

Weekly Macro & Markets View

Highlights and View

- **Pound surges as UK government and EU agree on a revised withdrawal agreement**

The revised withdrawal agreement and parliament forcing an extension request have substantially reduced Hard Brexit risks.

- **Further gains for the S&P 500 last week, though a new high is proving elusive**

Following a decent rally from the wobbles of September, US stocks appear to be running out of steam and will require a strong earnings season to keep the momentum going and break higher.

- **China's Q3 GDP growth slowed further despite improving economic data in September**

The improvement in economic data might not last as trade uncertainties persist. The growth outlook remains tilted to the downside with further monetary and fiscal support needed.

Hard Brexit risks are reduced



Source: Bloomberg

Last week, the UK and the EU agreed on a revised withdrawal agreement. Most of Theresa May's former deal remains intact such as transition period, paying into the EU budget, citizens' rights etc. Key changes relate to the Irish backstop solution. According to the agreement, the whole of the UK will leave the EU customs union, but in practice the actual border will be between Northern Ireland and the rest of the UK (which is why the DUP is against the deal), with goods checked at points of entry into Northern Ireland. The EU also softened some of its red lines as Northern Ireland's parliament could decide to leave the arrangement four years after the end of the transition period at the earliest. A vote in parliament scheduled for Saturday was delayed, however, with parliament forcing the UK government to ask for an extension to the Brexit deadline from end of October to end of January instead, in order to reduce the possibility of a hard Brexit. A vote on the revised withdrawal agreement is now likely early this week. Overall, it's certainly a positive that the EU and the UK government have finally agreed on a revised deal. Even if the deal is not ratified by parliament and new elections are called instead, UK Prime Minister Boris Johnson would then most likely campaign on his deal and not on no-deal, thereby significantly reducing the no-deal risk. While the situation remains fluid and risks persist, the GBP has rallied on the news and the reduced Hard Brexit risk.

US: Stock rally shows signs of tiring, as economic data underwhelm

Another week of gains for stocks, although the S&P 500 backed off on Friday from challenging the summer highs. With better tariff news and expectations for an October Fed rate cut now largely priced in, it seems that it will be down to earnings and economic data to provide that next leg higher. While earnings season is off to a good start, attention will focus on forward guidance, where we suspect caution will dominate given the slowing growth environment. On that front, data last week mostly fail to raise optimism that the weaker trend is soon to

reverse. Retail sales fell in September, although from solid levels in the months before. The same is true for industrial and manufacturing production, which both fell into negative territory in September after a brief surge in August. As expected, a payback was also due in the housing market with both building permits and housing starts falling. That noted, home builder sentiment rose to the highest level since the beginning of 2018.

Eurozone: Sentiment stabilises at weak levels, the ECB debate on the inflation target intensifies

Sentiment in the Eurozone appears to have stabilised somewhat recently, though the flash PMIs released later this week will be crucial to watch to see how much of this is sustainable. The ZEW expectations indicator for Germany, often a useful leading indicator for German and Eurozone activity as a whole, was virtually unchanged in October, from September, at around -23. It had been as low as -44 in September, close to levels reached at the worst points in the Eurozone debt crisis and Global Financial Crisis. However, despite the bounce in recent months, the survey remains

well below its long-term average and is still consistent with contraction in the German economy. Meanwhile, various ECB policymakers made speeches last week on the merits or otherwise of changing the ECB's inflation target to make it symmetric around 2% instead of the existing "below, but close to 2%". The incoming ECB president, Christine Lagarde, will review the ECB's monetary policy objectives and the tools it can use to achieve these objectives when she takes over in November.

China: Some stabilisation for now

September activity and lending data show signs of stabilisation, but not strong enough to reverse the weaknesses prevalent in previous months. September industrial production was resilient at 5.8% YoY, led by a strong rebound in mining activities. Fixed investment grew by 5.4% YTD, roughly in line with the August figures. Retail sales ticked up from 7.5% to 7.8% YoY and service output improved by 0.3% to 6.7%. Despite such improvements, Q3 real GDP growth came in at 6% YoY, even weaker than the last two quarters. With the recent monetary stimulus,

broad money supply (M2) expanded moderately with robust growth in new loans, primarily led by short-term lending, which is probably not an ideal structure for a sustainable trend. While some effects of monetary easing seem to be reflected in stronger credit data, we believe more stimulus is needed given that uncertainties around US-China trade still prevail despite slightly positive developments from the last round of trade talks.

Asia: Trade woes not yet over

Trade data deteriorated further with a number of countries reporting declining shipments in September. Taiwan, after its export growth crossed into positive territory in August, experienced an unexpected contraction of 4.6% YoY, driven by subdued demand for metals and machinery with a pronounced decline in trade with China. Korea's exports, reported earlier this month, also saw a similar trend. Elsewhere in ASEAN, a similar bleak picture persists. Indonesia's exports fell by 5.8% YoY while Singapore's export growth was still deeply negative with September

electronics exports shrinking by about 25% YoY. PMI new export orders for major countries stand below 50, hinting at a further contraction in forthcoming shipments. As China's imports continued to shrink in September amid a broader economic slowdown, exacerbated by uncertainties around the US-China trade dispute, we do not expect that the trade woes will be over soon for Asia.

Credit: Steady inflows help to support credit spreads

The search for yield and a preference for defensive assets continue to push investors into investment grade credit mutual funds. YTD inflows have now surpassed \$100bn in Europe and \$80bn in the US. These steady flows have supported credit spreads so far, but may also bring weakness in the future. More and more regulators have pointed out the risks of a lack of liquidity in the bond market should market conditions deteriorate and asset managers need to sell large holdings. In the US, primary market sales disappointed with only \$10bn priced, due to

earnings blackouts and robust September activity. Financial issuers dominated with Bank of America selling \$4bn in two tranches after its Q3 earnings release. US banks generated mixed results but most of them were able to beat forecast, benefiting from higher trading revenues, especially in the fixed income space. We see more challenges for European banks as a weaker economy and the negative yield environment will increase pressure on profitability.

What to Watch

- Bank Indonesia will probably cut its policy rate further as macro data deteriorate. Taiwan export orders are expected to ease while Malaysia consumer prices might pick up as a result of higher food prices. Korea's Q3 GDP, Singapore's industrial production and Australia's flash PMIs will be released this week.
- No changes in monetary policy are expected at the final ECB meeting of Mario Draghi's presidency, however, he will likely emphasise the need for fiscal policy to do more to support growth.
- In the week before the much-anticipated Fed rate decision, the focus will be on the PMI readings for October and new home sales, while a busy week for earnings will also keep investors' attention.

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Mythenquai 2
8002 Zurich

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