

# CHIEF ECONOMIST'S COMMENT

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## Markets and Trends 2019 – Update

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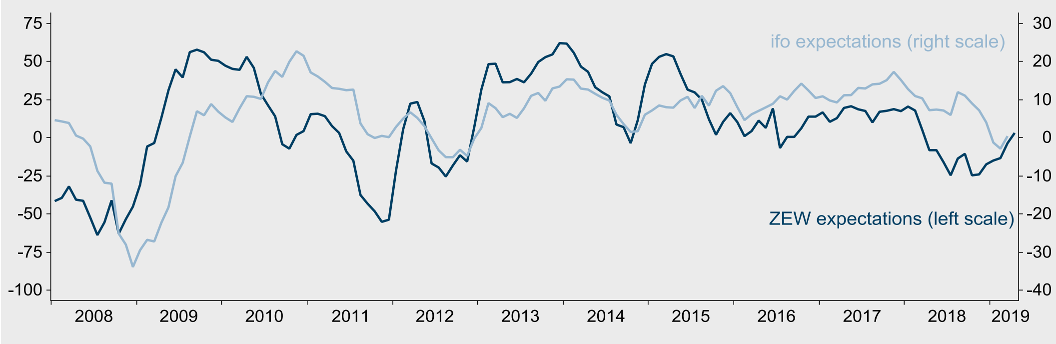
Four months have now passed since the publication of our 2019 Annual Outlook "Global Economy in the Gym". As we expected, weak economic activity initially persisted in many countries. However, the first leading indicators are already pointing to a cyclical turnaround. Share prices have anticipated this and – as we forecast – have duly recovered. Still, central banks surprised (not only) us with their change of tack. Obviously, the ECB and the Fed do not consider their economies to be in sufficiently good shape to load on more weights (higher interest rates). For this reason, we have lowered our interest rate forecasts accordingly. The latest developments in international trade and regarding Brexit, were factored into our baseline scenario. An adjustment to the 70 % probability of this scenario occurring is therefore not necessary.

### Global expansion continues – inflation edges up

2018 was marked by a significant economic slowdown in China and Europe, while in the United States growth picked up due to strong fiscal stimuli. Although the United States will lose some of its momentum in 2019, the euro area and China are likely to provide renewed cyclical impetus. We expect to see a stabilisation in other emerging markets. It is unlikely that the global economy will be able to quite match the above-average growth rates that were achieved in previous years.

Recovery in sight

Indexes for Germany, balance




Sources: Macrobond, Helaba Research

In the **United States**, annual average GDP growth should decline slightly from 2.9 % (2018) to 2.6 %. The tailwind provided by fiscal policy will weaken but this will to some extent be offset by continued very accommodative monetary policy. President Trump's trade policy remains a risk factor – but perhaps also an opportunity. He may reach an agreement with China on the reduction of tariffs, after tariff increases were implemented last year. There are no signs of an investment boom.

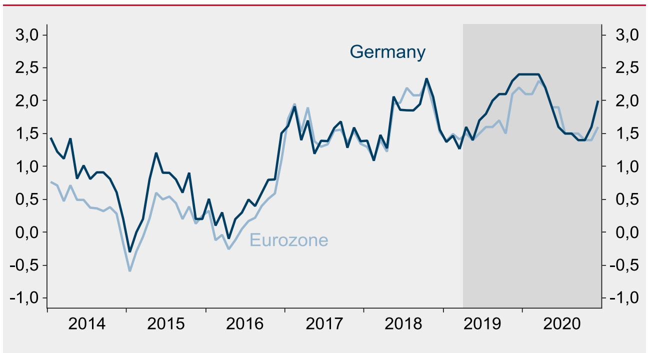
The **Chinese** economy will undergo a further structural slowdown. However, the government is responding with substantial monetary and fiscal policy countermeasures so that the downturn will remain within the bounds of what the government considers acceptable. Cyclical fears will thus be eased.

After a weak second half of 2018, the economy in the **euro area** and **Germany** should recover in the course of 2019. Meanwhile, the expectation components of important leading indicators have rebounded. For this year, we anticipate economic growth of 1.4 % in the euro area and 1.3 % in Germany. While foreign trade is expected to make a slightly negative contribution to growth, consumption will provide a significant boost, partly fuelled by a more expansionary fiscal policy. The construction industry will enjoy an exceptional boom, especially in Germany.

At the end of 2018 and in early 2019, global **political uncertainty** had increased noticeably: trade conflicts between the United States and China and with the EU appeared to be escalating. Due to the government shutdown in Washington, the US government operated on a contingency basis for weeks. In addition, the lack of agreement in the British parliament raised the spectre of a disorderly Brexit. With the extension of the deadline until the end of October 2019, this risk has been mitigated for the time being, although there are no signs yet of an actual solution to the crisis. Overall, however, we continue to assume that the negative factors of the trade dispute and Brexit will become less important for the global economy and the financial markets.

