July 15, 2019

Weekly Macro & Markets View

Highlights and View

- **Powell's dovish statements help lift the S&P 500 to an all-time high**

  The FOMC is almost certainly going to cut rates at the end of July. However, we doubt that this will be enough to reignite growth momentum in the US.

- **ECB minutes confirm concerns about low inflation**

  We expect the ECB will announce within the next few months that it is resuming QE asset purchases and cutting the deposit rate further into negative territory.

- **The coalition's tax package of AUD 158bn passes the Australian parliament**

  The tax cuts are expected to lift household spending and consumer confidence. Nevertheless, their effectiveness needs to be observed further given a pessimistic economic outlook and fragile housing market.

Powell keeps the door open for a rate cut in July

Source: Bloomberg

Helped by further dovish comments from Jerome Powell, the S&P 500 rose to a fresh all-time high and closed above 3'000 for the first time in its history. While they didn't provide any major new insights, Powell's statements supported the view that the FOMC will cut rates at its meeting at the end of July as global uncertainties and trade disruptions weigh on the economic outlook. A pre-emptive rate cut would be welcome as it would help to mitigate some of the headwinds the global economy is facing. Though certainly taken as a positive by financial markets, it remains to be seen whether a rate cut would be enough to reignite growth momentum, particularly in the US where capacities remain tight. Small business optimism ticked down in June with capex plans falling back towards the recent lows seen around the turn of the year. Both hiring and compensation plans fell as well, but remain at solid levels for now. Meanwhile, initial jobless claims dropped back to 209'000 last week, signalling a continuously tight labour market. Higher than expected inflation numbers helped to lift bond yields, with 10yr Treasury yields rising by almost 9bps, the largest weekly gain in more than three months. While the annual headline CPI inflation rate slowed down to 1.6% in June, Core CPI ticked up to 2.1% from 2.0% the month before.

Eurozone: Bund yields rebound as the result of excessive investor positioning

Industrial production in the Eurozone rose 0.9% MoM in May, following three months of decline or stagnation. The pickup in output was broad-based across countries and sectors (Germany +0.7%, France +2.1%, Italy +0.9%, Spain +0.5%), however, on a YoY comparison industrial production still declined 0.5%. Moreover, business confidence surveys in the manufacturing sector remain weak and are still consistent with declining output growth. The ECB minutes from the June monetary policy meeting showed that it is concerned by low inflation, noting that 'inflation was still projected to reach only 1.6% in 2021, which was seen to remain some distance away from the Governing Council's inflation aim'. Overall, the minutes were on the dovish side, and we expect the ECB to re-start QE within the next few months. Nevertheless, yields were higher on the week, with the German 10yr Bund increasing to -21bps at the end of last week from -36bps at the beginning. However, the move was probably reflective of excessive investor positioning rather than something more fundamental.

China: The economy continues to struggle, while targeted support keeps kicking in

At a first glance, China's ballooning aggregate financing, up from CNY 1,395bn in May to 2,260bn in June, suggests that the old style financing boost is back again. However, total social financing increased by only 0.3ppts to +10.9% YoY, which is rather moderate. Credit growth has been boosted by a smaller contraction in shadow-banking components and higher local government bond issuance to support infrastructure-spending, but medium- and long-term corporate loans still contracted. Exports were down 1.3% in June and 1% in Q2, driven by weaker shipments to the US and the EU and impacted by sluggish global trade and the impact of higher US tariffs that became effective in May. Producer price inflation is close to slipping into negative territory following its zero print in June. Meanwhile, industrial production, fixed asset investment and retail sales growth accelerated in June. The latter benefited from a reduction in car inventories ahead of new emission standards. Q2 GDP growth fell from 6.4% to 6.2% on a YoY basis, but recovered somewhat surprisingly from an annualised 5.7% to 6.6% QoQ.

Australia: The housing market is signaling stabilisation but remains fragile

The May home loan value fell by 2.4% MoM, with lending to owner-occupiers and investors declining by 2.7% and 1.7% respectively. Although weak data for the property market prevailed, the pace of the slowdown decreased. Meanwhile, macro policies turned more favourable for the housing sector. The cash rate of the Reserve Bank of Australia (RBA) remains low at 1% while mortgage lending rules have been eased. Banks are no longer required to apply the minimum 7% interest rate stress test, and now have more flexibility make calculations using their own risk assumptions. However, a minimum mortgage rate buffer of 2.5% still needs to be applied. While this will probably make it easier to get new housing loans at cheaper interest rates, it raised concerns about rising household debt, which already stands at a high of 190% to income. Besides, consumer and business confidence indices dropped sharply, impacted by global uncertainties. Nevertheless, we expect the government's tax cut package, effective from this month, to boost household spending and lift consumer sentiment in the following months.

Asia: Disappointing data in Japan and Singapore

In Japan, the household activity index within June's Eco Watcher Survey was dragged down by the weak service component. The corporate index was unchanged. Digging deeper, we take note of an improvement at manufacturers, but a deterioration among non-manufacturers, particularly those active in the transportation business between China and Japan. Machinery orders fell in May following three monthly increases, while machine tool orders plunged 38% YoY in June, the steepest fall in ten years. The advance estimate of Singapore's GDP for Q2 showed a disappointing performance. GDP fell by 3.4% on a sequential annualised basis, almost offsetting its 3.8% gain in Q1. In YoY terms, real GDP was up only 0.1%. Remarkably, the manufacturing sector saw the third consecutive quarterly decline. We therefore expect accommodative fiscal and monetary policies to follow. Meanwhile, Malaysia held up relatively well in May with industrial production growth of 4% and an improvement in manufacturing sales of 6.7% YoY. Similarly, India's industrial production growth was solid at 3.1% YoY.

Credit: Spreads seem to be hitting a floor

Despite a generic 'risk on' tone last week, aided by Fed Chair Powell's reaffirming the case for rate cuts during his congressional testimony, credit spreads were mixed. While investment grade spreads held in, high yield was weaker in both CDS and cash with European high yield cash spreads underperforming notably. Interestingly, even some European high yield bonds have become negative yielding. While US issuance picked up, investors remained discerning and some deals had to offer significant new issue premiums. European issuance is expected to slow in the holiday season, while global fund inflows into credit also slowed down last week. Deutsche Bank unveiled its restructuring plan, which was greeted by pessimism, with Cocos, equity and CDS all declining significantly. To us, this continues to highlight the loss of market share in trading by European banks, and, more broadly, continued fragilities in the banking sector. All in all, while juicier lower rated deals are still attracting strong order books, it seems in general spreads are now looking more unpalatable to many credit investors.

What to Watch

- We believe the Bank of Korea will cut its policy rate by 25bps either this Thursday or at its next meeting at the end of August, as economic momentum remains lacklustre and inflationary pressures are not a concern. Bank Indonesia has kept its policy rate stable, but we believe it has now room to cut by 25bps as capital account concerns have decreased.
- Following today's public holiday in Japan, the focus will be on economic data that will be published towards the end of the week like exports and CPI for June. In Australia, we will watch as to whether strong labour market data remain largely driven by part-time employment. Finally, Singapore will release export data for June.
- In the US, retail sales and the University of Michigan's consumer sentiment will give insights into the current state of the household sector while housing starts, building permits and the NAHB Housing Market Index are expected to show a stabilisation in the housing market.

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