

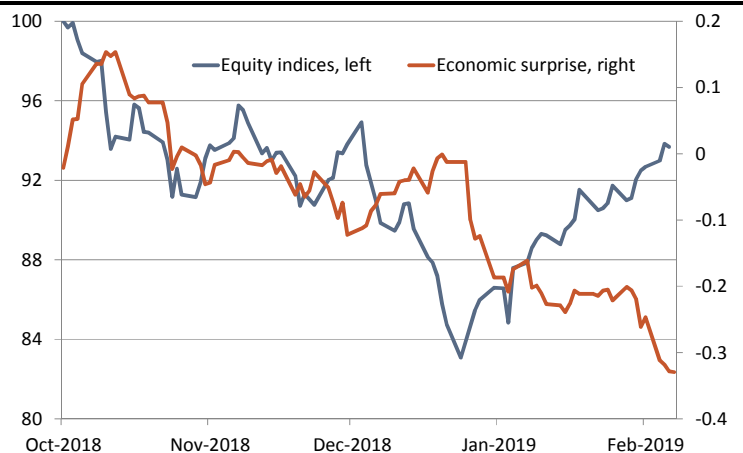


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8 February 2019

Stocks rebound as global economies slump

Uncoupling – rising US and European equities amid worsening economic data



Daily data. Source: Bloomberg. Data show a weighted average of US (60%) and European (40%) data. Equities: 1 October 2018 = 100 (S&P 500 and EURO STOXX 50). Economic surprise data based on Bloomberg eco surprise indexes

- **Global economies slump, but stocks rebound:** Despite the [continued downbeat economic news since the start of 2019](#) – highlighted by the Bloomberg surprise indexes that measure the deviation of actual data releases from consensus estimates – US and European stock markets have staged significant recoveries from their sharp swoons in late-2018. First, the good news – on stocks.
- **Four factors have driven the stock market rebounds:** First, the dramatic sell-off in late-2018 that had built in too much pessimism – exacerbated by widespread speculation about US recession – lowered valuations to attractive levels. Second, with mounting worries about China’s economic slump, Chinese policymakers signalled significant new monetary and fiscal stimulus. Third, markets were buoyed by rising expectations of a US-China agreement on trade and other such issues that would ease tensions and open up Chinese markets.
- **Central banks’ dovish tilt:** Fourth, the US Fed did a U-turn following its rate hike and fumbled communications in mid-December. In its January guidance, the Fed conveyed an explicitly dovish message signalling that it would remain on hold. The European Central Bank and Bank of England have also struck dovish tones, while the People’s Bank of China eased monetary policy further, and the Bank of Japan continued its aggressive QQE and yield curve control programmes.
- **Mounting signs of economic weakness:** The deteriorating economic performance is a global issue, highlighted by China’s softer consumption and falling trade and spreading signs of weakness in Europe. In the US, while employment and consumption have remained healthy, falling confidence surveys point toward more moderate growth ahead. Almost everywhere, PMI surveys and industrial production are slumping.
- **China’s slump is important and shrouded in uncertainty:** It is highly likely that economic activity in China is weaker than official data indicate. But reliable data are elusive. As the key driver of global trade and growth, it is not surprising that China’s declining trade data is mirrored by contracting exports and industrial production in Japan, South Korea and other Asian nations, along with Germany and other major trading partners.
- **China’s potential growth is slowing:** While the US’s aggressive tactics come at a bad time for China and are accentuating its slump, they are not the root cause of its problems. Even with more stimulus and a solid trade deal, China faces a trajectory of slower growth. Look for falling global trade volumes in the first half of 2019.
- **The biggest economies in the EU face headwinds:** Germany’s industrial sectors have large exposures to China and are harmed by trade tensions. France’s social and political issues are denting economic activity at least temporarily. Italy’s leaders are reversing pro-growth reforms and turning their country into an economic basket case again. The UK and, to a lesser extent, the EU27 have to grapple with tail risk of a hard Brexit. These headwinds can significantly affect coming economic data.

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