December 4, 2017

Weekly Macro & Markets View

Highlights and View

- **The US Senate passes its version of the tax reform bill**

  The Senate's approval is a crucial step towards significant tax cuts and a simplification of the tax code. Ironing out the differences with the House's version could take some time but a compromise is likely.

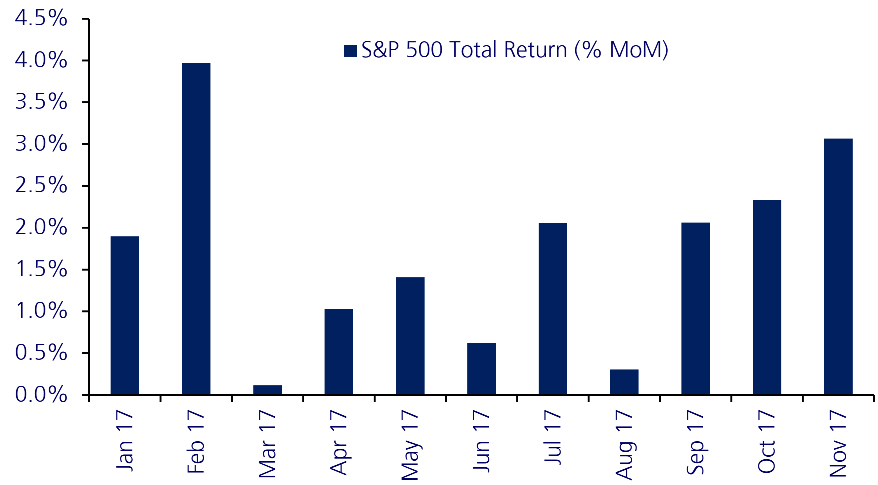
- **Market sentiment is lifted by tax reform optimism and solid economic data**

  Equity investors will benefit from lower corporate taxes in the US while the economic upside from the tax reform is expected to be limited.

- **The global manufacturing PMI surge to the highest level since 2011 as both activity and prices gain momentum**

  A further acceleration appears to be underway in the global economy, supported by a broad-based investment recovery.

The US stock market reaches another record high on tax reform optimism



Source: Bloomberg

The S&P 500 ended November on an upbeat note delivering positive total returns in every single month so far this year – a highly unusual occurrence. Investor confidence was briefly shaken on Friday when optimism on the tax reform was overshadowed by revelations that former National Security Advisor Michael Flynn had pled guilty to lying to federal agents and intends to cooperate with Special Counsel Robert Mueller. This could potentially lead to further investigations involving persons in President Trump's inner circle. For now, however, positive sentiment keeps the upper hand, helped by the Senate's approval of the tax reform bill. While the outcome was expected, some Republican holdouts raised the risk of a delay. The Senate's approval is a crucial step towards long-awaited tax reform, but now the differences with the House's version have to be ironed out – a process that is likely to end with a compromise but offers several pitfalls and the risk for further delays ahead.

Market sentiment was also supported by another set of solid economic numbers. The ISM Manufacturing ticked down to 58.2 from 58.7 but remains deeply in expansionary territory, in particular taking into account that new orders picked up to 64.0 from 63.4. Consumer confidence has further improved from already very high levels with a strong uptick in expectations indicating an ongoing willingness to spend.

Eurozone: No signs of a slowdown in growth

Last week saw another strong set of data from the Eurozone, with the European Commission economic sentiment indicator hitting its highest level since 2000. The pickup in sentiment was broad-based across countries and sectors. The latest bank lending data also confirmed the robust growth outlook. Eurozone corporate lending picked up to 2.9% YoY in October from 2.4% YoY in September, while lending to households remained unchanged at 2.7% YoY. Inflation, however, still remains subdued in the Eurozone. Headline inflation ticked up only modestly in November to 1.5% YoY from 1.4% the previous month. Core inflation was unchanged at 0.9% YoY. Nevertheless, there are signs of price pressures building in many of the business surveys. For example, the Eurozone Manufacturing PMI output prices component is at its highest level since 2011. Given the strength of growth in the Eurozone, we would expect inflation to gradually pickup over the next few quarters, which should put some upward pressure on government bond yields.

