January 28, 2019

Weekly Macro & Markets View

Highlights and View

- **G3 flash manufacturing PMIs surprise on the downside, led by declines in Japan and the Eurozone**

  The lack of a resolution on global trade weighs on confidence and business activity, with weak new orders signalling a softer near-term outlook.

- **The ECB recognises downside risk to the Eurozone growth outlook**

  The ECB is now unlikely to raise rates this year and will probably announce another liquidity operation for banks in the coming months.

- **China's PBoC and CBIRIC announce measures to support bank's perpetual bond issuance**

  These measures were interpreted as quantitative easing by some investors, though PBoC officials have denied this today.

German business confidence slumps at the turn of the year

Source: Bloomberg

Last week saw the Eurozone composite PMI continue its downtrend, falling to 50.7 in January from 51.1 in December, while the German ifo business climate indicator also fell sharply. Indeed, most worrying was the decline in German manufacturing sector confidence, with the PMI falling to 49.9 from 51.5 in December, i.e. close to stagnation territory. What's more, the forward-looking new orders component of the German manufacturing survey fell to around 45, deep in contraction territory. There has been a long list of negative factors that have impacted the Eurozone, and especially Germany because it is such a large exporter, over the past few quarters. Domestically, changes to emissions standards have affected auto production, while political uncertainties in Italy and France have also weighed. Internationally, the China slowdown and US-China trade dispute as well as more recently Brexit have also had an impact. This has led to a high level of uncertainty for businesses and has depressed economic activity, especially investment.

On balance, we still expect an eventual stabilisation in business confidence and growth in H1, but risks are now high and this benign scenario will depend on some positive developments to support sentiment, such as a thawing in US-China trade relations, and supportive measures or signals from monetary and fiscal authorities in the Eurozone and globally.

ECB: The bank now recognises risks, but policy options limited

It is somewhat encouraging to see that the ECB has now clearly recognised the weakness in the data and has changed its assessment of the balance of risks to the outlook from 'broadly balanced' to 'to the downside'. ECB President Mario Draghi said last week at the press conference following the ECB's monetary policy meeting that 'the incoming information has continued to be weaker than expected on account of softer external demand and some country and sector-specific factors. The persistence of uncertainties in particular relating to geopolitical factors and the threat of protectionism is weighing on economic sentiment.' Although there were no changes to monetary policy, we expect the ECB will announce further liquidity operations for the banking sector in the coming months and that it will not raise interest rates at all this year. However, the ECB's manoeuvring room to support the economy is limited, putting the onus on fiscal policy in the Eurozone to help support the recovery.

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US: Trump agrees to temporarily reopen the government

The S&P 500 suffered its first negative weekly performance since before Christmas, receding 0.2%, although the trading week ended on a positive note. The reporting season for Q4 earnings is now in full swing with decent numbers, though less impressive than in recent quarters. Sales have been roughly in line with expectations so far while earnings are beating consensus by little more than 1%, both represent the weakest surprises in years. Due to the shutdown economic data were in short supply, but the Markit Manufacturing PMI of 54.9 in January, after 53.8 the month before, indicates that business activity rebounded despite trade uncertainty and the government shutdown. Further adding to an improving outlook, President Trump has agreed to temporarily reopen the government until February 15th to allow for bipartisan negotiations. An agreement covering both border security and immigration that is acceptable to both sides should be feasible, but the risk of a renewed shutdown in three weeks remains.

Japan: The latest deterioration in economic indicators gives us reason for concern

It was a bad week for Japan as far as economic indicators are concerned. Without any obvious distortions (like last year's natural disasters or any plant shutdowns) the Manufacturing PMI fell from 52.6 to the boom/bust line of 50, marking the steepest drop in five years. The fall was broad-based across all sub-indices, with the output index tumbling from 54 to 49.2 and new export orders falling for the third month in a row to only 46.1. The Reuters Tankan also marked a setback in January, with the manufacturing diffusion index falling from 23 to 18, driven by further weakness in the transport equipment sector. Finally, the export recovery in Q4, following a dismal Q3 performance, was weaker than expected, with general machinery exports to China being the weakest link. As was widely expected, the Bank of Japan left monetary policy unchanged, but lowered its GDP growth forecast for this fiscal year as well as the median inflation forecast for next fiscal year by half a percentage point, incorporating the fall in energy prices.

Asia: Exports and industrial production continue to suffer in the region

Asian export data were disappointing across the board once again. Korea was the first country to give us a glimpse into January export performance, with exports in the first twenty days down a whopping 14.6%. The main drag was weak demand for semiconductors from China and Hong Kong, Korea's main export market for semiconductors. Falling unit prices added to the woes. Petroleum products and ship exports also fell in the double-digit percentage range. Other weak export data in the region refer to December data, with export orders in Taiwan down 10.5% YoY, while Thailand's exports were down 1.7%. Unfavourable readings for Taiwan's industrial production can be linked to electronic parts, with weakness in the tech sector in line with our somewhat gloomy outlook for 2019. Finally, both the Bank of Korea and Bank Negara Malaysia kept monetary policy unchanged, as expected, but their respective outlooks appeared to be rather dovish.

Credit: Investor appetite roars back in the primary market

In the late stage of the cycle, unhindered ability to access credit markets is a fundamental strength. Hence to us, what happened in primary markets last week was far more telling than the price action in secondary markets. While secondary markets were generally firm, except in cash high yield where spreads widened modestly, primary markets were giving signs that the pent up demand of investors waiting on the sidelines is finally emerging. While we felt the opening up of the US high yield primary market some time ago was a significantly positive development, last week saw one of the heaviest supply weeks in around six months. Demand was strong across the board, with IBM, Volkswagen and Accor seeing strong oversubscription in Europe, while new issue concessions practically disappeared in the US. Flows into credit are also showing tentative signs of improvement. All is not well though, as the latest ECB lending standards survey may indicate some pressure on Italian banks, while the ECB's lack of proactiveness on TLTROs is disappointing.

What to Watch

- Given the reopening of the US government a lot of pent-up data are about to be released this week including home sales, building permits, durable goods orders, retail sales and a first estimate of Q4 GDP growth. No change is expected from the Fed, though investors will focus on any signals regarding a pause in the rate hike cycle.
- EC confidence surveys and Q4 GDP data are likely to confirm lacklustre growth in the Eurozone.
- China's Vice Premier Liu He will visit the US to continue trade talks while China will publish its official NBS PMIs for January. Australia will release its AiG Manufacturing PMI along with NAB business confidence and Q4 CPI and PPI data. GDP data for Q4 will be released in Taiwan. December data for retail sales, industrial production, housing starts and the labour market will be published in Japan.

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