

## Rising risks

We expect a further gradual weakening in growth, caused by trade tensions and related uncertainties.

- \_ The signs of lasting damage from ongoing trade conflicts continue to grow.
- \_ For now, much of the data merely points to a temporary slowdown in global growth, rather than a full blown recession in either the United States or the Eurozone.



Johannes Müller  
Head of Macro Research

Three months ago, we warned that: "The outlook for the world economy is getting cloudier. Escalating trade tensions could trigger further downgrades." Sadly, this has now come to pass. In several export-oriented economies, notably Germany and Japan, we had to cut our growth forecasts for both 2019 and 2020. For the U.S., we have left our 2020 forecast unchanged at 2%, but now expect just 2.3% for 2019, 0.2% less than three months ago. The U.S cut is not actually related to 2019 economic performance. Instead, it is due to a revision of past data, dating back to 2018. To be sure, U.S. economic momentum is weaker this year, with the stimulus from tax cuts continuing to fade. However, that has always been reflected in our gross-domestic-product (GDP) forecast.

Indeed, if you look at the U.S. in isolation, forward-looking economic signals remain decidedly mixed, rather than unambiguously negative. For example, the ratio between leading and coincident economic indicators remains near its recent peak. Leading indicators, such as new orders in manufacturing, help to predict future trends. Coincident indicators, such as personal income, are measured in real time. So, if personal income was to shrink at the same time as orders began to deteriorate, you would, all else equal, notice a decline in the ratio. In past cycles, there have usually been substantial declines

in the ratio, well before U.S. recessions started. The current pattern more closely resembles past temporary slowdowns. Another indication is, companies' continuous hiring of temporary workers. And, financial conditions broadly remain in line with economic growth of just above 2%.

Of course, you can always find reasons to worry. One particular bugbear is the yield curve. Recently, it has inverted in the U.S. and elsewhere, meaning that, for example, yields on 10-year U.S. Treasuries fell below those of 2-year U.S. Treasuries. In economic terms, the best way to think of inverted yield curves is as measuring the willingness of fixed-income investors to pay for "recession insurance." The more inverted yield curves are, the higher the implied recession risk premium investors are willing to settle for. That merely suggests, though, that plenty of investors are already quite gloomy – not that they are necessarily right to be gloomy. Also worth noting is that inverted yield curves of this sort are, if anything, self-denying rather than self-fulfilling prophecies: by driving down long-term yields, bond markets make a recession less likely, even in the absence of central-bank action.

Instead, the U.S. Federal Reserve (the Fed) looks set to continue its policy of 1998-style pre-emptive cuts, even as it

remains reluctant to embark on a full-blown cutting cycle. We expect two more interest-rate cuts in the next 12 months. For the European Central Bank (ECB), we expect a small cut of 20 basis points to -0.60%, the introduction of a tiering system for central bank deposits, and a resumption of asset purchases as part of a broad package. We also expect these steps to be enough to stabilize the situation.

Both the Fed and ECB have been put in an unenviable position. Signs of financial-market nervousness and real economic damage in key countries such as Germany can mostly be traced back to global trade tensions. Yet, as central bankers rightly lamented at their recent conference in Jackson Hole, there is little monetary policy can do to alleviate the longer-term damage caused by protectionist policies. As we explained in our trade special (see CIO Special – Free trade under attack as of 5/17/18) last year, temporary protectionist measures are akin to taxing a highly efficient production technology. And permanent protectionist measures are akin to destroying existing production facilities at home and abroad. So, at least in an economy at full employment before a trade shock, all you eventually get from printing money (in one way or the other) in reaction to a trade shock is an economy just as much poorer, but with inflation added to the list of economic woes. The correct policy prescription, in our view, would be to simply stop the trade hostilities.

Unfortunately, there is little sign of global trade peace breaking out any time soon. Aside from the erratic policy pronouncements by the U.S. President, there are worrying signs of protectionist trends catching on. This includes not only the conflict between South Korea and Japan, but also between the European Union (EU) and several developing countries. The new European Parliament will probably be more willing to flex its muscles, notably on trade issues related to environmental concerns. We continue to hope that economic self-interest will prevail – eventually. In the meantime, trade conflicts in general

and the one between the U.S. and China in particular remain a drag on the global economy. By contrast, we are reasonably confident about two other frequent political worries. On Brexit, we think that by constantly beating the "No-Deal" drum, the new Prime Minister Boris Johnson is likely to prevent the UK and the remaining EU 27<sup>1</sup> from sleepwalking into a "No Deal." In Italy, snap elections seem to have been avoided for the time being.

So, to sum it all up, the world is facing decelerating growth. However, we do not expect a recession in the U.S., nor in China, nor in the Eurozone as a whole. We believe that monetary policy is set to remain expansionary, providing support to the economy and financial markets. In Europe, there are signs fiscal policies might ease, though probably not enough to have much of an economic effect in the next 12 months. Inflation should remain low, at least for now. Could we, and central banks, be wrong in this comparatively benign assessment? Of course, and in more ways than one!