### Rising inflation rates

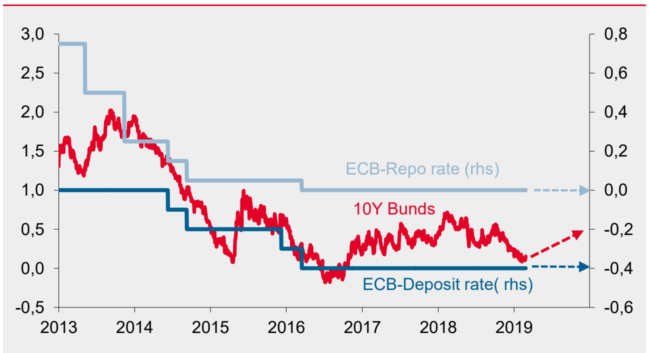
Consumer prices, % yoy




Sources: Macrobond, Helaba Research

### No rate moves by the ECB in 2019

% %




Sources: Datastream, Helaba Research

Higher inflation rates on the horizon

**Inflation** kicked off 2019 at a generally lower pace than expected, mainly due to energy prices. Since the beginning of 2019, however, the oil price has eased away from its low of around 50 US dollars and is currently trading at around 70 US dollars. The dip in inflation will therefore prove to be short-lived. The core index also indicates a trend towards higher inflation rates. Higher collective bargaining agreements, not only in Germany, are pushing up consumer prices. With an average of around 1.5 % for this year in the euro area, however, the ECB's inflation target of just under 2 % is unlikely to be reached.

### Central banks shift course

We (and the majority of the economics community) were caught out on the wrong foot by the major central banks. Over the past few months, the **Fed** and the ECB have completed a U-turn in monetary policy – with arguments of differing strength. The US Federal Reserve primarily reacted to developments on the financial markets: Not only will it stop reducing its balance sheet from September, but it has also radically changed its outlook for the key interest rate. We now expect the Federal Funds Rate to remain unchanged for the foreseeable future, while the financial markets are already speculating about the timing of the first rate cut.

Due to heightened cyclical risks, the **European Central Bank** has cancelled the interest rate hike it had signalled for this year. At the same time, the abundant supply of liquidity in the economy will be maintained by new long-term tenders, which should support the euro area economy. We do not now expect the ECB to make a cautious interest rate move until next year.

The cyclical tailwind for the **US dollar** is weakening. In the absence of backing from the Fed, the dollar's yield advantage over the euro is shrinking. The US currency, which has so far proven resilient, is likely to weaken. Trump's fiscal policy, in particular, is now turning out to be a burden on the greenback. The euro-dollar exchange rate will rise to 1.25.

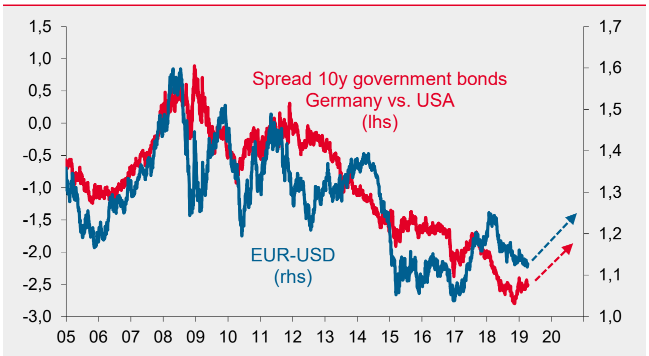
Less scope for higher yields

The recovery in the euro area economy over the course of the year should provide room for rising **yields** on German bonds. The decision of the ECB's Governing Council to leave key interest rates unchanged until the end of the year will nevertheless have an impact and put a ceiling on bond yields at a modest level. The yield on 10-year German Bunds should settle at around 0.5 % by the end of the year. We expect the yield on 10-year US Treasuries to reach 2.7 %. In particular, relatively stable inflation expectations indicate that significantly lower yields in the United States are unlikely.

Credit defaults at banks remain below their long-term average and corporate debt ratios continue to be low. Covered bonds, which are still in good shape, are facing reduced demand from the ECB. Overall, we expect a moderate rise in risk premiums for **credits**.

## US yield advantage falling, when will the dollar follow?

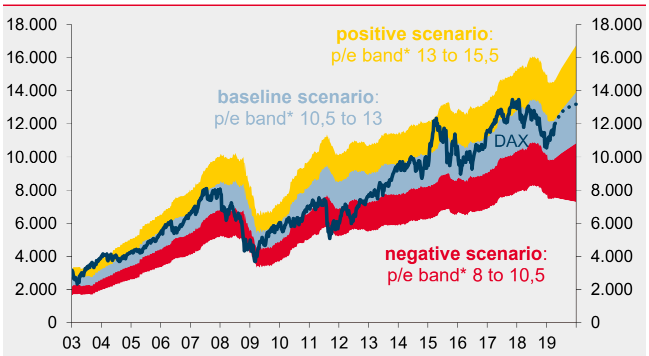
%-points USD




Sources: Macrobond, Helaba Research

## DAX with upside potential

Index points




* based on profit forecasts for the next twelve months

Sources: Datastream, Helaba Research

With interest rates at a persistently low level and sufficient economic growth, demand on **real estate** markets will remain high. This contrasts with a supply of properties that is still too small. The consequence is a sustained rise in rents and prices. Thus there will be a further increase in the overvaluation that already exists in certain submarkets.

Equities attractive

Our expectations for **equities** have so far proven accurate. Despite economic headwinds in the first quarter, they posted significant gains. Estimates for economic growth in the most important developed countries were continually revised downwards. However, it is perfectly normal that uncertainty about economic growth is greatest in the run-up to economic turning points. After all, equities are about half a year ahead of the real economy. Yet, equities also offer the highest returns in the very period leading up to an economic trough. Over the next few months, stock prices should be underpinned by improved prospects for growth and corporate profits. In addition, they will be supported by monetary policy remaining extremely loose. For the DAX, this continues to imply a fundamentally derived range of 10,500 to 14,000 points. Towards the end of the year it should be trading at 13,200 points.

Gold less in demand

Even in 2019, **gold** will probably not be able to break out from the range of 1,200 and 1,400 US dollars per troy ounce. This is supported by low real interest rates in the US and a predominantly accommodative monetary policy. However, at the current stage in the cycle, the yellow metal appears less attractive than other investments such as equities. ■