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ZURICH

Weekly Macro & Markets View

Highlights and View

- **The 13th NPC de-emphasises the role of quantitative targets, and favours fiscal over monetary policy**

  We believe that the economic agenda presented at the NPC will help China to navigate a 'soft' deleveraging and transition towards a more sustainable growth model.

- **US nonfarm payrolls rise 313'000 while the participation rate jumps to 63%**

  The healthy employment situation is drawing more people back to the labour market, which helps to moderate the upwards pressure on wages.

- **The ECB makes a small change in language, omitting reference to expanding QE if needed**

  The overall tone of the ECB meeting was dovish, and we expect QE to continue to the end of 2018, with a gradual taper in Q4.

China sharpens its long-term economic strategy at 13th NPC

	2018 Target	2017 Target		2017 Actual
GDP	*Around* 6.5%	*At least* 6.5%	↓	6.9%
CPI	3%	3%	↔	1.6%
M2	*Steady growth*	12%	↓	8.2%
TSF	*Steady growth*	12%	↓	12%
Fiscal Deficit (% GDP)	2.6%	3%	↓	3%
Local Govt. Rev. Bond (RMB)	1,350bn	800bn	↑	
Urban job creation	*At least* 11m	11m	↑	13.5m
Urban unemployment	< 5.5%	*None*	↓	5.0%
Coal Capacity Cuts (tons)	150m	150m	↔	>160m
Steel Capacity Cuts (tons)	30m	50m	↓	>50m

Source: Bloomberg

In abolishing the two-term limit for the presidency, China's 13th National People's Congress (NPC) has made the concentration of political, economic, and military power around President Xi official. This political milestone also preludes profound shifts in economic policy. The 13th NPC unveiled radical strategies to achieve the objectives of poverty and pollution reduction, innovation, financial regulation, and supply-side reforms. Quantitative targets will become less binding, and will even be dropped in the case of money supply. In our view, this formalises the role of monetary policy as a back-up tool to address exceptional situations of squeezed liquidity.

Chinese authorities are now focused on channelling money to the 'real economy'. First, banks will be forced to migrate off-balance sheet loans to their books and disclose NPLs, thereby reducing credit supply to the non-productive areas of the economy. Second, fiscal policy will be used as the primary tool to support low and middle-class households, corporate innovation, SMEs, etc. Additionally, Beijing will increase the quota for central and local government bonds and freeze the general public deficit target, thereby seeking greater transparency and control over public expenditures. We believe that this economic agenda will help China to navigate a 'soft' deleveraging and transition towards a more sustainable growth model.

US: Stocks rebound on solid data and tariff exemptions

As expected, the stock market recovered last week after it became clear that neither Jerome Powell's remarks nor Donald Trump's tariff announcement significantly increase the near-term risks for the US economy or financial markets. Nevertheless, further developments around the tariff discussion and potential retaliation of US trading partners need to be monitored. Economic data were again mostly on the positive side with the ISM Non-Manufacturing Index staying close to its multiyear highs, indicating that the US service sector remains in splendid health. The labour market shows a positive mix as well with payrolls climbing a solid 313'000 in February. At the same time, the unemployment rate remained at 4.1% as the participation rate rose back to 63% from 62.7%. Investors took some comfort in the slowdown in wage growth as the marked pickup in January was one of the triggers for the severe stock market sell-off. Growth in average hourly earnings fell to 0.1% MoM from 0.3%, lowering the annual rate to 2.6% from a revised down 2.8% in January.

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Eurozone: The ECB omits QE expansion reference, but the overall tone is still dovish

At last week's ECB meeting and press conference, ECB President Mario Draghi struck a dovish tone. Although the introductory statement omitted the usual phrase that QE could be expanded in duration or size if needed, it was not a great surprise as it had been widely flagged that this language was likely to be dropped at some point. Draghi said that omitting the phrase did not mean the ECB's reaction function had changed. Rather, he emphasised that an ample degree of monetary stimulus was still needed to move inflation back up to target. The ECB's forecast for inflation in 2019 was also revised down by a tenth of a percentage point, to 1.4% from 1.5% previously, though the forecast for 2018 was left unchanged. Overall, investors interpreted the ECB meeting as dovish, with Eurozone government bond yields falling back and the euro a bit weaker against other major currencies on Thursday. We still expect the ECB to end QE in 2018, with a gradual taper of asset purchases in the final quarter of 2018.

Japan: The Bank of Japan is likely to stick to dovish rhetoric

As expected, the BoJ left its policy unchanged. Governor Kuroda sounded decidedly dovish, stating, "…we are still away from achieving our goal. It's not a time to discuss exit policy." as he tried to reduce short-term expectations of tightening, following earlier comments around potential "exit" strategies. With inflation on the rise but still undershooting the BoJ's target, and given the composition of the new board, we expect ongoing dovish statements. Indeed, Governor Kuroda emphasised again the need to guide inflation expectations higher and avoid discussing future policies too early: "For forward guidance, it is appropriate to show the market our outlook path, but clearly showing future policy measures is still controversial". Meanwhile, economic data were affected by temporary disruptions. The Eco Watchers Survey was hurt by bad weather and likely by financial market volatility. Domestic investors were net sellers of foreign securities, leading to a net inflow of JPY 1.67tn in February. As a result, the USDJPY remains in a downward trend. A more convincing stabilisation is needed to support local equity markets.

Bonds: Core yields modestly higher on surge in US payrolls

Core bond yields see-sawed during the week. Initially lower in response to dovish central bank communications, they moved higher on Friday as US payroll growth surged. BoJ Governor Kuroda clarified that it was too early to debate exit policy, and the ECB press conference was interpreted as dovish. On Friday, US payroll data showed a surge in job creation, confirming strong momentum in the economy. Wage inflation was weaker than expected, however, helping to contain fears of aggressive Fed tightening, with Treasury yields ending the day modestly higher at 2.89%. In the Eurozone, Italian government bonds have been resilient so far in the aftermath of the elections. Spreads versus German Bunds only widened by around 5bps over the course of last week, though they widened by more versus other Eurozone government bond yields such as those of Spain. However, we believe that Italian government bonds remain vulnerable over the next few months as we are likely to see fiscal slippage through either tax cuts and/or more government spending, regardless of what government coalition is eventually formed.

Credit: Despite broader risk-on sentiment, credit remains lacklustre

The risk-on sentiment supporting equities last week did not have the same effect on credit markets. While CDS index spreads managed to end tighter on the week, cash spreads were more mixed and ended the week wider for US indices. Heavy supply weighed on spreads, with the US primary market dominated by a $40bn jumbo deal from CVS. Though demand for US investment grade (IG) credit remains strong, with anecdotal reports of $120bn of orders for the CVS deal, the question is how long will the strong supply/demand technicals last. YTD supply for IG is lower than last year by around 20% in both US and Europe, but spreads are not much tighter. Flows have been negative across several credit markets and products. At the same time, organic leverage trends don't show material improvement despite strong earnings growth, while ever larger debt financed deals on M&A and LBO fronts are positive for equities and negative for credit. Therefore, it should be unsurprising that the rally in equities may not translate into better credit returns.

What to Watch

- US small business optimism is expected to remain high, while retail sales should recover from the recent weakness. Investors will focus on CPI data for any signs of increasing price pressure.
- In Japan, PPI, core machine orders and the final print of industrial production will be in focus. In China, industrial production, fixed asset investment and retail sales will be released.

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