Weekly Market View

Most major central banks are yet to respond to the global growth slowdown. This raises the chances of further policy easing by the ECB, Fed and BoJ in the coming weeks

Equities: Hong Kong stocks have benefitted from easing political tensions and strong inflows, but they need to cross technical hurdles

Bonds: EM USD government bonds remain attractive despite idiosyncratic risks, given inexpensive valuations

FX: The GBP's outlook improved amid reduced risk of a hard Brexit; it remains structurally undervalued

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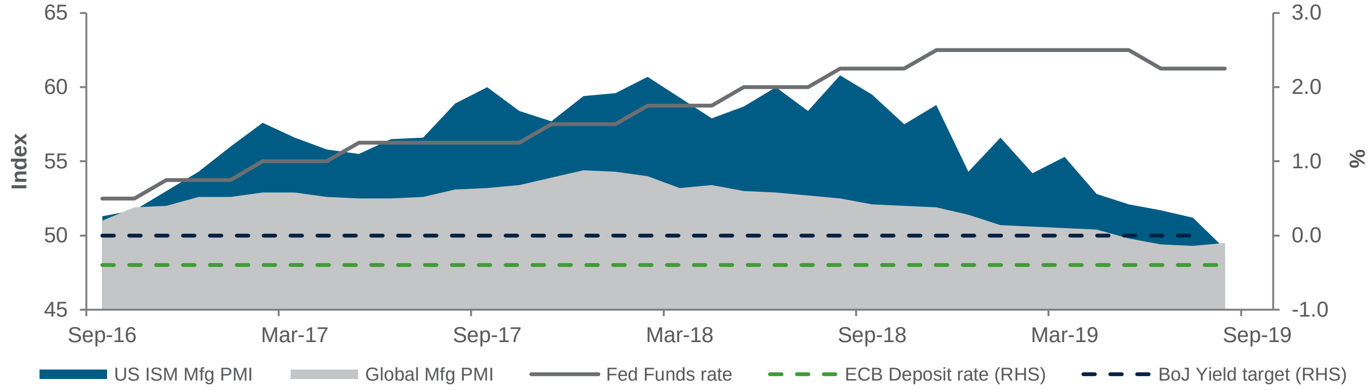
Chart of the week: Central banks are likely behind the curve

Global central banks have barely acted to reverse a persistent economic slowdown, especially in the manufacturing sector

Global and US manufacturing sector PMIs; Fed Funds Effective Rate, ECB Deposit Facility Rate and BoJ yield target (RHS)



Source: Bloomberg, Standard Chartered

Editorial

Monetary easing season

Global equity markets and benchmark bond yields rebounded over the past week as the US and China prepared to resume trade talks, while concerns about a hard Brexit eased.

Data in the past week confirmed that the services sector remains robust worldwide, including in the US. However, the US manufacturing sector has started contracting, joining Europe, Japan and China, where it has been contracting for a few months. Contraction in US new orders suggests further weakness near term. The concern is that the weakness in manufacturing could hurt the still-robust labour markets, infecting consumer and business sentiment. Thus, today's US jobs report will be watched closely for signs of weakness.

Against this backdrop, the ECB policy meeting (12 Sept.), followed by the Fed (18 Sept.) and the BoJ (19 Sept.) become critical. Markets have factored in a 10-20bps cut in the ECB's Deposit Facility rate this month. There is also a chance ECB President Draghi may signal renewed bond purchases.

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Policymakers fall behind the (bond market) curve

Although government bond yields rebounded this week, they remain sharply lower YTD amid a pullback in growth and inflation expectations.

However, policymakers have been slow to react to this weakness. While US money markets are factoring in around four 25bps rate cuts by the Fed by end 2020, the Fed's own forecasts in June had pencilled in only one rate cut. This implies there is limited scope for government bond yields to fall significantly further unless data deteriorates further from here, forcing markets to price in more rate cuts. We expect one to two more Fed rate cuts in 2019, with prospects for further cuts in 2020.

We also note that the US 10-year Treasury yield has fallen close to the market's long-term inflation expectations, which signals that the US's financial conditions have turned easy. This, too, would likely be a constraint against a further decline in bond yields.

UK headed for another election?

Prime Minister Boris Johnson's current tenure appears limited after he lost control over the Brexit agenda, with the UK parliament voting in favour of delaying the Brexit date beyond 31 October 2019. Johnson also lost his parliamentary majority after 21 Conservative MPs were expelled from the party for defying the government whip.

