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# Weekly Macro & Markets View

## Highlights

- The US-Japan strategic alliance takes center stage during PM Abe's meeting with President Trump
- US 10y Treasury yields briefly dip to critical levels before rebounding from the lower end of their recent range
- US President Trump reaffirms 'One China' policy in a harmonic telephone call with China's President Xi

## Our view

- Avoiding disputes about economic issues is a positive for the US-Japan relationship
- We expect yields to move higher, but political risks and a rather dovish Fed may cause some headwind near term
- Recognizing the 'One China' policy removes a big impediment for a more pragmatic US-China relationship

## Greece negotiates with its creditors ... again


Greece is locked in another potential down-to-the-wire negotiation with the EU and IMF regarding the next tranche of its bailout funding. There is still some time for a deal to be agreed, as Greece has enough money to cover its expenditures for the next few months. However, it faces large repayments of around €6bn in July, some of which are due to the ECB. A deal must be agreed to before this if Greece is to make these payments and avoid defaulting.

There are a number of sticking points that could make reaching an agreement difficult. The EU and IMF want Greece to pre-legislate certain extra reforms (such as to pensions and income tax) in case it is unable to meet future targets. In addition, the latest IMF Article 4 review of the Greek economy was unusually blunt, calling Greece's current government debt-to-GDP level unsustainable. The next stage of the bailout was supposed to involve IMF participation as a creditor, but this looks increasingly difficult given the IMF`s assessment of the Greek economy. Unfortunately, the German parliament has agreed to the existing bailout for Greece only upon condition that the IMF would eventually also participate in the bailout. While there is still some time for negotiators to find a compromise, the risk of a negative outcome such as a Greek default on its debt repayments has increased.

## US: Consumers' financial expectations take a hit

Consumer confidence has receded in February, but remains close to the post-recession high. The move lower was driven by weaker expectations and in particular by a steep drop in the expected change in the financial situation. The drop reflects an unwinding of the post-election boost and supports our view that consumer spending is unlikely to accelerate significantly from current levels. On the other hand, initial jobless claims fell back within a hair's breadth of a multi-decade low, underlining the ongoing strength in the labour market. The earnings season is well underway with almost three quarters of the companies in the S&P 500 having reported. The beat-miss-ratio currently stands at 75%, with the average earnings surprise at 3.6%. This lifts the blended annual growth rate to 5.2%, up from 3% in the previous quarter but still some way off the 11% investors expect in 2017. Stock markets nevertheless took courage from the reports, with the S&P 500 rising 0.8% to reach a new all-time high.



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## Japan: Abe meets Trump

PM Abe was the second head of state to visit President Trump, indicating the importance of the US-Japan relationship. This was reconfirmed in the official statement following the weekend meeting, which focused primarily on the security alliance. The firing of a North Korean ballistic missile into the Sea of Japan during the meeting only reinforced that alliance. Economic aspects took second stage, which we believe plays in Japan's favour, as Trump's criticism regarding currency manipulation was not a prime focus. Trump acknowledged that the BoJ's monetary policy is focussing on the fight against domestic deflation. Economic issues will be discussed in a new "economic dialogue" forum, which will be headed by Japan's Finance Minister and Deputy Prime Minister Aso and US Vice President Pence. We appreciate that economic issues have been moved to a working level. Japan's support package proposal to strengthen US employment, which was in the headlines before the summit, has not been formally announced.

## ASEAN and India: Central banks, the new regime

The Reserve Bank of India stood pat and changed its stance to neutral from accommodative. To us, this matches the choice of other Asian central banks, which have remained on hold since Q4 last year, following a year of monetary easing. Central banks have grown more vigilant since headline inflation picked up, pushed by commodity prices. In EM Asia, food and energy prices account for a sizeable share of the consumption basket and could spill over to core CPI. Global policy uncertainty has also motivated a more neutral monetary stance. Asian currency and sovereign assets have partly recovered from the US election shock, but the risk of a stronger dollar and volatile portfolio flows have increased. Overall, we are unlikely to see a repetition of the 2016 bond rally, but we remain positive on sovereign high-yielders, such as Indonesia. Finally, Asian growth has gained momentum. In India, we expect activity to rebound in Q2. A small uptick in Asian CPIs should keep policy rates still, with hiking risks in the Philippines.

## Bonds: Yields rebound from critical levels

The rally in core bonds persisted into the first half of the week, with the 10yr Treasury yield testing a critical level at 2.34% before rebounding, with similar moves in the dollar index. While gilt and Bund yields also retraced some of their declines, spreads vs Treasury yields extended. There was no clear driver behind the moves, but upcoming European elections and US political developments are impacting investor sentiment. Weak hourly earnings data in the prior week's payroll data also triggered a repricing of near term inflation risks, with a pullback in inflation breakeven rates and a more dovish near-term Fed outlook. We were encouraged that critical levels held and maintain our view that yields are unlikely to revisit last year's lows.

## Credit: Is a cautious Fed lending survey a canary in the coal mine for credit?

Credit markets were soft in Europe, but largely unchanged in the US last week. Weakness in Europe was driven by peripheral issuers amid news on France and Greece. Interestingly, the European utility indices underperformed high yield, mostly due to a larger peripheral issuers' weighting in the former. While high yield also continues to catch a bid globally as flows remain supportive, the latest Fed lending standard survey struck a more cautious tone. Lending standards tightened for yet another quarter for corporates, while also tightening in some other categories. The lending standards for corporates have historically led defaults in the credit market, and the cautious tone is occurring despite strong results from US banks. This survey warrants continued monitoring by credit investors in case it indeed turns out to be the canary in the coal mine.

## What to Watch

- US small business confidence is expected to recede from multi-year highs while PPI and CPI will give important clues as to the persistence of underlying price pressures.
- Inflation in the UK is expected to have accelerated further, driven by higher commodity prices and a weaker pound. Retail sales should have recovered somewhat from their steep drop in December.
- German Q4 GDP and the ZEW survey are likely to confirm that growth is strong for now.
- China's credit growth should show the usual surge at the start of the new calendar year. Bank Indonesia is expected to stay pat.

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