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## Five issues to watch this week

Weekly Market Compass: Key data releases and international tensions could impact global markets

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Feb 19, 2019 | Kristina Hooper, Chief Global Market Strategist

From key data releases to international tensions, there are five issues that I'm watching closely this week. Before I detail those, let's review what we've learned in recent days that could impact markets going forward:

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### Five things we learned last week

1. Last week, I discussed several **"swords of Damocles"** that have been hanging over markets. One of those was removed last week when US President Donald Trump signed a bill to continue funding the US government. At the same time, Trump declared a national emergency on the issue of immigration at the US-Mexico border. However, I believe that this declaration - as well as any subsequent litigation that may seek to nullify it - should be a non-event for markets. I believe this outcome is far better than the alternative - another government shutdown - which would have hurt the economy, forced the Federal Reserve to "fly blind" in its decision-making, and risked a credit downgrade for the US.
2. Last week also brought the delayed release of US December retail sales. They were disappointing, to say the very least: down 1.2% (and ex-autos, down 1.7%)<sup>1</sup> versus expectations of a 0.1% increase. This was a surprise given what we heard from a number of companies during the holiday season about their sales (and it underscores the importance of stock selection in the retail space, as some companies are clearly faring better as the retail industry evolves). What was particularly jarring was that this was the worst reading since September 2009. However, one data point does not a story make, and so we will need to wait for January retail sales (to be released on March 1) to give us a sense of whether an alarming trend is underway. I suspect that at least some of the December drop was a result of falling stock prices, as they have historically tended to correlate with a reduction in retail sales. And so my suspicion is that January's sales figures may be better, given the improvement in stock prices. However, we will need to follow this closely.
3. Gross domestic product (GDP) growth in the UK disappointed in the fourth quarter, up just 0.2%.<sup>2</sup> December was particularly unfortunate, with GDP growth in negative territory for the month. Continuing the theme we saw with the US retail sales data, this was the worst GDP growth print since 2009 for the United Kingdom. However, in this case I believe the culprit was economic policy uncertainty brought on by Brexit. And so I expect more of the same as we receive data on the first two months of 2019, given that we still have no resolution to the Brexit drama. In fact, UK Prime Minister Theresa May lost another vote on her Brexit plan in the House of Commons on Feb. 14, increasing the possibility of a "crash out" Brexit. I must add that it was not particularly comforting to hear European Commission President Jean-Claude Juncker say that it is now "in God's hands."<sup>3</sup> However, the possibility of a second referendum seems to be gaining some momentum given that seven Members of Parliament (MPs) from the Labour Party have broken away to form their own group advocating for another "people's vote"- with the potential for more MPs to join them. It is also worth noting that Bank of England Governor Mark Carney's speech last week also rang alarm bells about the difficult situation the UK economy finds itself in with Brexit. The Bank of England believes that there is the possibility of a recession in the back half of the year depending on how Brexit unfolds.

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4. Recent European industrial data is also concerning. December industrial production for the EA-19 countries fell 0.9% from November - and is down a dramatic 4.2% year-over-year.<sup>4</sup> This data does not paint a pretty picture; and January Purchasing Managers Indexes (PMIs) suggest weakness has continued at the start of 2019. However, I believe there are two catalysts that could positively help the eurozone economy this year: consumer strength, helped by positive real (inflation-adjusted) wage growth, and Chinese stimulus. Historically the eurozone economy has done well when China's economy did well, and vice versa. So if China's current increase in stimulus - both fiscal and monetary - stimulates the Chinese economy, this could positively impact the eurozone at some point.
  5. Chinese Lunar New Year retail sales were weaker than expected, up just 8.5%. This was a significant drop from last year, when sales growth was 10.2%.<sup>5</sup> What's more, this is the first year in a decade in which retail sales growth was below the double-digit mark. This is in sync with a sharp drop in manufacturing PMIs (both the official and the Caixin readings). Again, this is a common theme that we are seeing in a number of countries, but I am still optimistic that Chinese stimulus should be significant enough to boost its economic growth, although it may take some time.