The PM also failed to get parliament's support for a general election (he needs two-thirds of the 650 MPs to support). However, this could be a temporary impasse, as opposition parties would likely support such a move after the bill to delay Brexit has been approved by the House of Lords, becomes law and is executed by the PM. An election would effectively be a second vote on Brexit.

We see two other possible scenarios: a) The opposition votes out Johnson's government in a no-confidence vote (which requires a majority of one) and forms either a very short-term government that simply crosses the 31 October Brexit deadline or a so-called "Unity" government with or without the help of the Conservative party rebels. Such a government may aim to conclude Brexit after securing a better deal with the EU. b) A "Unity" government could call for a legally binding second referendum for the public to decide whether to leave the EU and under what terms.

The above implies elevated near-term volatility in UK assets, although they ultimately reduce the chance of a hard Brexit. The GBP is also structurally undervalued, leaving us medium-term bullish (see page 5).

Hang Seng jumps as government withdraws extradition bill

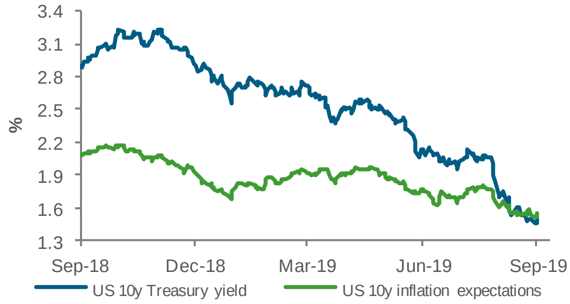
Hong Kong's Hang Seng index delivered its biggest one-day rise since 2011 on Wednesday after Chief Executive Carrie Lam said she would withdraw a controversial extradition bill. Although technical indicators (see page 4) suggest we need to see a further extension of the rebound before confirming the start of a longer-term uptrend, some flow indicators suggest onshore China investors find Hong Kong H-shares more attractive than the Shanghai A-share market after the so-called A-H premium rose close to a three-year high following the outperformance of A-shares this year. A total of CNY 70bn flowed "southbound" from the mainland to Hong Kong equities in August, the largest net-purchase this year. This, combined with the partial easing of political tensions, could offer support to Hong Kong equities near term.

What we are watching

ECB policy; US trade talks, inflation, retail sales; China credit growth.

US benchmark long-term bond yield has fallen close to the market's long-term inflation expectations, which signals easing financial conditions; this implies limited scope for a further decline in bond yields

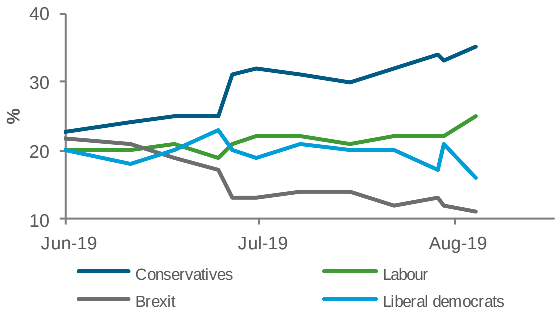
US 10-year Treasury yields; US 10-year inflation expectations



Source: Bloomberg, Standard Chartered

UK's ruling conservative party has gained in the polls at the expense of the Brexit party after PM Johnson took charge, but it remains well short of a majority

YouGov polls showing likely support for major parties in the event of an election



Source: Bloomberg, Standard Chartered

Hang Seng has bounced from key technical support, but follow through is needed to confirm medium-term uptrend

Hang Seng index and 200-week moving average

Source: Bloomberg, Standard Chartered

What does this mean for investors?

Equities

Are Hong Kong stocks primed for a rebound? The Hang Seng index has rebounded from a strong technical support (200-week moving average), roughly coinciding with the November low of 24,540, amid signs of easing political tensions.

The index's rise above the mid-August high of 26,356 indicates that short-term downward pressure may be fading. Two indicators may tell whether the rebound is the start of a new uptrend: a) if the rise is associated with strong momentum (14-day RSI above 70), and b) a break above the previous peak (April high of 30,280, 14% from Thursday's close).

Given that the index is holding above key support levels, a 25,000-30,000 range looks probable in coming weeks. Interim resistance is at the 200DMA (27,455; 3.5% above Thursday's close). Subsequent resistance is at the July high of 29,007. The strong pick-up in flows from onshore China investors (see page 3) is likely to provide another leg of support to Hong Kong equities.

