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Pessimism on growth outlook recedes despite US-China trade deal uncertainty

Highlights

- **November was another strong month for financial markets with US equity indices up 3-5% as generally positive economic data eased fears over the global growth outlook and despite fluctuating progress on a US-China trade deal.**
- **US GDP growth for 3Q19 was revised up to 2.1% and there are some signs of improvement in the previously weak housing and manufacturing sectors. President Trump appears however to be adopting a more aggressive stance on trade.**
- **German GDP unexpectedly rose in Q3, avoiding a recession though a strong pick up looks unlikely. UK PM Johnson is looking to win a parliamentary majority at December 12 elections in order to push through his Brexit deal.**

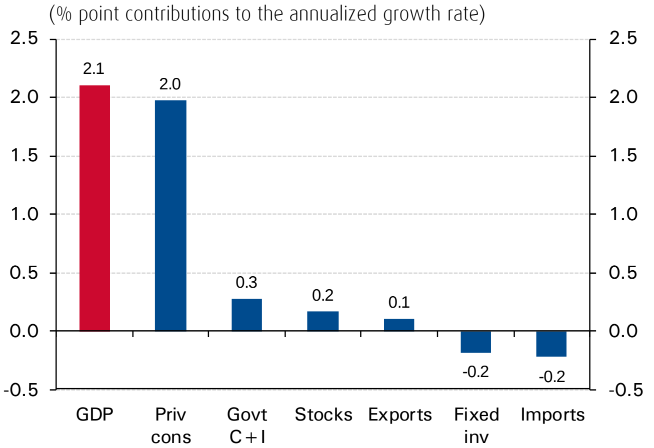
November was another strong month for financial markets, with key US stock indices up 3-5% and 10-year treasury yields consolidating their post-summer climb hovering at around 1.8%. Although progress on a 'phase one' US-China trade deal fluctuated and appeared to have stalled by early December, pessimism on the growth outlook eased amid generally positive survey signals on activity, an upward revision to US GDP in 3Q19 and news that Germany avoided a technical recession. Brent crude prices also rose further above $60/bbl, though sentiment remains somewhat negative on a weak fundamental outlook going into 2020 and uncertainty over OPEC+ policy.

US GDP growth revised up in Q3 and pessimism eases

The second estimate of US GDP for 3Q19 saw growth revised up to an annualized 2.1% from 1.9% before. This left growth above the 2.0% recorded in Q2, helping to allay fears of a slowdown. Growth in consumer spending – which accounts for around 70% of the economy – was unrevised at a solid 2.9%, but private investment recorded a much smaller fall than previously estimated at -0.1% (-1.5% before) thanks to stockbuilding. (Chart 1.) 'Nowcast' estimates for Q4 have growth slowing to a range of 0.8-1.5%, which would leave growth for 2019 overall at 2.3% – still a decent performance in the context of the trade war with China, higher interest rates versus last year, fading fiscal stimulus and a mature economic cycle. While growth looks likely to slow to below 2% in 2020, fears of a recession have eased amid continued resilience of the labor market (jobs growth smashed through expectations at 266,000 in November), some signs of recovery in the previously weak housing and manufacturing sectors, recent Fed rate cuts and reduced risks from overseas.

Chart 1: Contributions to US GDP growth in 3Q19

(% point contributions to the annualized growth rate)

