September 9, 2019

Weekly Macro & Markets View

Highlights and View

- **The US ISM Manufacturing index dips below 50 for the first time since 2016**

  Manufacturing new orders have reached the lowest level since the financial crisis, underlining how US manufacturing is suffering from trade uncertainty and the global slowdown.

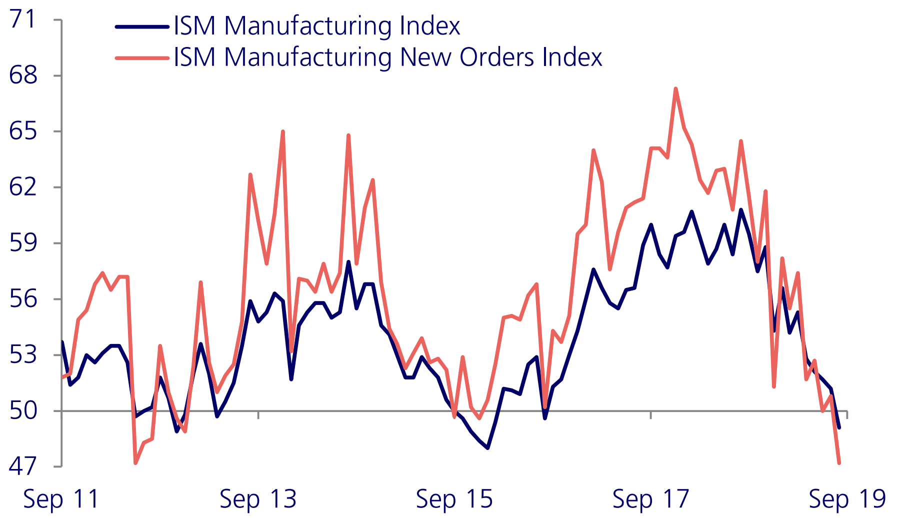
- **Boris Johnson suffers several defeats as parliament opposes his Brexit plan**

  The parliament's move reduces the risk of a no-deal Brexit at the end of October, but risks remain and the uncertainty continues to weigh on the economy.

- **Italy's new coalition government was confirmed last week, after a large majority of Five-Star Movement members approved it**

  The new Italian government will be less confrontational on the 2020 budget, reducing near term risks, however Italy's medium-term fiscal and economic challenges remain significant.

US manufacturing is heading for a contraction



Source: Bloomberg

The S&P 500 entered the seasonally challenging month of September on a positive note, rising 1.79% last week and is now less than 2% away from its all-time high reached in July. Investors' moods were lifted by the prospect of new trade talks between China and the US, which are expected to take place in October. While this sounds promising, the tariffs imposed so far and the continued uncertainty regarding the global outlook are taking their toll. The ISM Manufacturing index fell to 49.1 in August, dipping below 50 for the first time since 2016. Even worse, manufacturing new orders dropped to 47.2, matching the lowest level since the financial crisis. While manufacturing faces a contraction given the challenging global environment, the service sector is faring much better, showing that the domestic economy remains less affected by the trade war so far. The ISM Non-Manufacturing index rose back to 56.4 in August after the dip in July, with new orders signalling a continuation of the positive environment. However, both surveys show continued weakness in the export business. Meanwhile, the labour market remains healthy although fewer new payroll jobs than expected were created in August. Wage growth slowed slightly to 3.2% YoY but the monthly pick up was the highest in a year, making it more difficult for the Fed to justify an aggressive move at its meeting next week.

UK: Parliament opposes PM Johnson's Brexit plan

Boris Johnson suffered a number of defeats last week as parliament moved ahead to avoid a no-deal Brexit on October 31. With the support of 21 Conservative MPs it passed a bill that forces PM Johnson to ask the EU for another extension of the Brexit deadline until January 31. The parliament then rejected Johnson's call for a new general election. Labour leader Jeremy Corbyn signalled his willingness to support an election but only after legislation to avoid a no-deal Brexit is in place. Sterling fluctuated as the political events unfold but ended the week in positive territory as the latest events reduce the probability of a hard Brexit in October. Meanwhile, the economy continues to suffer as both the global slowdown and Brexit uncertainty weigh on business activity. The Manufacturing PMI fell to 47.4, the lowest level since 2012, signalling an accelerated contraction in the manufacturing sector. Although services continue to fare better, the Services PMI dipped back to a modest 50.6 after its brief recovery in July.

