

Weekly Macro & Markets View

Highlights and View

- **Trade negotiations between the US and China end without any compromise, hitting investor confidence**

Though talks will continue, the latest escalation makes it more difficult to find a 'face-keeping' solution.

- **The European Commission predicts Italy's budget deficit will be 3.5% of GDP in 2020**

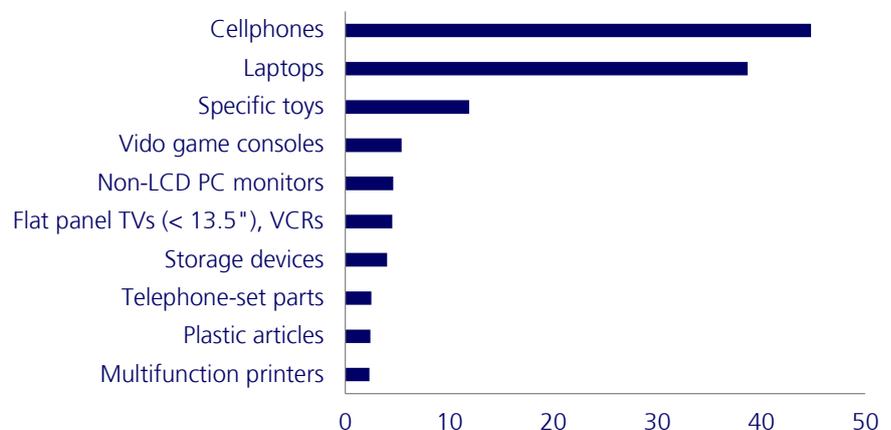
Similar to last year, another budget standoff between Italy and the EU looks likely in the next few months.

- **Credit market weakness may not yet be the harbinger for a deep correction**

While credit fundamentals are poor and spreads tight, strong investor demand in the primary market still indicates that a buy on dip mentality may persist for some time.

US-China trade dispute escalates, hitting global equity markets

Top 10 US imports from China not yet tariffed (USD bn)



Source: US Int. Trade Commission, Bloomberg

Global equity markets suffered their worst week this year as an escalation in the US-China trade dispute spooked investors. President Trump increased tariffs from 10% to 25% on imports from China worth USD 200bn. Talks between China's delegation, led by Vice-Premier Liu He, and top US negotiators in Washington ended without a solution. Trump urged China to turn prior commitments into law within one month or face tariffs on an additional USD 325bn of imports that have not been tariffed yet, with details to be published today, Monday. Even though China intends to retaliate, no details have been announced yet. China's Vice Premier Liu He said that the amount of required additional imports of US goods needs to be realistic and that all extra tariffs need to be removed as a precondition for a deal. He also urged the US not to harm China's sovereignty and dignity, but vowed to keep the dialogue open. In our opinion, a crucial problem for China is the distinction between changes in regulations versus changes to national law, with the latter perceived as difficult to achieve. Despite Trump's rhetoric, we believe that new tariffs would negatively impact a wide range of US retailers, manufacturing companies and consumers with dire consequences for both business and consumer confidence and investment plans. Global investors reacted nervously, with the S&P 500 futures down more than 1%, China's domestic 'A'-shares down 1.7%, and the CNY weakening.

Global: The global economy continues to struggle, though with some signs of stabilisation

Global growth remains weak, with some signs of stabilisation but no indication of a stronger rebound. Supply chain disruptions in Asia appear to be waning, with a stabilisation in exports data across the region and leading indicators such as PMI new export orders picking up in April. Improvements are patchy though, with the Eurozone still in industrial recession, slowing momentum in the US manufacturing sector, and global trade in contraction. Services activity, which has been resilient, also softened in April, leading to a decline in the global composite PMI. Looking

forward, a number of central banks cut rates last week, which should help to support the expansion, but vulnerable EMs remain under pressure. Trade uncertainty, amplified by the setback in US-China trade talks, will continue to weigh on capex spending and business sentiment, with downside risks to the global cycle persisting. While we anticipate a modest improvement, global growth will stay sluggish over the coming months.