Bonds

Are you still positive on EM bonds despite idiosyncratic risks? We continue to view Emerging Market (EM) USD government bonds as having the highest probability of outperforming global bonds. Although idiosyncratic risks have been a recent focus, the asset class was supported by improved risk sentiment in the past week. We believe inexpensive valuations and the small weight of countries facing idiosyncratic risks like Argentina (which has only about a 1% weight in the EM USD bond index) are supportive factors.

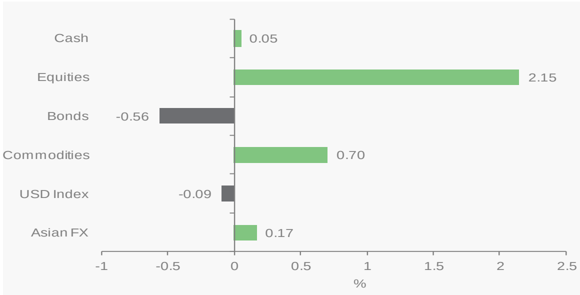
Within Asia, trade-related concerns have led to greater demand for higher-quality Investment Grade (IG) bonds at the expense of High Yield (HY) bonds. This has meant that the yield premium offered by HY bonds over IG bonds has increased substantially. However, we would need to see more stabilisation in China's economic data before considering turning positive on Asian HY bonds.

FX

Is the USD peaking? The USD pulled back from two-year highs amid improving global risk appetite. EUR/USD set new trend lows around 1.0925 and GBP/USD rebounded from 1.1960, while USD/CNH pulled back from a new high at 7.1960. Hong Kong's political uncertainty eased from more extreme levels, and the UK parliament moved to effectively reduce the risk of a hard Brexit. Weaker US manufacturing data also supported market expectations of a Fed rate cut later this month, with increased chances of subsequent cuts.

Alongside the ongoing Brexit developments, next week's ECB policy meeting and President Donald Trump's comments on trade deals with both Japan and China are likely to drive near-term trading, with spikes in volatility likely as news breaks. Meantime, the slow, but likely peaking USD uptrend remains in place. A sustained break above 1.1270 in EUR/USD and 1.2310 in GBP/USD would improve the near-term outlook for both pairs and keep the USD on the defensive.

Benchmark (USD) performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

*Week of 29 August 2019 to 05 September 2019

Global equity market technicals have turned positive

Technical levels of key markets as of 05 September 2019

Index	Spot	1st support	1st resistance	Short-term trend
S&P	2,976	2,890	3,029	↑
STOXX 50	3,485	3,435	3,535	↗
FTSE 100	7,271	7,205	7,380	↗
Nikkei 225	21,086	20,580	21,800	↗
Shanghai Comp	2,986	2,860	3,045	↗
Hang Seng	26,516	25,500	27,500	↗
MSCI Asia ex-Japan	620	590	622	↗
MSCI EM	1,003	957	1,021	↗
Brent (ICE)	61	56	62	↓
Gold	1,520	1,515	1,575	↑
UST 10Y Yield	1.56	1.30	1.79	↓

Source: Trading Central, Standard Chartered

Note: Arrows represent short-term trend opinions

EM USD bond yield premiums have fallen lately amid improving risk appetite

Yield premium on EM USD government bonds over US Treasuries

Source: Bloomberg, Standard Chartered

EUR/USD needs to break above 1.1270 for an uptrend

EUR/USD

Source: Bloomberg, Standard Chartered

Top client question

What is the outlook for the GBP?

The likelihood of a hard Brexit declined after the UK parliament took control of the Brexit agenda and the expulsion of 21 Conservative MPs from the party reduced PM Johnson's majority. We also believe the GBP remains structurally undervalued, making it our preferred major currency over the medium term. Having said that, Brexit uncertainty is likely to keep volatility elevated in the near term.

On page 3, we laid out three possible political scenarios evolving over the coming weeks, which would dictate GBP's near-term direction: a) a general election called after the current bill to delay Brexit is approved by the House of Lords and executed by the PM. b) The opposition votes out Johnson's government and forms either a very short-term government that simply crosses the 31 October Brexit deadline or a so-called "Unity" government, with an aim to conclude Brexit after securing a better deal with the EU. c) A "Unity" government could call for a legally binding second referendum for the public to decide whether to leave the EU and under what terms.

