January 13th, 2020

Dodging the Wars

- **Global economic data solid as trade war noise abates**
- **Good momentum in risk assets re-established**
- **China economic data set for a rebound**
- **Global debt issuance strong and meeting good demand**
- **Iranian crisis passes its worst point but leaves a worrying legacy.**

The global economy seems to be settling after trade war trouble in the middle of 2019. Most parts of the world are showing a modest amount of growth supportive both of further advances in equities and government bonds yields that stand pat. The markets were relieved that the Iranian situation backed off from the threat of war. The direction of travel for financial markets is that the good momentum in risk assets has been re-established.

US – upbeat consumer confidence

With hopes that the consumer will support growth in 2020, it was encouraging to see that the US payrolls number brought a little something for everyone, a bit like a late-running Santa Claus. For those looking for signs of resilience in the US economy, the fact that the average addition to jobs through the fourth quarter averaged 184,000 per month, after accounting for revisions, would have been good news. So too the unemployment rate, which held stable at its multi-decade low of 3.5%.

The headline number at 145,000 new jobs filled was a little on the low side and gave some ammunition to the bond bulls who inflation as a thing of the past. US bonds rallied as a result. Also, on the softer side was the tiny rise in wage growth, another reason to remain sanguine about the inflation outlook.

The lack of wage growth is somewhat worrying for consumer spending; however, surveys show that consumer confidence is upbeat. A recent Bloomberg consumer confidence index reading reached the highest level for the expansion.

China – back on the mend

Data this week should show that China is back on the mend. The market expects fourth-quarter GDP of around 6% improvement on the 5.5% posted in Q3. December readings for retail sales investment and industrial production should all show improving trends.

Europe – it could be better it could be worse.

As the new decade opens, the eurozone holds to its permanent position of being stuck somewhere in the middle of stop and go. The eurozone starts the year highly dependent on the resilience of consumer spending and hopes for Donald Trump to calm down on his trade wars. Eurozone equities have quietly continued to perform despite the challenges.

Last week's eurozone economic data reports were encouraging, but even at their best, it still only implies eurozone GDP growth of around 1%. November retail sales growth rebounded from a weak October reading to +1.0% month-on-month. Industrial production growth was stronger in Germany and France in particular.

The good news - eurozone domestic demand ended 2019 relatively buoyantly as wages and employment firmed. Retail sales reports at year-end were surprisingly cheerful. Such cheer was also captured in the Markit Eurozone purchasing managers business activity index for the services sector that improved to a four-month high. Investment in major economies like Germany has been a plus. However, this has mostly been confined to the housing sector. Investment in plant and equipment is at disappointing levels. The major member states are also looking forward to a modest fiscal boost in 2020 though this will be scaled back on earlier overheated expectations.

Unfortunately, so far, there are only limited signs of better news spreading to the manufacturing sector. Remember the overall regional composite purchasing managers index is still languishing at its lowest level since 2013. The export indicator has been negative for 15 consecutive months with German new manufacturing orders falling by 1.2% in November, weaker than expected. The Bundesbank notes that declining manufacturing activity was the main reason why there was next to no growth in German GDP in the third quarter.

Global debt Issuance vibrant and easily absorbed

Despite global tensions, debt investors continue happily to supply liquidity to corporate issuers at the start of 2020. In Asia, the first week has seen $10 billion of new issuance easily absorbed by the market, setting a record for the post-crisis period. Globally, credit spreads have been resilient in the face of the bumpy geopolitical start to the year.

In the US, the start of the year has been just as frenetic for new issuance. Upwards of $60 billion of new bonds were placed. As an indication of the ease with which this happened, Bloomberg reports that about three-quarters of new bonds placed traded at better levels once they entered the secondary market. The volume issued this week is the fourth highest on record for US high grade. 54% of the new issuance was BBB-rated, exactly in line with the current weighting in the major indices.

The dynamic of the market now is that it seems to be both a buyers' and sellers' market alike. For those looking to issue, now is a good time with rates at historically low levels across all maturities. The curve is flat in USD, and credit curves are not very steep either. For investors, the problem is one of yield. Government bond yields are deeply unattractive. Corporate debt spreads may have tightened a lot over the last quarter of 2019, especially in December. However, as the ratio of credit bond yields to government yields are closer to the middle of historical ranges. This trend may be suggestive of further strength to come as investors remain happy to accumulate credit risk to keep portfolio yields in line with targets.

Iranian crisis ended but not over

The crisis in the Middle East 'ended' almost as quickly as it started, thankfully without significant escalation. However, no one should assume that all is now fine. There are several medium to long term consequences of the US's actions. In the wake of the US action, Iran completely withdrew from the previous agreement on nuclear development. The French Foreign Minister has warned that if Iran walks away from the agreement that they have the capability to build a nuclear device within 1-2 years. Fortunately, the Iranians have said that they will continue to allow IAEA inspections. However, no one should underestimate the consequences of Iran accelerating its pursuit of a nuclear capability. The fact that Russia's President Putin and Germany's Angela Merkel made a joint statement in the past few days reiterating their hope that Iran would recommit to the previous nuclear deal underlines the seriousness of the matter.

A further consequence is to push the theme of multilateralism still further. Inevitably this means that more countries will have to reconsider their reliance on and relationship with the United States. The fact that Germany and Russia find more in common on Iran than Germany does with the United State is telling. China and Russia are significant players in the Middle East both in regime support and funding. China is already one of the biggest trading partners of Iran and Saudi Arabia and has close ties with the United Arab Emirates.

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