing results. Broad credit growth, while still suggesting that economic activity remains under pressure, is showing more signs of stabilization. All in all, while Chinese policymakers look set to succeed in arresting the growth slowdown, the relatively modest stimulus measures taken so far (i.e. compared to the 2015/16 slowdown) are unlikely to lead to a significant and sustainable demand boost. Moreover, longer term concerns remain present. Slowing productivity growth, a rapidly ageing society and the unsustainable trajectory of credit growth still call for caution.



## Forecasts for 2019-2020

	<u>GDP</u>			<u>Inflation</u>		
	2018	2019	2020	2018	2019	2020
<b>US</b>	2.9	2.6	1.8	2.4	1.6	1.9
		2.4	2.0		1.9	2.2
<b>Eurozone</b>	1.9	1.1	1.0	1.7	1.2	1.4
		1.1	1.3		1.3	1.4
<b>Japan</b>	0.9	0.4	0.6	1.0	0.6	1.2
		0.6	0.5		0.6	1.0
<b>China</b>	6.6	5.5	5.0	2.1	2.0	2.3
		6.2	6.1		2.1	2.1

Update May 2019, Consensus forecasts

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