Weekly Macro & Markets View

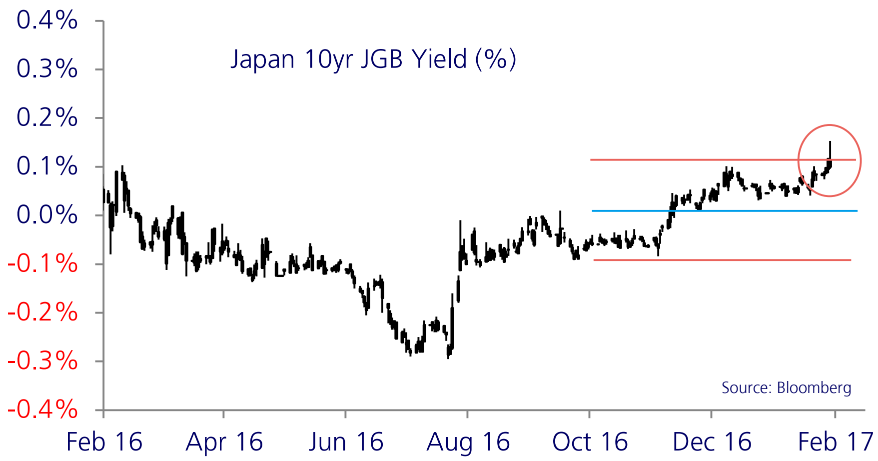
Highlights

- On average, Asian manufacturing PMIs remain firmly in expansion, with India recovering above 50
- Tech companies dominate issuance with jumbo deals from Microsoft, AT&T and Apple totalling $37bn
- Deutsche Bank reports a higher than expected Q4 loss, driven by lower market share in trading revenues

Our view

- The Asian manufacturing rebound has further to go as India starts to recover from demonetisation shock
- The supply surge may be a sign of continued releveraging and needs active monitoring by credit investors
- European banks are losing market share in trading to US banks, which will be unhealthy if not addressed

Is the Bank of Japan still controlling the yield curve?



As widely expected, the Bank of Japan left its monetary policy unchanged at its first Monetary Policy Meeting of the year. GDP growth forecasts were revised upwards for FY16-18, in line with expectations, partly reflecting the new national account standards. Three days later, markets were shaken as doubts emerged as to whether the BoJ was still able or willing to defend its yield curve control (YCC) policy of keeping the 10yr JGB yield 'around' zero amid a global rise in yields. Though the BoJ never made it clear how the word 'around' should be defined, market participants perceived a range of +/- 10bps as tolerable.

At Friday's 'Rinban' JGB purchase operation, the lack of offers for longer dated maturities caused bonds to sell off, with the 10yr JGB yield surging above 0.15% and USDJPY falling. Markets calmed down only after the BoJ announced unlimited fixed-rate bond buying operations, pushing the yield back below 0.1%. In addition, Governor Kuroda reconfirmed that the BoJ is determined to continue its "powerful easing" policy to reach its 2% inflation target. We believe this should put a stop to further yen appreciation, though policy makers will rush to assure that they are not targeting the currency rate, in order not to be characterised as currency manipulators by the new US administration.

Bonds: Central banks lean against higher yields

As expected, the Fed, the BoJ and the BoE kept policy unchanged last week, maintaining a dovish stance despite stronger data. The BoJ was forced to scale up asset purchases to defend its yield target amid rising global yields. This helped to stabilise the 10yr yield, but the curve steepened beyond this maturity. A dovish BoE kept its inflation forecast unchanged, despite a higher growth outlook, which left the 10yr gilt yield down 12bps on the week. With gilt purchases about to expire and inflation building, we suspect gilts may come under pressure, particularly if the BoE's upbeat growth forecast materialises. The Treasury curve was broadly unchanged, as the Fed signalled that it is in no hurry to raise rates while the payroll report delivered muted wage inflation, despite firm job growth. This benign mix is likely to be temporary, however, with inflation staying on investors' horizon.

