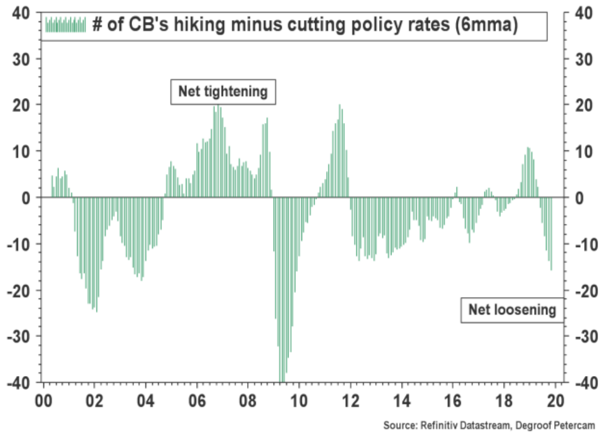
MACRO ECONOMIC UPDATE

November 2019

Welcome signs of hope in manufacturing but global growth outlook remains clouded

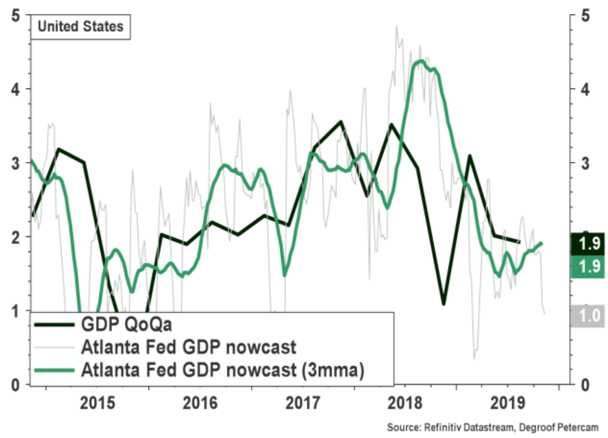
- ✓ Global growth hovers just below 2.5% - a level that is often seen as a threshold to avoid a global recession - with overall sentiment still pointing to slowing growth (see graph below). Encouragingly, compared to last month, the narrative improved. The uptick in manufacturing confidence suggests the global industrial downturn is not deepening further (but instead points towards a slight acceleration).
- ✓ The US and China seem to be 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. What's more, Washington hinted that talks with the EU could proceed, rather than imposing tariffs on imported cars (though a final decision will be made on November 13).
- ✓ That said, for now at least, the bigger story is still that economic growth has slowed down materially compared to 2016-2018. So far, the malaise in the automobile industry shows no clear signs of abating. Importantly, confidence in the service sector continues to come down and labour markets across the globe are losing steam. What's more, geopolitical uncertainty is unlikely to disappear going forward. Trade tensions (China is unlikely to make significant concessions on industrial policy and technology) and Brexit uncertainty looks set to linger on in the foreseeable future, which will continue to cloud the outlook for investment.
- ✓ The combination of weakening economic momentum, (geo)political uncertainty, below target inflation and weakening price pressures has led central banks to become much more dovish in recent months. Central banks across the globe have been loosening policy following a very brief period of tightening (see graph below), implying that a possible scenario of secular stagnation should not be dismissed so easily.
- ✓ There has been more talk about fiscal stimulus. Germany's economy, for example, could benefit from a short-term boost and permanently higher investment. But then again, there's no guarantee that this will happen with full conviction. Finance minister Scholz said the government could afford a fiscal expansion of €50bn (~1.4% of GDP) but the willingness to use that money remains fairly limited so far.

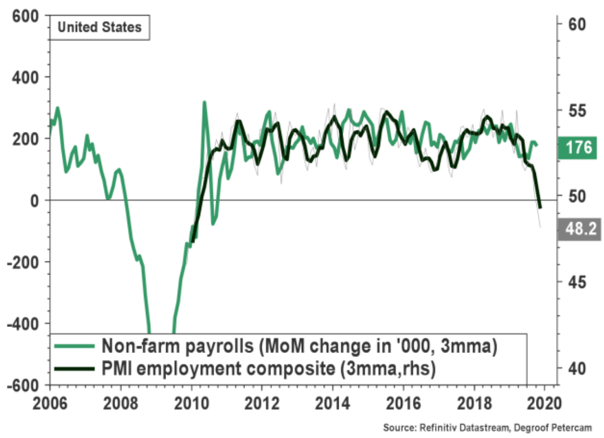


Macro Research Contact
Hans Bevers | Chief Economist | + 32 2 287 97 04 | h.bevers@degroofpetercam.com

