

# Weekly Macro & Markets View

## Highlights and View

- **Global economic data become more mixed, with the G3 Manufacturing PMIs edging lower**

We see this as a healthy stabilisation following a period of very strong momentum, and expect global growth to remain firm over the coming months.

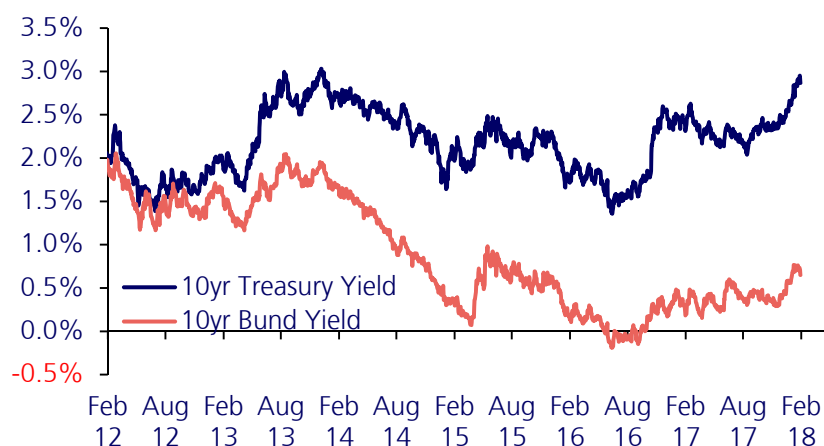
- **Global bond yields roll over as US issuance is well received**

We expect bond yields to edge lower as policy support and search for yield remain in place while a lot of good news on growth and inflation has been priced in.

- **Eurozone business confidence declines sharply in February**

Despite the declines, business surveys such as the PMI and German Ifo are still consistent with robust growth in the Eurozone.

## Bond sell-off fades as Treasury yields reach favourable levels



Source: Bloomberg

The sell-off in bond markets faded last week, as economic data became more mixed while the ECB minutes did not show any urgency to tighten policy. The 2yr Bund yield, which rose to -0.5% mid-week on expectations of ECB lift-off, retraced 4bps on Friday. The 2yr Treasury yield, which reached 2.28% intraday on the release of the Fed minutes and strong issuance, also ticked down, as did the 10yr yield after failing to reach 3%. US debt issuance, at USD 258bn, was also digested reasonably well, with bid to cover ratios down slightly but still in line with recent trends. As the weekly short-term issuance was the highest since 1994, this is encouraging.

Inflation is clearly back on investors' radars, and this week's PCE release will be important. Expectations have already been revised up, however, and we believe this is broadly reflected in higher yields. With more mixed economic data, investors will also be wary of simply projecting recent strength forward. Though the Fed is becoming increasingly confident with regard to its growth forecast and rate projection, a fair amount of Fed tightening is priced in by now, with limited further upside. This underpins our view that the sell-off in bonds is likely to pause, with Treasury yields at attractive levels.

## Credit: The market resumes its underperformance versus equities

After a short hiatus during the recent equity sell-off, credit seems to have resumed its path of underperformance versus equities, largely driven by outflows and higher government bond yields. High yield CDS spreads, for example, are notably wider for the year, while global equity indices seem decently up for the year. The recent substantial outflows from credit are a crucial aspect worth watching for investors. Encouragingly, flows did stabilise somewhat last week, but a question about the solidity of investment grade flows has now been raised. This is crucial in our opinion

because we think that it is largely supply/demand technicals that are perhaps the last buffer keeping a lid on credit spreads, as spread levels are close to or at historically tight levels, while fundamentals have weakened. The earnings season has by and large been supportive for equities, especially in the US, but there doesn't seem to be much respite for leveraging up organically, as well as inorganically through leveraged buy-outs and M&A.