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### Five issues to watch this week

Looking ahead, here are five key events to focus on in the coming week:

- 1. Release of the FOMC minutes.** On Feb. 20, the Federal Open Market Committee (FOMC) will release the minutes from its January meeting, in which it changed its game plan and stated that the case for raising rates has weakened. This is the single most important event of the week because it will give us much-needed insight into the Federal Reserve's thinking around its significant change of heart. In particular, I am interested in seeing the discussion around balance sheet normalization, given that the Fed's willingness to alter its plan was the single biggest development in the last FOMC announcement, in my opinion. This is especially so given recent reports that the Fed may end balance sheet normalization this year.
- 2. US durable goods orders for December.** This report comes on Feb. 21, and it's important to watch because it is likely to be the area where we see the most damage created by economic policy uncertainty stemming from current trade conflicts. This has important ramifications given that economic downturns have often been caused by drops in investment. Therefore, we want to get a sense of that situation.
- 3. US-China trade talks.** This is another "sword of Damocles" that's hanging over markets. After holding talks last week in Washington D.C., the US trade delegation will be in Beijing this week to continue negotiations. It is clear to me that very little progress has been made. White House economic advisor Larry Kudlow, in attempting to put a positive spin on talks thus far, has characterized them as having a "good vibe."<sup>6</sup> That characterization alone should be worrisome, in my view. (I don't know about you, but if my mechanic told me my car had a "good vibe," or if my doctor told me after a checkup that my body had a "good vibe," I'd be uneasy to say the very least.) And those comments should drive home how little progress has been made - and indeed this was confirmed by US Trade Representative Robert Lighthizer, who explained that "we feel that we have to make headway on some very, very important and very difficult issues."<sup>7</sup> Make no mistake - this sword is still dangling over markets and, if the US does not give an extension to the March 1 tariff deadline, that will be problematic, in my view. In the meantime, I expect volatility as markets are buffeted by varying reports and assessments coming out of the talks.

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**4. Trade conflict with the European Union and Japan in the offing.** On Feb. 17, the US Commerce Department submitted its "Section 232" national security report on the dangers of imported cars to US security. The report has not been publicly released, but there is concern that it may include recommendations for very significant tariffs on imported cars. This could be the start of trade wars in other "theaters" around the world, so we will want to follow this situation closely.

**5. Spain.** A rejection of his budget plan has caused Spain's prime minister to call for snap elections for April 28. There is significant uncertainty over what the outcome of those elections might be, but the European Union is reportedly very concerned that a new Spanish government could follow in the footsteps of Italy and be more Euroskeptic in nature, and bring more instability to the country and to the European Union.

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#### Source

<sup>1</sup>US Census Bureau as of Feb. 14, 2019

<sup>2</sup>Office for National Statistics, as of Feb. 11, 2019

<sup>3</sup>The Telegraph, "Brexit breakthrough is in God's hands, says Jean-Claude Juncker," Feb. 18, 2019

<sup>4</sup>Eurostat, as of Feb. 13, 2019

<sup>5</sup>Nasdaq, "China Lunar New Year retail sales rise, but pace slowest in years," Feb. 11, 2019

<sup>6</sup>Reuters, "'Good vibe' U.S.-China trade talks followed by soybean purchases," Feb. 1, 2019

<sup>7</sup>BBC, "US-China trade talks break up without a deal," Feb. 15, 2019

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#### Important information

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Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

In a "no-deal" or "crash out" Brexit, the UK would leave the EU in March 2019 with no formal agreement outlining the terms of their relationship.

EA-19 countries are the 19 European Union member states that have adopted the euro as their common currency.

Purchasing Managers Indexes (PMI) are a commonly cited indicator of the manufacturing sector's economic health.

The Caixin/Markit Purchasing Managers' Index (PMI) for China is considered an indicator of economic health for the Chinese manufacturing sector. It is based on survey responses from senior purchasing executives.

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

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