Based on those, any improvement in the political outlook would mean the following:

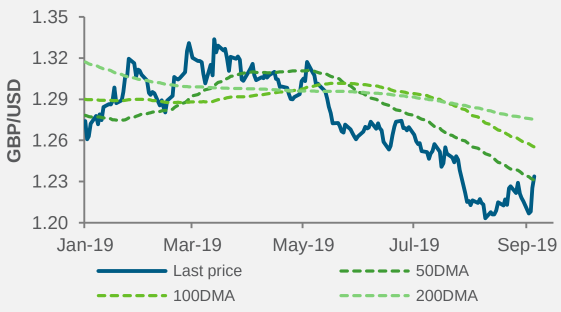
- Any initial delay in Brexit could see GBP/USD sustainably break above the August high at 1.2310 towards 1.2500.
- If a "Unity" government is formed and General Election is delayed, GBP/USD could rally through resistance at 1.2780 (June high) and 1.2880 (the first retracement of the 1.4375-1.1960 decline).
- If confidence grows that a clear Brexit endgame is probable and that public opinion is not favouring a no-deal solution, GBP/USD could challenge two clusters of resistance, firstly around 1.3200 (50% retracement and 200-day moving average), and secondly between 1.3400 and 1.3650.
- If the odds of a remain outcome rises towards a comfortable majority in polling, the next area of resistance for GBP/USD is within 1.4100-1.4400.

If the situation deteriorates or continues to "stumble along", the downside risks are:

- Continued near-term political dithering, possible legal challenges of various types and a breakdown in unified opposition to a no-deal Brexit could lead to a quick and likely divisive General Election that requires a coalition to form a government. No-deal Brexit risk would rise, and GBP/USD would likely re-test the recent low at 1.1960, working towards the October 2016 "Brexit flash crash" low around 1.1450.
- If a Conservative/Brexit Party alliance becomes a likely outcome, the risk of a no-deal Brexit would become largely priced into the market. Given that this risk is currently perceived at 20-30%, GBP/USD could fall initially to 1.10, with scope to challenge the all-time low recorded in 1985 around 1.03 and, of course, the psychological 1.00 thereafter.
- As a footnote, it may be interesting to know that following the collapse to 1.03 in March 1985, GBP/USD traded at 1.88 by the end of 1987.

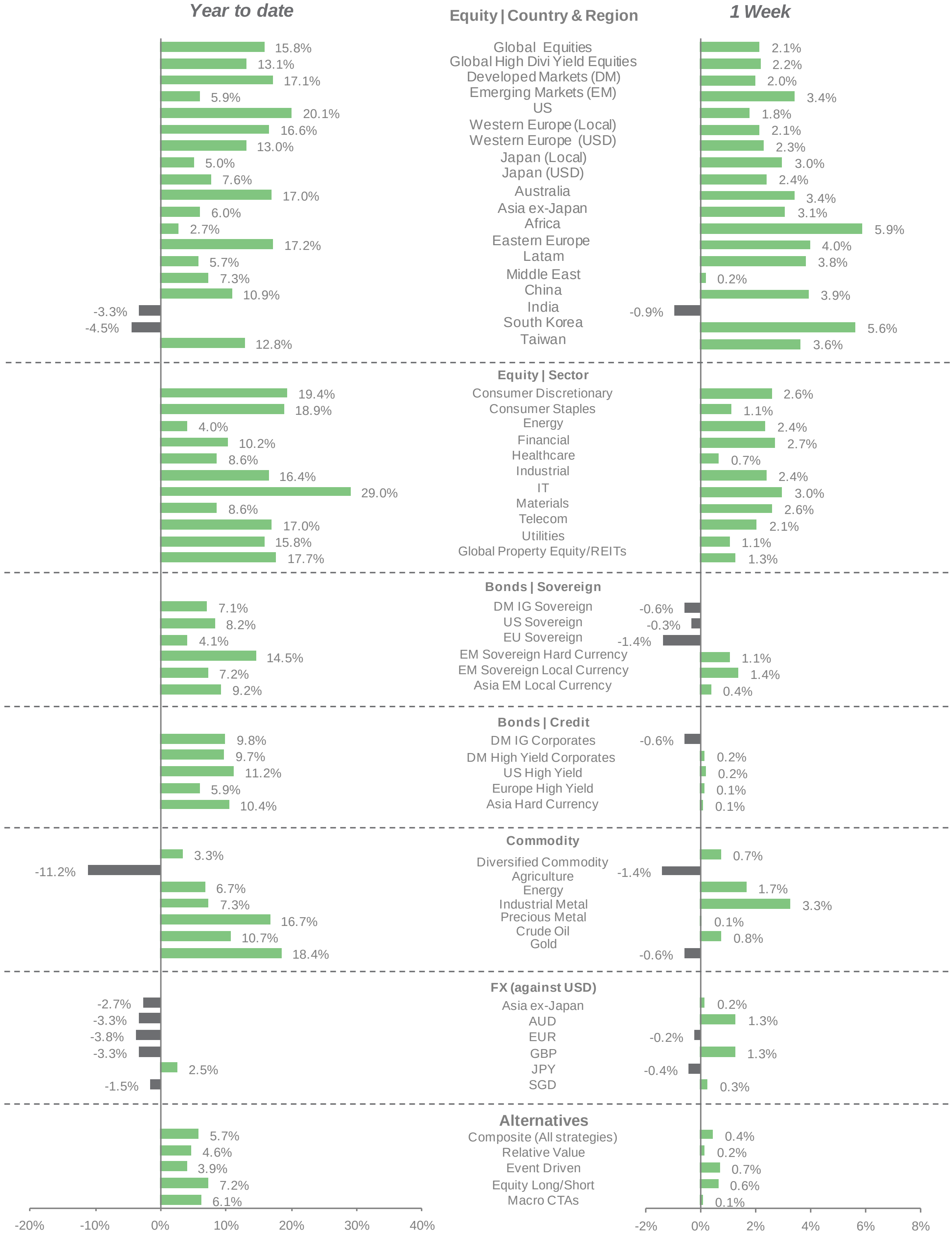
A sustainable GBP/USD break above 1.2310 could see the pair rise towards 1.2500 and then towards 1.2880