🇺🇸 US growth slips below 2% while labour market faces downward risks

- Confidence surveys in the US still point towards a continued slowdown in economic activity. Economic growth has slipped just below the estimated potential growth rate of 2% with no swift turnaround in sight. Risks remain tilted to the downside. This is illustrated for example by several indicators including the Atlanta Fed GDP tracker which points to around 1.0% growth (annualized) in Q4 (see graph below), the ISM manufacturing index which revealed a third straight monthly contraction in industrial activity, and the Conference Board's CEO confidence survey which suggests growth will grind to a halt in 2020.
- Prospects for corporate profits and capex have been weakening against the back of escalating trade tensions while the positive impact of the Trump tax cuts is fading away. Confidence in the service sector also weakened significantly since the start of the year. What's more, the upcoming 2020 Presidential election is likely to contribute to more uncertainty.
- Household consumption remains the driving force of the US economy as consumer confidence (despite being over the top) and real disposable income growth hold up well. Moreover, lower interest rates seem to have supported the housing market again as of late.
- Looking ahead, developments in the labour market remain key in this respect. Both the September and the October payroll report confirmed that the labour market expansion continues. However, momentum is gradually but surely slowing. The pace of job gains is coming down, wage growth has stopped accelerating since the end of last year and forward-looking indicators paint a somewhat worrying picture on future job gains (see graph below)
- Meanwhile, underlying inflation pressures have softened compared to last year with core PCE inflation (the Fed's preferred inflation metric, now at 1.7%) staying below target since the start of the year. This reduction has occurred alongside a decrease in unit labour costs (which is now being reversed). Both headline inflation and inflation expectations have come down too.
- The Fed cut interest rates again in October (by 25bp to between 1.50%-1.75%, in line with expectations) for the third time since 2008. Given the subdued outlook described above, and even though the message from both Jerome Powell, the median dot plot and markets suggest otherwise, the Fed is probably not completely done in terms of loosening monetary policy.

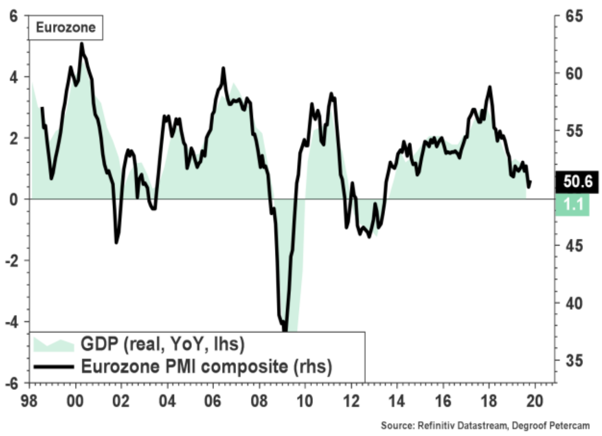


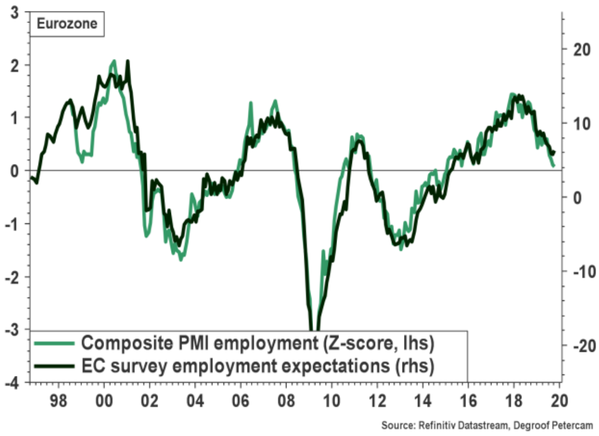


🇪🇺 Growth and inflation remain weak at the end of the year

- Following a strong start of the year, growth fell back significantly in both the second and third quarter (from 1.8% to only 0.8% QoQa. Despite the (small) rise in the eurozone composite PMI in October (from 50.1 to 50.6), confidence remains consistent with lacklustre growth in Q4 (see graph below).

