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Weekly Macro & Markets View

Highlights and View

- **Global bond yields rise on hopes of a breakthrough in US-China trade negotiations**

  Yields are vulnerable to a snap back should progress on negotiations stall, given a weak macro backdrop, elevated political and geopolitical risk, and dovish central banks.

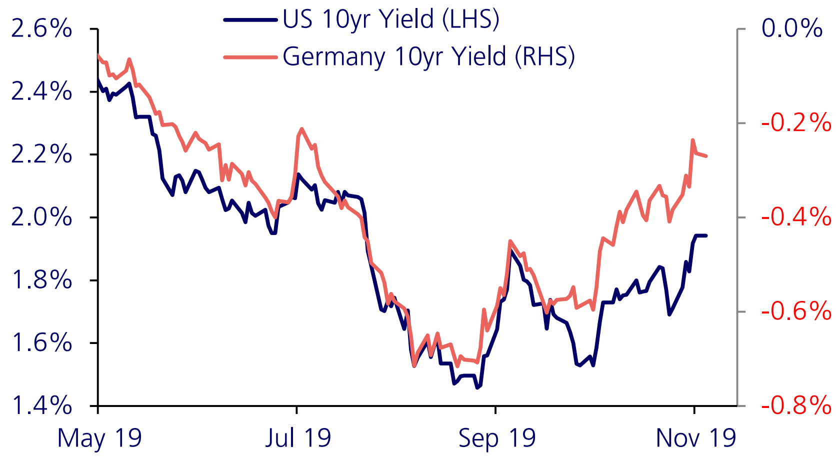
- **The credit market underperforms equities amid the bond yield spike, while some US stock indices hit new highs**

  Equities should have room to outperform credit, where the technical picture is strong but fundamentals are deteriorating and price action last week suggests an over-owned market.

- **The ISM Non-Manufacturing Index rises to 54.7 in October**

  The improvement is an important signal that the spillover effects from a still struggling manufacturing sector remain limited so far.

Global bond yields rise on hopes of a trade deal



Source: Bloomberg

The prospect of a rollback in tariffs catalysed a global bond sell off last week, amid a broader risk-on rally. Investors were encouraged by reports that a US-China 'Phase 1' trade agreement, which looks increasingly likely, may also involve a rollback in existing tariffs, along with a deferral of US tariffs scheduled for December 15. Treasury yields ended the week just below 1.95%, up from 1.69% a week earlier, and are now approaching the levels prevailing before the August 1 tariff announcement that escalated the US-China trade war. Global yield curves steepened and investors reduced expectations of further Fed rate cuts, with only one additional cut priced in by the end of 2020. Some technical levels were reached, most notably with the 10yr Bund yield rising over the 200d MA for the first time in over a year, leaving it at -0.26%, up from -0.59% a month ago. Meanwhile, macro data are mixed, with last week's global PMI data consistent with ongoing stabilisation in manufacturing activity, but with increasing contagion to the services sector and labour markets. The binary nature of the trade negotiations means that yields are vulnerable to a snap lower should progress disappoint, given a weak macro backdrop, elevated political and geopolitical risk, and dovish central banks.

Credit: Bond yield spike causes further lag to equities

Credit markets showed some signs of jitters mid-week amid the bond yield spike, although spreads ended the week tighter, but notably lagged the performance in equities. It seems that while most investors would welcome higher bond yields, total return driven investors were impacted by the sharp move in bond yields and were shedding positions. We believe that, unlike equities, the credit market doesn't seem under-owned given the flows seen this year, and any signs of underperformance should drive profit taking given the performance of the year.

Higher yields boosted bank stocks. The German finance minister also proposed a softening of Germany's stance on the banking union, but this is unlikely to be a game changer as there is significant opposition to various parts of the proposal from both inside and outside Germany. European supply was heavy, while fund flows remain positive, confirming that the strong technical picture remains in place. The US lending standards survey showed weak demand and tighter standards, which normally forebodes higher default rates.

