April 9, 2018

Weekly Macro & Markets View

Highlights and View

- **US economic data remain strong, but soften at the margin**

  The ISM surveys show that business activity has receded from multi-year highs while the employment situation remains healthy despite the latest dip in new nonfarm payrolls.

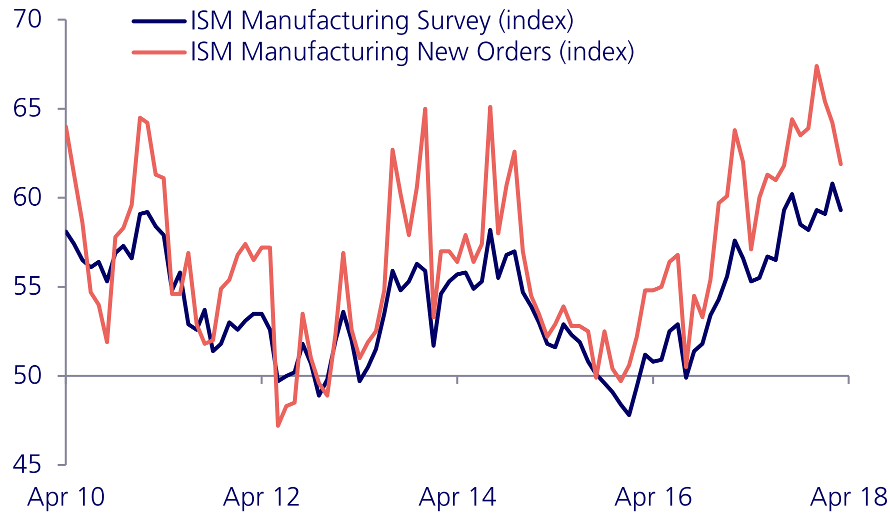
- **The tit-for-tat between China and the US continued with Trump hinting at another wave of tariffs**

  While a lot of the recent tariff rhetoric should be considered posturing ahead of negotiations, the risk of an escalation remains.

- **The global PMIs decline sharply amid a broad-based slowdown across regions and sectors**

  Global growth is moderating, and we expect conditions to stabilise as economic fundamentals remain favourable.

Business activity slows from very strong levels



Source: Bloomberg

The S&P 500 ended another volatile week in negative territory, receding 1.4%, as the trade war rhetoric between China and US kept dominating the headlines. We still think that the final economic impact of any imposed tariffs will be limited, but the risk of an escalation of mutual threats and a vicious cycle remains. Meanwhile, the latest ISM surveys confirm our view of solid but slowing economic momentum. The ISM Manufacturing index ticked down to 59.3 in March from 60.8 while the Non-Manufacturing survey fell to 58.8 from 59.5. In both cases, the slowdown in new orders was somewhat more pronounced, but still indicates a continuation of solid business activity. The latest set of labour market data did not have a major impact on markets as it was broadly in line with expectations. The 103’000 new payrolls in March may look somewhat disappointing but should be seen in the context of a very strong number the month before (326’000). The unemployment rate remained at 4.1% while the broader underemployment rate fell back to 8% from 8.2%, matching the 11-year low reached last autumn. Average hourly earnings growth accelerated to 0.3% MoM from 0.1%, lifting the annual rate to 2.7% from 2.6%. All in all, the latest set of economic data continue to signal a positive environment for the stock market as economic momentum is holding up and there are no signs of overheating that could force the Fed to tighten at a faster than expected pace.

Global: Growth slowing, but conditions remain favourable

Momentum in the global economy is slowing, following the sharp upswing over the past year. The Global Manufacturing PMI dipped in March amid a broad-based slowdown across regions and sectors. Global trade data show a similar picture, with a moderation in leading Asian export data underway. While some of the weakness in European and Japanese indicators likely reflect adverse weather conditions, and as seasonal effects are still impacting Asian data, some forward-looking indicators, including new export orders, have also deteriorated. This indicates that global growth is peaking, though remains at a healthy level. We expect momentum to stabilise over the coming months, as underlying conditions are favourable, and maintain our view that global growth will track modestly above trend in 2018. In response to more mixed data and rising geopolitical risk, central banks should become more cautious in removing stimulus, particularly as inflation remains weak in most regions. This should lend some support to the global economy in the months ahead.

