Investment Insight

December 2018

Eurozone weakening

The US economy continues to expand. In the Eurozone, by contrast, the main drivers, Germany and France, are noticeably weakening. France in particular is threatened by a massive slump in consumption due to the current protests.

The US economy remains robust: even after the first scheduled revision by the Bureau of Statistics, gross domestic product in the past quarter grew strongly by 3.5%. However, the structure is slightly altered according to the new figures. These show that private consumption and public spending delivered somewhat less impetus than previously assumed. Conversely, corporate investment performed better, and inventory accumulation was even stronger than expected. The current quarter's starting situation has worsened slightly with this development. This is because the scope for a further increase in inventories and thus for additional impetus for GDP growth in the 4th quarter are smaller.

However, this effect is partly offset by the latest data on private consumption. Real consumer spending in October was a surprise here, showing a sharp increase of 0.4%. The continuing encouraging development of the US labour market is a key support of private consumption. This is proven by the latest consumer confidence survey for November by economic research institute The Conference Board. Although the overall index fell slightly following an 18-year high in October, US citizens now rate opportunities to find a new job more favourably than they have since 2001.

At the same time, an at best gradual weakening is initially expected in corporate investment. This assessment is supported by the earnings data for the 3rd quarter. Earnings growth has further accelerated. The weak investment in the past quarter therefore appears not to mark the beginning of a slump across the whole economy yet. There is thus much to suggest that economic growth will remain robust in the short term, before government stimuli ending and worse financing conditions in 2019 cause a more significant slowdown.

Unlike in the US, sentiment in Europe is and remains poor. In Germany, following the disappointing purchasing managers' survey, the results of the IFO survey were also sobering: the IFO barometer fell from 102.9 to 102.0 points, just above the cyclical low of July (101.9 points). At that time, fear of US car tariffs had reached a peak. Sentiment has now returned to almost the same level again, without punitive tariffs having been imposed to date.

Business expectations (98.9 points following 99.9 points) fell even more sharply than the assessment of the current situation (105.4 points following 106.1 points). Whereas the service sector's business climate had a stabilising effect, the IFO industry index fell to its lowest level in almost two years. Here too, business expectations are the driving force and point downwards similarly steeply to the Manufacturing Purchasing Managers' Index. Within the manufacturing sector, automotive manufacturing was particularly weak until into the 3rd quarter. There is now a downward trend across the board. Even in the computer sector, which swam against the tide for a long time, the business outlook has recently deteriorated significantly. All in all, the message from the PMI and the IFO is the same: cyclical momentum further decreased in the 4th quarter.

Looking to the future, there are rougher waters ahead in the German labour market

The economic slowdown is still hardly felt in the German labour market. The seasonally adjusted unemployment figure fell again in November, by 16,000. At 5.0% the unemployment rate reached a new record low for reunited Germany. However, the number of job vacancies has recently stagnated at a high level (around 800,000 according to the Federal Employment Agency). The number of new job vacancies has in fact fallen. This will sooner or later also be reflected in decreasing employment growth. Looking to the future, there are therefore rougher waters ahead in the German labour market. In the Eurozone, the decline in the unemployment rate has already slowed. Higher employment is now already only a small supporting factor for the consumer climate. Since the end of 2017, private consumption in the Eurozone has been weakening. In Germany and France, it beat the previous year's level by only 0.8% in the 3rd quarter. One reason for this is energy prices, which have risen by around 10% compared to the previous year.

Although oil prices fell significantly in autumn, which is expected to bring some relief, in France this effect is more than offset by the current protests by the so-called »yellow vests«. Their protest was initially against rising oil prices, but now expresses general dissatisfaction. The »yellow vests« have been blocking important transport routes since mid-November and are setting up road blocks in numerous towns. Some businesses can no longer be reached at all, many people hardly dare to leave the house. In parts of France, retail is expecting reductions in sales of up to 35%. French consumer confidence has also massively worsened. Consumers are primarily looking ahead less optimistically. This reflects the fear many French people have of further losses in purchasing power as a result of tax rises and increasing inflation. All in all, the aforementioned developments show that a short-term recovery of the economy in the Eurozone is not to be expected. For the time being, the outlook remains dismal. Eurozone growth is likely to be only a good 1.0% at the start of 2019 as well.

For the ECB, the economic and inflation environment is increasingly uncomfortable

The inflation process in the Eurozone has also stalled. According to Eurostat's first estimate, the annual inflation rate fell from 2.2% to 2.0% in November. At the same time, core inflation (excluding energy, food, alcohol and tobacco prices) fell from 1.1% to 1.0%. Despite sharply rising wages, core inflation is also only expected to be 1.3% to 1.4% at the end of 2019. For the ECB, the economic and inflation environment is thus increasingly uncomfortable. Although it is unlikely to postpone the planned end of the QE programme at the end of the year as a result, it will instead be all the more dovish on the interest rate outlook and let it be known that rising key rates from autumn 2019 onwards are by no means certain.

The financial markets have recently turned their attention to Buenos Aires. The rapprochement in the trade dispute between China and the US has boosted equity markets. But tailwind also came from the Federal Reserve. It emphasised that the time of »automatic« interest rate hikes will soon be over. Equity markets in the US saw this as an indication of the pace of tightening monetary policy slowing and rallied. Emerging market stock markets, which had recently suffered considerably under US interest rate hikes, were also boosted. In our view, the interbank lending markets are now, however, too optimistic. We continue to expect two additional interest rate hikes in 2019 before the Fed takes a break. In the short term, there is therefore a risk of rising US yields before the trend takes a clearer downward turn during 2019.

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