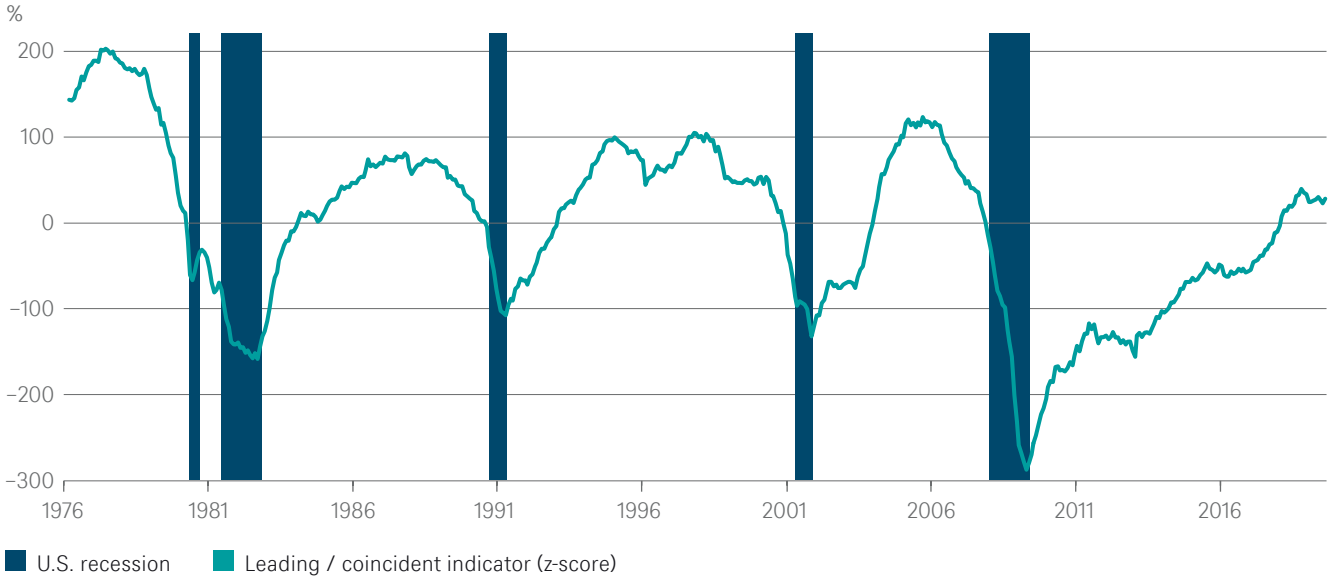
In the U.S., there are some worrying signs of profit margins getting squeezed. In the past, corporate America has typically reacted by laying off workers, sometimes quite suddenly. It remains too early to say, though, whether the trade-war-induced shock will play out exactly along those lines. Contrary to much of recent conventional wisdom, trade wars do not usually, or even necessarily, cause recessions. They tend to damage how much existing plants and businesses are worth in the long term, not necessarily how much of the remaining capacity might remain idle for a few quarters. And if trade tensions continue to escalate, there is an alternative scenario at least worth considering. That scenario is likely to be familiar to anyone still remembering the stagflationary<sup>2</sup> days of the 1970s: just as with oil shocks, adding loose monetary and fiscal policies to a trade shock is likely to be inflationary in the longer term. Let's hope today's policymakers do not repeat those mistakes.

<sup>1</sup> The "EU 27" include all member states of the European Union except for the UK.

<sup>2</sup> Combination of the words "stagnation" and "inflation," referring to a period where inflation is high while the economy is stagnating.

**A LOW-NOISE INDICATOR**

The ratio between leading and coincident U.S. economic indicators remains near its recent peak. That is suggestive of a temporary slowdown, not a recession.