Eurozone: Equities hit by trade dispute; another budget standoff between Italy and the EU likely

Eurozone equity markets were down around 4% last week, buffeted by trade dispute concerns. Economic data were also patchy. German industrial production increased by 0.5% MoM in March, but a boost to construction output due to favourable weather was a large part of the driver. Factory orders in Germany only rebounded modestly in March after a large fall in February. Industrial production data for other Eurozone countries were soft, France (-0.9% MoM), Italy (-0.9% MoM), Spain (-1.2% MoM) and point to a weak number for the Eurozone as a

whole when it is released later this week. Finally, Italy's composite PMI fell back below 50 in April, indicating that GDP growth could also fall below zero in Q2, despite rebounding into positive territory in Q1. Italy's weak growth outlook and high debt-to-GDP ratio is a long-term concern. Indeed, the European Commission predicted in its spring forecast that Italy's budget deficit would rise to 3.5% of GDP in 2020, setting Italy on a potential collision course with the rest of the EU once again.

APAC Central Banks: RBNZ, BNM and BSP cut rates by 25bps, while RBA and BoT remain on hold

The central banks of New Zealand, Malaysia and the Philippines each cut their policy rate by 25bps, while those of Australia and Thailand left rates unchanged. This was fully in line with our expectations. Though the central bank in Australia has room to cut rates amid lower inflation and still falling house prices, it seemed unlikely to us that the RBA would cut shortly before elections and as employment growth remains brisk. However, we believe there is room to ease monetary policy into the second half of the year, as the strong labour market is not boosting services

inflation and inflation prints for Q1 and April were well below the RBA's target range. Malaysia's BNM may also have scope to cut again, as the growth outlook remains tepid due to external (US-China trade dispute) and internal (tighter fiscal policy) reasons. In the Philippines inflation remains well within the BSP's target range, allowing for another rate cut later this year. Meanwhile, we expect the Bank of Thailand to remain on hold for the rest of this year with an eye on financial stability, even though growth concerns and muted inflation leave scope for easing.

Credit: Weakness may not yet be a harbinger for a turn

We believe that a deep correction is likely to be in the cards for credit, although we are not yet convinced that last week's weakness is a harbinger of this. Credit markets weakened last week, in line with the risk-off environment triggered by an escalation in the US-China trade dispute. European credit underperformed while higher beta assets took a sizeable hit, with European high yield cash spreads and European bank stocks declining notably. While secondary markets were weak, primary markets, especially in the US, saw a deluge of issuance and strong demand. Credit

market fundamentals remain poor in our view, and spreads are still tight despite last week's widening. However, what may still underpin credit is pent up demand from cash positions built up in Q4 and further boosted by inflows. US primary market deals are showing decent order books, and more importantly, muted new issue concessions. Given the painful rally for many investors this year, it may be too early to rule out a further 'buy on dip' mentality, for now.

Covered Bonds: Steady performance likely to persist as investors and borrowers value the asset class's strength

With European banks still facing profitability issues and lower NII, we think that covered bonds will remain one of the cheapest and most efficient sources of funding, while providing decent volatility-adjusted returns to fixed-income investors. After a strong start in Q1, new issuance volume has declined and April has been the least active month of the year, with only half of April 2018 volume. But some issuers took advantage of the flat credit curve to issue long-dated bonds. Spreads continued to move tighter and compression between jurisdictions has pushed some French

and Dutch spreads below German Pfandbriefe. More than half of the benchmark constituents now have negative yields, but investor demand remains strong, especially from bank treasuries, given the cost of holding cash at the ECB deposit facility. Additional support is coming from the ECB, which reinvests all its redemptions into the corresponding asset classes, translating into around €1.7bn of monthly gross purchases on average until year end.

What to Watch

- In the US, the NFIB survey will show whether the escalation of the US-China trade dispute has had an impact on small business optimism, while retail sales growth is expected to slow down from last month's acceleration. Finally, the latest set of housing data will indicate whether the recent stabilisation has continued.
- The second estimate of Eurozone Q1 GDP, the ZEW survey and Eurozone industrial production data are likely to indicate a mixed outlook overall for the Eurozone.
- We believe Bank Indonesia will keep its policy rate unchanged at 6% on Thursday. In Australia, federal elections will take place on Saturday. We will watch Australian business confidence for April and consumer confidence for May as well as Q1 wages and April employment data. In China, the focus will be on April data for industrial production, FAI and retail sales. April exports in India, Indonesia and Singapore as well as Malaysia's Q1 GDP data will also be in focus.

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