Investment Insight

November 2018

Lull in exports

Export growth is slowing globally. American trade policy and the economic downturn in China are both contributing to this. The German economy has recently suffered from one-off effects in the automotive industry and its GDP growth has in fact probably slipped into negative territory.

The uniformly robust pace at which the US labour market is advancing this year is really a phenomenon – only the hurricanes have been causing volatility now and then. According to the Department of Labor and Employment, 250,000 new jobs were created in October, which is more than the consensus had expected (200,000). However, the increase is largely a counter-reaction to a weak September (118,000), which was skewed downwards due to Hurricane Florence. The 3-month moving average continues to move sideways at a high level (212,000). The unemployment rate remains at a 48-year low of 3.7%. And the leap in the annual rate of hourly earnings to 3.1% is due to a statistical base effect; the uptrend should flatten again in the coming months.

The booming labour market thus paints a picture of an unchanged robust economic upturn. But the latest corporate surveys indicate that the high-level momentum is slowing down. The ISM Purchasing Managers' Index for manufacturing fell somewhat more than expected in October, dropping from 59.8 to 57.7 points and thus reaching its second lowest level in 15 months. The orders sub-index in fact slipped to its lowest level in this period, falling from 61.8 to 57.4 points. If nothing else, declining foreign trade is reducing manufacturing sector optimism. The corresponding sub-index fell to its lowest level in almost two years. Although the *Trump* government's isolationist policy initially hurt the USA's trading partners, it is evidently now also starting to hit US companies.

This is not a problem for the short-term GDP outlook – private consumption and a further boost from corporate investment are likely to keep the expansion rate in the final quarter of 2018 at a relatively high level of around 3.0%. Looking further ahead, the higher interest rates should, however, generate increasing headwind. We therefore see the latest decline in the ISM Index as the start of a sustained slowdown accompanied by a noticeable deceleration of GDP growth in the coming year.

In China, economic momentum has already slowed further. The latest purchasing managers' surveys show this. According to data from the National Bureau of Statistics (NBS), the manufacturing barometer fell from 50.8 to 50.2 points in October and thus reached its lowest level in more than two years. There was also a downtrend outside of the manufacturing sector. The pertinent Purchasing Managers' Index combines the service sector and the construction sector. It plummeted to 53.9 points and thus to a 14-month low (see figure below). The worsening of the foreign trade environment continues to weigh on the manufacturing sector. The relevant subcomponents of the NBS's PMI survey fell to the second lowest level in six years, dropping from 48.0 to 46.9 points.

The government views the continuing slowdown with concern. The plan is to support weakening consumer demand by cutting the tax on car purchases. It is discussing halving the current rate of 10% to 5%. Beijing already helped the economy in this way in 2016. According to hints made by the politburo, further measures for stimulating the economy could include additional income and corporate tax cuts and government spending programmes, as well as further monetary policy stimulus in the form of, for example, cuts to the required reserve ratio. We expect these steps to contribute to preventing an intensification of the economic downtrend and achieving stabilisation in the medium term.

A recession in Europe continues to be only a risk scenario

In the Eurozone, the official GDP figures for the 3rd quarter fell short of the already low expectations. Year-on-year, growth dropped well below 2.0%. As well as the ongoing export weakness, a German one-off effect was also responsible for this. Due to the problems with the new emissions tests, automotive production plummeted by close to 10% in the past quarter. It must therefore in fact be anticipated that German economic output declined slightly in Q3. Although a technical recovery is to be expected for Germany and thus also the Eurozone in the final quarter of 2018, the rate of expansion can be expected to drop back again at the start of 2019, and our forecast anticipates GDP growth of only 1.3% in the 1st quarter of 2019.

The slump in foreign trade continues to be primarily responsible for the growth slowdown. Domestic demand remains a supporting factor with stable European real-estate and labour markets. A recession thus continues only to represent a risk scenario. During 2019, we could even see a return to a slight acceleration of growth in the Eurozone. This would require, however, that none of the political trouble spots (Brexit, trade war, Italian budget dispute) escalate and that the Chinese government succeed in supporting the country's economy in the long term.

Signs that the global slowdown will continue have become clearer

On the equity markets, hope blossomed again at the start of November following the bleak month of October. *Donald Trump* announced a »great« deal with China, causing confidence to grow simultaneously that in the end reason could prevail in conflicts such as in Brexit and Italy. The equity markets began a global recovery rally, and safe havens such as German government bonds and Treasuries fell. The oil price is noticeably losing its fear premium.

The financial markets ignored the weak economic data. But the signs that the global slowdown will continue have become clearer. This can primarily be seen in the global lull in export orders. If the political easing continues, although the equity markets could initially receive further tailwind, we orient ourselves less on the volatile political environment than on the economic trend – and in the Eurozone that is clearly pointing downwards. Accordingly, we think that risk assets will come under pressure again while the safe havens will regain popularity.

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