UK: Service sector impacted by bad weather

The latest PMIs send a mixed message about the current state of the British economy. The Manufacturing PMI ticked up slightly to 55.1 in March from 55.0 in February, indicating that the manufacturing sector is maintaining a decent momentum, although it was the weakest quarter in a year and new orders fell to the lowest in nine months. On the other hand, the Services PMI fell relatively sharply to 51.7 from 54.5, reflecting the weakest service sector performance since July 2016. While the slowdown can be partially explained by subdued consumer demand due to Brexit-related uncertainty, unusually bad weather in March is likely to be a key factor for last month's weaker business activity. Nevertheless, the underlying economic weakness was also reflected in new car registrations, where the downward trend continued in March. Although some seasonal distortion is possible, the fact that the annual rate dropped to -15.7% does not bode well for overall household spending.

Switzerland: Economic activity normalising

Booming conditions in the Swiss economy are now moderating. The manufacturing PMI dropped from a cycle high to a more normal level in March, undershooting Consensus expectations by a wide margin. One bright spot was the employment sub-component, which rose, suggesting that companies remain positive and are willing to expand the workforce. The KOF leading indicator also dipped in March, as domestic demand did not offset weaker activity in the industrial sector. Inflation remains low, with core CPI at 0.6% YoY, still far below the SNB's target. The weaker data are in line with our below-consensus view on Swiss GDP growth, and we see this as a sign of normalisation, rather than the beginning of the end of the expansion. Our weaker growth outlook underpins our view that the SNB will only very cautiously remove stimulus. Sight deposits also ticked up over the past weeks, indicating that the SNB remains active in forex markets, amid rising geopolitical risk.

Japan: Tankan not as bad as commentators make you believe

Many economists and commentators have put a negative spin on Japan's Tankan for Q1, the quarterly corporate survey conducted by the Bank of Japan published on Easter Monday. Indeed, the headline diffusion indices and capex projections were down from Q4, but we are more upbeat, focussing on three points: 1) Q4 data were revised up, making the deterioration look more severe, even though the level remains high. 2) While most commentators focus on big manufacturing companies, data for small companies were more encouraging. It is remarkable that the diffusion index for conditions across all companies marked a 27-year high. 3) Capex budgets and profit forecasts were down slightly on an overall basis, driven by a more negative outlook by non-manufacturing companies. Managers tend to give very cautious investment and profit forecasts at the start of a fiscal year, but usually get more optimistic throughout the year. Encouragingly, planned investment spending for FY18 is the strongest we have seen for the last ten years. Scarcity of labour and machinery suggests that capex will remain solid.

Asia: Less optimistic Manufacturing PMIs

The arithmetic average of Asian manufacturing PMIs fell by 0.2pts to 52.2 in March, led by a decrease in the output sub-index. Meanwhile, input pricing pressures declined in China but remained very acute in other countries due to oil and metal costs. Nine out of twelve manufacturing PMIs declined, with Korea, Malaysia and Thailand printing below 50. Manufacturers flagged weaker demand, especially from overseas. We think that disruptions around Chinese New Year are partly to blame. Additionally, manufacturing activity is normalising from very strong levels.

In contrast to other countries, Australia registered a record-high manufacturing PMI of 63.1. Metal products and machinery equipment were in high demand, consistent with investment rebounding in the sectors of public infrastructure, agriculture and mining. However, retailers are pessimistic due to disappointing retail sales and the fragile financial situation of Australian consumers.

What to Watch

- Small business optimism is expected to soften from very strong levels in the US, while inflation rates will be lifted by base effects as last year's massive mobile phone price cuts will fall out of the annual comparison
- In Asia, the focus will be on China' trade, financing and inflation data for March, but we will also keep an eye on Taiwan's export statistics and Singapore's GDP in Q1. We do not expect the Bank of Korea to hike its policy rate, even though one policy board member may suggest it.

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