Focus

19 december

'Big Picture: more of the same, but less'

Economy

- **Worldwide: Stability**

  KBC predicts the gradual stabilisation of global economic growth in 2020 against the background of the gradually cooling growth of the US and European economies. The manufacturing industry will still continue to struggle everywhere for a while, so it will take some time before there is a global geopolitical (trade) thaw. The main focus is on maintaining trust in the service industries, which account for most of the economy.

- **Euro Area: Tentative GDP Growth**

  Economic growth will gradually consolidate from quarter to quarter, with the year ending with a real GDP growth of 1.0%. Just as in 2019, KBC expects private consumption to continue making an important contribution to growth in 2020. It is true that consumer confidence has diminished somewhat compared to previous years, but it is still remarkably strong, as is evident from, for example, surveys of the plans for important expenditure in 2020. That strength is attributable to solid job creation and employment market performance, the robust growth of purchasing power and a further increase in employment.

  > *'While European economic activity will continue to be weak in 2020, we are not heading for a deep or long-lasting recession'*

  And in budgetary terms growth next year will also receive a boost. The draft budgets submitted by the governments to the European Commission indicate that fiscal policy can support economic growth somewhat in the years to come, albeit in a relatively limited way and not in all European countries

  Factors that will restrict GDP growth in 2020 are rooted, for example, in the weaker external environment that is negatively impacting the industry. Moreover, we also expect Brexit and global trade tensions to create uncertainty next year.

- **US: Further Slowdown**

  In 2020, the world's largest economy will continue to perform well, albeit at a slower pace. The trust of business leaders in the manufacturing industry will need time to recover from the downward trend in export-based industrial production. That continuing weakness will not affect the domestically-oriented service sector because trust in the service sectors is still strong.

  > *'The US indicators confirm a scenario of gradually cooling growth, but not a severe recession. We're aiming for a growth rate of 1.7%'*

  In a historical perspective, since consumer confidence is still strong, KBC doesn't expect a sharp fall in the coming year. The scenario predicts a solid growth contribution by private consumption, despite the fact that the labour market is showing signs of cooling off. However, we don't expect any extra growth impulse because the trade tensions will continue to curtail growth in 2020.

Central Bankers: Flexibility is an Advantage

- **ECB: Looking at Fiscal Policy**
  In 2019, both the ECB and the American Federal Reserve eased their monetary policies by lowering their key rate. While some ECB managers continue to support a further easing, KBC does not agree and advocates a constant (low) key rate. However, the ECB's arsenal is exhausted and questions are being asked about the effectiveness of the recent measures to stimulate the economy in order to support economic growth and the increase in inflation. In 2020, the ECB will continue to actively support stimulation of the economy through the national budgets without abandoning its accommodating stance.
- **Fed: Hopeful**
  There is also internal division here, as is evident from the differing opinions on the world's economic and monetary future. Despite a gradual and ongoing slowdown, the US economy is still growing significantly while inflation remains close to the 2% target. The orthodox Fed governors looking at the domestic economy therefore see no reason to ease their monetary policy. But the followers of Fed chair Powell have been urging caution for some time now because the negative consequences of developments outside the US are also being taken into account.

> *'Strategic differences of opinion make the future key rate less relevant. We don't expect any Fed or ECB interest rate cuts in 2020'*

- **Interest Rate Forecasts: Lower for Longer**
  Given that the US-China trade war, Brexit and other international developments are still generating considerable uncertainty, we remain cautious in our projections for the future development of the long-term interest rate. By the end of 2020, we expect a long-term interest rate of 0.2% on German government bonds and 1.9% on those from the US. KBC still believes that the bonds are too highly valued.

Distractions: More of the Same in 2020

The main risk elements for 2020 continue to be the trade tensions, not least between the US and China, and Brexit. These risks are dominating the headlines and as such are generating volatility on the financial markets.

- **Brexit**
  The approval of the withdrawal agreement is nothing more than a temporary measure to prevent the UK from crashing out of the EU in 2020 with major economic losses. The shape of the future long-term relationship between the UK and the EU will have to be decided in 2020. At the moment, the deadline for a comprehensive trade agreement has been set for the end of 2020, but given the complexity of the issue it is very unlikely that the deadline will be achieved. Tensions will rise again as this fresh deadline approaches.
- **US/China**
  We do not expect a comprehensive trade agreement to be signed any time soon, even if a temporary agreement can provide short-term relief. The signed agreement will probably not contain any significant concessions so at most will provide some temporary distraction, possibly combined with a slightly positive economic impact. An incomplete Phase 1 deal is not expected to solve the structural problems. No concessions will be made on structural issues, such as the lack of a credible Chinese system for enforcing intellectual property rights and State intervention in industry. The battle for technological global supremacy will not be resolved in 2020.
- **US/EU**
  It is still a matter of conjecture as to whether President Trump will decide to direct his trade war towards the EU in 2020. That would be disastrous for the export of European – read German – cars. Such a scenario must be avoided at all costs, given that it can and will put the already very fragile German economy under more pressure and hinder the recovery of the European economy.
- **Elections**
  The closer we get to November 2020, the more uncertainty there will be about the result of the American elections. We expect the current political power situation in the US to continue.