- ✓ Global trade tensions have hit the Eurozone industry hard, especially in Germany. Industrial production growth has turned negative on the back of the malaise in the car sector and on-going (geo)political uncertainty, with the downturn showing no signs of an imminent end. Manufacturing PMI confidence (now at 45.9 versus 45.7 in September) has now recorded below the 50 no-change mark for nine successive months. Meanwhile, the outlook for both exports and investment has deteriorated quite a bit.
- ✓ Both service sector and consumer confidence, even though they have come down significantly from their peak levels at the start of 2018, 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 are softening significantly (see graph below). And with business surveys also showing that labour shortages are easing, wage growth is more likely to slow than to rise over the coming year.
- ✓ This does not bode well for inflation. Underlying inflation remains stuck at around 1% and shows no signs of picking up despite the acceleration in wage growth over the past two years. In addition, inflation expectations have declined aggressively.
- ✓ The combination of undershooting inflation figures and downbeat growth prospects has led the ECB to announce new stimulus measures in September including another deposit rate cut (to -0.5%) and net asset purchases (of €20 bn per month for 'as long as it takes with purchasing ending only shortly before the next rate hike')
- ✓ The anaemic outlook for growth and inflation looks set to increase the pressure on the ECB to do more in 2020. However, there's a lot of controversy surrounding monetary policy these days. More importantly, this is unlikely to have a meaningful impact. Monetary policy is constrained by the zero lower bound (true, not exactly zero) and QE-programmes are subject to diminishing returns. 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 about a fiscal boost is gaining traction, the overall stance can still be described as hesitant at best. More conviction on this is would be highly welcome.
- ✓ Meanwhile, on the positive side, Germany's finance minister Scholz has stressed the need to deepen and complete the European Banking Union (including a deposit insurance mechanism). At the same time, there's still no consensus on this in Germany or beyond. Moreover, Scholz's offer would not be a free lunch.

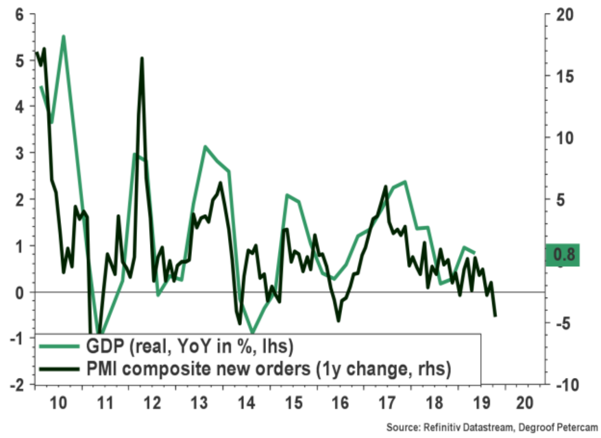


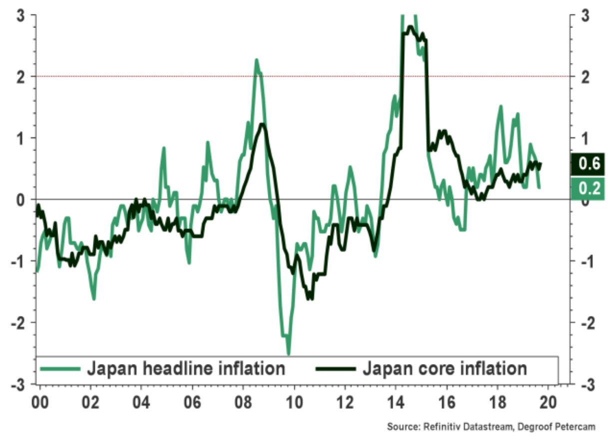


Weak growth and inflation keep BoJ in easing stance

- ✓ Prospects for growth and inflation remain bleak. Most confidence indicators point to a weakening growth momentum (see graph below). The outlook for industrial production, consumption and capex remains downbeat 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.

