August 5, 2019

Weekly Macro & Markets View

Highlights and View

- **The Fed cuts its target rate by 25bp to a range of 2-2.25%, and ends its balance sheet reduction earlier than expected**

  We welcome the Fed's move but a single cut won't be enough to stop the economic slowdown, particularly given the uncertain outlook regarding trade and global growth

- **President Trump announces a 10% tariff on the remaining 300bn USD worth of Chinese imports into the US as of September 1**

  The threat further increases the uncertainty weighing on global business activity and supply chains, causing additional damage to both US and global growth

- **Eurozone growth slows in Q2, and business sentiment is weak in July**

  Weak growth in Q2 means that there is not much resilience left in the Eurozone to an escalation of trade tensions

Investors head for the exit

Source: Bloomberg

Stock markets were on a roller coaster ride last week as investor optimism and concerns alternated with the S&P 500 suffering the worst week since last December, falling 3.1%. As expected, the Fed cut its target rate by 25bp to a range of 2-2.25%. The S&P 500 fell by almost 2% from its intra-day high as Fed chair Powell's comments were less dovish than hoped for by investors. In particular, he noted that the cut was not the beginning of a lengthy cutting cycle. We nevertheless expect further cuts later this year. Despite the initial disappointment, the stock market almost fully regained pre-Fed levels the following day before President Trump crashed the party with his announcement to raise a 10% tariff on the remaining 300bn USD worth of Chinese imports as of September 1. Trump appears to be frustrated by the lack of progress in negotiations with China. Markets and business activity remain vulnerable to any further disruptions of an already weak global growth environment. The fragility was reflected in the latest ISM survey numbers. New exports orders fell to the lowest level since early 2016 when investors worried about the slowdown of China's economy. Meanwhile, consumer confidence jumped almost back to its post-recession high in July, likely helped by the re-acceleration in wage growth. The mood could quickly change, however, as the announced tariffs will have a direct impact on purchase prices of a number of consumer products.

Eurozone: Growth slows in Q2, as trade war and weak confidence increase downside risks for H2

GDP growth slowed in Q2, to 0.2% QoQ from 0.4% QoQ in Q1. Furthermore, soft business confidence and signs that the manufacturing slump is spreading to the service sector suggest that growth could slow further in H2 and early 2020, increasing the risk of a recession. By country, Italy saw flat growth, after a small contraction in Q1, thereby narrowly avoiding a technical recession, though this is small comfort. France saw modest positive growth (+0.2% QoQ) while in Spain GDP growth was strong (0.5% QoQ). Germany is yet to report but could see a negative print when its Q2 data come out on 14 August. Meanwhile, the European Commission`s Economic Sentiment Indicator fell to around a four-year low in July, led by industrial confidence but also a weaker service sector. Equity markets fell sharply last week, but more because of the escalation of trade war tensions, rather than just the weak data. Unless these tensions de-escalate quickly, risk assets in the Eurozone are vulnerable to further declines.

UK: PM Johnson's majority is shrinking

The manufacturing sector remains stuck in a downturn entering the third quarter with the Manufacturing PMI remaining at 48.0 in July. Production and new orders fell as the British economy still faces the double headwinds from Brexit uncertainty and the weak global growth environment. New export business was dragged down by lower intakes from the EU and China. Continued manufacturing headwinds were also reflected in employment in the sector declining the fourth month in a row. There were more reports about companies routing supply chains away from the UK in advance of Brexit. Consumer sentiment ticked up in July but remains close to its multi-year lows. Meanwhile, Prime Minister Boris Johnson's majority in the House of Commons shrank to a single seat as the anti-Brexit Liberal Democrats won a by-election in Brecon and Radnorshire. The slim majority will make it more difficult for PM Johnson to push his plans through parliament. At the same time, it increases the chances of early elections.

APAC: Manufacturing PMIs point to a stabilisation

July PMI data came with a silver lining after a bleak picture in June. China's Caixin manufacturing PMI ticked up slightly from 49.4 to 49.9 while India's PMI was solid at 52.5. Australia's manufacturing PMI experienced a robust rebound from 49.4 to 51.3. Over the last few months all eyes were on Japan, Korea and Taiwan, as they were among the first getting hit by global trade disruptions and the semiconductor cycle downturn. Although the Japanese and Korean manufacturing PMIs continued to be fragile, Taiwan's PMI, after plummeting in June, came back strongly from 45.5 to 48.1. Similarly, ASEAN's data declined at a slower pace from 49.7 to 49.5. Nevertheless, the region's new export orders bounced back strongly from 49.5 to 50.8, hinting at a slight expansion further ahead. Meanwhile, house prices in Australia rose by 0.1% MoM, supporting signs of a stabilisation, while June building approvals came in lower than expected, down 1.2% MoM and 25.6% YoY. We expect the Reserve Bank of Australia (RBA) to take a 'wait-and-see' attitude in August.

North Asia: Trade tensions increase on two fronts

As elaborated on our front page, the US announcement to impose more tariffs on imports from China came as a negative surprise. We believe that China will retaliate. More stimulus to support the domestic economy will be forthcoming to counter the negative impact on growth in Q4 and next year, while we may see a temporary frontloading impulse for exports in August. Even before the escalation, the Politburo implicitly called for managing the deleveraging process carefully, which indicates to us that the focus is currently more on supporting the economy. Meanwhile, Japan has removed South Korea from its 'white list' of trusted trading partners, adding to the political tensions that have recently intensified. This will make it more difficult for South Korea to import intermediate products for its technology and automotive sectors, causing supply chain disruptions, which again urges more monetary and fiscal support. In Hong Kong, as we had suspected last week, retail sales volume plunged by 7.6% YoY in June, and was particularly weak for luxury items, down 17.1%.

Credit: Is this the big correction or another pause that refreshes?

Credit spreads widened notably last week across investment grade and high yield, on an escalation of US-China trade tensions. While the market appeared overheated for quite some time, it was the central bank 'put' that kept pushing spreads close to cycle lows. With the Fed having cut rates and the ECB about to do so, our take is that credit markets seem to be running ahead of what actual policy action will deliver, in other words a lot of optimism is already priced into credit valuations, while the weak growth dynamics are not. Encouragingly, as we had hoped for, it seems that the ECB is likely to 'tier' interest rates on excess reserves for banks but this did not prevent banks from selling off aggressively last week in the stock markets. While the market is focussed on the US Treasury curve, the Bund curve has flattened much more aggressively since the beginning of the year which implies further pressure on banking sector profitability. With spreads still tight, risk reward is skewed to the downside in credit but it is still too early to conclude that we are at the start of a major correction in credit.

What to Watch

- In the US, the ISM Non-Manufacturing Survey is likely to show that the service sector remains less affected by a weaker growth environment and global trade tensions
- The final Eurozone PMIs and German industrial production and factory orders data are likely to highlight the vulnerability of the Eurozone as trade tensions escalate
- Five APAC central banks' MPCs will convene this week: Australia, New Zealand, India, Thailand and the Philippines. We expect a 25bps policy rate cut by the RBI, the RBNZ and the BSP, while Australia's RBA and Thailand's BoT are expected to stand pat, even though the latter may give a slightly more dovish outlook. As for economic indicators, our focus will be on Q2 GDP data in Japan, Indonesia and the Philippines as well as export data in China, Taiwan and the Philippines

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