Eurozone: Some ECB policymakers express concerns over re-starting QE

Despite poor data in the Eurozone last week, some ECB policymakers seem to have cold feet regarding re-starting QE. France's central bank governor, Francois Villeroy de Galhau, said, '[The ECB] also has the option of re-starting net asset purchases at any time. Is it necessary to do so just now? This is a question to be discussed'. German industrial production fell by 0.6% MoM in July, on the back of a 1.1% MoM fall in June, bringing the YoY rate of output growth to -4.2% YoY. The Eurozone composite PMI for August was consistent with only modest growth, and the detail of the survey shows increasing signs of manufacturing weakness transmitting to the service sector. On balance, we still expect a package of easing measures to be announced this week, including re-starting QE, but the risk that the ECB disappoints is higher now than it was just a few weeks ago. More fundamentally, the difficulties in deciding the next steps for monetary policy highlight the need for fiscal policy to do more to support growth in the region. Meanwhile, Italy's new coalition government has been confirmed, reducing some near term risks.

Switzerland: The SNB is likely to resist a further rate cut, but risks are high and policy options are limited

GDP expanded by 0.3% QoQ in Q2 but annual growth slumped to only 0.2%, mainly reflecting base effects from last year's strong expansion. Activity was supported by private consumption while most other components were weak. Equipment investment slumped, in line with survey evidence that show that business sentiment has been hit by elevated uncertainty. The data are consistent with our view of a continued expansion this year, but with sluggish growth at around 1%. The ECB is set to announce a stimulus package this week and consensus now expects a further rate cut by the SNB, to counter the impact on the Swiss franc. We disagree as the SNB is not keen to lower rates further, with the preferred option being to rely on forex interventions to stabilise the franc. So far, pressure on the franc have been manageable. Risks are high, however, and the SNB's policy options are limited, with risks to growth and inflation to the downside.

China: China ratchets up stimulus

China's PBoC announced both a broad cut in the Reserve Requirement Ratio (RRR) by 50bps on Friday as well as another targeted cut of 100bps in two stages for some city commercial banks, injecting about CNY 900bn of liquidity. This move follows a rather strong pro-growth stance evident in various major policy meetings last week. During the State Council meeting, Premier Li called for a timely use of RRR tools and an acceleration in local governments' special bond issuance by bringing forward some of the 2020 quota. However, these funds must not be used for land or real estate development. We also note that Vice Premier He urged a more proactive stance of fiscal policy at a policy meeting of the Financial Stability and Development Commission. The action taken as well as the tone of the statements confirm our view that there will be more stimulus, but in a more targeted manner, avoiding any speculative consequences. Meanwhile, export growth turned negative again in August, down 1% YoY, with exports to the US tumbling by 16% YoY. Imports continued to remain weak, down 5.6% YoY.

Asia: A close look into regional manufacturing PMIs

As Manufacturing PMIs are critical leading indicators, we have examined closely what the August figures mean for the region. Overall, we see weaknesses almost everywhere except in Australia and China. Although last week's initial flash figure pointed to a decline, Australia's official Manufacturing PMI showed a robust improvement from 51.3 to 53.1, while China's Caixin Manufacturing PMI crossed the 50 baseline into expansionary territory. With other economic data improving as well, the Reserve Bank of Australia has reasons to be optimistic, leaving its cash rate unchanged in September. Elsewhere, the picture was not as bright. The figures for Singapore, Taiwan and Japan remained sluggish. ASEAN's Manufacturing PMI dipped further into contractionary territory from 49.5 to 48.9, with contractions prevalent in Indonesia and Malaysia. Even Vietnam, a major beneficiary from US-China trade tensions, lost steam. While its Manufacturing PMI is still above 50, at 51.4, it's now hovering five points below its November high.

What to Watch

- Despite some policymakers expressing reservations, the ECB is expected to announce a range of easing measures when it meets on Thursday including cutting the deposit rate and restarting QE.
- The Fed has entered the blackout period ahead of its meeting next week. Small business optimism, retail sales, consumer confidence and CPI/PPI numbers will be published this week.
- In China, we expect a modest improvement in August money and credit data, but lower CPI and PPI prints. Taiwan's tech export growth should have picked up in August, but will remain lacklustre. In Japan, the focus will be on the second real GDP growth estimate for Q2. We expect a downward revision on slower capex growth as well as weak machinery orders in July.
- The central bank of Malaysia is expected to cut its policy rate by 25bps, following its counterparts in the region. Industrial Production in India and Malaysia will remain subdued while building approvals and home loans for Australia will probably improve given a strong rebound in the construction index this week.

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