- **Clashes in the Oil-Producing Countries**
  The mood and stability of the oil-producing countries are intrinsically unpredictable. The power of the OPEC cartel has diminished in recent years and will continue to do so in 2020. Now that Aramco has officially listed on the stock exchange, it will again become clear that the growth in oil supply will be controlled by the American shale oilfields. Both factors balance each other out. KBC expects a stable oil price of 60 dollars per barrel throughout the year.
- **Exchange Rate Fluctuations**
  The past few years were characterised by extensive fluctuations in the currencies of a large number of emerging economies (Turkey, South-Africa, Brazil, Argentina, etc.). That depreciation was often the consequence of domestic problems (debts, politics/economic crisis, etc.). However, the main risk factors currently seem to be limited in terms of their destructive capacity, mainly due to the continued low (and negative) interest rates and the stability of the US dollar.

Risk Appetite More Aggressively Positioned Towards Shares

2019 was a peak year, with average returns of between 15% and 25%. That optimism is largely rooted in the rapid stock market recovery in the first quarter, which helped to fully compensate for the disastrous fourth quarter of 2018. That optimism recently grew because the fear of recession evaporated, the operating results over the third party quarter were better than expected and the trade talks between the US and China created a positive momentum. Added to that, it looks as if the sting has been taken out of Brexit.

So KBC AM is no longer positioned 'very defensively'. Although caution will still be necessary in 2020, the first economic growth shoots are enabling a shift from defensive to cyclic, growth-oriented sectors. We expect profit stabilisation in the euro area, among others; where strong and stable consumer demand should keep the German spectre of recession at arm's length. Overall global profit will be determined by permanently high purchasing power supported by permanently low inflation.

- **Stock Markets**
  Shares offer the best return prospects in the medium to long term and their relative valuation also continues to be attractive. In 2020, preference will be given to high-quality, stable companies that create added value for the shareholders – for example, through the purchase of treasury shares. KBC AM expects a normalisation of the returns: it is unlikely that shares in 2020 will be able to finish in double positive figures. In the long or medium-to-long term, we're aiming for a 6.5% return for a global share selection.

> *'KBC AM expects a normalisation of returns on equity. In the long or medium-to-long term, we're aiming for a 6.5% return for a global share selection.'*

- **Bonds**
  Due to the extremely low and negative interest rates, bonds will remain very expensive, so the bond portfolio is focusing mainly on short-term bonds as a strong buffer against the expected fluctuations on the share markets.
- **The Euro Above the Dollar**
  Cash is still not recommended due to the predictable negative return. That excess cash can best be kept in euros.
- **Regional Level**
  The prospect of a trade war will weigh marginally on growth and on earnings as a result of higher import costs, but US companies are less sensitive to this than Asian or European companies. Not only are American consumers bolstering growth, but the US also has a more closed economy. US shares are therefore preferred to European shares. US economic growth remains the strongest in the world, while we are still waiting for growth to pick up in Europe and Asia.
- **Sector Positioning**
  There is a commitment to shares of materials, industrials, cyclic consumer products, financials and information technology. In other words, a commitment to the first growth shoots.

Topics Within the Portfolio

In addition to the above major tectonic plates, in 2020 the global economy will also be subject to other political and geopolitical forces. In and of themselves, they do not immediately have the potential to impact the global sentiment or risk appetite, but they can function as catalysts for existing turmoil.

- **Emerging Economies/Growth Markets**
  While the shares in emerging economies haven't done well over the past few years, growth markets can probably return to favour in 2020. These types of markets fare relatively well in a positive stock market climate when the local economy recovers and they are attractively valued compared to the rest of the world. Particularly the Southeast Asian countries still have enormous potential, while the export component of the economies in Latin America, for example, has a huge advantage thanks to the lower exchange rates. It is still too early to say, but these factors can probably all be ticked off in the course of 2020. The only thing we can't immediately see are strong commodity markets, which usually also support performance.

'Emerging economies didn't have a great year but can probably return to favour in 2020'

- **Cash is King**
  European companies have been generating significant operating cash buffers for some time. Those free cash flows remained (and remain) stuck on the balance sheet, causing the debt ratios to fall back to levels prompting clear decisions: invest or pay out, given that excess cash has an adverse effect on valuation levels. That will also be the case in Belgium, since the debt ratio of operating companies in 2020 may drop back to 6% of the total assets. We expect a further movement of capital away from the balance sheet to the shareholder. That can be by way of stable or higher dividends, or by means of tax-efficient purchase programmes. As the third option, mergers and acquisitions will produce positive returns. In 2020, the consolidation wave that is already happening will keep rolling on in an attempt to secure global domination over a sector and insource all kinds of technologies as a bolt-on strategy.
- **Environment**
  KBC Asset Management will continue to focus on drinking water so that it can respond to obsolete and inadequate water infrastructure, climate change and the problem of water quality and wastewater treatment.
- **Shareholder Compensation**
  Another focus will clearly be on companies with existing or future purchase programmes, supplemented by a partial shift from growth shares to value shares.

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