March 4, 2019

ZURICH

Weekly Macro & Markets View

Highlights and View

- **The global manufacturing PMI fell further in February, but activity in emerging markets is rebounding**

  Stronger EM activity is encouraging and we maintain our view that the global economy should stabilise, though the PMIs show that headwinds persist in many regions.

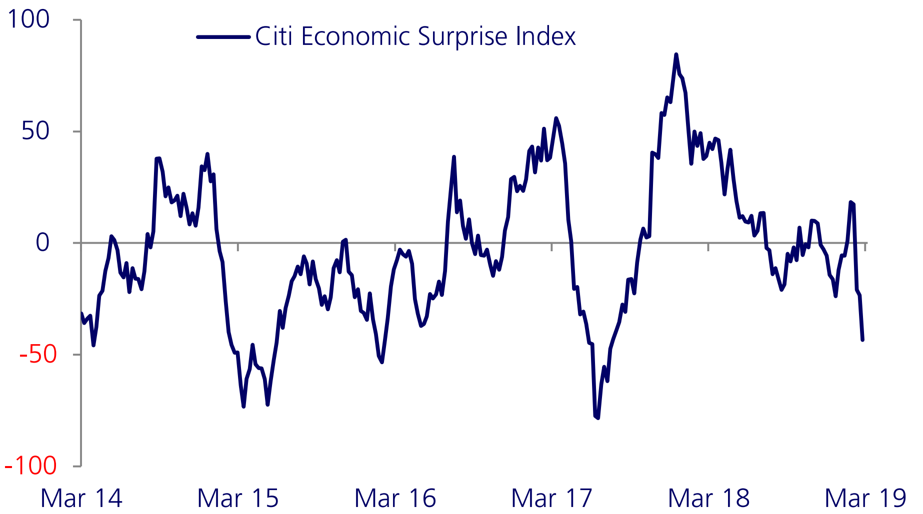
- **The US ISM Manufacturing index falls to the lowest level since November 2016**

  At 54.2 the index signals growth is decent, but significantly below last year's level.

- **Theresa May promises parliament a series of votes on the next steps in the Brexit process**

  Giving parliament the opportunity to vote on whether or not to leave the EU without a deal and then, consequent to that, whether or not to ask for an extension significantly reduces the risk of a chaotic Brexit.

The US economy is losing momentum



Source: Bloomberg

The S&P 500 climbed back into slightly positive territory for the week on Friday as investors focused on the latest positive headlines from US-China trade talks despite another set of mixed economic data. The Citi Economic Surprise Index is now back in deeply negative territory, having suffered the steepest monthly drop since January last year. After a shutdown-induced delay, GDP data for the final quarter of 2018 were published showing that growth slowed down to 2.6% QoQ annualised in Q4 from 3.5% in Q3. Looking into the future, the slowdown is expected to continue as indicated by the ISM Manufacturing index dropping to the lowest level since November 2016 in February and new orders falling back after last month's rebound. Vehicle sales ticked down in February, indicating that consumer spending is unlikely to pick up significantly in the near term. Housing starts tumbled by 11.2% MoM in December, though flat building permits are signalling a stabilisation in the housing market.

On a more positive note, the Conference Board's Consumer Confidence Index rebounded in February, driven both by the present situation as well as future expectations. Meanwhile, inflation has stabilised close to the Fed's target with PCE Core ticking up to 1.94% YoY in December.

UK: The UK parliament will have a say on the future of Brexit

Sterling rose to the highest level against the USD since last July on the latest political developments that make a no-deal Brexit at the end of this month less likely. Theresa May will present the results of her negotiations with the EU to parliament by March 12. Should parliament reject the deal, there will be a vote on whether or not to leave the EU without a deal. If that is rejected, parliament will then vote on extending the deadline for leaving the EU. With the Labour party now supporting a second referendum a number of Brexit-supporters have signalled their willingness to agree to a revised deal with the EU. While a potential extension reduces the near-term risk of a chaotic Brexit, the uncertainty regarding the future relationship with the EU remains a drag on growth. The Manufacturing PMI fell back to 52 in February, indicating that economic momentum remains modest. Consumer sentiment ticked up slightly in February but remains close to its five-year low, signalling households' cautious outlook on their future.

