Weekly Macro & Markets View

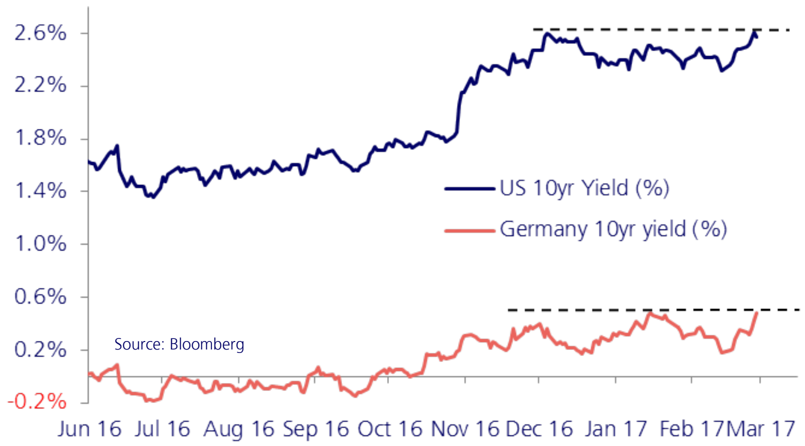
Highlights

- 235’000 new payrolls were created in the US in February while wages grew 2.8% YoY
- The ECB turns less dovish as it recognises stronger data
- The WTI oil price tumbled below USD 50 a barrel, while base metals sold off

Our view

- The US labour market is in solid shape, but wage growth remains relatively modest
- The ECB is still likely to continue with QE in 2017
- Despite the tug of war between US supply increases and OPEC supply restrictions, global demand should support oil prices

Bond yields face resistance… at least for now



Bund and Treasury yields rose sharply last week on strong data and shifting central bank expectations, in spite of plummeting oil prices. While the firm US payroll removed the last hurdle for a Fed rate hike this week, the data were in line with expectations and did not cause a repricing of the near-term rate path. The 2yr Treasury yield edged down after the release, closing at 1.35%, which nonetheless takes it back to a level last reached in 2009. Despite the sell-off, market pricing continues to look dovish compared to the Fed’s 2018/19 rate hike projection, which will be closely watched this week.

Draghi’s upbeat press conference, and speculation that the ECB could raise rates before ending QE, supported an equally sharp rebound in Bund yields, with the 10yr up 13bps to 0.49%, which matched January’s high. With the short end of the curve still constrained by QE and negative policy rates, this triggered a further steepening of the Bund curve. Given these conditions, the hurdle for a further rise in Bund yields is likely to be high near term.

The Swiss 10yr yield also rose sharply, turning positive for the first time since 2015 and providing some relief to the SNB. The 10yr JGB, by contrast, remains anchored by BoJ yield curve targeting policy, but rising yields elsewhere will put pressure on the central bank.

US: A healthy labour market continues to create a decent number of jobs

As the Fed entered its self-imposed blackout period, the market’s focus lies on the last few data points ahead of the FOMC meeting on March 15th. The latest labour market data further support the view that the Fed will hike rates for the second time in three months this week. 235’000 new payrolls were created in February, slightly below last month’s figure but above the 12-month average. The tick down in the unemployment rate to 4.7%, despite an increase in the labour force participation rate to 63%, is a further sign of the labour market’s current strength.

The underemployment rate dropped to 9.2%, matching the post-recession low. Despite the solid employment environment, wage growth has picked up only modestly. Average hourly earnings grew 0.2% in February, the same as the month before. The annual rate rose to 2.8% from 2.6%, meaning that real wage growth remained almost flat compared to a year ago. Consumer credit posted the smallest gain since 2012 in January, another hint at a potential slowdown of household spending.

ECB: Less dovish language, but still continuing with QE

At last week's press conference, ECB President Mario Draghi recognised the improvement in the macro data and that the risks to the economic outlook have tilted less to the downside. Draghi said that the governing council had decided to remove the phrase "to act using all the instruments available within its mandate" from the introductory statement because there was less of a sense of urgency. Draghi also said that there was no discussion on extending the Targeted Long-Term Refinancing Operations (TLTRO), the last phase of which is scheduled to end later this month. The latest ECB projections showed real GDP growth forecasts for '17 and '18 revised 0.1pp upwards to 1.8% and 1.7% respectively (the '19 GDP growth forecast was unrevised at +1.9%). Headline inflation projections for these two years were also firmer, especially for '17 (at +1.7% from +1.3%), but forecasts for core inflation remained largely unchanged. Overall, we expect a continuation of QE asset purchases through the whole of 2017, but if the data continue to exhibit strength, investors may increasingly focus on when the ECB will scale back QE further.

Eurozone: Q4 GDP breakdown confirms strength of domestic demand

The final estimate of Eurozone Q4 GDP was confirmed at 0.4% QoQ (+1.7% YoY), matching the prior quarter's expansion rate. Household consumption remained the largest growth driver, contributing 0.2pps to headline growth. Other domestic demand components also contributed, with government spending and investment each adding 0.1pp to growth. However, net exports were a drag. The survey data in Q1 are thus far consistent with an even stronger pace of growth than in Q4. The hard data, such as industrial production and retail sales, have not yet improved as much as the surveys would suggest, but are showing signs of some betterment. German industrial production rebounded 0.1pp more than expected in January to 2.8% MoM, following an upwardly revised -2.4% (from -3.0%) in December. The increase in output was broad-based, including capital, consumer goods, and manufacturing and mining.

UK: Hammond keeps his powder dry to face future turbulences

The spring budget, presented by Chancellor Hammond last week, did not contain any major surprises. One of the key points is the decision not to immediately spend the extra savings generated by the better than expected financial situation. Clearly, Hammond wants to keep his powder dry to be able to confront any Brexit related turbulence in the future. In fact, keeping the planned budget trajectory the same as back in November implies a slightly more expansionary fiscal stance in 2017/18 from current levels. As the British economy will face increasing headwinds going forward, the reduced fiscal headwind is welcome. Economic data weakened last week. Both industrial and manufacturing production fell in January but this came after solid development the month before. Theresa May faces more opposition on her way to triggering Art. 50 as the House of Lords amends the Brexit bill to give lawmakers a veto over the final deal. The bill will now return to the House of Commons where it should pass without the amendments given the Conservatives' majority. However, a further delay cannot be excluded.

China: Accommodative fiscal policy, stricter risk management from the NPC

The NPC affirmed its commitment to economic stability, by maintaining a fiscal deficit target of 3% of GDP for 2017. Fiscal policy should increasingly rely on local governments and public-private partnerships. M2 and TSF growth targets of 12% are also accommodative. We think that the pledge to "more neutral" monetary policy could translate into more interbank rate hikes. Capital flow controls should remain in place. Policy makers appear especially determined to regulate wealth management products and the bond market. Ongoing macroprudential measures should cool mortgage loan growth. To tackle corporate leverage, the preferred strategy combines ongoing capacity reduction in steel and coal with a push for debt-to-equity swaps and securitisation. We believe that private investors alone will not solve the NPL issue, and that the government will have to bear some of the losses. A further increase in nominal GDP would help, but remains conditional to the continuation of commodity prices and trade recovery.

What to Watch

- After another set of solid labour market data, a Fed rate hike this week is now almost a certainty. The market will now focus on the FOMC's future rate trajectory.
- The Dutch elections are unlikely to see the far-right party gain power.
- The Bank of Japan should keep its policy rate unchanged. Bank of Indonesia should also stay on hold. In China, retail sales, fixed asset investment, and industrial production data will be released. We will watch Singaporean export data to confirm the momentum in Asian trade.

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