

Weekly Macro & Markets View

Highlights and View

- **US retail sales show the biggest decline in almost a decade**

The big drop was distorted by a number of special factors but the underlying trend shows that consumer spending is softening.

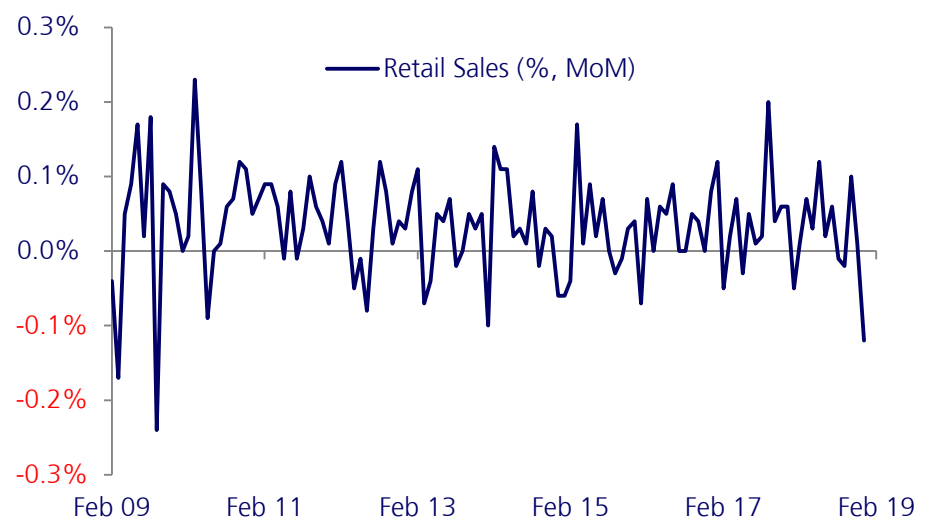
- **Germany sees zero growth in Q4, narrowly escaping a technical recession following negative growth in Q3**

A firming of German data is expected, but developments are vulnerable to progress on trade talks and a stabilisation in EM growth.

- **Snap elections are announced in Spain, after government fails to pass its 2019 budget**

The uncertainty may cause some volatility in Spanish equity and bond markets, but a coalition government dominated by mainstream parties is the most likely outcome.

Retail sales plunge



Source: Bloomberg

The S&P 500 kept climbing higher last week, gaining 2.5%, as investors ignored softening economic data and focused on reassuring rhetoric from the trade talks between the US and China. Few details are known so far but talks are set to continue this week. Meanwhile, economic data continue to soften, strengthening our view that growth momentum is slowing. NFIB small business optimism has fallen to the lowest level since Donald Trump's election victory in November 2016, with hiring plans ticking down. Industrial production fell 0.6% MoM in January after an almost flat December. The biggest disappointment came from retail sales, which showed the largest monthly decline in almost a decade. While the figure was distorted by a number of special factors it nevertheless points to a slowdown in consumer spending. On a more positive note, the University of Michigan's Consumer Sentiment Survey has rebounded from its two-year low in February with some of the key components indicating households' increased willingness to buy big-ticket items. Households' longer-term inflation expectations fell back to match the all-time low reached in 2016, confirming the lack of urgency for the Fed to tighten monetary policy. However, core CPI inflation remained at 2.2% in January showing that price pressure is still holding up.

UK: Business investment weighed down by Brexit uncertainty

The British economy is weighed down by the uncertainty around the UK's future relationship with its biggest trading partner, as well as a slowdown in global and particularly European growth. Industrial production fell 0.5% MoM in December after an already negative November. Overall, GDP growth slowed to only 0.2% QoQ in the final quarter of 2018, down from 0.6% in Q3. The decline in business investment accelerated to -1.4% QoQ, falling each quarter in 2018, and the annual decline is now the biggest since 2010. Consumer spending held up reasonably

well, growing by 0.4% QoQ, while overall growth would have slowed even more without a boost from fiscal spending. On a positive note, while core inflation stuck at 1.9% YoY in January, headline CPI inflation slowed to 1.8% YoY from 2.1% the month before, supporting households' real purchasing power. Accordingly, retail sales rebounded in January from their fall in December.

