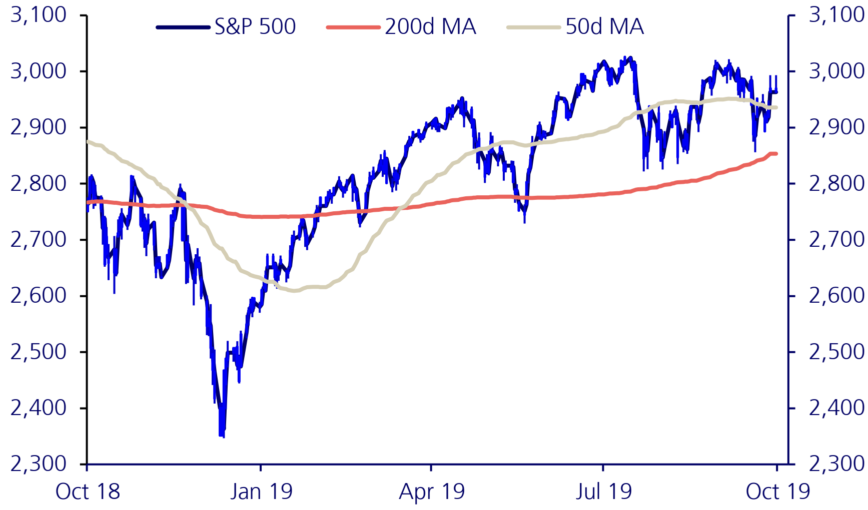
October 14, 2019

Weekly Macro & Markets View

Highlights and View

- **The US and China agree on a partial trade deal**
  It's promising that the trade war is not escalated for now but the agreement has very limited scope and is unlikely to remove uncertainty on business prospects and the economic outlook
- **Sterling with biggest 2-day gain in a decade on Brexit optimism**
  We see some progress in ongoing negotiations, but obstacles remain challenging and the risk of a no-deal Brexit is still very high as time is running out
- **ECB minutes reveal considerable differences of opinion within the governing council on decision to restart QE**
  The minutes confirm the impression from speeches of various governing council members and make incoming ECB President Christine Lagarde`s job harder

Trade optimism lifts the stock market



Source: Bloomberg

The S&P 500 traded in negative territory for most of last week just to turn positive on early indications that China and the US will agree on a trade deal. However, markets gave up a significant part of the gains once the details of the agreement were announced. China agrees to buy more agricultural goods and wants to implement reforms to intellectual property protections while the US will suspend the planned increase in tariffs due this week. It is promising that the two biggest economies in the world refrain from escalating their trade war. Nevertheless, the agreement covers few of the controversial subjects, does not remove any of the tariffs imposed so far and will do little to remove uncertainty for businesses and consumers. The bleaker outlook is reflected in the latest small business survey, as well. While still solid, it fell to the lowest level since March, with both hiring and capex plans ticking down. On the other hand, the University of Michigan's consumer sentiment index rebounded from its recent multi-year low, although mainly driven by current conditions rather than future expectations. Finally, CPI inflation numbers remained steady in September with the headline figure staying at 1.7% YoY and core at 2.4%. Producer prices softened markedly, indicating that price pressure is likely to diminish in the coming months.

Eurozone: ECB minutes highlight difficult task ahead for Lagarde

The ECB minutes released last week confirmed the considerable difference of opinion on the governing council on the wisdom of restarting QE. While most members agreed that the economy was weak, and a "very large" majority of members agreed to reduce the deposit rate by 10bp, "a number of members" viewed the case for restarting QE as not sufficiently strong, either because they did not think it would be effective or because they viewed it as "an instrument of last resort". This highlights the difficulties that Christine Lagarde, the next ECB President, will face in getting a consensus for even more monetary easing. Indeed, we do not expect much more easing from the ECB, instead fiscal policy will need to do more. Eurozone finance ministers agreed on a new mechanism last week, the Budgetary Instrument for Convergence and Competitiveness (BICC), worth initially around 20bn euros, to spur reforms and investments in the region. However, the size of the fund is relatively small, suggesting that unfortunately a larger fiscal stimulus will only be forthcoming if the economy weakens further.

