BERENBERG

PARTNERSHIP SINCE 1590

MACRO NEWS 04/03/19

Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

RISK UPDATE: FIRST SIGNS OF SPRING?

Berenberg Macro Flash

While economic growth in the US will slow down modestly this year, Europe and East Asia will regain some momentum from spring onwards after a grey winter. Two months into the new year, we maintain our key calls for 2019. Although the risk is rising that the rebound in Europe and East Asia may be delayed a little, the economic and political newsflow by and large suits these calls.

- US economic data are more mixed than before but remain in line with healthy real GDP growth of above 2%.

- On the negative side, export-oriented manufacturing is softening a bit more than expected in Europe, East Asia and, to a lesser extent, also in the US. For at least two more months, the downturn in global trade and manufacturing will likely deepen.

- On the positive side, however, domestic demand and labour markets in core Europe outside Italy are holding up better than expected, weathering the manufacturing recession with only limited damage so far (see for example Chart 1 below on Eurozone employment). Consumer confidence and the services PMI for the Eurozone even edged up in February from -7.9 to -7.4 and from 51.2 to 52.3, respectively.

- More importantly, some of the pieces needed for a more positive outlook from spring onwards are slowly falling into place with some progress on trade, Brexit and Chinese risks.

Resolving two key uncertainties, namely Brexit and US-EU trade tensions, is taking longer than we expected last autumn. Since the start of the year, we have thus reduced our 2019 growth forecasts slightly for some regions, for instance from 1.2% to 1.1% for the Eurozone, from 0.9% to 0.7% for Japan and from 1.8% to 1.4% for the UK. The key risk to our call is that the renewed upturn in Europe and East Asia may start a few months later rather than that it may not happen at all.

FOUR CONDITIONS FOR A RENEWED UPTURN

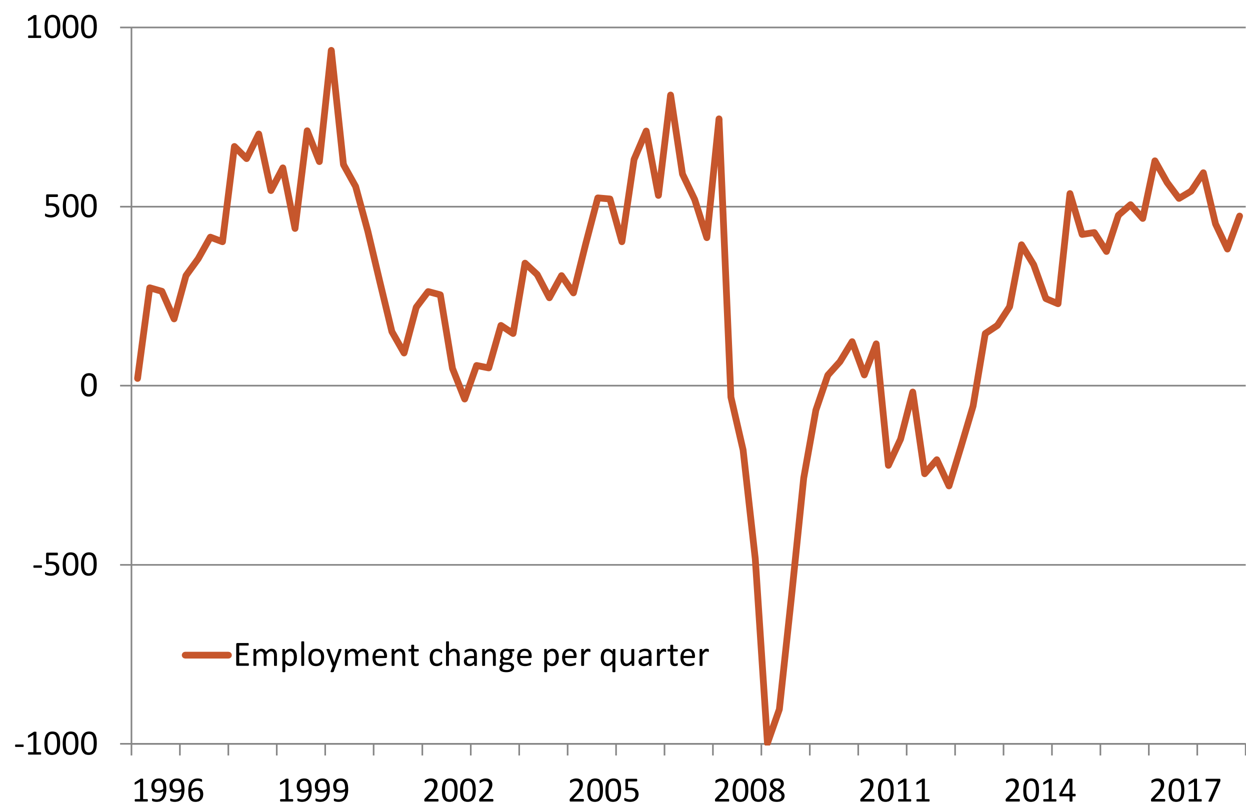
Early this year, we identified four conditions that need to be met for our scenario of renewed momentum after a soggy winter to play out: trade tensions will have to ease, China will have to turn the corner, the UK will need to avoid the no-deal hard Brexit and central banks will have to get real. In addition, France and Italy will need to dodge their domestic political risks in order to not spoil the outlook for Europe.