UK: The BoE lifts its growth forecast for 2017

Growth momentum has slowed down slightly, but remains solid overall. The Manufacturing PMI ticked down to 55.9 from 56.1 last month, indicating continued solid growth in the manufacturing sector. While new orders remained robust, input price pressures clearly intensified, soaring to the highest level on record. The loss of momentum was more visible in the service sector with the Services PMI falling to 54.5 from 56.2. On the positive side, business expectations have improved. Job creation has slowed to a five-month low, however, reflecting the uncertainty firms are facing with regard to Brexit. The BoE acknowledged the solid momentum by significantly increasing their growth forecast for 2017 from 1.4% to 2%. Despite the upwards revision to growth, inflation forecasts were largely unchanged thanks to a reassessment of the neutral rate of unemployment. With massive inflationary pressure building up, the BoE's relatively dovish stance is likely to be challenged in the coming months.

US: A healthy labour market and strong momentum in manufacturing

The latest batch of data confirm the healthy state of the US economy. The ISM Manufacturing Index accelerated to 56.0 with new orders picking up to the highest since 2014, indicating a continued recovery in manufacturing. Momentum remains strong in the service sector as well, with the ISM Non-Manufacturing basically remaining flat at 56.5. New orders slowed down slightly, but remain firm at 58.6. Consumer confidence remains close to post-recession highs. Expectations have ticked down slightly, albeit from a very strong level. Sentiment is certainly supported by a healthy employment outlook. 227'000 new payrolls were created in January while the unemployment rate ticked up to 4.8%. This was driven by a higher participation rate, however, indicating that more people are being drawn back into the labour market. The slowdown in wage growth will buy the Fed more time to slowly continue the rate normalization process. The latest Fed minutes confirm that the FOMC is in no rush. Accordingly, the next move in interest rates is expected in June.

Eurozone: Jump in inflation unlikely to deter ECB from QE

Eurozone headline inflation rose to 1.8% in January from 1.1% in December, mainly on the back of base effects from higher oil prices compared to the same time last year. However, core inflation was unchanged at 0.9%. Headline inflation is likely to rise above 2% in February, as these base effects will then be at their most pronounced. Assuming no further increase in oil prices this year, headline inflation should then gradually fall back. Indeed, the ECB has downplayed the recent pickup in headline inflation, emphasising that core inflation remains very low and suggesting that it will continue with its QE programme at the projected pace of 60 billion euros from April, at least until the end of the year. However, with political uncertainty high ahead of elections in France and possibly Italy, investor sentiment will remain fragile and government bond markets volatile. Finally, data released last week showed Eurozone GDP grew at an above trend pace of 0.5% QoQ (1.8% YoY) in Q4. The final estimate of the Eurozone composite PMI survey showed that the strong momentum continued into Q1.

China: Tightening monetary policy

This is the time of the year when it is more difficult to gauge how China's economy is performing. Why? Lunar New Year fluctuates every year between January and February, causing distortions to statistics as normal seasonal adjustments are not able to capture the impact properly. Economic indicators, like industrial production, will only be available in March, comprising January/February data. Consequently, economists have to focus on 'soft' survey data like PMIs. While the official NBS Manufacturing and Non-Manufacturing PMIs were roughly unchanged in January, the Caixin Manufacturing PMI showed a slowdown in domestic demand momentum and a strong acceleration in external demand. This, again, reflects the impact of Lunar New Year, and should not be over-interpreted. Meanwhile, the PBoC raised the Standard Lending Facility rate on Friday, when domestic markets re-opened after the Lunar New Year holidays. Though this is not helpful for equity markets, we believe it shows the authorities' strong determination to fight recent credit excesses, which needs to be applauded.

What to Watch

- Among Japanese economic indicators, we will focus on the Eco Watchers Survey and machine tool orders for January. PM Abe's meeting with President Trump at the end of this week will reveal whether Japan's offer to support job creation in the US through investments by Japanese firms will alleviate pressure from the new US government.
- China's export statistics for January will probably show a distorted upswing, while aggregate financing data may reveal the usual credit surge at the start of every new calendar year.
- We expect the central banks of Australia, Thailand, and the Philippines to stand pat. The Reserve Bank of India should also stay on hold, although this is a close call. Mexico's central bank should hike by 50bps.

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