August 19, 2019

Weekly Macro & Markets View

Highlights and View

- **Government bond yields slide to historical lows on weak global macro data and disruptive trade developments**

  Profound action is required, both on the monetary and fiscal front, to put a floor under yields and build confidence in the global economic outlook.

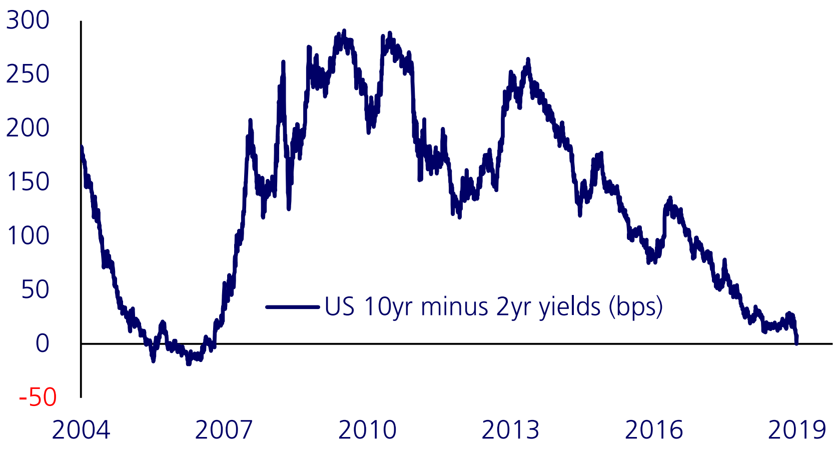
- **Inflation picks up in the US while filling open jobs remains a challenge for small businesses**

  A tight labour market and accelerating inflation will make it more challenging for the Fed to take a very dovish stance at its next meeting in September, potentially disappointing the market.

- **China's economic data for July disappointed**

  Policy support needs to accelerate in order to avoid a downward spiral.

Bond markets signal recession risk



Source: Bloomberg

Bond yields fell to new lows last week, with the 30yr Treasury yield below the 2% mark, the 10yr Bund yield at -0.71% and the 10yr Swiss yield at a stunning -1.12%. Close to one third of global debt is now negative yielding. The 10/2yr segment of the US yield curve inverted intraday on Thursday, though it later rebounded and closed slightly above zero, and the gilt and Swiss bond markets saw similar inversions. This is likely to have contributed to negative sentiment towards risk assets, as an inverted curve is often a good predictor of recession. The latest slide in global yields reflects geopolitical risk, poor macro data and erratic news on the US-China trade war, with a sharp repricing of central bank actions as a result.

Central bankers will convene at the annual Jackson Hole meeting this week, likely focusing on how to arrest the global growth slowdown and delay the next recession. Negative interest rates are, by themselves, unlikely to provide sufficient stimulus to trigger a turnaround. The downward adjustment in yields has been significant though and is pricing in a substantial amount of stimulus ahead of the ECB and Fed meetings in September. Unless data worsen significantly, yields may well see some stabilisation in the weeks ahead.

US: Filling open jobs is a key challenge for small firms

The S&P 500 ended the week with a loss of 1% despite a solid run on Friday. The market fluctuated by at least 1.2% on four of the five trading days, reflecting the current tug of war between trade worries, recession fears and the hope for more central bank stimulus. Regarding the latter, chances for a dovish Fed surprise in September fell somewhat last week as most of the economic data and particularly inflation numbers came in stronger than expected. Headline CPI inflation accelerated to 1.8% YoY in July from 1.6% with core CPI picking up to 2.2% from 2.1%. Strong retail sales reflect a healthy consumer sector and a positive domestic environment. Small business optimism also picked up in July with the jobs-hard-to-fill measure jumping back up to match the all-time high reached at the end of last year, underlining the tightness of the labour market. A tight labour market and accelerating inflation will make it harder for the Fed to signal as much monetary easing as investors are currently pricing in, particularly if trade tensions ease as the stock market seems to expect.