Switzerland: Boom time for Swiss manufacturers

Third quarter GDP rose by 0.6% QoQ, which was the highest quarterly growth rate since 2014. The mix was good, with solid increases in investment and net trade, while consumption expanded more modestly. Construction fell, confirming that housing market headwinds persist. We believe that growth will stay strong in Q4 and into 2018, led by manufacturing, but with positive spin-off effects on the economy more broadly. The manufacturing PMI spiked higher in November to the highest level since 2006, with both current output and new orders matching pre-crisis levels. Clearly, exporters are benefitting doubly, from the surge in external demand and the weaker franc. Other survey data released last week were also strong, though the broader economy is still lagging behind, in part reflecting sluggish consumption. We do not expect the SNB to change policy in the December meeting, but a move towards tighter policy in 2018 looks increasingly likely given strong data and a weaker franc.

Asia: PMIs powering ahead!

The global economic picture is improving and Asia is no exception. After a rather subdued October, Asian PMIs are powering ahead in November reaching ~52.8 on an equal-weighted average basis, which is one point above the year-to-date average. Both overseas and domestic demand recovered. Employment also rose, a sign that confidence is gaining strength. Top performers were Australia (+6.2 to 57.3 points), Malaysia (+3.4 to 52), Taiwan (+2.7 to 56.3), and India (+2.3 to 52.6). In Australia and Malaysia, a combination of local infrastructure spending and strategic roles in global trade explain the rebound. Taiwanese producers are hiring to cater to ongoing tech demand. As for India, it is slowly exiting the GST trauma. One exception to this bullish reading is China: the Caixin and the official PMI are roughly stable. Ongoing prudential tightening is probably to blame. Finally, we want to stress that more countries are reporting increases in average selling prices. These remain modest relative to the pressure of energy and raw material input prices, but indicate some normalisation in inflation.

Japan: A week full of mixed data, with most of the negative ones being one-offs

The Ministry of Finance Q3 corporate survey revealed both positive and negative insights. On the negative side, recurring profits fell for the first time in six quarters on a sequential basis, though they were still up 5.5% YoY. However, this was far below consensus expectations of 18.4%. While the manufacturing industries continued to show strong profit growth, the service sector experienced a slump, which follows a very strong outcome in the prior quarter and thus may be just a pullback, probably caused by one-off costs. The fact that capex continued to be strong, not only in the manufacturing industries but also in construction and the service sector, shows that we should not read too much into the disappointing profit numbers. On a seasonally adjusted basis, recurring profits remain close to their record high reached this summer. Industrial production grew weaker than expected in October, but corporate production forecasts remain very optimistic. Consumption related indicators were also weak, but again due to temporary factors. We are looking through these blips, and remain optimistic.

India: The manufacturing sector recovers

Following an underwhelming 5.7% YoY in Q2, GDP growth rebounded to 6.3% YoY in Q3, on the back of improved manufacturing and fixed investment growth. The recent introduction of the Goods and Service Tax (GST) has hit the manufacturing sector. It seems, however, that confidence is slowly returning, following efforts by the government to simplify the GST processes and alleviate tax rates. Overall, we see the reforms as structurally positive, as they focus on tax compliance and formalisation of the economy. Additionally, the announced recapitalisation of public sector banks should gradually support investment. That said, we think that the government will retain a flexible attitude when it comes to policy enforcement. Indeed, other parts of the economy, like agriculture production and private consumption, remain lacklustre. As regional (2018) and general (2019) elections approach fiscal policy is likely to remain supportive.

What to Watch

- The ISM Non-Manufacturing Survey is expected to reveal a continuation of the positive mood in the US service sector, while labour market data will show whether this translates into a better employment environment.
- Export and CPI data for November will be the focus in Asia this week. In Japan and China, we will also have a closer look at service related PMIs and consumer confidence.
- We do not expect any changes in monetary policy rates when the MPCs of the Australian RBA and the Indian RBI convene this week.

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