Eurozone: Germany sees zero growth in Q4, but equities rally

Economic growth in Germany was virtually flat in Q4 last year. This means Germany avoided falling into technical recession in H2 2018, but it is still not a great result. There is not yet a detailed breakdown, but the German statistics office said that net exports, as well as household spending, were weak, though investment, especially in construction, was strong. Although problems in the auto sector related to the changes in emissions standards are unwinding, wider industrial production momentum weakened, meaning German data could remain soft for a while.

In order for data to firm up certain things need to go right, such as progress in trade talks, a stabilisation in emerging market growth, and no further significant domestic shocks or disruptions. However, Eurozone equity markets continue to ignore the weak data, with investors focused more on signs of improving trade relations between the US and China (though no deal has yet been announced) and also better lending data out of China. The EuroStoxx index was up 3.4% last week.

Spain: Snap elections will likely lead to a coalition government of mainstream parties

General elections will be held in Spain on April 28, the third time in four years, after the Socialist-led minority government was unable to pass its 2019 budget. Fresh elections could cause some volatility in local equity and bond markets, but this is unlikely to be too severe. Admittedly, anti-establishment or extremist parties have seen their support increase in recent years. However, they have nowhere near the same level of support as in Italy for instance. In Spain, the far-left Podemos Party is currently polling at around 15%, and the far-right VOX party is polling at around 10%.

More mainstream parties, such as the Socialist Party, PP (People's Party) and Citizens Party are collectively polling at around 60% or more of the total vote, making it likely that a coalition dominated by some of these parties will form the next government in Spain, rather than an anti-establishment government. However, there is an outside chance that the far-right VOX party could become part of the next coalition government, which could in turn worsen tensions between the central government and Catalonia.

China: Economic data distorted, but lending growth bottoms, suggesting better times in H2

Last week we cautioned not to be surprised by strong lending data, as they tend to spike in January. Indeed, aggregate lending surged to a record high, higher than consensus had expected. However, even with the seasonal effect stripped out, lending has clearly picked up following strong 'guidance' by the government. Aggregate lending growth to the real economy inched higher from the record low of 9.8% YoY in December to 10.4%. M2 growth moved up to 8.4% following strong liquidity provisioning by the PBoC. China's exports surged 9.1% YoY in

January, but we caution that this largely reflects frontloading before Lunar New Year, which occurred earlier than last year. It is notable that trade with the US is slowing. Both commodity and high-tech imports were weak in value and volume terms. Finally, disinflationary forces led to a two-year low in producer price inflation of only 0.1%, a warning signal for industrial profits, while consumer prices were up only 1.7%. High level trade talks between China and the US will continue this week. A breakthrough seems possible, but may also need more time.

Credit: Santander reminded investors about subordinated bonds' risks

Despite having issued USD 1.2bn of AT1 bonds the week before, which was perceived as a positive sign by investors, Santander decided last Tuesday to skip the first option to call €1.5bn of perpetual contingent-convertible notes next month. That is unprecedented in the AT1 market and Santander's bonds tumbled to 97 cents from par following the announcement. While some investors believe this is an idiosyncratic story and still expect most banks to call bonds, we believe they should be more prudent in recognising and pricing the risks of extension

and write downs. Handelsbanken, Unicredit and BBVA were able to attract strong demand for AT1 or Tier2 new issuance. AT1s, also known as CoCos (contingent convertible), are the riskiest form of bank debt, as the notes can be written off or converted into equity if a lender's capital level drops too low. Lenders can also skip coupon payments without triggering a default. With more bail-inable debt now coming to the market, we expect to see price tiering as investors should more adequately price extension or default risk.

What to Watch

- The Markit PMIs will show whether the US economy was able to keep its strong momentum despite weaker global growth while housing market data are expected to show a stabilisation.
- Fitch will release its assessment of Italy's credit rating on Friday, February 22, with a downgrade to BBB- possible. Flash Eurozone PMI data will also be scrutinised for any signs of stabilisation in Eurozone business sentiment.
- Bank Indonesia is expected to leave its policy rate unchanged, but may follow other APAC central banks towards a more dovish tilt. As for economic data, the focus will be on exports, with Japan, Singapore and Thailand reporting January data, and we will get a first glimpse of 20-day February export data in Korea. Japan will report machinery orders and all industry activity data for December and department store sales in January, while the focus in Australia will be on labour market data for January and Q4 wages.

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