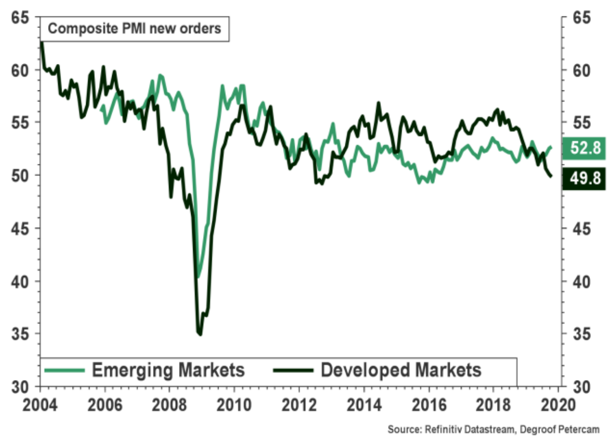
- ✓ Unsurprisingly, the Bank of Japan continues to strike a dovish tone. Given the subdued outlook for growth and inflation the BoJ stated it will keep both short- and long-term interest rates at present or lower levels for as long as there's risk that the momentum towards hitting its 2% inflation could be lost. At the same time, the BoJ continues to emphasize the risk of unwelcome side effects of its policy (i.e. financial stability concerns).

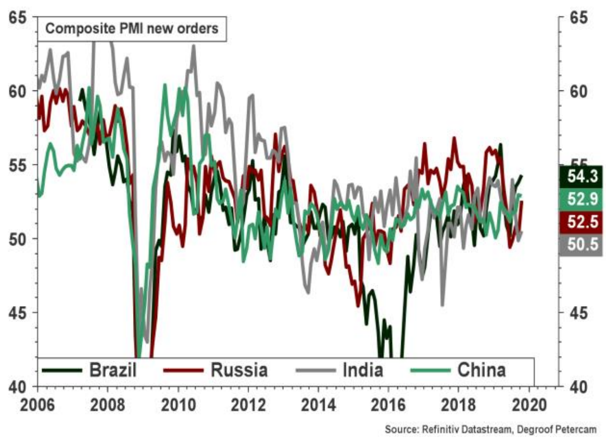




Rise in EM manufacturing confidence unlikely to set off a strong economic upturn

- ✓ On aggregate, EM confidence is holding up significantly better than in the DM world (see graph below). Industrial production has slowed markedly in recent months to below 2% in year on year terms. Encouragingly, however, despite low levels in many countries and regional divergence, overall manufacturing sentiment has picked up more recently. This suggests, industrial production growth should accelerate from current disappointing levels. Meanwhile, inflation remains modest according to both hard data and surveys, providing central banks with room to keep monetary conditions fairly loose.
- ✓ Budgetary and monetary policymakers in China have been stepping up efforts via lower interbank interest rates, targeted RRR cuts (again in September), tax cuts (mostly directed towards families and SME's) and some extra investment spending. All in all, stimulus was well measured and modest relative to the measures taken in 2015-2016 when policymakers pushed for higher growth through a boost in credit growth. So far, economic results remain unimpressive. Admittedly, broad credit has been showing more and more signs of stabilization and PMI Caixin manufacturing confidence (though probably an overestimation) increased significantly in October.





✓ All in all, however, this is probably not the start of a broad-based and sustained upturn in activity. Growth is likely to remain under pressure in the coming quarters. The sharp rise in pork prices is weighing on the purchasing power of Chinese consumers. In addition, the strong activity in the real estate sector is weakened by tighter regulations. And the prospect of ongoing geopolitical tensions implies the external climate will remain challenging going forward.

Forecasts for 2019-2020

	GDP				Inflation		
	2018	2019	2020		2018	2019	2020
US	*2.9*	**2.2**	**1.5**		*2.4*	**1.7**	**1.8**
		2.3	*1.8*			*1.8*	*2.1*
Eurozone	*1.9*	**1.2**	**0.9**		*1.7*	**1.2**	**1.3**
		1.1	*0.9*			*1.2*	*1.2*
Japan	*0.8*	**1.1**	**0.2**		*1.0*	**0.6**	**0.5**
		1.0	*0.2*			*0.6*	*0.7*
China	*6.6*	**5.5**	**5.0**		*2.1*	**2.6**	**2.5**
		6.2	*5.9*			*2.5*	*2.5*

Update November 2019, *Consensus forecasts*

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