

Weekly Macro & Markets View

Highlights and View

- **The British parliament supports the withdrawal deal in principle, but rejects the tight time table**

As the EU agrees to grant another extension the risk of a no-deal Brexit has fallen dramatically with the UK likely to head for new elections in December.

- **Eurozone business surveys confirm weak growth, but with some hints of stabilisation**

Eurozone growth remains weak with stabilisation signs still tentative. Nevertheless, investor sentiment has been supported recently by diminished risks relating to trade and Brexit.

- **The S&P 500 rises close to a record high despite falling corporate earnings**

The fall in Q3 earnings was well expected by investors but risks are building with regard to future development as earnings expectations and economic data diverge.

Tentative stabilisation in Eurozone data



Source: Bloomberg

There were tentative signs of stabilisation in some of the Eurozone manufacturing PMI survey indicators such as new orders and inventories last week, and the latest ECB bank lending survey showed a net easing in lending standards to enterprises in Q3, after a tightening in Q2. The German ifo Business climate index also stabilised in October. However, the detail of the Eurozone PMI survey revealed a further weakening in hiring intentions in both services and manufacturing, and the overall composite PMI is still consistent with very weak growth. Therefore it is too early to conclude that the worst of the region's economic slowdown is behind us, especially given our view that the US economy will continue to slow down in 2020.

Investors nevertheless have been cheered by the provision of more central bank liquidity and the reduction of significant tail risks in recent months. The thawing in trade relations between the US and China and diminished hard Brexit probability are both relevant to Europe in particular. The upshot is that Eurozone equities are up around 20% so far this year, recently surpassing levels reached in January 2018. (The US S&P 500 is also up round 20% so far this year). However, for these gains in Europe and elsewhere to be sustained into 2020, macro-economic risks are also likely to have to diminish, with a substantial improvement in economic data and business sentiment needed.

US: S&P 500 close to record high despite falling earnings

The S&P 500 came within a hair's breadth of reaching a new all-time high last Friday, fuelled by signals of progress in US-China trade talks and the latest batch of corporate earnings. The earnings season is in full swing now with more than 40% of companies having reported their numbers so far. The average earnings surprise currently stands at 4.4%, slightly above average, which results in overall earnings falling by 0.5% compared to the same quarter last year. The fact that the market is close to a record high despite negative earnings growth shows that the

weakness was well expected. However, a gap has opened in regard to future earnings growth where consensus expects a solid rebound beginning in the current quarter while economic data still point to a continuation of the challenging environment. Although Markit's Manufacturing and Service PMIs stabilised in October, the Composite index just ticked up to 51.2 and remains dangerously close to its multiyear lows.

Credit: Strong technicals continue to mask poor fundamentals

Credit markets continued to remain firm with spreads tightening last week, although their performance lagged that of equities, particularly in the US, where equity indices neared all-time highs. The supply demand technical remains supportive in credit, with strong inflows recorded again in most parts of the credit market, driven by a search for yield and an accommodative monetary policy. Primary markets saw less volume, but strong demand. In the European primary market, US can maker Crown European Holdings issued the tightest ever coupon of 0.75% for a high

yield issuer, while Pernod Ricard saw nearly nine times oversubscription for the 12-year tranche of its €1.5bn bond issue. Lending standards in Europe improved marginally, and it is encouraging to see Italian banks continuing to reduce their non-performing loans (NPLs), although the impact of recent economic weakness on future NPL growth remains to be seen. Despite spread tightening, fundamental trends remain weak with S&P Global Ratings indicating that the upgrade to downgrade ratio in US high yield is now at its lowest since 2009.

Global: Some relief for the global economy

The combined G3 flash manufacturing PMIs, which are released ahead of the global PMI data, were broadly unchanged in October and have now been flat since the end of Q2. Similarly, while global trade is still in contraction, some leading Asian trade data, including exports for Taiwan and South Korea, appear to be in a bottoming process, helped by better dynamics for semi-conductors. This is encouraging and suggests some relief for the battered industrial sector. Signs of an inflection point in the data, however, are only tentative. With economic uncertainty still

high, broader dynamics around global capex spending are likely to remain weak. Also, while the G3 PMIs were positive on activity, the employment components were weaker, indicating some contagion to the broader economy. Against the backdrop of weak macro data and high uncertainty, global central banks continue to loosen policy, with rate cuts in Chile, Indonesia, Turkey and Russia last week. Further easing measures are expected and this will help to stabilise growth, but is unlikely to drive a more marked turnaround in the global economy.

Asia: While still fragile, trade is potentially stabilising

As bellwethers, Taiwan and Korea's exports tend to provide useful signals for tentative trends in global trade. While the latest data seem to indicate some signs of stabilisation, they are still at a very fragile level to suggest any meaningful recovery. Taiwan's export orders in September were down 4.9% YoY, less than the 8.3% YoY drop in August. The rebound can partly be explained by a lower base effect from September last year. The PMI new export orders, while still deep in contractionary territory, also appeared more encouraging with a robust improvement from

43.2 to 47.9. South Korea's 20-day exports in October declined by 14.2% YoY on a working day adjusted basis, slightly better than the 17% drop on a like-for-like basis in September. Japan's shipments also pointed to a slower pace of decline with exports falling 5.2% YoY. With some signs that the global semiconductor cycle is bottoming in addition to the current US-China trade truce, there is a ray of hope for further recovery. Nevertheless, we doubt that trade data for the region will soon improve meaningfully as trade uncertainties still prevail.

Japan: Front-loaded demand seems more modest this time

The front-loaded demand before the October tax hike was clearly reflected in the September sales data with nationwide department sales up by 23.1% YoY from 2.3% growth in August. Vehicles sales released earlier this month also showed a surge from 4% to 12.8% YoY but supermarket sales picked up only by 2.8%. Compared to the last tax hike in 2014, which showed a surge of 27.5% in auto sales, the size of front-loaded demand in 2019 seems to be more modest. Therefore, we might see less of a contraction in consumption after the tax

hike this time. However, we need to wait for subsequent sales data to establish a more concrete view. Meanwhile, the flash manufacturing PMI for October shows a slight deterioration from 48.9 to 48.5. More pronounced was a slump in new orders from 47.4 to 44.4. However, the drop in stock of finished goods from 46.5 to a record low of 43.5 signals that demand was more brisk than expected. We also note an uptick in new export orders, which is encouraging.

What to Watch

- We expect the Bank of Japan (BoJ) to keep its policy rate unchanged. Major September data for retail sales, industrial production and employment will be released in Japan, while the October manufacturing PMIs for most countries in the region will be published as well.
- In the Eurozone, bank lending data, the European Business and Consumer Confidence surveys and the first estimate of Q3 GDP are likely to show growth remains weak.
- The Fed is likely to cut its target rate again at its meeting this week. Q3 GDP numbers are expected to show a slowdown from last quarter while the ISM Manufacturing index will be closely watched for signs of stabilisation.

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