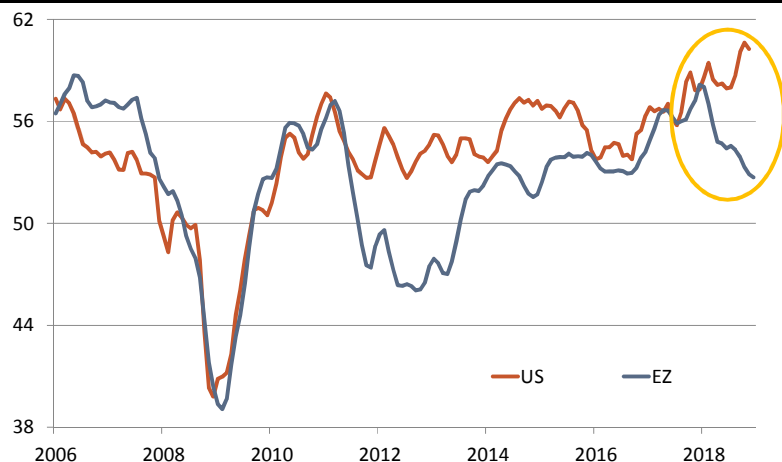


21 December 2018

2018: the year of the gap

The transatlantic gap – diverging fortunes in 2018 (composite PMI)



Monthly data. Source: ISM, Markit/CIPS.

- 2018 – a year of asymmetric shocks:** Following rapid and synchronised global growth in 2017, observers like us had been quite optimistic about the prospects for 2018 at the start of the year. While the US lived up to expectations, a series of shocks has steadily eroded the bullish sentiment elsewhere. Trade wars, the Chinese slowdown, wobbly emerging markets, a temporary spike in oil prices, the follies of Italian populists and, of course, Brexit have taken their toll.
- The US – a place apart in 2018:** Supported by deregulation, tax cuts and a pro-business tax reform, the US with its huge domestic market managed to shrug off the series of external shocks and political risks in 2018. Instead, the US enjoyed its fastest growth (2.9%) since 2005. With confidence riding high, consumption and business investment have grown solidly despite a further correction in interest-sensitive residential investment. As a result, a major gap has opened up between the US and its more export-orientated trading partners in Europe and Asia (see chart).
- The Eurozone – a serious slowdown:** After a solid 2.5% gain in real GDP in 2017, growth has slowed down sharply to an annualised rate well below the 1.5% trend in H2 2018. Regional problems such as the auto-related issues in Germany and the sharp drop in exports to Turkey this autumn exacerbated the unusually potent cocktail of external risks. As the damage has started to spread from the external to the domestic economy, data are likely to soften further in the next few months – see [Eurozone: anatomy of a serious slowdown](#), dated 10 December 2018.
- Towards some transatlantic convergence:** The transatlantic gap in sentiment is now as wide as it was during the euro crisis. We do not expect it to get much wider. In the US, growth will remain healthy but moderate somewhat as the fiscal stimulus starts to fade. This will allow the Fed to slow the pace of rate hikes – expect “one and done” for 2019. Amid less exuberant GDP growth, the actual and potential damage from trade tensions may become more visible in the US. With China apparently ready to make concessions, we look for trade wars to give way to trade deals eventually. This would help to reduce global risks and make it easier for China to achieve a soft landing.
- Can common sense prevail?** In Europe, Italy’s radical government seems ready to back down by enough to avoid an immediate debt crisis, while the UK will likely do what it takes to avoid a hard Brexit (20% risk) in the end. Chances are that, after a grey winter for Europe, the transatlantic gap can give way to some transatlantic convergence again as European growth strengthens modestly from spring onwards.
- Good luck for 2019:** Despite issues in some pockets of the credit market, the Western world does not yet exhibit major credit, wage or investment excesses that would require a cleansing recession soon. As rates of core inflation remain well behaved, central banks can afford to slow their policy normalisations if needed to keep growth on track. As long as the world can dodge the worst political risks, 2019 could turn into a better year than markets are pricing in today.

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