April 15, 2019

Weekly Macro & Markets View

Highlights and View

- **China's credit boost in March surprised to the upside**

  We believe that China's authorities are determined to relax lending conditions, particularly to private SMEs, which should help stimulate economic growth into 2H 2019.

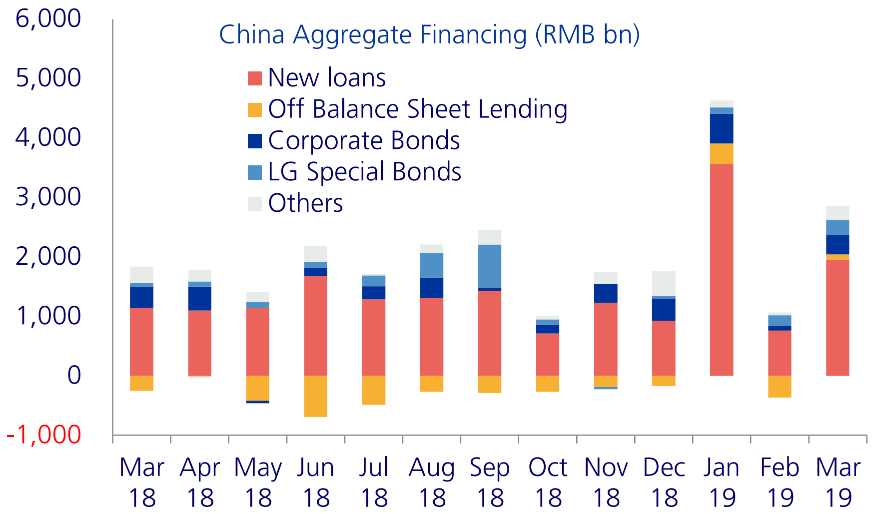
- **The ECB's tone becomes more dovish on concerns about the Eurozone's growth outlook**

  Further policy stimulus, including more aggressive forward guidance, is likely from the ECB in the coming months, but policy options are limited.

- **The EU grants the UK another extension to Art. 50 until the end of October**

  The move reduces the immediate risk of a hard Brexit but extends the period of uncertainty for firms and households, weighing on the growth outlook.

Global equity markets celebrate China's strong credit impulse



Source: PBoC, Barclays

The S&P 500 was trading in a narrow 20 point range just below 2,900 last week but the futures spiked higher on Friday immediately after China's credit data for March were released. Aggregate financing, the PBoC's measure of credit to the real economy, surged from RMB 703bn in February to 2,860bn in March, far above consensus expectations. A record high had been marked in January, at 4,635bn. In March, both household and corporate loans grew, the former dominated by mortgage loans, while the latter was driven by new medium to long-term loans. Adding central and local government loans to new aggregate financing, the growth in outstanding credit increased to 11.1% YoY, confirming that the credit impulse has indeed been strong in Q1. We note that the PBoC is channelling liquidity in the banking system to private companies, particularly SMEs, following Presidents Xi's strong guidance announced late last year. Monetary aggregate M2 rose 8.6% in March versus 8% in the prior month. Export growth in March was also stronger than consensus had expected, but due to Lunar New Year distortions we would rather focus on Q1 numbers, which show that export growth slowed to 1.4% YoY vs. 3.9% in Q4. Import growth slumped by 4.8%, suggesting that domestic demand remains weak. Overall, we believe that the strong credit impulse supports our base scenario of a stabilisation of China's economic growth in Q2 and a recovery in the second half of the year.

UK: Brexit has been postponed again

At an emergency summit the EU decided to grant the UK an extension to Article 50 until the end of October. This reduces the immediate risk of a hard Brexit but it also prolongs the period of uncertainty for households and firms. Both will be reluctant to spend or invest given the clouded outlook that will weigh on the growth environment in the coming months. In addition, political risks remain high as the pressure on the Prime Minister is massive and new elections are another potential headwind for business activity. The extension period would be cut short if Theresa May's initial withdrawal agreement with the EU passes in a fourth vote. The chances of this happening seem slim but, facing a longer than expected delay, some pro-Brexit Tories may decide to support the deal after all. Meanwhile, talks with the opposition continue, which could crystallise around the UK remaining in a customs union with the EU. See our topical thoughts for more details on the latest Brexit developments.

