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ZURICH

Weekly Macro & Markets View

Highlights and View

- **The British Parliament overwhelmingly rejects Theresa May's withdrawal agreement**

  This result increases the likelihood of a softer Brexit and an extension of Art. 50 as time for new negotiations is running short.

- **Stocks continue to surge, with the S&P 500 breaking through a key technical resistance level**

  Momentum is pulling cash in from the sidelines and has likely further to run, but global growth prospects and earnings revisions need to stabilise to maintain the bullish spirit longer term.

- **China's growth weakened further in Q4**

  We believe growth will continue to slow in Q1, but selective stimulus measures should help to stabilise growth towards summer.

Theresa May suffers a historic defeat in Parliament

Source: Bloomberg

With less than ten weeks to go until Britain leaves the EU the British Parliament is still struggling to agree on the withdrawal terms, not to mention the future relationship with the EU. Theresa May's proposed deal with the EU was rejected by 432 votes to 202 – the biggest loss for any UK government on record. A day later she survived a no-confidence vote in the House of Commons, initiated by the Labour party, as Tory rebels and DUP members flocked back to support her. May has now tried to open cross-party talks to find a solution that could win a majority in Parliament. The move to reach out to rival parties increases the likelihood of a softer Brexit as there is a solid majority to avoid the no-deal scenario. Sterling rebounded after the announcement. However, cross-party talks may prove to be tougher than investors currently anticipate as rival leaders start to lay out their conditions to enter talks. In addition, the EU may be unwilling to meaningfully improve its offer. Given the historic defeat, minor concessions from the EU are unlikely to tip the balance in Parliament, but time is too short for negotiating any major changes to the current deal with the EU time before March 29th. Therefore, an extension of Art. 50, one way or another, looks increasingly likely.

Markets: Equities break to the upside

Investors in risk assets maintained their bullish mood last week, with the S&P 500 breaking through what had been deemed to be an important resistance level. Stocks have now completed a 'V'-shaped recovery with many markets now up over 10% following the precipitous selloff in December. Cash that had been pulled into the safety of low-yielding money market funds towards the year end is now being redeployed. Rising expectations of a US-China trade deal and further policy stimulus by China helped last week, despite the continuing woes of the Brexit saga and intransigence around the partial US government shut down. With stocks breaking to the upside and money still on the sidelines, it seems that the current momentum surge could last for a bit longer. Earnings expectations continue to be ratcheted lower, although this seems to have largely been priced in. However, a pause to refresh the rally would be healthy and it will be important that global economic data start to show improvement if the bullish sentiment is to be maintained into the spring.

US: Consumer sentiment falls in January

The stock market continues to climb the wall of worry with the S&P 500 gaining 2.9% last week. While the government shutdown lingers on without leaving significant traces in the economy so far, it is increasingly weighing on the sentiment of both households and firms. Meanwhile, investors are shifting their focus to the reporting season for Q4 earnings. It kicked off on a mixed note but provided some relief as a number of banks reported improvements after a weak last quarter. On the economic front there was not too much news, not least since some of the expected data had to be postponed due to the shutdown. Importantly, the NAHB Home Builder Index stabilised in January after the steep fall it suffered during the two months before. Initial jobless claims ticked down towards the recent lows despite the shutdown, underlining the current strength of the labour market. Finally, the University of Michigan's Consumer Sentiment Survey suffered the biggest monthly drop in six years in January, but remains well above the post-recession average.

Eurozone: Annual data show a slowdown in Germany, but no recession; AKK calls for tax cuts

The German statistics office estimate for annual growth in 2018 showed a slowdown to 1.5% from 2.5% in 2017. This annual estimate is released before the official Q4 GDP number, but the statistics office also said that GDP grew slightly in Q4, which means that Germany avoided a technical recession (Q3 growth had been negative due to the diesel emission standards change affecting auto production, as well as other factors). However, the slowdown in the German economy in 2018 has still been substantial and has prompted calls for fiscal expansion from CDU leader Annegret Kramp-Karrenbauer (AKK) amongst others. With a substantial budget surplus of 1.7% of GDP and low government debt to GDP ratio, Germany is one of the few countries in the Eurozone to be in a position to engage in a large fiscal expansion without risking unnerving bond markets. Such a programme would help the wider Eurozone too. Meanwhile, despite the weak macro data, risk appetite continued to improve last week on hopes of a US-China trade deal, with Eurozone equities gaining 2% over the week.

China: Growth continues to weaken, but lending seems to be picking up somewhat

China's GDP growth slowed to 6% on an annualised sequential basis, down from 6.4% in Q3, and from 6.5% to 6.4% on a YoY basis. For the year 2018, GDP was up 6.6% YoY vs. 6.7% in 2017. We do not read too much into these official figures, but it is obvious that growth slowed and will slow further in Q1 before stabilising. Despite a recovery in industrial production in December, weakness in the economy is still concentrated in the manufacturing industries, while the service sector continues to be solid. Fixed asset investment suffered from a deterioration in both manufacturing and property investment. The slowdown could not be compensated for by accelerating infrastructure investment, which is part of the official stimuli measures. Broad credit growth in December was stronger than consensus had expected, lifting sentiment towards China's economy, but we note that on a YoY basis credit growth merely stabilised slightly below 10%, a decade low. Authorities have promised more stimulus, but in a more focussed manner than previously, which makes sense to us.

Credit: The rally continues, supported by US bank results

The eagerly awaited US bank results for Q4 and the outlooks were generally decent, which, along with hopes for an improvement in the US-China trade dispute, led to a continued rally in risk assets, including credit. Credit spreads tightened notably, with cash outperforming CDS. The tone was fairly strong in primary markets as well, with most new deals coming in at healthy concessions and then performing well. European banks continued to issue more senior non-preferred debt (BNP Paribas last week, following Unicredit the week before) as banks strive to meet new regulatory requirements, with little development on the TLTRO front from the ECB. While US banks generally performed well after the results, the read across to European banks may not be as rosy, as they have been trailing performance in trading. Fixed income trading revenues of US banks were poor, and indeed Société Générale issued a profit warning that it could see revenues decline by over 20% in the fourth quarter. Italian bank assets were also under pressure, while PG&E intends to file for Chapter 11 bankruptcy.

What to Watch

- The G3 flash PMIs will be watched closely for signs of stabilisation in the global economy.
- We expect the ECB to announce an extension to its liquidity operations (TLTRO) for banks and to recognise that risks are to the downside in the coming months, however, this week's meeting may be too early for such a change.
- We expect the Bank of Japan to keep monetary policy unchanged, but it may revise down its growth forecast for this fiscal year and its inflation outlook for next fiscal year. In South Korea, GDP growth in Q4 is expected to have remained stable at 0.6% QoQ. We expect the Bank of Korea to keep policy rates unchanged on Thursday. As for economic indicators, we will focus on Japan's export and department store sales as well as Taiwan's industrial production in December.

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