September 30, 2019

Weekly Macro & Markets View

Highlights and View

- **Credit supply surged in September, with a record number of deals and the heaviest volumes of the current cycle**

  The supply surge is typical of advanced credit cycles, with leverage likely to tick even higher, confirming our view that a credit bear market could occur in the coming quarters.

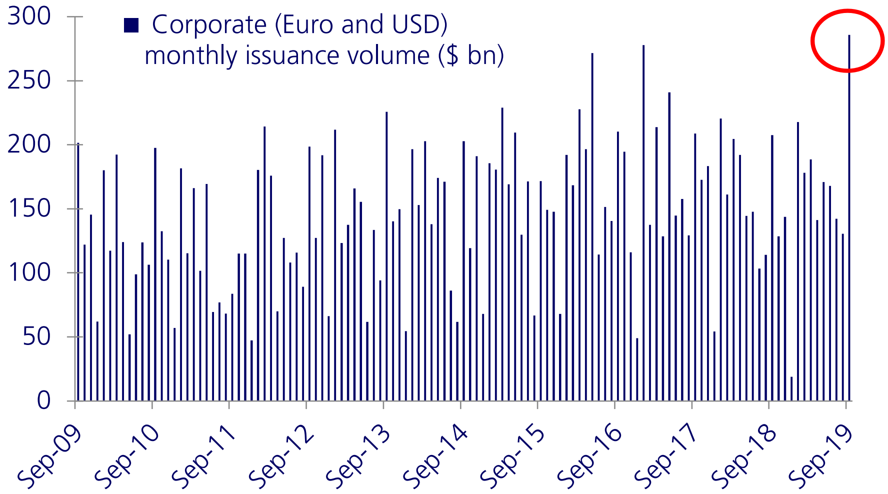
- **The Eurozone PMI declines sharply, with manufacturing weakness spreading to service sector**

  Unfortunately, the PMI survey confirms our view that the Eurozone is likely to slip into recession in the next few quarters.

- **The UK Supreme Court rules PM Johnson's five-week prorogation of parliament was unlawful**

  While a blow to Johnson, it does not change the situation as parliament has passed a law forcing the government to ask for another extension, which Johnson vows not to do.

Credit supply surge a late cycle signal



Source: Barclays, Bloomberg (Note: Corporate issuers include financials and non-financials)

Supply in credit markets has surged in September, which we think is a sign that the credit cycle is quite advanced. The first week of September saw global credit issuance hit an all-time record, with the US credit market seeing around $75bn in deals. While September is typically a strong month for issuance, the volumes this month have been the strongest since the start of the current economic cycle. Furthermore, supply has been broad-based with 127 high grade issuers tapping the US credit market, which is a record in itself.

We think there are some warning signs below the surface around such surges in supply. Typically peaks in supply are followed by spread sell-offs after a few quarters, as excessive debt is taken by corporates. This is supported by the peaks in supply seen during 2001 and 2006, which were subsequently followed by a substantial spread widening after a few quarters. They are often a precursor to another wave of leveraging, which at current levels of leverage is bad for creditors. While the often cited argument has been the decline in yields due to dovish central banks, we think this is more likely the symptom rather than the cause. If anything, we think given the lag of spread peaks to supply peaks, it confirms our view that a potential credit bear market is likely in coming quarters.

UK: The Supreme Court deals another blow to PM Johnson

In a unanimous judgement, the Supreme Court ruled that Boris Johnson's prorogation of parliament for five weeks until October 14 was unlawful. Accordingly, MPs reconvened in Westminster the day after the court's ruling. While the decision is another blow to Boris Johnson, it does not fundamentally change the situation. Parliament has already passed a law that forces the government to ask the EU for another extension of Art. 50 if there is no withdrawal agreement by October 19. An agreement with the EU is still possible, particularly as Johnson at some point seemed to signal a willingness to soften his opposition to a special treatment of Northern Ireland. Nevertheless, the risk of a no-deal Brexit remains substantial as time for a deal is soon running out. Sterling reflects these risks, weakening 1.5% last week. The move was exacerbated by dovish comments from BoE's Michael Saunders indicating his willingness to consider rate cuts even if there is a Brexit deal.

