March 11, 2019

Weekly Macro & Markets View

Highlights and View

- **The ECB announces low rates for longer, a new TLTRO and slashes its forecast**

  The surprise of the timing is a small positive, but the ECB could have done more. Overall the policy response is disappointing.

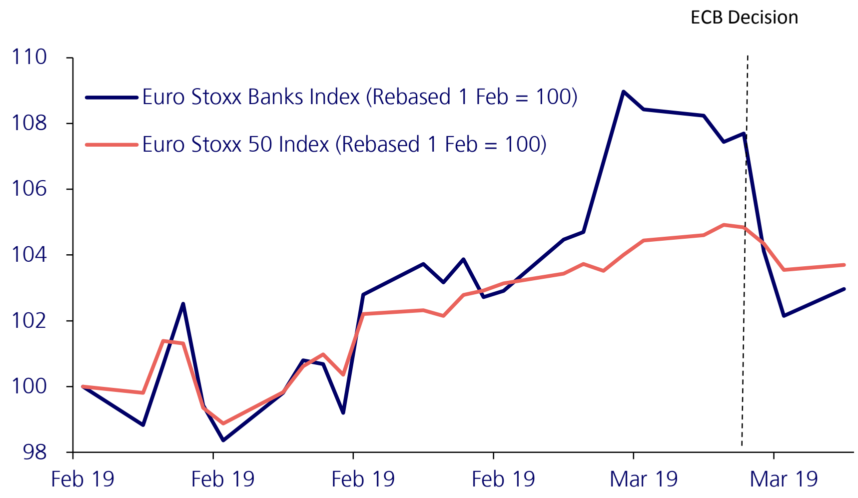
- **The ECB is planning a fresh round of cheap loans to banks in a new TLTRO starting in September**

  While the ECB delivered the 'shock', the 'awe' was woefully missing as the details of the loans don't seem as positive as we had expected, which also explains the drop in bank equities and credit.

- **China's government announces fiscal expansion at this year's NPC**

  Targeted support is directed to key infrastructure projects, private enterprises and the consumer, which needs to be applauded as a 'prudent' policy approach.

Underwhelming response by ECB to growth slowdown



Source: Bloomberg

At its regular monetary policy committee meeting last week the ECB recognised that economic conditions have deteriorated substantially in the Eurozone. It slashed its growth forecast for this year to 1.1% from a previous forecast of 1.7%, noting that a number of external and internal factors had contributed to the slowdown in growth, and cut its outlook for inflation as well. To support growth and inflation, the ECB committed to keeping interest rates at current levels, at least through the end of 2019, and announced a fresh round of liquidity operations for banks starting in September (TLTRO3). While the announcement of these measures was somewhat earlier than many had expected, the actual measures were underwhelming. Futures markets had already priced out the chances of a rate increase this year, so in this respect the ECB was simply playing catch-up. Moreover, the ECB could have been more ambitious on the TLTROs. Overall, investors were disappointed, with bank stocks in particular selling off. While we also would have liked the ECB to do more, we recognise that monetary policy alone will not be enough to create much stronger growth in the Eurozone. Fiscal policy could do more, especially in Germany, and there is also a need for continued structural reform. Furthermore, in the near term the cyclical outlook for the Eurozone will also be determined in large part by global developments such as EM and US growth and the US-China trade dispute.

Credit: ECB's TLTRO delivers the 'shock', but not the 'awe'

We wrote last week that some credit investors were expecting, overoptimistically in our view, that the ECB would announce a 'shock and awe' policy on the extension of cheap loans to banks, commonly referred to as TLTROs. While the ECB delivered the 'shock', the 'awe' was woefully missing. We are disappointed due to a number of reasons. Firstly, the new loans are only of two years maturity, unlike the current maturing four year loans. Secondly, the new loans will start only in September 2019, rather than our preferred start of June, which may cause banks to refinance a big part of previous borrowing before the new loans are made. Lastly, we fear that the new loans may not be as cheap as the maturing ones, although more clarity will emerge when the ECB releases technical details. While some commentators feel that the ECB has been 'ahead of the curve', our more pessimistic view is reflected in both equities and credit. The Eurostoxx bank index initially rallied by 1% after the announcement, only to decline by over 5% thereafter.