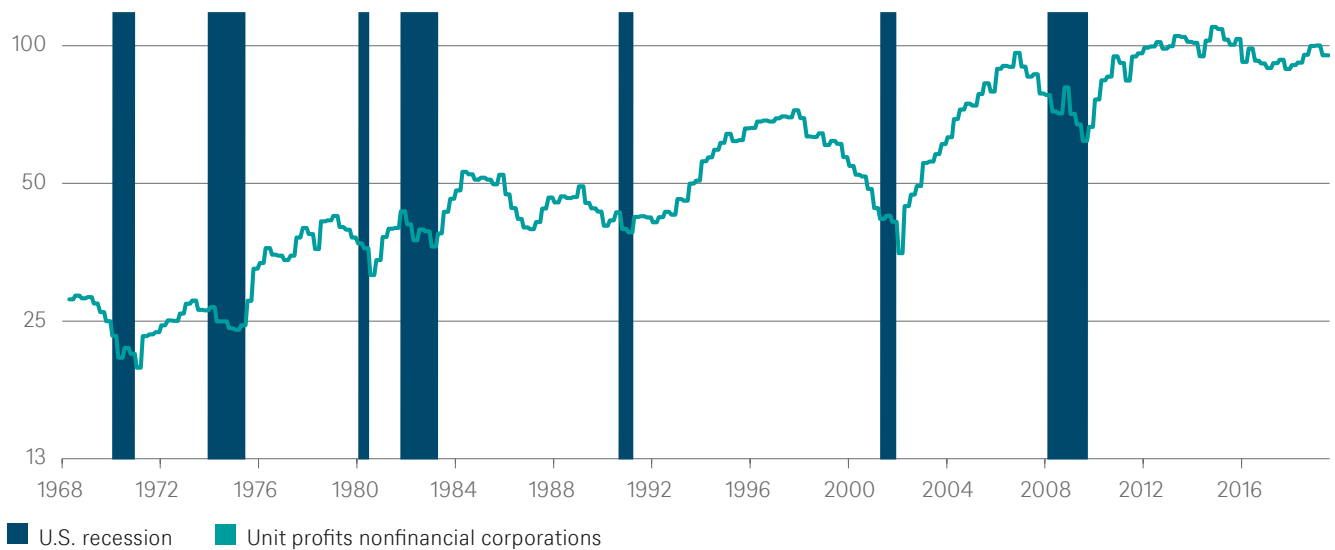


Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 8/30/19

**U.S. UNIT PROFITS HAVE STARTED TO STALL**

One of the more worrying signs for the U.S. economy concerns corporate profits. These are down 4.9% so far, which is not yet enough to serve as reliable recession signal. slowdown, not a recession.

indexed: 1/1/09 = 100



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 8/30/19

All opinions and claims are based upon data on 8/30/19 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. DWS Investment GmbH

## GLOSSARY

One **basis point** equals 1/100 of a percentage point.

The **European Central Bank (ECB)** is the central bank for the Eurozone.

The **European Union (EU)** is a political and economic union of 28 member states located primarily in Europe.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

**Fiscal policy** describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

**Inflation** is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

**Treasuries** are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

The **U.S. Federal Reserve**, often referred to as "the Fed", is the central bank of the United States.

A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is **inverted**, bonds with longer maturities have lower yields than those with shorter maturities.

#### Important Information – EMEA

The following document is intended as marketing communication.

DWS is the brand name under which DWS Group GmbH & Co. KGaA and its subsidiaries operate their business activities. Clients will be provided DWS products or services by one or more legal entities that will be identified to clients pursuant to the contracts, agreements, offering materials or other documentation relevant to such products or services.

The information contained in this document does not constitute investment advice.

All statements of opinion reflect the current assessment of DWS Investment GmbH and are subject to change without notice.

Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical performance analysis, therefore actual results may vary, perhaps materially, from the results contained here.

Past performance, [actual or simulated], is not a reliable indication of future performance.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses.

This document and the information contained herein may only be distributed and published in jurisdictions in which such distribution and publication is permissible in accordance with applicable law in those jurisdictions. Direct or indirect distribution of this document is prohibited in the USA as well as to or for the account of US persons and persons residing in the USA.

DWS Investment GmbH 2019

#### Important Information – UK

Issued in the UK by DWS Investments UK Limited. DWS Investments UK Limited is authorised and regulated by the Financial Conduct Authority (Registration number 429806).

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS") are communicating this document in good faith and on the following basis.

This document is a financial promotion and is for general information purposes only and consequently may not be complete or accurate for your specific purposes. It is not intended to be an offer or solicitation, advice or recommendation, or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein. It has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor.

This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are suitability and appropriate, in light of their particular investment needs, objectives and financial circumstances. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information and it should not be relied on as such. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

© DWS 2019

Publisher: DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany

#### Important Information – APAC

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS Group") are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS Group, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

DWS Group does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by DWS Group. Investments with DWS Group are not guaranteed, unless specified.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance.

Although the information herein has been obtained from sources believed to be reliable, DWS Group does not guarantee its accuracy, completeness or fairness. No liability for any error or omission is accepted by DWS Group. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. All third party data (such as MSCI, S&P, Dow Jones, FTSE, Bank of America Merrill Lynch, Factset & Bloomberg) are copyrighted by and proprietary to the provider. DWS Group or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

The document was not produced, reviewed or edited by any research department within DWS Group and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other DWS Group departments including research departments. This document may contain forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS Group as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without DWS Group's written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS Group to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation ("FDIC") or any other governmental entity, and are not guaranteed by or obligations of DWS Group.

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited and the content of this document has not been reviewed by the Securities and Futures Commission.

© 2019 DWS Investments Hong Kong Limited

In Singapore, this document is issued by DWS Investments Singapore Limited and the content of this document has not been reviewed by the Monetary Authority of Singapore.

© 2019 DWS Investments Singapore Limited

Publisher: DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany

CRC 070233 (09/2019)