1. On **trade**, China and the US seem to be heading for an interim deal, possibly to be sealed at a summit around 27 March according to a Wall Street Journal report. Both Xi Jinping and Donald Trump have their own political reasons to de-escalate the costly tensions. Such a potential deal would not resolve US concerns about forced technology transfers, skewed market access and unfair subsidies for good. To encourage Chinese compliance with new commitments, the US will continue to occasionally remind Beijing that the US could wield a big stick – the threat of punitive tariffs. Still, the US and China seem eager to come to some understanding. That would bolster business confidence in Asia, the US and in export-oriented economies such as Germany and Japan. Unfortunately, US-EU trade tensions will take longer to defuse, partly because the EU will apparently need until its 20-21 March summit to agree its own negotiating position. US threats to impose car tariffs could now come to the fore at any time. Trump has until 17 May to react to the US Commerce Department's "findings" as to whether car and/or car part imports threaten US national security. But as long as these tariffs – and the potentially serious EU counter-measures – are not imposed, markets will probably take their cue from progress in the US-Chinese talks and assume that the US and EU will eventually find a way to contain tensions as well.
2. Trade data for Japan, other East Asian countries and Europe suggest that **China's slowdown** continues to worsen. However, first signs are appearing that China's stimulus is starting to work. China's credit impulse has started to turn up in the last two months (see Chart 2). We maintain our view that if the stimulus already in the pipeline turns out to be insufficient to stop the rot in China, Beijing will open the credit taps further.
3. Less than four weeks ahead of the scheduled **Brexit**, the dense fog in London has not lifted. While all options remain on the table, the mid-February revolt of some moderates on both sides of Britain's political aisle has changed the dynamic, though. The tail risks of extremely negative outcomes, either a no-deal hard Brexit or a political earthquake that could propel left-wing Labour leader Jeremy Corbyn to power, have receded to 15% from 25% for the hard Brexit and to 15% from 20% for Corbyn. Amid peak uncertainty, this is good news for the UK and its European neighbours. A likely Brexit delay will on its own resolve nothing. But a UK vote for a delay, possibly on 14 March, would be another sign that, come what may, the UK parliament will shy away from the no-deal hard Brexit that would be an immediate sudden shock to confidence and investment on both sides of the Channel.
4. **Central banks** have changed their tone significantly in the last two months in response to less robust growth and to inflation data that remain well behaved even in countries with tight labour markets. They will not compound the risks to growth by erring on the hawkish side. The US Fed has put rate policy on hold for now and looks set to end the partial reversal of its balance sheet expansion in late 2019 already. The ECB will almost certainly delay the first hike in its refi rate from autumn 2019 until well into 2020 and offer banks a new long-term refinancing operation before mid-2019.

It is early days. But on balance, the news flow on these top four issues has been somewhat encouraging so far this year. The grey winter is not yet over, though. Especially for the Eurozone, our near-term calls remain well below consensus, with risks for the next few months still tilted to the downside. Relative to the Bloomberg consensus, we look for weaker data near-term followed by a stronger rebound thereafter. While our forecast of a 1.1% gain in Eurozone GDP this year is thus below the 1.4% Bloomberg consensus, we project 1.7% growth for 2020, above the Bloomberg consensus of 1.5% - see Forecasts at a Glance.