Equities: Stocks stumble as investor attention focuses on poor economic data

Having been buoyed by the dovish pivot in central banks' positions since the start of the year, investor attention seemed to shift focus last week to the underlying deterioration in economic conditions outside of the US. Equities experienced a modest setback in most regions, despite the ECB's latest TLTRO easing measures as another round of poor economic readings underscored what is becoming a fairly pronounced global growth slowdown. The combination of weak PMIs from a number of countries, along with worrying export data from Taiwan and China, disappointing US payrolls, and substantial cuts in the ECB's growth and inflation forecasts, was finally enough to derail equity momentum. US stocks failed to break above short-term resistance levels, while the V-shaped recovery in other regions also looks to have stalled, at least for the time being. Consequently we now consider a pullback to be likely, though acknowledge that valuations remain reasonably supportive of stocks and that some good news on the macro or political front could revitalise the bull run.

US: Payrolls slump, but the labour market remains healthy

The S&P 500 suffered its worst week this year loosing 2.16%. Despite the generally weaker trading environment investors reacted relatively calmly to a very soft payrolls number on Friday. With only 20'000 new payrolls in February, firms created the lowest number of jobs in more than a year. However, distortions and later revisions are not unusual with this data series and the latest print certainly does not fit with the other labour market data that were published recently, including initial jobless claims, the unemployment rate, ISM data and ADP employment figures, all of which show that the labour market remains very healthy. Wage growth picked up, with average hourly earnings growth accelerating to 3.4% YoY in February, a post-recession high, while the underemployment rate dropped to 7.3%, the lowest level since 2001. Meanwhile, the ISM Non-Manufacturing index jumped to 59.7 with new orders rising to a very solid 65.2, indicating that US economic momentum remains strong.

China: Easing bias confirmed at China's NPC

For us, 'Prudent' was the keyword in Premier Li's Government Work Report at this year's National People's Congress (NPC) when explaining the fiscal and monetary support. We believe that the ailing economy will be supported at a measured and targeted pace, not by a massive stimulus as on previous occasions. While the central government intends to spend more for key infrastructure projects, education, technology and rural development, it will cut administrative expenses. Lower taxes and fees, as well as a substantial increase in special local government bond issuance, will support private investments to spur industrial upgrading, particularly in the technology sector and high-end manufacturing. However, murky shadow-banking channels will be restricted. The fiscal push will be financed by making greater use of unused fiscal funds. Although bigger than consensus had expected, the slump in aggregate financing in February is purely a partial unwinding of the substantial boost provided last month. Taking both months together, credit growth is solid.

Asia: PMIs continue to falter

Most Asian PMIs continued to deteriorate in February, with India as a notable exception. Apart from India, Vietnam and the Philippines, most PMIs are below the 50 watershed line. In the case of emerging Asian countries, readings below 50 tend to indicate weaker, but usually not negative economic growth. We are particularly concerned by the continuously negative readings in bellwether countries like Korea and Taiwan. Korea's PMI fell to a nearly four-year low of 47.2, with the new export order measure tumbling to 46.2, the lowest reading since 2013. In Taiwan the manufacturing PMI deteriorated further to 46.3, while the new export measure tumbled to 41, an eight-year low, confirming worries for one of Asia's leading export nations. In both countries the deteriorating semiconductor cycle has had an impact, in addition to China's slowing economy. The only bright spot to us, apart from India, is a better reading for the leading 'new orders minus inventories' indicator, which seems to be bottoming out and should help to avoid a contraction in industrial production in emerging Asia.

What to Watch

- The UK parliament will vote on the amended withdrawal agreement. If the revised deal is rejected, parliament will then vote on whether a no-deal Brexit is to be excluded and, if so, whether to seek an extension to Art. 50.
- Eurozone industrial production data and ZEW survey will give more hints as to the state of the recovery.
- In the US, small business optimism is expected to remain high, as is consumer sentiment, while inflation is likely to have stabilised in February.
- In China, January/February aggregate data for key economic indicators will be released on Thursday while the NPC will conclude on Friday. No major changes in monetary policy are expected when the Bank of Japan's MPC convenes on Friday, and the quarterly BSI survey and machinery orders for February will be in focus. Elsewhere, we will keep an eye on the release of Indonesian export, Malaysian industrial production, and Indian industrial production and inflation data as well as Australian business and consumer confidence.

Disclaimer and cautionary statement

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

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