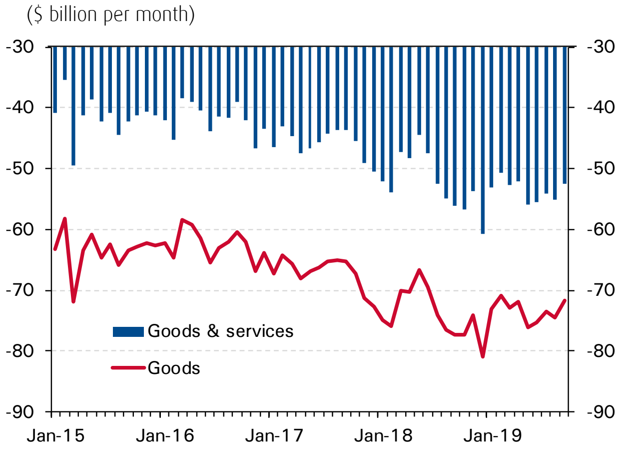


Source: Refinitiv / NBK

Meanwhile however, President Trump appears to be readopting a more aggressive stance on trade, perhaps emboldened by solid US economic performance, the stock market hitting record highs and a recent narrowing of the trade deficit. (Chart 2.) In early December he threatened fresh tariff measures on France ($2.4 billion in goods), Argentina and Brazil (steel and aluminum) and the EU (due to aircraft subsidies). Progress on a 'phase one' trade deal with China also appears to have stalled over disagreements on enforcement, tariff rollbacks and Chinese displeasure over US support for Hong Kong protesters, with the next round of US tariff hikes still scheduled for December 15. While an initial US-China deal could be welcomed by financial markets, it would be limited in scope, leave difficult issues such as intellectual property theft unresolved and could also result in a longer delay in securing a more substantial agreement to bring tariffs back down. Trump is unlikely to yield much ahead of the

Presidential election in November, and warned that that could be too early even for a 'phase one' deal.

Chart 2: US trade balance



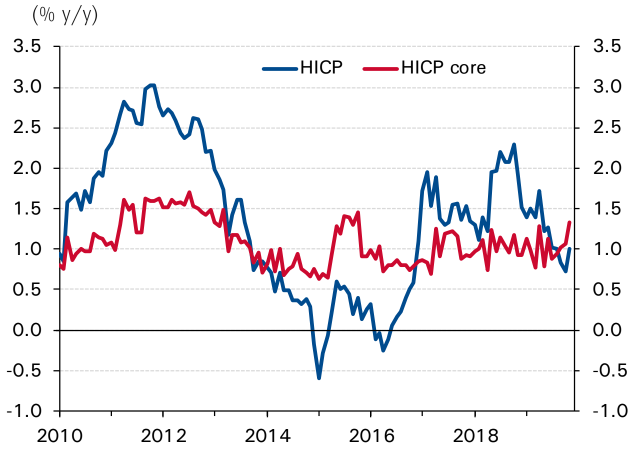
Source: Refinitiv

Germany avoids recession; ECB to start policy review

In Europe, the German economy managed to grow by 0.1% q/q in 3Q19, narrowly avoiding a technical recession after contracting in Q2 and only slightly underperforming the Eurozone overall (0.2%). Solid growth in household spending (+0.4%) and government consumption (+0.8%) helped offset a decline in investment (-3.5%), though exports managed to rebound (+1.0%) following a large decline in Q2. Nevertheless, while the domestic economy continues to benefit from low unemployment (though retail sales did fall 1.9% m/m in October) and surveys of business sentiment including even manufacturing have picked up slightly of late, there are doubts over the strength of any upturn. The composite PMI remained in negative territory in November (49.4) and the German government is under pressure to loosen fiscal policy to support still-sluggish growth at home and elsewhere in Europe.

The ECB Governing Council will meet on December 12 and while policy should be left on hold, the bank may announce a strategic review of its monetary policy. The most fundamental aspect of the review could be a revisit of the bank's 'close to but below 2%' inflation objective, which was set in 2003. The target has been consistently missed over the years with inflation averaging just 1.4% y/y since 2010 while core inflation averaged just 1.1% and never exceeded 1.7%. (Chart 3.) A new target could be set at a more precise 2% both to reduce ambiguity and to provide backing for the bank to keep policy looser for longer, though another option is lowering the target to make it easier to hit. There will also be debate around using monetary policy to address climate change, with climate activists (championed by Christine Lagarde, the ECB President) for example calling for the bank to eliminate bond holdings of corporates deemed to be environmental underperformers.

Chart 3: Eurozone inflation



Source: Refinitiv

The UK general election takes place on December 12 with the outcome pivotal to the Brexit issue for years ahead. Current PM Boris Johnson's Conservative Party has maintained a significant though narrowing lead in the opinion polls as of early December, and if sustained would likely see him win a parliamentary majority, push his Brexit deal with the EU through the legislature and see the UK leave the EU at the end of January. Failure to win a majority however – still highly plausible not least due to tactical voting by the public across party lines reflecting Brexit preferences – would open the path to a second referendum sometime in 2020 and potentially reverse Brexit altogether. A Conservative majority is generally viewed as being good for short-term growth by lifting the uncertainty that has weighed on the economy and investment over the past three years. However, exit would merely leave the UK in a transition period due to expire at the end of 2020 after which the UK could still be forced to trade with the EU on WTO terms if no comprehensive trade deal has been agreed. This could see the pound back under pressure.

