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ON TRACK? THREE BIG BETS FOR 2019

Berenberg Macro Flash

We are cautiously optimistic for 2019 - see Global Outlook. While US growth will lose a little momentum as the 2018 fiscal stimulus expires, growth in Europe, China and Japan will rebound somewhat from spring onwards after a grey winter. We base this call on three big bets:

1) Approaching election year 2020, US President Donald Trump will want to strike some trade deals instead of escalating his costly trade wars to such an extent that a weaker US economy would hurt his re-election prospects.

2) China will avoid a hard landing, adding to its late 2018 stimulus measures until it works. In the year in which the Communist Party celebrates its 70 year anniversary of taking power, it does not want to send tanks into the streets to quell protests against rising unemployment.

3) The adults in the UK parliament will take control, preventing a hard Brexit with a cross-party majority.

As a fourth point, we can add our bet that, in the absence of serious inflation risks, central banks will be the counter-cyclical buffer again if need be. They will adjust their policy outlook to prevent demand growth from faltering too much for too long.

How are our calls doing so far this year? On balance, the evidence is mostly encouraging.

First, the USA and China started serious mid-level negotiations on trade last week. That these talks were extended into a third day last Wednesday amid media reports of some progress bodes well for future talks.

Second, following a number of measures in late 2018 of which the impact is still in the pipeline, Chinese media reported on Tuesday that the authorities plan tax cuts 'on a large scale' and higher public spending to boost demand. Separately, on Wednesday the PBoC injected Rmb570bn ($84bn) into the financial system.

Third, the crushing defeat for Theresa May's complex Brexit deal and Jeremy Corbyn's failed attempt to unseat her have narrowed the UK's Brexit options. We see more signs that the cross-party majority in the House of Commons against a hard Brexit will assert itself soon. The hard Brexit risk remains at 20% for now. But it may soon recede. Of the three major options now available to the UK parliament, a hard Brexit seems to command least support. Less unlikely would be a highly contentious decision to call a new referendum. More likely, parliament will go for a softer Brexit which avoids the Irish border conundrum by keeping the entire UK and not just Northern Ireland in the customs union and single market for goods.

In addition, Fed chair Powell has taken back his misguided December 2018 comment that the Fed‘s balance sheet reduction is on “autopilot“. Instead, a succession of Fed speakers and the recent Fed minutes have confirmed that the central bank is flexible and data dependent. We expect the Fed to remain on hold until the end of 2020, possibly after one hike in early 2019.

It is very early days. A hard Brexit remains a serious risk. The Chinese economy may take a while to respond to more aggressive stimulus. US-Chinese trade talks could still go wrong. We also have to brace ourselves for some Huawei-style upsets on the way and for Trump raising the pressure on the EU again shortly, perhaps tweeting “big car tariffs coming if you don’t offer me big concessions within 30 days“, before US-EU talks may get into the decisive phase. Also, other risks could arise (Macron backing down too much in France? Italy going wild again? Geopolitics taking a turn for the worse in some sensitive place?)

In the age of Trump and other populists, such risks abound. Still, on balance, the evidence so far this year supports our calls that political risks are more likely to recede than to escalate. If so, business expectations could indeed start to move up again in a couple of months.

Unfortunately, we still have to get through a grey winter first. Our near-term calls for economic growth are well below consensus, especially for Europe. Unlike consensus, we look for a clear rebound thereafter leading to above consensus growth for 2020. With luck, the rebound could start in spring 2019 already.

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