

# Weekly Macro & Markets View

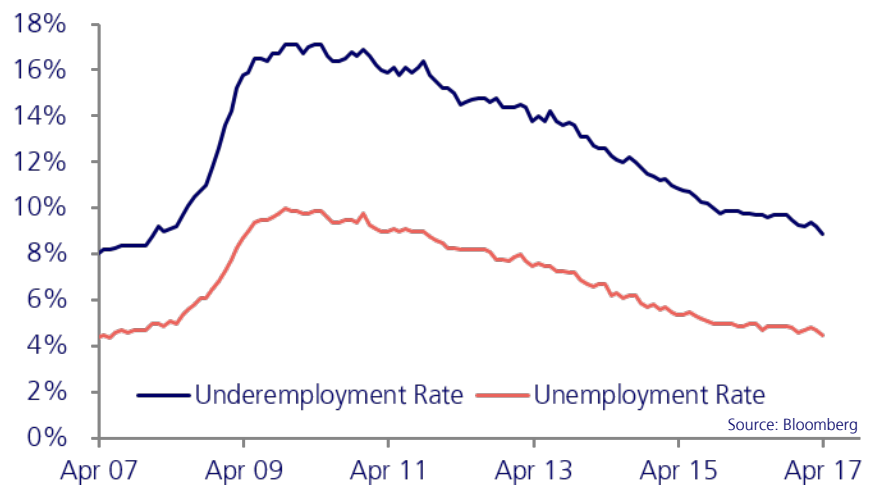
## Highlights

- President Trump hosted a meeting with President Xi in Florida in an amicable environment
- US military action in Syria shows a change in policy and challenges Russia's approach
- US payrolls disappoint, though unemployment falls to a cycle low of 4.5%

## Our view

- We believe threats of a trade war between the US and China have subsided for now
- Geopolitical risks remain high, though market pricing implies investors may have become immune
- Non-farm payroll data is notoriously volatile, labour market remains robust

## Broad measures of US unemployment at cycle lows



With US stocks experiencing a period of consolidation following a robust start to the year, investor focus last week was on the Fed minutes and economic data. The March minutes proved more hawkish than expected, revealing some members were factoring in the potential for fiscal initiatives to lift growth and inflation. More important, however, was the discussion on ending the reinvestment of maturing MBS and Treasury purchases, the remaining part of the QE initiative. While no detail was given about timing, we believe that any change will be well signalled to the market and a gradual scaling back is unlikely before next year. Clearly this will be highly data dependent.

On the data front, economic releases were generally a bit softer, in keeping with our view that some moderation was likely following a very strong run. Both the manufacturing and non-manufacturing ISM readings slipped back to 57.2 and 55.2 respectively, though still indicative of solid growth ahead. It was the employment report, however, that got most attention. Payrolls disappointed, with only 98k new jobs reported in March versus expectations of 180k. It should be noted that this is a highly volatile series subject to major revisions, so we are reluctant to read too much into it. The alternative household survey proved much stronger and resulted in the unemployment rate falling to a new cycle low of 4.5%, though wage growth was again rather disappointing, up only 0.2% on the month.

## Bonds: Flatter curves amid political risk and disappointing data

The Fed's hawkish minutes failed to lift yields as geopolitical risk, uncertainty around the French election, and a large miss on the US payroll dominated investor concerns. The 10yr Treasury yield broke below 2.30% on the payroll, but later recovered to end the week at 2.38%, remaining within the closing range that has held since December. While the curve has flattened, rates are fairly well anchored around the Fed's 'terminal rate' forecast of 3%, with the 5Y5Y forward at 2.93%. By contrast, Bunds rallied sharply last week,

with the 10yr Bund yield back at 0.22%. While dovish signals from the ECB, a hint that rate hike talks are premature, supported the rally, political risk was the other key driver. With less than two weeks until the first round of the French election, and with polls still divided, spreads are widening. Concerns around Italy have also risen and are likely to persist beyond the French election. The 10yr BTP/Bund spread remained above 200bps last week, compared to 138bps for Spain.