China 10-year government bond yield; consensus estimate for China's fiscal deficit for 2019



Source: Bloomberg, Standard Chartered

Market performance summary*



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 05 September 2019, 1 week period: 29 August 2019 to 05 September 2019

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	GE	Exports SA m/m	09-Sep-19	Jul	–	-0.1%
	EC	Sentix Investor Confidence	09-Sep-19	Sep	–	-13.7
	CH	New Yuan Loans CNY	09-Sep-19	Aug	1200.0b	1060.0b
	CH	Money Supply M2 y/y	09-Sep-19	Aug	8.2%	8.1%
TUE	US	Consumer Credit	10-Sep-19	Jul	$16.000b	$14.596b
	CH	CPI y/y	10-Sep-19	Aug	2.6%	2.8%
	CH	PPI y/y	10-Sep-19	Aug	-0.9%	-0.3%
	US	NFIB Small Business Optimism	10-Sep-19	Aug	–	104.7
	US	JOLTS Job Openings	10-Sep-19	Jul	–	7348
WED	US	PPI Ex Food and Energy y/y	11-Sep-19	Aug	–	2.1%
THUR	JN	Core Machine Orders y/y	12-Sep-19	Jul	-4.3%	12.5%
	EC	ECB Deposit Facility Rate	12-Sep-19	12-Sep	-0.5%	-0.4%
	US	CPI Ex Food and Energy y/y	12-Sep-19	Aug	2.3%	2.2%
FRI/ SAT	US	Retail Sales Ex Auto and Gas	13-Sep-19	Aug	–	0.9%
	US	U. of Mich. Sentiment	13-Sep-19	Sep P	90	89.8

	Event	This Week	Date	Period	Actual	Prior
MON						
TUE	AU	RBA Cash Rate Target	03-Sep-19	3-Sep	1.0%	1.0%
	EC	PPI Y/y	03-Sep-19	Jul	0.2%	0.7%
	US	ISM Manufacturing	03-Sep-19	Aug	49.1	51.2
	US	ISM New Orders	03-Sep-19	Aug	47.2	50.8
WED	AU	GDP y/y	04-Sep-19	2Q	1.4%	1.7%
	CH	Caixin China PMI Composite	04-Sep-19	Aug	51.6	50.9
	CH	Caixin China PMI Services	04-Sep-19	Aug	52.1	51.6
	UK	Markit/CIPS UK Composite PMI	04-Sep-19	Aug	50.2	50.7
	EC	Retail Sales y/y	04-Sep-19	Jul	2.2%	2.8%
	US	Trade Balance	04-Sep-19	Jul	-$54.0b	-$55.5b
	CA	Bank of Canada Rate Decision	04-Sep-19	4-Sep	1.8%	1.8%
THUR	US	ISM Non-Manufacturing Index	05-Sep-19	Aug	56.4	53.7
FRI/ SAT	GE	Industrial Production WDA y/y	06-Sep-19	Jul	–	-5.2%
	US	Change in Nonfarm Payrolls	06-Sep-19	Aug	–	164k

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue
Previous data are for the preceding period unless otherwise indicated
Data are % change on previous period unless otherwise indicated
P - preliminary data, F - final data, sa - seasonally adjusted
y/y – year-on-year, m/m - month-on-month

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