Weekly Macro & Markets View

Highlights and View

- **The UK government agrees on a draft exit agreement, resulting in the Brexit minister resigning**

  The plan requires EU ratification and parlimentary approval. Its controversial nature suggests further political wrangling and disruptions ahead.

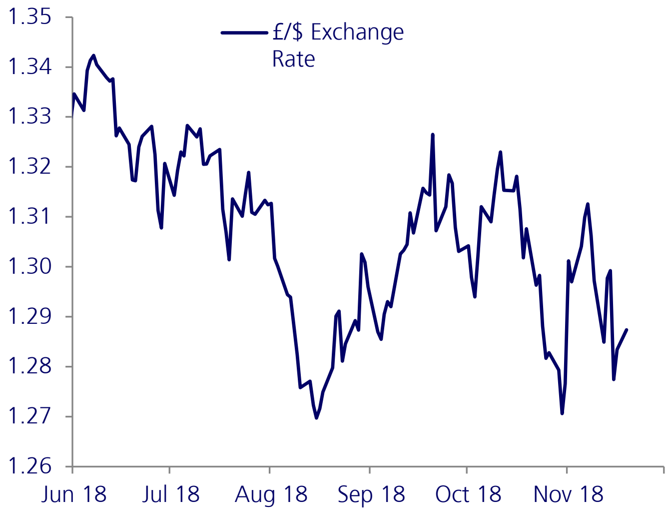
- **German GDP contracts in Q3, for the first time since 2015**

  GDP should rebound as emissions related disruptions to the auto sector fade, but sentiment remains downbeat and growth has peaked.

- **The central banks of Indonesia and the Philippines raised their policy rates to 6.00% and 4.75% respectively**

  Both central banks front-loaded the bulk of their rate hikes in 2018, but remain data-driven and will probably deliver at least one more rate hike each in 2019.

Sterling suffers on unloved Brexit draft



Source: Bloomberg

It was no surprise that economic data in the UK were all but pushed aside last week, with all attention on the draft exit agreement within the Tory party and the Machiavellian dealings surrounding it. While evidence of rising real wages was certainly a welcome sign, it failed to translate into higher consumption. Retail sales were on the weak side while house prices fell.

The big news was on Brexit, with the government agreeing to proceed with the PM's plan, though at the cost of ministerial resignations, including that of the Brexit secretary himself. The plan, which would keep the UK in a customs union, maintain payments to the EU and require abiding by the European Court of Justice during the transition period (now possibly extended beyond 21 months), has clearly angered hard-line Brexiteers. The highly contentious Irish border issue has a 'backstop' that would mean no physical border, even if a 'hard Brexit' ensues. This would be a temporary customs union for both Northern Ireland and the rest of the UK, with Northern Ireland ultimately more closely tied to EU rules and regulation if no further agreement is reached. Given that the plan has still to be formally agreed by the EU and then approved by the UK parliament, its chance of passing, as it stands, seems slim. From a market perspective further turbulence is expected, with sterling the most obvious conductor of angst, while business investment is threatened by the ongoing uncertainty.

Eurozone: German GDP contracts on disruptions in the auto sector

Third-quarter Eurozone GDP growth was only 0.2% QoQ, half the pace for Q2. The weak headline growth rate reflects slowing growth in Italy and contraction in Germany, where GDP came in at -0.2% QoQ. This was the first negative quarterly print since 2015 and annual growth, at 1.1%, is tracking at the lowest level since 2014. Weakness likely reflects disruptions to the auto sector due to new emission standards and we anticipate a rebound in Q4. Industrial production also fell in September, taking the Q3 growth rate to -0.1%, but car production rebounded, suggesting that conditions for the auto sector are already stabilising. Broader sentiment has, however, also taken a hit, and the ZEW survey indicator fell further in November, to the lowest level since 2016. The expectation component was unchanged though, tentatively suggesting that the region may be past the worst. While we anticipate growth to rebound in Q4, risks around Italy, global trade and the slowdown in China persist.