US: The S&P 500 aims for a new all-time high

The S&P 500 closed on Friday within 1% of its record high, fuelled by positive data from China and a promising kick-off to the earnings season by JPMorgan and Wells Fargo. Economic data were a bit more mixed, however. Initial jobless claims fell to only 196'000, reaching a new 49-year low and underlining the tightness of the labour market. On the other hand, JOLTS job openings fell to 7.1m in February, the lowest level in a year, mirroring the soft spot that was observable in nonfarm payrolls as well. Small business optimism was basically unchanged in March though the jobs-hard-to-fill measure rebounded to its all-time high, signalling one of the key challenges for firms in the US. The University of Michigan's consumer sentiment index ticked down to 96.9 as expectations deteriorated, particularly compared to the perception of current conditions, which were slightly better than in the previous month. Finally, headline CPI inflation accelerated to 1.9% YoY in March while the core measure slowed to 2.0% from 2.1%.

Eurozone: The ECB sounds noticeably more dovish, but policy options appear limited

There was no change in policy last week, but ECB President Mario Draghi was noticeably more concerned about weak growth. He said that the ECB would assess whether it needed to 'mitigate' the possible side effect of negative rates on banks. This was a reference to potentially tiering interest rates on excess reserves in order to boost bank profits. Draghi also mentioned that the ECB was assessing the pricing of the new TLTRO 3 programme in the context of the economic outlook, and that details would follow. This suggests the ECB may offer more generous terms than originally envisaged. However, while these measures may help at the margin, they are unlikely to be a game changer in terms of the Eurozone economic outlook. Rather this will be determined by global growth, trade tensions, and whether or not there are any further domestic shocks. China's credit impulse is improving, which should in time feed through to Eurozone growth. However, trade tensions are at risk of re-escalating between the US and EU after the US announced last week that it may impose tariffs on USD 11bn worth of imports from the EU.

Japan: The economy remains in the doldrums

Economic data released last week confirm that growth slowed significantly in Q1, probably coming close to a standstill. Weaker data in the manufacturing sector have been confirmed by disappointing core machinery orders, as the recovery in February that followed the slump in January was weak, with orders still down 5.5% YoY, while machine tool orders, a leading indicator, were down 28.5% in March. We believe business investment contracted in Q1. Consumption data have also disappointed. Consumer confidence fell for a sixth month in a row, to the lowest level in three years, with all sub-components down. This was confirmed by weak household activity data in the Eco Watchers survey for March, while corporate activity and employment related diffusion indices also fell. The outlook for future conditions has not fallen as dramatically, but that may simply reflect expectations for a recovery during the 10-day 'Golden Week' holidays, which should only give a temporary boost in our view. Meanwhile, Japanese equities continue to underperform global equities.

Credit: 'The need for yield' is lowering the credit quality of the market

Credit gained notably last week, outperforming equities amid robust investor appetite and solid inflows. The primary market is a decent barometer for end investor appetite and the $100bn order book for $12bn Aramco bonds grabbed headlines, although the bonds didn't fare as well in the secondary market immediately following the sale. While Aramco bonds are of a good credit quality, Banco BPM's Additional Tier 1 Contingent Convertible Bond, rated Caa1 by Moody's, was also successfully placed with investors. Despite already elevated corporate leverage levels, issuance by lower rated borrowers continues to accelerate. Meanwhile, on the fundamental front, there is not much evidence of improvement. While US earnings season is just starting, we don't expect much improvement in leverage. In fact, Chevron's agreement to buy Anadarko indicates that current low financing costs may foster further M&A activity. The ECB lending standards survey was also lacklustre. All in all, 'the need for yield' is masking worsening credit fundamentals, but this is likely to persist in the short term.

What to Watch

- The G3 flash PMIs will be closely watched to assess if growth dynamics are finally starting to bottom out.
- In the US, retail sales are expected to rebound from their soft patch while building permits and housing starts should have recovered in March as well.
- Various business surveys in the Eurozone, including the flash PMIs, will be important to watch to see if there is any stabilisation in manufacturing confidence.
- We will focus on the remaining economic indicators for March and Q1 for the Asian region over the next two weeks, in addition to the monetary policy meetings of the Bank of Japan, the Bank of Korea and Bank Indonesia, with no policy rate changes expected. On Wednesday, Indonesian federal and local elections will take place. Incumbent President Joko Wikodo leads in the polls by a narrowing margin. US-China trade negotiations appear to be in their final round, while US-Japan trade talks will kick off today.

Disclaimer and cautionary statement

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