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## Eurozone: Hard and soft data starting to align

The Eurozone composite PMI rose further in March and is now tracking at its highest level since 2011. Last week also saw some 'hard' activity data tentatively aligning with stronger survey data. Eurozone retail sales rose firmly in February and an upward revision to prior data left the growth rate at 1.8% YoY, rebounding from recent weakness. German data were strong, with both industrial output and exports surprising on the upside in February. Weather sensitive construction was a key driver, but investment and consumer good production were also decent. Data were softer

outside of Germany, with disappointing industrial output in Spain and France, though this was partly weather related. Looking through this, manufacturing activity was actually strong in Spain, boosted by capital goods, but the underlying trend appears softer in France. With both sentiment and activity running at a healthy pace, there is little to suggest that the growth upswing has peaked yet, despite political risk.

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## Asia: Solid economic data support investors' appetite

The latest PMIs for March confirm the good health of the Asian manufacturing sector, with the regional equal-weighted average edging up slightly to 52.4 from 52.3. In China, the rising new-orders-to-inventory ratio augurs well for the rest of the region. We observe that regional new export orders moderated slightly, which is not surprising following very strong trade data in Q4. However, Taiwan and Singapore, two countries at the heart of Asia's trade value chain, delivered very solid PMIs. Australian manufacturers benefitted from domestic

demand for infrastructure projects. Korea underperformed, likely due to China's economic sanctions. We note that the input price sub-index is peaking in most countries, which should provide some relief to margins. Economists have revised up their growth expectations for EMs, putting a lid on further positive surprises. Yet, investors' appetite for EM assets is growing: the past three weeks have seen \$7.2bn of inflows into EM equities, bringing YTD inflows to 13bn. It seems that the rotation from the US to EMs is ongoing, as US equities are seeing sizeable outflows.

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## China: Xiong'an – A new economic zone designed to match Shenzhen and Pudong

China's government has announced plans to develop the Xiong'an New Capital Area in Hebei province, about 100km from Beijing and Tianjin (dubbed as the 'Jing-Jin-Ji' area). Xiong'an is being designed to become China's second capital, as it will take over non-core functions from Beijing. It will also be developed into a new high tech and ecological centre, and will help to support China's booming service industry. China has proven to be able to transform vision into reality by successfully developing new economic zones such as Shenzhen, close to Hong Kong, or

Shanghai's Pudong district. The project will certainly help to drive China's urbanisation process forward. Infrastructure investment spending is believed to add up to more than 0.5% of GDP over the next five years. We believe the new project will help to alleviate property price inflation in Beijing, while property sales and home purchase restrictions have immediately been implemented in the new district in order to avoid the usual speculative excesses.

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## Credit: The ECB allows time to Venetian banks

Despite geopolitical tensions, credit spreads were only slightly wider in Europe and largely unchanged in the US last week, with European high yield names and covered bonds underperforming.

The European financial sector got some support from recent developments. The ECB stated on Tuesday that the two Italian banks, BPVi and Veneto Banca, were solvent, which means they are now 'eligible' for precautionary recapitalisation under the BRRD provisions, easing the risk of a bail-in by

senior creditors. Subject to European Commission approval, their capital shortfall could be resolved via a bail-in of subordinated bondholders and a capital increase provided by the Italian government or the Atlante Fund. This is a positive signal for the Italian banking system. Deutsche Bank also confirmed on Friday that the EUR 8bn capital increase launched on March 21 was fully subscribed by investors.

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## What to Watch

- Some key data points in the US will be retail sales and consumer confidence, along with CPI inflation. It will be interesting to note if the strong confidence readings of late are maintained and translate into higher spending.
- China will publish the usual economic data set for March. We do not expect any change in policy rates when the Monetary Policy Board of the Bank of Korea meets on Thursday. In Singapore, trade data and the initial GDP estimate for Q1 will be disclosed. As the MAS announces its semi-annual monetary policy, we see little chance of a change.
- Due to the Easter holiday, *Weekly Macro & Markets View* will not be published on Monday, April 17, 2017. Publication will resume Monday, April 24, 2017.

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