BANTLEON
Institutional Investing

Investment Insight

July 2018

Global disruptions

Despite the currently healthy growth figures in the USA, concerns about the global economy are on the rise: Business expectations are falling in Europe; turmoil and currency depreciation loom in China and emerging markets. Safe havens are currently in demand.

The US economy is still booming – GDP growth in the last quarter is likely to have climbed to a long-term high. The activity data for April available to date is already pointing in this direction. The recently published figures for May support this view, although they show a mixed picture. For example, the data on consumption was disappointing. According to the Bureau of Economic Analysis (BEA), real spending by private households stagnated in May. April's growth was revised down from 0.4% to 0.3%. It looks like quarterly average GDP growth momentum will be just under 2.0 percentage points.

Shipments of civilian capital goods, which are used to calculate corporate investments in GDP statistics, were also below expectations. At +0.2% following +0.8%, they more or less trod water. Incoming orders, which tend to be leading indicators, slackened. Overall, the momentum of corporate demand for capital goods has therefore recently flagged. Growth momentum in the GDP statistics is accordingly expected to be somewhat lower in second quarter than the first, at just under 0.5 percentage points.

By contrast, foreign trade was extremely positive. The statistical office's preliminary estimates for the May balance of trade unexpectedly revealed a third consecutive decrease in the deficit (USD -64.8 billion following USD -67.3 billion in April, excluding services). This completely cancelled out the expansion of the deficit seen in the two previous quarters. Exports were the driving force, heading for an annualised increase of more than 10% quarter on quarter in real terms. That would be the best result for more than four years. At the same time, imports showed at best a slight increase.

Another slowdown in US growth can be expected

Foreign trade is thus likely to make an overall contribution of around 1.0 percentage points to GDP growth. Together with contributions to growth of around 0.5 percentage points each from companies' inventory accumulation and from government demand, we therefore see GDP growth at around 4.0% in the second quarter – a marked recovery after the slump in the first quarter (2.0%). Nevertheless, the expansion momentum in the middle of the first half of the year would »only« return to the approximately 3.0% seen in the previous three quarters. Another slowdown in US growth can also be expected. This is indicated by the investment outlook for companies, which has been depressed by worsened financing conditions. In addition, we expect the tailwind from foreign trade to become weaker in likely reaction to the expansion of trade disputes.

Unlike in the USA, corporate sentiment in the Eurozone and especially in Germany has continually deteriorated since the start of the year. The IFO index sank to a 13-month low in June. Although, having already reached a 2-year low in April, IFO business expectations stabilised, the recent pause should be seen as nothing more than a temporary respite. Looking ahead, IFO expectations should continue to fall, due not least to the foreign trade environment. The Eurozone's export momentum had already peaked at the end of 2017. The trade dispute instigated by *Donald Trump* is now reinforcing the downward trend.

It is important to distinguish between direct and indirect effects of the dispute. The greatest direct danger for the Eurozone is posed by the possible punitive US tariffs on cars. They are currently hanging over German vehicle manufacturers like a sword of Damocles. For example, export expectations for automotive production have fallen particularly sharply and are hurting the overall index for the industry. Business expectations for the automotive industry have also worsened disproportionately. In addition, however, the USA is firing an increasing number of broadsides at China in the trade war. Further uncertainty factors ultimately include the Brexit negotiations and the difficulties in various emerging markets (including Turkey, Argentina and Brazil).

In the Eurozone too, the European Commission's sentiment indicators were mixed in June. On balance, a slightly negative trend predominated. The Italian crisis was not responsible for this. Although Italian companies are sceptical, Italian consumers appeared more optimistic in June than in previous months because they are hoping for the implementation of election promises. On balance, the positive boost to the sectors of the domestic economy predominated, meaning that economic confidence increased in Italy in June (109.6 following 108.4 points). Looking ahead, however, we remain sceptical. The debate about the budget for this year and next is likely to lead to tensions in every respect – within the government and with the Eurozone's partner countries. The risk of new financial market turmoil with correspondingly negative impact for the real economy therefore remains high.

We are currently seeking out safe havens

Italy, Germany and particularly *Donald Trump's* protectionist confrontational approach continue to keep the financial markets on their toes. Stock markets around the world recently came under pressure again – not least in China. Homegrown problems are additionally causing uncertainty there. The process of debt reduction in China appears not to be going as smoothly as expected after all. In addition to Chinese equities, the exchange rate also recently suffered. Greater signs of economic slowdown in China are just as possible as financial market turmoil spreading to the rest of the world. In addition to the risk of an escalating trade conflict and the prospect of a global weakening of growth in the second half of the year, this is an additional reason for our currently critical assessment of risk assets. We are currently seeking out safe havens.

BANTLEON BANK AG
Bahnhofstrasse 2 | CH-6300 Zug
Telephone +41 (0) 41 728 77-58 | bantleon@bantleon.com