US: Treasury yields slip on a dovish tone from the Fed

Data continue to reflect a strong economy, with growth tracking above trend. Readings last week were largely in line with expectations, with retail sales decent, core CPI inflation ticking down to 2.1% YoY, and a mixed picture emanating from the Philly Fed and Empire manufacturing surveys. However, it was comments from Fed members acknowledging a more challenging global environment and cautioning against having a fixed rate trajectory that caught investors' attention. Bond yields retreated, the 10yr yield falling 10bps on the week to 3.06%, and rate hike expectations for next year eased marginally. Broadly, the week's events support our view of a strong economy that is beginning to come off the boil. That noted, bond yields are likely to move back up in the coming weeks should risk appetite return, as we suspect it will. While equities largely trod water last week, the upcoming meeting between Presidents Xi and Trump at the end of the month has the potential to improve the mood, given low expectations.

China: More policy easing needed

October economic activity data were disappointing overall. Despite an uptick industrial production growth remains weak. Retail sales growth slowed sharply, particularly for autos, electronics and furniture. Fixed asset investment offered a glimpse of hope, with infrastructure investment growth returning to positive territory, while manufacturing investment growth by SOEs accelerated following policy stimulus. Property investment growth weakened, and floor space sold continued to contract. A bigger worry is the continuing downtrend of credit growth, with shadow financing contracting again and special bond issuance by local governments slowing as annual bond quotas are exhausted. Aggregate financing growth fell to its slowest pace since 2005, which does not bode well for the economic outlook for the next few months. Policy stimulus needs to gain more speed in order to see growth stabilise. Meanwhile, US VP Pence continued to voice strong criticism about China's Belt & Road initiative during the APEC meeting in Papua New Guinea over the weekend. China's President Xi strongly defended the plan.

Asia: One hike for macro stability, one for inflation

The central banks of Indonesia and the Philippines raised their policy rates to 6.00% and 4.75%, respectively. Total rate hikes this year amount to 175bps in each country. The central banks are targeting different objectives, though. Bank Indonesia wants to facilitate macro financial stability by reducing the current account deficit. The government's measures to contain imports have not been very effective so far as consumption remains robust and is fuelling import growth. Meanwhile, ongoing infrastructure projects lead to sustained capital goods imports. It will take some time for the cancellation of second priority infrastructure projects to impact trade data. In the Philippines, the central bank is tackling above-target inflation. Encouragingly, headline inflation is peaking. Legislation to replace rice import quotas with tariffs is about to be implemented and should ease food inflation. However, the Philippines' central bank will remain vigilant and data driven.

Credit: Spreads gap wider, underperforming stocks

Credit spreads experienced persistent stress last week as risk aversion rose amid the continuing headwinds of moderating economic growth, geopolitical tensions and significant weakness in oil prices. While CDS spreads widened, cash credit spreads gapped out, with investment grade spreads widening by around 13bps across both the US and Europe. High yield markets were hit hard as US high yield indices and the energy sector index spreads widened by over 50bps and 60bps respectively. Beneath the large index moves, a number of single names suffered distress as well. JC Penny CDS moved out to price in a near certainty of default, while CDS spreads of Pacific Gas & Electric (PG&E) widened by around 350bps, and GE bonds continued to drop. While primary markets saw some big deals being placed, the overall tone was cautious as new issue discounts rose and some high-profile deals were pulled. Overall, last week's price action was consistent with the underperformance of credit in the late stage of the cycle and should not surprise seasoned investors, despite some signs of panic selling being evident.

What to Watch

- Japan will report its Manufacturing PMI for November as well as department store sales and CPI data for October. Taiwan's October industrial production and export orders need to be watched for a rebound, while Thailand's exports as well as CPI data for Malaysia and Singapore will be in focus.
- The Eurozone flash PMIs will be critical to watch as a further fall could point to growth slipping back below trend.
- With American Thanksgiving this Thursday it is likely to be a fairly quiet week, though there will be a number of housing market indicators out, including starts, permits and existing home sales. Given recent weakness it will be important to see signs of stabilisation. Retail sales on Black Friday will also be noteworthy.

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