May 15, 2017

Weekly Macro & Markets View

Highlights

- Merkel's CDU party wins in North Rhine-Westphalia local elections
- The BoE left the Bank Rate and the Asset Purchase programme unchanged but slightly lowered its GDP forecast
- Australia presented a conservative budget, focused on spending for infrastructure and affordable housing

Our view

- The win increases chances that Merkel remains Chancellor after the federal elections
- The BoE still seems too optimistic on growth in the UK as momentum has slowed further entering Q2
- We welcome the budget's focus, but think that the fiscal impulse is unlikely to revive household income

China's 'Belt and Road' project is gaining steam

Source: Xinhua

Four years ago, President Xi launched the 'New Silk Road' concept, also referred to as the 'One Road, One Belt' plan, intended to connect China with economies in Asia, Africa and Europe via road and sea (see map). These countries account for 60% of the global population and 30% of global GDP. Hosting 28 heads of state at a 'New Silk Road Strategy' conference in Beijing yesterday and today, Xi offered concrete funding for the plan. CNY 100bn will go into the Silk Road Fund and CNY 380bn will go to special lending schemes by the China Development Bank and Export-Import Bank of China to support infrastructure and private manufacturing projects as well as financial cooperation. China will also sign business and trade agreements with more than 30 countries, including a trade deal with the US that was announced last Friday, following the Trump-Xi summit last month. While the US-China agreement will not have any substantial impact on overall trade flows, we appreciate that the US government seems to continue to avoid tensions with China. This view is emphasised by the fact that the US sent delegates to the 'Belt and Road' summit in Beijing.

China also published important economic data for April today, which confirm that economic momentum is slowing. Industrial production was up 6.5% YoY versus 7.6% in March, while fixed asset investment growth moderated to 8.9% YoY, mainly due to a slowdown in manufacturing investment. Property investment and retail sales growth remain robust.

South Korea: Is Moon ready for a 'sunshine policy' revival?

Moon, Jae-in, a liberal from the Minjoo Party, was elected as South Korea's new president in last week's snap elections, following the impeachment of Park, Geun-hye of the conservative Liberal Korea Party. Voters elected Moon with 41.4% of the votes, clearly ahead of his main conservative and centre-left competitors. Moon promised to rejuvenate the economy through a fiscal programme, corporate reforms and support to SMEs. Moon also pledged to improve relations with both China and North Korea. This does not mean a revival of the 'sunshine policy' of his liberal predecessors towards North Korea many years ago, but a two-track approach combining sanctions and dialogue. To us, this is a step forward in lowering geopolitical tensions, though North Korea will remain a threat and Kim, Jong-un, North Korea's leader, an erratic and unpredictable risk, as the latest missile test on Sunday shows. However, we regard US President Trump's recent hints of willingness to enter into a direct dialogue with North Korea as a step forward.

Credit: Credit outperforms equities as shorts reportedly capitulate

Credit markets were firm last week, outperforming equities, with cash markets catching up with the rally seen in CDS indices over the last few weeks. While the rally was helped by a 3% bounce in the oil price, which is up by another 2% to 3% this morning, there were some anecdotal reports that investors have been closing out or rather capitulating on short positions. Primary markets were active too, with both US and European markets seeing heavy supply and low new issue discounts. Flows were generally positive, with the exception of the US high yield market, which saw selling by ETF funds, although this had a muted impact on secondary markets. Interestingly, in some pockets, shorts are now being reset by investors who had been patient so far. There was heavy protection buying in the retail sector, for example, after disappointing results from Macy's kicked off a broad repricing in the sector.

US: Investors look through politics, pushing stocks to new highs

Although there was great interest and media coverage last week around the very public sacking of FBI Director Comey, investors seem to have become rather immune to the recent volatility of White House developments. Indeed, market volatility contrasts sharply, with the VIX index falling to a 24-year low of 9.6 on Tuesday, while equities scaled new highs. We are encouraged by the outperformance of the more cyclical sectors of the stock market, most notably semiconductors, though still see only modest upside for US stocks from current levels. With a good earnings season now largely complete, attention was on economic data, which were generally supportive. Consumer confidence ticked back up towards a cycle high, while retail sales for April showed a decent start to Q2 on the back of higher revisions to prior data. Although investors are now fully pricing in a 25bps rate hike by the Fed in June, inflationary pressures are modest at best, and it was notable that core CPI slipped back to 1.9% YoY, from 2.0%.

Eurozone: Draghi recognises better macro outlook

Last week's data confirmed an improvement in the hard data in the Eurozone closer to the surveys that have been robust for the past few months. Q1 GDP growth in Germany came in at 0.6% QoQ, after 0.4% QoQ in Q4. Although the German statistics office recognised that mild weather may have flattered the contribution to growth from construction, it also said that the pickup was broad-based with investment in machinery and equipment, government and household consumption, and net exports all contributing to growth.

Elsewhere, ECB President Mario Draghi recognised the improving macro picture in remarks to the Dutch parliament. He said that the recovery had become firmer and more broad-based and that forward guidance was meant to address tail risks, which were now less of an issue. This suggests the ECB will change its language at its June meeting de-emphasising low interest rates and eventually preparing the ground for a reduction in QE asset purchases, most likely in 2018.

LatAm: A mixed inflation bag

Peru joined the club of regional monetary easing by cutting 25bps from its benchmark rate, bringing it to 4% as economic activity slowed sharply following the severe coastal El Nino impact. This is welcome news and we expect that further easing is in the cards as disinflation is already setting in. In Chile, inflation data should allow the central bank to make one additional rate cut, and the Colombian central bank still has room for 100bps in rate cuts. In Brazil, inflation is now below the central bank target of 4.5% for the first time since 2010 and more rate cuts are in the cards, too. The Argentine monetary authority is fighting sticky inflation that will prevent it from reaching its 2017 goal. In contrast, Mexican inflation reached a nine-year high and moved closer to the 6% mark. The central bank will keep tightening but will wait for the FED move first.

What to Watch

- The ZEW survey and second estimate of Eurozone GDP are likely to indicate that growth is strong in the Eurozone.
- We expect Bank of Indonesia to stand pat. Japan, Malaysia, the Philippines, and Singapore will disclose their Q1 GDP growth numbers, which should reflect the lift of activity in the region.
- At the upcoming central bank meetings in Chile and Mexico, we expect a last 25bps cut in Chile and no action in Mexico.

173001566 (01/16) TCL

ZURICH®