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Eurozone: Rehn signals aggressive ECB stimulus, sentiment weakens further

Finnish central bank governor, Olli Rehn, said last week that the ECB should come up with a "significant and impactful" stimulus package at its next meeting in September, and that it was better for the ECB to overshoot than to undershoot market expectations. He also refused to rule out adding equities to quantitative easing asset purchases. This suggests that the ECB is gearing up for a large stimulus package on September 12, which could help revive risk appetite in the near term.

Meanwhile, however, data continue disappoint. The ZEW survey of investor expectations fell much more sharply than expected, to levels last seen during the depths of the Eurozone debt crisis in 2011/12 and the Global Financial Crisis in 2008. Indeed, the German economy contracted in Q2 by 0.1% QoQ, driven by a fall in net exports, while Eurozone wide industrial production fell 1.6% MoM in June, bringing the annual rate of output growth to -2.6% YoY.

China: A dismal set of July data

China's economic data for July came in weaker following the rebound in June and far below consensus expectations. Industrial production fell from 6.3% to only 4.8% YoY, a record low since statistics started in 1990 (adjusted for Lunar New Year distortions). Export weakness and relocation activities in the auto, machinery and electronic equipment sectors were a major drag. Fixed asset investment growth slowed from 6.3% to 5.2% YoY, driven by weaker property and infrastructure investment growth particularly by private-owned companies. Land sale volumes plummeted by 36.8%, as authorities tightened their grip on property developers. Nominal retail sales growth fell by 2.4 ppts to only 7.6% YoY, as the special boost in auto sales in June faded with a bang. Aggregate financing as well as new bank loans also came in far weaker than expected. Shadow banking credit contracted following the crackdown on property developers. Growth in monetary aggregate M2 fell from 8.5 to 8.1% YoY. Policy support measures need to accelerate over the next few months and should remain targeted.

ASEAN/ Australia: Data came in not as bad as expected

In line with global equities, regional stock markets suffered last week, with the MSCI Australia and MSCI ASEAN down by roughly 6% from their July highs. However, the latest economic data came in not as bad as expected. Australia's consumer and business confidence improved modestly, following the tax and interest rate cuts last month while the July unemployment rate remained at 5.2%. Exports in Indonesia and Singapore weakened at a slower pace. Indonesia's shipments were down by only 5.1% YoY in July, better than consensus had expected, while imports contracted by 15.2% YoY, exceeding the contraction in exports. This helped to narrow Indonesia's large current account deficit, accounting for about 3% of GDP. Singapore's July exports fell by 11.2% YoY, compared to a 17.3% plunge in June, driven by weak electronic exports. Meanwhile, Malaysia Q2 GDP was robust at 4.9% YoY, supported by buoyant private consumption. Some delayed infrastructure projects will be restarted, supporting growth. However, global headwinds will continue to restrain further improvements in the regional economies.

Credit: Dispersion rises despite negative yields

Credit markets are sending signals that all is not well for the weakest borrowers, despite tight spreads on aggregate. Last week saw a number of divergences develop further within credit. While CDS spreads ended the week mostly tighter, outperforming equities, cash credit was notably wider. At the same time, the US energy sector underperformed the broader high yield universe, with spreads now significantly wider for the sector than in January. The ratio of US high yield CCC spreads to broader high yield index spread is at the highest since 2003. Overall, high yield markets have been underperforming investment grade credit for quite a while, even before the recent macro worries surfaced. On the other side of the spectrum are strong credits. Nestle's 10yr Euro denominated bond, for example, was trading with negative yields, marking the first time that such a long duration corporate bond has done so. While it is encouraging to see credit differentiation, it is an ominous sign that the weakest borrowers will struggle to survive in the next recession as the elevated leverage of the last few years begins to bite.

What to Watch

- Investors will listen carefully to Jerome Powell's statement at the Jackson Hole meeting on Friday for clues about the Fed's intention to provide further monetary stimulus, while the G7 meeting over the 24-26 August will also be worth watching.
- A vote of confidence will take place in the Italian parliament on August 20, while flash estimates of the Markit PMIs for the Eurozone, US and Japan (i.e. G3) will be released on August 22.
- Bank Indonesia (BI) is expected to keep its policy rates on hold in the coming MPC meeting while maintaining its dovish tone. We expect both July export orders and industrial production to remain weak in Taiwan. In Thailand, both weak domestic and external demand suggest disappointing export and import data in July.

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