US: Better data overshadowed by impeachment proceedings of president

Stocks again shied away from record highs, not helped on Friday by talk of potential financial market sanctions on China. While media attention was on this and on the impeachment proceedings initiated against the President, economic data painted a more constructive picture of the US economy. Housing appears to be in decent shape with new and pending home sales surprising positively, although house price appreciation is now at a modest pace of 2% YoY. First cut of September PMI readings were also a little better than expected, ticking up to 51 and 50.9 for the manufacturing and services readings respectively, but we will be watching the more indicative ISM series next week before passing judgement. With the labour market remaining particularly robust, personal income was again good for August, outstripping spending, while core PCE inflation, up two tenths to 1.8%, is now not far away from the Fed's 2% target. While this dynamic will give the hawks reason to question further rate cuts, in our opinion economic risks remain firmly to the downside as we look further forward.

Eurozone: Recession risks increase

Last week's Eurozone PMI survey showed a further decline in business confidence and economic activity, after what had appeared to be some stabilisation over the past few months. The Eurozone manufacturing PMI fell to 45.6 in September from 47.0 in August, its lowest level since late 2012, while the services PMI also declined sharply, suggesting weakness in the manufacturing sector is finally spreading to the service sector. What's more, forward-looking components within the survey such as new orders and companies' hiring intentions also fell, suggesting further weakness in the overall survey ahead. The latest ECB bank lending data show that credit growth is still holding up for now, while the composite PMI for Q3 as a whole is still consistent with modest growth. However, the direction of travel in the business confidence indicators is concerning and suggests that the Eurozone will slip into recession in the next few quarters, absent a significant change in monetary and fiscal policy and improvement in trade tensions.

North Asia: US-Japan trade deal agreed

PM Abe and President Trump signed a joint statement about a new goods and digital trade agreement. The deal will have to undergo legislative approval in both countries, which is expected to go smoothly, enabling the terms to become effective in early 2020. It is highly likely that Japan will not have to suffer from any new tariffs on auto exports to the US, while the US will benefit from more agricultural exports to Japan. Meanwhile, Japan's manufacturing PMI fell 0.4 points to 48.9 in September, with most sub-indicators contributing negatively. Industrial production fell more than expected in August, while retail sales reflected our expected VAT hike induced frontloading surge.

South Korea's exports tumbled by 21.8% YoY in the first twenty days of September, with semiconductor exports down nearly 40% YoY. While these numbers appear dramatic, and are certainly not good, we would caution that they are distorted by fewer working days, and we expect a reversal in October. In China, manufacturing PMIs rebounded in September, which we believe is just a blip.

ASEAN: The easing cycle has further to run

As broad-based economic data deteriorate, regional central banks are acting to support growth. The Philippines' central bank (BSP) cut its policy rate by 25bps to 4% while also lowering the reserve requirement rate by 100bps. With August inflation below 2% YoY, the Philippines' real policy rate remains among the highest in Asia, leaving the BSP plenty of space for further easing if needed. The Bank of Thailand (BoT) stood pat in September. With the current policy rate at 1.5%, the BoT doesn't have much room for aggressive cuts while worries over high credit growth and household debt service vulnerabilities still prevail. After a resilient reading in July, Singapore's industrial production declined by 7.5% YoY in August, dragged down by a 28% drop in electronics production. With Q2 GDP of 0.1% YoY, concerns over a potential technical recession for Singapore have emerged. We expect the MAS to reduce its SGDNEER slope by 50bps in Q4 and fiscal stimulus to be forthcoming. However, whether these measures are sufficient to lift the economy out of danger of recession remains to be seen.

What to Watch

- China's markets will close next week on Tuesday to celebrate the National Day holidays, and will reopen on Tuesday the following week.
- The monetary policy boards of Australia's RBA and India's RBI will convene. While we expect the RBA to stay on hold, a 25bps cut is expected by the RBI for two of its policy rates.
- In Japan, the consumption tax will be hiked from 8% to 10% on Tuesday, October 1. We believe that the BoJ's quarterly Tankan indices will deteriorate in manufacturing, but remain steady in the non-manufacturing sectors. In Australia, the release of numerous economic indicators is on the agenda, while five Asian countries will publish CPI data for September.
- In the US, ISM manufacturing and non-manufacturing data will be important given the improved PMI readings, while payroll week always offers investors cause for thought.

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