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Global Outlook: Improving Economic Data Boosts Investor Sentiment

After enduring challenging market conditions throughout 2019, the global economy began 2020 on firmer footing, with the phase one US-China trade deal and the Conservative victory in the UK polls providing support for risk assets going into the new year. With bright spots appearing in the economic data as downside risks abated, we entered the year with a cautiously optimistic outlook, waiting for further indication that a recovery in the economic fundamentals would be sustained, and thus would continue to provide support to risk assets into the first half of the year.

As we now find ourselves one month into the year, we are encouraged by recent economic data releases on a number of fronts, with leading indicators suggesting that a broad-based recovery (albeit more muted given a subdued growth outlook) is now underway. Despite the recent coronavirus outbreak and the Iranian missile attack which have clouded the outlook so far this year, new data continues to provide us with evidence that after a period of economic weakness, the global economy is on the up.

Cooling US-China Trade Relations Boost Markets

In January, the US and China officially signed a “phase one” trade deal, signalling a truce in a yearslong trade war. While removing the immediate threat of re-escalation in the tensions, the agreement included tariff reductions on $120 billion in Chinese goods to 7.5%. Over 2019, these tariffs and uncertainty relating to the ongoing trade conflict weighed heavily on the Chinese economy, constraining global trade. As a result, markets reacted positively to the long-awaited deal, starting the year on a positive note as equities rallied on the cooling of tensions. In an extension to this, China announced today that it will cut tariffs on $75 billion of US imports by half, starting next week. According to China’s Ministry of Finance, the move was made “to promote healthy and stable development of Sino-US economic and trade relations”. While the statement did not mention the current coronavirus outbreak, it is expected that alongside what was agreed in the phase one deal, the reduction in tariffs form part of the government’s plans to stimulate the economy as it grapples with the economic impact of the virus. On Saturday, the ministry suspended tariffs against some US imports that could be used to help treat victims of the virus. Markets moved higher on today’s announcement.

Improving Economic Data

Recent data suggests that business concerns over near-term global economic weakness had eased prior to the latest intensification of the coronavirus outbreak. Positive growth drivers now point to a 2020 stabilisation due to positive investment sentiment, monetary loosening and an easing in trade tensions. The best near-term indicators for global growth are the global PMI surveys, which are showing a tentatively positive picture. After declining steadily from their 2018 peaks, they have stabilised in recent months, with parts of Asia looking especially promising. The balance of economic data surprises has also improved, turning slightly positive in the G10 and considerably less negative in Emerging Markets. It is clear that fundamentals are now improving, providing a brighter outlook for 2020 which is supportive of risk assets.

In the US, firmer business activity and orders helped lift a gauge of US service providers to a five-month high in January, indicating steady growth in the broader economy. The Institute for Supply Management's non-manufacturing index climbed to 55.5, exceeding the median projection in a Bloomberg survey of economists, from 54.9 a month earlier. A measure of business activity climbed to an almost one-year high. The improvement in services and rebound in manufacturing show business optimism is building in the US, a positive sign of stabilisation and recovery in the data.

In the UK, a firmer reading for the services PMI completed a full set of stronger survey data for January. The bounce in the services PMI followed strong rebounds in the manufacturing and construction surveys, sending the composite PMI to a 16-month high of 53.3. Despite the coronavirus outbreak clouding the outlook in the near term, activity is expected to strengthen as we move through the year and the benefits of a looser fiscal stance emerge.

Looking to the Eurozone, final figures for the Eurozone PMIs were positive. The composite PMI was revised 0.4 points higher to 52.5, only slightly below the 3-month high reached in December. This confirms that despite some signs of easing growth, the domestic demand-oriented services sector remained robust in early 2020, while we continue to see a bottoming out in the industrial sector, where PMIs are picking up however still remain in contractionary territory for now.

Coronavirus: Risks To The Recovery

Although the economic backdrop is improving, investor sentiment has wavered in recent weeks on concerns over the novel coronavirus outbreak in China. The virus has so far claimed more than 500 lives in China and sickened thousands, raising concerns that the Asian nation might have to declare force majeure if the situation worsens. Globally, the outbreak threatens to derail the tentative recovery in economic fundamentals, with the yet unknown economic impact of the epidemic expected to be felt in Q1 and potentially further into the year, depending on whether the virus can be quickly and effectively contained. Travel bans are expected to hit the tourism industry in Asia globally, while a sharp decline in China's Q1 growth would pose pressure on the global economy and could spark fears in financial markets. In response, the Chinese government has announced a series of measures to contain the negative impact, including measures to ensure banking sector liquidity, interest rate subsidies to affected firms and bank lending incentives. There is also room for more stimulus in March if required.

Given the disruption to the Chinese economy as a result of the outbreak, Chinese officials will be hoping that the US will agree to some flexibility on pledges in their phase-one deal. In the deal, China agreed to increase its imports from the US substantially, however should the outbreak weigh considerably on the country's outlook, flexibility may be required. China is set to release January trade data on Friday, providing a glimpse into this year's imports from the US. As it stands, economists estimate that overall trade in January likely contracted due to the Lunar New Year holiday, while the outbreak of the coronavirus casts a cloud over the outlook for the coming months.

Our Outlook & Positioning

As we continue to monitor market movements and economic data releases, we remain optimistic about the outlook, with leading indicators continuing to suggest a pickup in global activity is underway. There is no doubt that recent coronavirus outbreak has clouded the outlook, however as it stands, it is our view that sentiment will recover and Chinese stimulus measures will offset the short term economic impact of the virus outbreak, which we expect to be confined to Q1. As we have seen in markets this week, positive headlines are able break through the negative sentiment, and data suggests that progress is now being made towards containment. It remains our view that the initial panic will continue to abate, and therefore as it stands, we view this as a buy in opportunity as certain areas of equity markets become more attractively valued.