US: Stronger service sector data alleviate fears of a manufacturing spillover

The S&P 500 reached another record high last week despite President Trump pouring some cold water on investors' expectations regarding the progress made in trade negotiations and a potential rollback of existing tariffs. Economic data helped to lift the mood with the ISM Non-Manufacturing Index rising to 54.7 in October from 52.6 the month before. The better headline number and improvements in important sub-components alleviate fears about potential spillover effects from a still struggling manufacturing sector. The University of Michigan's consumer sentiment index ticked up slightly in November while the JOLTS survey revealed that the number of job openings trended down further in September, to the lowest level in 18 months. Finally, a surprisingly strong pickup in unit labour costs in Q3 lifted the annual rate to 3.1%, the highest in more than five years. The flip side was a quarterly fall in productivity for the first time since 2016 as firms remain reluctant to invest given the uncertain outlook and the soft global environment.

Eurozone: Equities boosted by better news on trade, despite mixed macro data

The final estimate of the Eurozone Composite PMI in October was revised up by 0.4 to 50.6, but at this level it is still only consistent with very modest growth in the region. Industrial production in Germany also fell -0.6% MoM (-4.3% YoY) in September, though factory orders were up 1.3% MoM (-5.4% YoY). Risk assets in the region were higher last week, however, with the Euro Stoxx 50 up 2%, while Eurozone government bond yields also moved higher as the news flow on trade improved, indicating how important these issues are for the region. Finally, the Spanish general elections over the weekend left an unclear outcome, with a hung parliament. The Socialists remain the largest party in parliament, but are well short of an absolute majority. The far-right VOX party did well, while the centre-right Citizens party lost a number of seats. A long period of coalition negotiations is now likely and possibly even fresh elections again in a few months' time. The continued political uncertainty will likely be a small drag on the economy and local asset markets.

Japan/China: Japan's distorted wage statistics and China's cut in lending rates

Wages in Japan suddenly spiked by 0.8% YoY in October, following an average drop of 0.5% YoY in the prior seven months. We do not read too much into Japan's wage statistics as they are distorted due to a change in the sample, meaning we are comparing apples to pears. We need to wait until next year for these distortions to disappear. Furthermore, the 'special' wage component surged because companies paid the commuter pass allowance in a lump sum before the consumption tax hike. Household spending data for September as well as very weak October data for the Eco Watchers survey, the Reuters Tankan Non-manufacturing and the Services PMI reflect the stronger than expected rush demand before the consumption tax hike and the following drop in consumption. Meanwhile, China's exports fell less than expected in October as US demand for Chinese goods picked up. The PBoC pushed down borrowing costs by cutting the one-year rate of its medium-term lending facility (MLF) from 3.3% to 3.25%, which we believe is just the starting point to channel rates even lower to spur lending.

Asia ex Japan/China: No light at the end of the tunnel yet

The central banks of Australia and Malaysia kept their policy rates unchanged at 0.75% and 3% respectively, while the Bank of Thailand (BoT) cut its benchmark rate by 25bps to 1.25%, back to a historical low. In an effort to curb the strong Thai Baht, which has negatively impacted export prices, the BoT announced certain measures to encourage capital outflows by allowing free transfer of funds and investment overseas as well as permitting exporters to keep their export proceeds and residents to trade gold in foreign currencies. Meanwhile, the Philippines' GDP for Q3 was surprisingly robust at 6.2% YoY, mainly driven by strong government expenditures due to temporary support of delayed budget spending. Q3 GDP for Indonesia came in at 5% YoY, slightly weaker than in Q2, and the slowdown was broad-based. The ratings agency Moody's has downgraded India's outlook from stable to negative, citing 'the probability of a more entrenched slowdown' given 'financial stress among rural households, a credit crunch and weak job creation'.

What to Watch

- In the US, small business optimism is expected to have remained high while CPI inflation has probably picked up in October. Retail sales will give crucial signals as to whether consumer spending has rebounded after a relatively soft September.
- In the Eurozone, the German ZEW survey is expected to rebound further in November, but the first estimate of German Q3 GDP could indicate that the country had been in technical recession.
- In Asia, we expect the Philippines's central bank, BSP, to keep policy rates unchanged next week while maintaining a dovish stance. Q3 GDP data will be reported in Japan, Hong Kong and Malaysia. In China, most of the relevant economic indicators for October will be released, and we will also keep an eye on Alibaba's 'Singles Day' online shopping extravaganza on Monday. In Australia, we will focus on business and consumer confidence as well as labour market and wage data.

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