Japan: Typhoon Hagibis causes havoc

Typhoon no. 19, or 'Hagibis', the worst in 60 years, hit Japan's east coast on Saturday with a record amount of rain and heavy winds, causing casualties and damage to housing and infrastructure. Public life in Tokyo and other cities came to a standstill. We believe that a negative impact on October retail sales, which will already suffer from the consumption tax hike, is highly likely. Confidence data for September, like the Eco Watchers and the Reuters Tankan surveys, experienced a bounce following several months of downturn. To us that purely reflects the rush-demand impact just before the consumption tax hike. The Reuters Tankan non-manufacturing component improved significantly from 19 to 25, but the outlook index stands at only 15, most probably reflecting an expected setback in the retail component after the tax hike. Meanwhile August core machinery orders disappointed, falling 15.5% YoY, worse than expected. August statistics still show falling wages, but we do not read too much into these numbers due to distorting sampling changes. Regular wages have probably risen by about 0.5%.

Australia: Public spending is the main engine for growth

Despite robust improvement in the manufacturing PMIs and the housing sector, business and consumer sentiment deteriorated in September, prolonging the downtrend since mid-2018. Business confidence fell from 1 to 0, while consumer sentiment slid from 114.7 to 112.3, the weakest level since October 2015. As confidence indicators tend to signal future developments for business investment and household spending, a weakening momentum hints at a further stagnation in consumption and investment growth. Tax refunds in July and August did not improve household sentiment and retail sales remain subdued. While the surge in iron ore exports has provided support to growth, it seems to have run out of steam amid a downward correction in global iron ore prices and a deterioration in China's steel demand. That said, public spending, which has been the biggest contributor to GDP growth so far this year, will continue to be the main engine for the economy going forward.

Asean: Fiscal and monetary policies play active roles in sustaining growth

In line with our expectation, the Monetary Authority of Singapore (MAS) reduced its SGDNEER slope by 50bps amid emerging concerns over a technical recession in Singapore. The advance print of Q3 GDP shows an expansion of 0.6% QoQ, mainly driven by resilient domestic services, which offset sharp declines in the manufacturing and export sectors. Meanwhile, Malaysia announced its budget for 2020. After certain incidents of fiscal mismanagement in the past, Malaysia's fiscal policy is now attracting more attention recently. As announced, the 2020 budget targets a 3.2% GDP deficit, larger than the original 3%. The upward revision seems not to have concerned the market, however, given that a lower tax base and higher fiscal spending are expected to support the economy. So far, Malaysia's economy has held up relatively well thanks to robust private consumption, reinforced by the disbursement of GST and income tax refunds in 2019. We expect fiscal and monetary policies will continue to go hand in hand to sustain growth in Malaysia and other regional economies.

Bonds: Bond yields spike higher on positive news on US-China partial trade deal and Brexit negotiations

Positive news on US-China trade and Brexit negotiations fuelled a spike higher in bond yields. The 10yr Treasury yield ended last week at 1.73%, compared to a low of 1.53% on Tuesday. Other markets moved similarly, with Gilt yields topping the move at 29bps, despite falling inflation expectations as sterling rallied. In Europe, reports of dissent around the relaunch of the ECB's QE programme also contributed to a move higher in yields. As expected, the Fed announced that it will increase reserve buffers by rolling out monthly Treasury bill purchases of USD 60bn. This is aimed at relaxing short term cash constraints, so should not be considered QE, but is likely to have helped to re-steepen the Treasury curve. Looking through elevated bond market volatility, global growth is weak and central bank actions have failed to move inflation expectations higher, with further easing measures likely. While yields could rise further on positive news on geopolitics and politics, we maintain our view that yields are capped, given our outlook for growth and inflation.

What to Watch

- Brexit discussions will likely dominate the EU summit this week, with a last-minute deal possible, but still risk of no agreement.
- In the US, housing data for September are expected to have softened after their strong run the month before while retail sales are likely to have ticked up.
- The main focus in Asia will be on China's economic data for September and Q3 GDP. In South Korea, we expect the Bank of Korea to cut its policy rate by 25 bps to 1.25%. In Australia, we will watch how full time and part time employment has developed. India's CPI probably picked up in September given certain upward pressures from food prices.

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Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

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