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Weekly Macro & Markets View

Highlights and View

- **The US Federal Reserve signals a more dovish stance, removing its tightening bias**

  The Fed's more pragmatic approach is welcome, making a pause very likely. However, markets seem too complacent to completely ignore the possibility of any further rate hikes given solid economic momentum.

- **Eurozone GDP growth weak in Q4, Italy falls into technical recession**

  Leading indicators suggest Eurozone growth will stay weak, with downside risks in the near term. An eventual recovery depends on better newsflow regarding the US-China trade dispute and improvement in EM data.

- **JEFTA, the EU-Japan trade deal, became effective last Friday**

  Amid global trade worries this trade deal is an encouraging signal that there are alternatives to increasing global protectionism.

The Fed capitulates

Source: Bloomberg

With a monthly performance of 7.9%, the S&P 500 enjoyed the strongest January since 1987, almost fully making up for the severe correction in December. Investor sentiment was lifted by the latest Fed statement, which dropped the reference to further gradual hikes and indicated a more flexible approach regarding its balance sheet reduction. The move away from a seemingly dogmatic tightening bias opens a full range of potential monetary policy steps in 2019. While we still expect the Fed to hike once or twice this year a pause in March now seems very likely. The latest batch of economic data certainly does not call for urgency. The ISM Manufacturing Index rebounded, driven by a jump in new orders. However, prices paid have shown the weakest reading since early 2016, indicating that price pressure remains muted. Firms added 304'000 new payrolls in January, underlining the healthy pace of job creation in the US, although last month's number has been revised down significantly. Annual wage growth eased slightly to 3.2% from 3.3% in December. The unemployment rate ticked up to 4%, driven by a pickup in the participation rate to 63.2%, the highest level since 2013, indicating that the strong labour market can still attract new people who have long given up looking for a job.

Bonds: Bond yields fall on a dovish Fed

A dovish Fed triggered a repricing of Treasuries, with the 2yr yield initially slumping to 2.46% as a Fed rate hike this year was priced out while almost a full rate cut is now expected for 2020. The 10yr yield dipped to an intraday low of 2.62% before the strong payroll report triggered a partial rebound. Inflation breakevens rebounded on the dovish Fed, helping to push down real yields. The curve steepened somewhat and the 5/2yr spread, which turned negative in December, edged into positive territory. Oil prices fell sharply in Q4 and this will weigh on inflation globally over the coming months, but underlying price pressures are unlikely to collapse, with US hourly earnings rising more than 3% annually and even Eurozone core CPI surprising on the upside in the latest data. Market pricing of the Fed rate projection looks too dovish, but a stabilisation in global data is likely to be required before a rate hike is back on the table. Upside to yields is limited, however, given the late stage of the cycle.

Eurozone: Growth stays weak and Italy falls into recession

Italy fell into technical recession in H2 2018, as GDP declined 0.2% QoQ in Q4, after falling 0.1% QoQ in Q3. This is the second time Italy has been in recession since 2009, reflecting both its low-trend growth and susceptibility to recent tightening in financial conditions. Wider Eurozone data was not as bad, but still a concern. Eurozone GDP grew just 0.2% QoQ in Q4, the same as in Q3. In addition, business confidence continues to fall, with the latest being the EC's economic sentiment indicator for January. On a more positive note, credit growth is holding up, with lending to the private sector growing at 3.4% YoY in December. Consumer confidence also rebounded in France as the yellow vests protest movement died down. However, in the near-term, overall economic conditions in the Eurozone are likely to get worse before they get better. Indeed, the risk is that weakness in the manufacturing sector will eventually transmit through to the wider economy unless there is an improvement in US-China trade relations soon and a stabilisation in EM data.

Switzerland: Headline data weaken, but it's not all bad

The economy is slowing, led by weaker external demand and sluggish domestic spending. In January, the manufacturing PMI slipped to the lowest level since 2016, though it's still firmly within expansionary territory. Underlying details were also more encouraging as the decline was mainly driven by weak price dynamics, likely reflecting a lagged effect of the sharp fall in oil prices in Q4 and a drawdown in stocks. New orders and employment were broadly unchanged. The KOF leading indicator disappointed but this mainly reflected the manufacturing downturn while services held up better. Consumer confidence was stable, though concerns around job security are edging higher. Finally, on a positive note, after a drawn-out period of weakness, retail sales expanded in Q4 at the highest pace since early 2017. Overall, the data are in line with our view of sluggish growth in 2019, but a near-term contraction continues to look unlikely.

Asia: PMIs falter, with few exceptions

January PMIs confirmed what we had already observed looking at Asian exports: Growth continues to slow broadly. Excluding Australia and India, where readings even improved above the 50 watermark line that separates between softening and accelerating growth, manufacturing PMIs fell in almost all Asian countries. The ASEAN aggregate even inched below 50, while Japan's manufacturing PMI tumbled by 2.3 points to 50.3. The leading measure, new orders minus inventories, has maintained its downward spin, while the new export orders index keeps deteriorating in most countries. Taiwan's 43.6 reading is particularly grim, as Taiwan suffers disproportionately from the worsening tech cycle. While China's official NBS PMIs remain resilient, the Caixin manufacturing PMI fell again to 48.3, indicating that private companies are still struggling with tighter financial conditions. This suggests that monetary policy across the region will loosen rather than tighten this year.

Australia: Business conditions deteriorate, while the housing market remains vulnerable

Australia's NAB business conditions tumbled from their 12-year high of 22, marked in April last year, to just 2.2 in December. Whether that is just a blip remains to be seen, but we also note that business confidence keeps sliding, though not as dramatically. Meanwhile, house prices keep falling as well, down another 0.8% on a seasonally adjusted basis in January for the eight capital cities, which brings the YoY reading to -7.6%. Home sales likewise keep falling, while statistics released today reveal that building approvals decreased another 8.4% MoM in December, down 22.5% YoY, much worse than consensus had expected. Slower credit growth is not helping either, and today's final report by the Royal Commission recommending changes in the financial industry may add to tougher credit conditions at the margin. We do not foresee a change in policy rates at tomorrow's RBA monetary policy meeting, but we believe that the pendulum will swing to ease monetary policy rather later this year despite a tight labour market.

What to Watch

- In the US, the ISM Non-Manufacturing index is expected to keep signalling a continuation of solid momentum in the service sector while initial jobless claims should fall back after the shutdown-induced distortion.
- "Shin nien qui le", Chinese New Year will be celebrated tomorrow. China's and Taiwan's financial markets are closed the whole week, Hong Kong's for three days from Tuesday to Thursday, Malaysia's tomorrow and Thursday and Indonesia's tomorrow.
- The monetary policy councils of five APAC central banks will convene this week: Australia, Thailand, the Philippines, India and Sri Lanka. We do not expect any change in policy rates, even though India's RBI may move to a more neutral stance.
- In Japan, we will watch the release of the services PMI and the Eco watchers survey for January, as well as wages, household spending and the trade balance for December. Indonesia's Q4 GDP will also be published.

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