Eurozone: Data weak overall, but risk appetite stays firm

In the Eurozone, the overall tone of the data was disappointing. The final release of the manufacturing PMI confirmed that it fell below 50 for the first time since 2013. What's more, Spain's manufacturing PMI fell much more than expected, to below 50 as well, having previously been more resilient. Leading indicators within the Eurozone manufacturing survey, such as new orders, also fell sharply, suggesting the pain is not over yet. Lending growth to non-financial corporations also slowed to 3.3% YoY in January from 3.9% in December. On a more positive front, French consumer confidence has rebounded around 10 points since the start of the year, gaining back all of the declines caused by the 'yellow vest' protest movement, which is now diminishing in intensity. However, French consumer confidence is still lower than it was a year ago. Equity investors continue to ignore the weak data in the Eurozone, with another good week for the Euro Stoxx 50 index, focusing instead on better news regarding trade tensions between the US and China.

Switzerland: Swiss exports show resilience, again

Swiss GDP grew again in Q4, up 0.2% on the quarter, following a contraction of 0.3% in Q3. Exports rebounded and the manufacturing sector showed firm growth while domestic demand was softer, with both construction and equipment investment contracting. The data confirm our view that the economy will expand in 2019, but at a much weaker pace than in 2018. This was corroborated by the KOF leading indicator, which has slipped and is now tracking well below its long-run average, though still in line with positive growth. The manufacturing PMI ticked up in February, diverging from the global and Eurozone indices that fell further. Part of the rebound was driven by inventories, so underlying strength is likely to be a touch softer, but the new orders component also edged higher, which is encouraging. While a Eurozone recovery remains critical for Switzerland, exports are once again proving to be resilient, helping to weather the downturn in the global economy.

China: The bull is back, despite poor data

Following a torrid 2018 that saw Chinese equities falling into a bear market, with declines of more than 20% from March highs, the bull returned last week with stocks now up by more than 20% from their December lows. The postponement of additional tariffs on March 1 by the US was well received, but stocks were also helped by MSCI announcing a significant increase in domestic 'A' shares to their indices. The additions, planned for May, August and November, would increase the weight of mainland listed securities from 0.7% of the EM index to 3.3%, giving China a total weighting of 34%. The buoyant equity move was in contrast to a further round of disappointing economic readings. Both the official manufacturing and non-manufacturing PMIs fell further, indicative of slow growth ahead, with the Caixin PMI also remaining below 50 despite a tick up. We continue to believe that growth is currently bottoming, if somewhat slower than hoped, and expect additional fiscal measures to be announced at this week's National People's Congress to safeguard that turn.

Credit: Rallying hard on ECB hopes

Credit markets rallied hard last week, even during days when equity markets were soggy, with sentiment boosted by better news on the US-China trade spat, along with a rally in Italian bonds. However, most importantly, investors seemed to be bullishly positioning ahead of the ECB's meeting this week, expecting the announcement of a potential full replacement package for the maturing cheap bank funding program referred to as the TLTRO. European credit especially financials, high yield and even bank stocks strongly outperformed. We think investor optimism from this week's ECB meeting seems excessive, since ECB officials' public comments don't suggest a consensus yet. However, the ECB should at least recognise the need for cheap funding, otherwise bank lending could be hit at a time when growth is slowing and banks are already expected to tighten lending standards. Broadly, we think credit market technicals are strong, which should support the momentum amid strong flows and a robust primary market that continues to see negative new issue concessions in the US.

What to Watch

- In the US, new home sales are expected to have fallen in December. The ISM Non-Manufacturing index is likely to indicate solid momentum in the service sector while new payrolls are expected to have weakened from January's strong pace.
- The ECB meeting will be important to see whether it responds to the weaker Euroyone data. One option would be to announce a new liquidity operation for banks, or at least indicate that such an announcement will be coming soon.
- Attention will be on Japan, with final GDP readings for Q4 and household spending, but the composite and services PMI will be keenly watched following the very poor run of economic data recently. We expect that news of further fiscal initiatives may be forthcoming from China and will be looking closely at the composite and services Caixin PMIs.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

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