Japanese growth stutters in Q3

Economic growth in Japan almost stalled in 3Q19 at an annualized 0.2%, down from 1.8% in 2Q19 as the continued weakness in the external sector weighed on the economy. (Chart 4.) Indeed, latest data showed Japanese exports falling for the 11th consecutive month in October by a worse-than-anticipated 9.2% y/y – its biggest fall in three years. Imports did not fare any better, falling by a staggering 14.8% reflecting continued weakness in domestic demand. The Japanese economy is likely to continue to struggle into 4Q19 as the effects of ongoing US-China trade tensions are compounded by the October sales tax hike, which is likely to put an additional damper on domestic consumption. With an economic outlook mired with downside risks, the Japanese government has unveiled a $120 billion pro-growth reform package.

Chart 4: Japanese GDP

(% q/q annualized)

Source: Japan Cabinet Office

China delivers targeted policy easing measures

China has embarked on a series of targeted monetary easing measures in a bid to support the economy amid headwinds from slower global growth and trade tensions with the US. The central bank cut its Medium-Term Lending Facility and 7-day reverse repo rates by 5 bps to 3.25% and 2.50% respectively. According to the latest PMI data, recent measures such as cuts in corporate tax and banks' reserve requirements may already be benefiting the economy. The official manufacturing PMI surprised on the upside in November, coming in at 50.2 for its first expansion in seven months. The official services PMI also gathered pace, rising to an eight-month high of 54.4. Both the private manufacturing and services indices also saw improvements in November, rising to 51.8 and 53.5 (a seven-month high), respectively. Finally, the yuan appreciated for the third straight month in November, with the central rate ending up 0.3% at RMB7.02/US$1, even as signals on trade talk progress were mixed.

Oil prices up despite trade, demand uncertainty

Brent crude finished November up 3.7% at $62.4/bbl. (Chart 5.) This was the benchmark crude's best monthly gain since April, coming on the back of an initial easing in trade tensions between the US and China – which seemed to have soured by early December as prospects for a trade deal faded. Brent was further boosted to above $64/bbl in early December by the surprise announcement that OPEC+ would cut production by an additional 0.5 mb/d from 1.2 mb/d to 1.7 mb/d effective January 2020, on top of the current voluntary 0.4 mb/d cut by Saudi Arabia. The deal will be reassessed in March 2020.

In total, this would deepen aggregate OPEC+ supply cuts to 2.1 mb/d and help the group support prices amid an expected stock build in 2020 due to subdued demand and robust non-OPEC supply growth. Demand for OPEC crude is projected to be at least 1 mb/d below current production levels, according to the IEA.

US crude production meanwhile set another record, rising to 12.9 mb/d in November; indeed, records show that the US became a net oil exporter in September (on a monthly average basis) for the first time in seventy years.

Chart 5: Brent crude oil price

($ per barrel, end of month)

Source: Refinitiv

GCC developments

Data continues to paint something of a mixed picture in the GCC. Dubai GDP growth clocked in at 2.1% y/y in 1H19, boosted by gains in wholesale and retail trade and transportation as well as by an uptick in real estate activity. However private sector credit growth in the UAE underwhelmed at 0.8% y/y in October (2.6% in Sept) and inflation remained in negative territory (-2.8% y/y) due to still falling housing rents. The UAE government also expanded the scope of its excise tax from December to include sweetened drinks and e-cigarettes.

Meanwhile, public finances in Oman and Bahrain have improved so far in 2019. Oman's budget deficit (ten months to October) narrowed by 19% to OMR1.5 billion or 7% of pro-rated GDP, on the back of lower expenditures. In Bahrain, the authorities expect the budget deficit to narrow from 6.3% of GDP in 2018 to 4.7% and 3.9% in 2019 and 2020, respectively, due to fiscal consolidation. Progress on this earned the kingdom an outlook upgrade (stable to positive) from the rating agency S&P. Finally, Saudi Aramco, despite paring back overseas listing plans for its partial IPO, expects to raise $24-25 billion from retail and regional investors. The UAE and Kuwait are reported to be investing $1.5 billion and $1 billion, respectively, in the oil major.

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