As Growth Headwinds Strengthen, Havens Should Remain Bid

This week’s data round has kicked off with a one-two punch for the global economic outlook. Data from two of the world’s top four exporters—South Korea and Germany—were very soft and suggest that the downturn in trade continues to reverberate around the global economy. Slow or slower global growth prospects suggest that safe havens should remain supported.

Preliminary export and import data for Sep from South Korea released today showed a near 22% Y/Y drop in exports in the first 20 days of the month. The reported 21.8% drop was the largest fall in (preliminary) exports since 2009 and extended the run of weakening export growth for an 11th consecutive month. Recent trends suggest that the tone of the initial report will be largely reflected in the full month’s data release on Sep 30th.

Details reflected a 30% Y/Y drop in exports to China and a 21% decline in exports to the US. Data revealed a further weakening in semi-conductor exports (which account for around 20% of total exports); semiconductor exports fell 40% Y/Y. The more recent emergence of trade tensions with Japan are perhaps too fresh to be reflected fully in these data (shipments to Japan were down 14% Y/Y) but suggest more headwinds for local exporters going forward (and more pressure for additional BoK support for the economy in the weeks ahead).

In Europe, meanwhile, the preliminary Eurozone PMI data rather suggest that the decline in activity in the manufacturing sector is spreading to services. Germany’s manufacturing base has been hit hard by a string of developments in the past few months—from the retooling of the German auto sector that was expected to have a temporary cooling effect on output, to Brexit and trade war concerns.

Service sector growth weakened in the latest month’s report, perhaps reflecting the ‘catch-22’ situation of low or negative interest rates designed to support the broader economy having the effect of weakening financial sector profitability (the ECB’s recent “tiering” announcement notwithstanding) and activity. Since the end of April, Europe’s Stoxx 50 index is up modestly but the Banks index is down 14%.

With the global economy softening, no obvious end in sight to US-driven trade tensions and global central banks starting to ponder how much ammunition they have left to boost growth and lift inflation, we are perhaps heading for a bumpy patch for financial markets, especially if US data start disappointing again after the recent run of positive, sequential surprises.

To some extent, speculative FX positioning already reflects a cautious outlook; CFTC data—broadly—suggest speculators are holding net long positions in the safe havens (JPY, CHF) and are net short the higher beta currencies (AUD and NZD). Elsewhere, however, investors have steadily rebuilt a net long exposure in stocks and maintain a sizeable—if much reduced versus 2018—net short position in US Treasury futures; investors are less prepared for bad news here, it would seem.

Next Tuesday’s US ISM data will be closely watched after this morning’s Markit data for a couple of reasons. Firstly, we think the employment components may provide some insight into the Sep US NFP data due at the end of the week. Market expectations—currently—center on a 140k rise in jobs after the disappointing Aug gain of 130k. Secondly, we note that the US ISM manufacturing index retains a fairly tight (66%) correlation with long-term trends in US stocks; another sub-50 print for the index might add downside pressure on US stocks.

Broadly, we think the global growth backdrop is poised to remain challenging. We think haven assets are likely to retain a premium in the near-to-medium term and the situation might well mean that the USD rally versus the JPY peaked—for now, at least—last week above 108. We look for USDJPY to edge back to 106.00/50 in the next 1-2 weeks.
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