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## Europe: Sharp falls in business confidence, but still consistent with robust growth

The Eurozone composite PMI fell by 1.3 points, to 57.5 in February from 58.8 in January, with large falls in both manufacturing and service sector confidence. The German Ifo business climate survey of 7,000 businesses also fell sharply to 115.4 in February from 117.6 in January, a seven-month low. The business climate survey is an average of two components: expectations and current conditions. It was the expectations component that fell the most, likely as a result of the financial market volatility earlier in the month. Although the current conditions

component also fell, to 126.3 from 127.7, it is still higher than in December and in fact at its second highest level on record. Indeed, overall business confidence, whether measured by the PMIs or the German Ifo survey, is still at extremely strong levels and consistent with robust growth in Germany and the rest of the Eurozone. Nevertheless, it will be important to monitor the business surveys over the next few months, as further sharp falls would be more of a cause for concern.

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## UK: Economic growth slows to the lowest level since 2012

The second estimate for Q4 shows that GDP growth has slowed more than initially thought, with the growth rate falling to 0.4% QoQ. The annual rate dropped to 1.4%, the lowest since 2012 and one of the weakest growth rates of all OECD countries. The slowdown was driven by a fall in the growth rate of consumption from 0.5% in Q3 to 0.3% in Q4, indicating that households are still being squeezed by falling real income. A pickup in government spending moderated the slowdown, while total business investment was flat and net exports dropped.

The labour market also softened slightly in December, with the unemployment rate ticking up to 4.4% from 4.3% and employment change slowing to 88'000 from 102'000 the month before. Despite the slightly higher unemployment rate, wage growth has picked up with weekly earnings (ex bonuses) accelerating to 2.5% YoY from 2.3% in November. The pickup in wages will mitigate the pressure on households and makes it more likely that the BoE will feel confident enough to hike rates later this year.

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## Japan: Although weaker, economic data are still solid

Japan's Flash Manufacturing PMI fell slightly by 0.8 points to 54 in February, remaining close to the four-year high marked last month. While the new order component and the new export order diffusion index showed more severe pullbacks, we are not too concerned and believe that export volume growth will remain brisk in Q1. Indeed, effective export volumes were up 9.2% YoY in January, stronger than consensus had expected. We tend to keep an eye on the monthly Reuters Tankan, a survey that is usually not in focus, but tends to give a good

glimpse of major quarterly corporate surveys. The manufacturing diffusion index fell six points from the 11-year high of 34 marked last month, with the materials sector being the biggest drag. The non-manufacturing index remained stable at 33, with the real estate component particularly brisk. Consumer prices spiked in January, up from 1% to 1.4%, but this was driven by volatile fresh food prices, while the various core measures remained roughly stable. Overall, the data set does not indicate the need for any imminent policy tightening.

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## Australia: Wage growth is slowly healing

Q4 wage growth came in at 2.1% YoY (private sector 1.9%, public sector 2.4%), up from 2.0% in Q3 and 1.9% in Q2. Public sector wages continue to experience faster growth than private sector wages. Nevertheless, we do observe an upward trend in several private sector segments such as mining, manufacturing, construction, healthcare, and art & recreation. The RBA will likely welcome these data and should be pleased by the fact that wage growth is now outpacing home lending growth. We remain cautiously optimistic: more data points are

needed to confirm a clear turnaround. We also highlight that real wage growth barely stands above 0% YoY. Going forward, we expect labour market tightening forces to put further upward pressure on wage growth. This process will likely occur at a slow pace, which leaves us comfortable with early 2019 as an estimate for the first monetary policy rate hike.

## What to Watch

- Consumer confidence and the ISM Manufacturing will show whether the upbeat mood in the US held up into February, while PCE Core inflation is likely to have picked up in January.
- General elections in Italy will take place on March 4. The result is likely to be a hung parliament that will require a coalition government, limiting the chances of extreme policies being adopted. In Germany, SPD party membership is expected to vote in favour of a new grand coalition.
- Several economic indicators for January and February will be published in Japan, plus the MoF Corporate Survey for Q4, which tends to be a precursor for the Tankan Q1 Survey. Most Asian countries will release their PMIs for February, while industrial production data from Korea, Singapore and Thailand will also be in focus. We believe the Bank of Korea will keep its policy rate stable at 1.5% on Tuesday.

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