April 16, 2018

Weekly Macro & Markets View

Highlights and View

- **China announces new liberalisation measures in the auto and financial sectors**

  The announcement of concrete steps to liberalise the financial industry is encouraging and should alleviate trade tensions with the US.

- **US headline CPI inflation accelerates to 2.4% YoY while Core CPI rises to 2.1% YoY**

  Rising annual inflation rates were fully expected as they are driven by base effects. The modest pick-up of the monthly core rate is more representative of the current trend.

- **The Q1 earnings season has kicked off in the US with modest surprises from some major banks**

  Decent earnings should lend support to equities, but expectations are relatively high as confirmed by the negative reaction to the latest bank earnings.

China gives a fist bump, not a knock-out punch

Source: iStock by Getty images

Following skirmishes on trade issues between the US and China, President Xi Jinping presented himself as a statesman last week, offering both visionary as well as concrete measures on how China is opening up its economy further. Similar to his speech at the Davos Forum last year, he made clear that China is taking a constructive attitude towards global trade and economic liberalisation while actively improving trade and investment opportunities for foreign partners. In his opening speech at the Boao Forum for Asia on Hainan Island, China, Xi announced an acceleration of market-opening reforms that had already been planned, but also surprised the global audience by relaxing foreign investment restrictions in the auto sector on a wider range than just for new energy vehicles. Xi also focused on dialogue rather than conflict to resolve disputes, thus indirectly pointing his finger at the US administration. Xi's opening speech was followed by a presentation by newly appointed PBoC Governor Yi Gang, who gave more specific details about financial market opening measures. Limits on foreign ownership of China's financial companies will be abolished, enabling foreigners to hold a majority in life insurance companies, fund managers and brokers, with a 51% cap until mid-2021. Stock Connect schemes will be promoted further. Overall, we are encouraged by China's new liberalisation measures, which need to be followed by swift implementation.

US: Inflation accelerates while consumer sentiment recedes

With the trade war rhetoric fading, the S&P 500 moved into calmer waters last week. Data confirmed the positive, though somewhat slowing, economic momentum. Small business optimism receded from its multi-year high in March to a still very strong 104.7. The individual components paint a more mixed picture with capital expenditure plans falling back to the lower end of last year's range while hiring plans have ticked up. Similarly, the University of Michigan's consumer sentiment indicator softened to 97.8 in April from 101.4 the month before.

Inflation accelerated as expected with the annual rates for headline CPI and Core CPI rising to 2.4% and 2.1% from 2.2% and 1.8% respectively, lifted by last year's massive mobile phone price cuts falling out of the annual comparison. Investors will now increasingly focus on the Q1 earnings season, which will gain traction over the next few weeks. JP Morgan, Wells Fargo and Citigroup reported better than expected but unspectacular results, dragging down their share prices.

msme@zurich.com

Eurozone: Q1 economic weakness likely temporary

Eurozone data continued its recent soft patch with industrial production falling 0.8% MoM in February after a 0.6% MoM fall in January. This brings the annual rate of output growth down to 2.9% YoY, from 3.7% YoY in January, and a recent high of 5.2% YoY in December. While extremely cold weather and difficulties with seasonal adjustments may have been partly to blame, the pace of growth in the Eurozone economy has undoubtedly slowed in Q1, compared to 2017 Q4. Nevertheless, we still expect the Eurozone to grow well above trend this year, with business confidence and activity data likely to at least stabilise, if not rebound, in the next few months. Underlying fundamentals in terms of credit demand remain healthy, while unemployment continues to fall, supporting consumer spending. In addition, the ECB minutes from the latest monetary policy meeting suggest the central bank is in a cautious wait and see mode at the moment and is unlikely to tighten policy aggressively in a way that could derail the recovery.

ASEAN: Singapore tightens policy on better economic fundamentals

The Monetary Authority of Singapore (MAS) announced a 'slight' steepening of the SGD NEER (Nominal Effective Exchange Rate) policy band. This the first step towards normalisation after two years of maintaining the slope at 0%. In our view, policy is rightly adjusting to improved economic activity, which troughed in H2 2016 thanks to a rebound in global trade. Encouragingly, GDP growth was up 4.3% YoY in Q1'18, boosted by manufacturing inventories as well as services growth. We expect domestic demand to lead headline growth in 2018, as exports growth normalises to a lower pace. Indeed, the labour market is tightening and wage growth picked up to 4% YoY in Q4'17, above its historical average. The MAS retains a cautious tone, though, as it is preoccupied by increased geopolitical tensions around global trade. Ultimately, we expect an orderly resolution of the US-China trade dispute, which would remove the main obstacle for further tightening. Finally, green shoots are also visible in ASEAN equity markets: earnings are improving, while past foreign outflows have led to cheaper valuations.

Bonds: Treasury curve flattens further as geopolitics weigh on yields

The Treasury curve flattened further last week amid geopolitical developments and a steady rise in the Fed rate hike path. The 10yr/2yr Treasury yield spread fell below 50bps for the first time this cycle, as the 2yr yield rose 9bps to 2.36% while the 10yr was well bid, ending the week at 2.83%. The US CPI print showed core inflation rebounding strongly to 2.1 %, but this was fully expected and did not cause a repricing in bonds. Bunds were also well supported, but the 10yr yield failed to break down below 0.5%. This is encouraging and in line with our view that Bund yields should move higher, from current depressed levels. Elsewhere, Italian political parties appear no nearer to being able to form a government. For now, investors are relatively relaxed with the situation, but in time we expect them to show more concern, with spreads on Italian government bonds likely to widen, especially as the chance of further economic reforms appears limited whatever government is eventually put in place.

Credit: Firm tone, but Fed's proposals for US banks may not be positive for creditors

Credit markets were firm last week, although they lagged equities somewhat. Within credit, CDS indices have been lagging cash markets for some time and last week was no different. Energy credit was boosted by much higher oil prices given heightened geopolitical tensions, which spurred US high yield credit spreads to tighten, while also being a factor in attracting inflows after a long period of outflows. This, along with muted supply in the US ahead of the earnings season, supported the US cash credit market in particular. In a significant development on the regulatory front, the Fed is proposing to simplify its capital rules for large banks and is seeking comment from market participants. If implemented, it would produce capital requirements for large banks that are firm specific and risk sensitive, and based on estimates may generally result in lower capital requirements than currently is the case. While US bank equities outperformed broader equities on the news, we think a dilution of stringent standards should be concerning, especially for creditors at such a late stage in the credit cycle.

What to Watch

- In Asia, the focus will be on China's GDP growth data for Q1 as well as March statistics for industrial production, fixed asset investment, retail sales and new home prices in March. The Bank Indonesia is expected to stay on hold when its monetary policy board meets on Thursday, while Japan's PM Abe will meet US President Trump in the US mid-week.
- US retail sales are expected to recover from the recent weakness while housing data should rebound from last month's dip. However, investors' focus will be on companies' reporting their Q1 earnings.
- The IMF/World Bank spring meeting kicks off this week, with global trade and geopolitics expected to be in focus

Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

ZURICH®