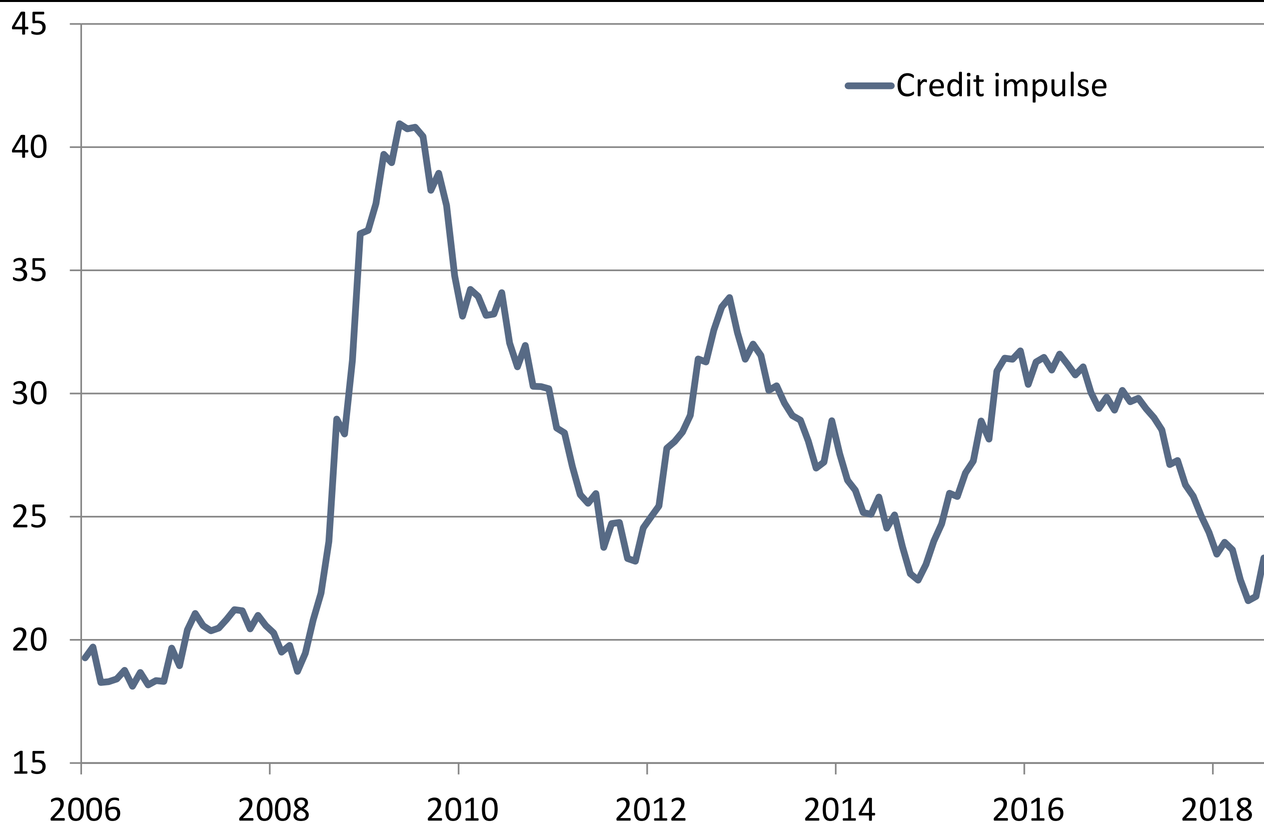
We will look at political issues in key Eurozone countries (France, Italy, Spain) shortly. On balance, the political situation looks sufficiently stable despite some serious problems caused by the radical government in Rome.

Chart 1: Eurozone (ex Italy) employment growth



Qoq change in thousand people in employment in the Eurozone excluding Italy. Sources: Eurostat, ISTAT

Chart 2: Chinese credit impulse – starting to turn up again



In ppt. Credit impulse equals the yoy change in credit volumes as a % of nominal GDP. Source: Bloomberg.

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact capitalmarkets@berenberg.de.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7889
www.berenberg.com
holger.schmieding@
berenberg.com