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Sustainability of current liquidity-driven rally and strong stock price

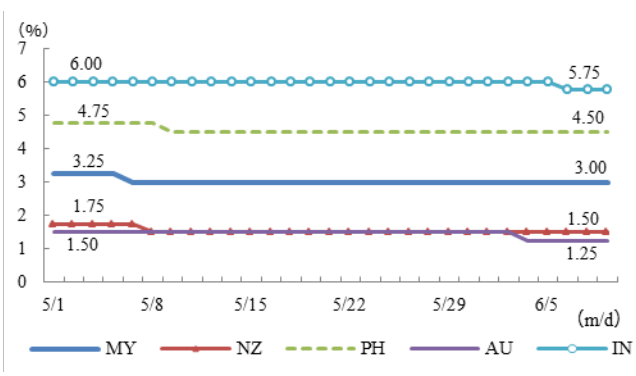
- The APAC stock price indices remained firm due to interest rates cut in the region despite worsening global manufacturing business confidence.
- At the earliest, interest rates cut by US in July and Eurozone in September are possible. Global stock markets are on the verge of liquidity-driven rally.
- We need to be aware that current market cycle is not driven by business cycle. Stock price is expected to continue to depend on US and China trade talks.

The APAC stock price indices remained firm due to interest rates cut in the region despite worsening global manufacturing business confidence.

Liquidity-driven rally generally refers to market in which stock prices rise due to increase in relative attractiveness of stocks, even when the economy and corporate performance are poor, as government bond yields fall with monetary easing. According to May US employment statistics, the number of employed persons in non-agricultural jobs fell sharply below market expectations. However, US stock market showed a liquidity-driven like rally as government bond yields declined and stock price rose due to expectations of early rates cut.

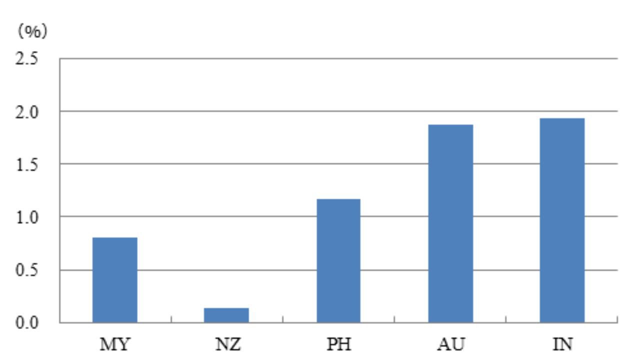
Meanwhile, in June 3, IHS Markit (British research agency), announced that May global manufacturing PMI declined 0.6 points MoM to 49.8 points, falling below 50 (the midpoint for economic growth forecast). However, central banks in APAC regions have been reducing interest rates (Diagram 1) and their stock prices have remained firm (Diagram 2).

"Diagram 1: Policy Interest Rates by APAC Regions"



(Note) Data from May 1 to Jun10, 2019.
(Source) SMAM, based on Bloomberg L.P. data.

"Diagram 2: Stock Price in Countries Due Rates Cut



(Note) Data from Apr 30 to Jun 10, 2019.
Malaysia = FTSE Bursa Malaysia KLCI Index
New Zealand = S&P/NZX 50 Gross Index
Philippines = Philippines Stock Exchange PSEi Index
Australia = S&P/ASX200 Index
India = S&P Bombay Stock Exchange Sensitive Index.
(Source) SMAM, based on Bloomberg L.P. data.

At the earliest, interest rates cut by US in July and Eurozone in September are possible. Global stock markets are on the verge of liquidity-driven rally.

Although US and German stock indices lagged behind that of APAC where interest rates were cut, rallied in June due to expectation for monetary easing. Earlier this month, several financial regulators, including FRB chairman Gerome Powell, have made dovish statements. Also in Eurozone, ECB announced on June 6 that it would postpone rates hike.

We expect higher possibility of interest rates cut in US and Eurozone. As for US monetary policy, interest rates cut is highly likely in July and September by 0.25% each. As for monetary policy in the Eurozone, the Deposit Facility rates are expected to be lowered from -0.4% to -0.5% at earliest in September and latest in December and EUR20bn worth of asset purchases are expected to resume in every month.

We need to be aware that current market cycle is not driven by business cycle. Stock price is expected to continue to depend on US and China trade talks.

It is said that liquidity-driven rally is often observed towards the end of recession and the beginning of the economic recovery. Therefore, with the recovery of economy and corporate earnings, the liquidity-driven rally will shift to economy-sensitive market and sustainable rise in stock prices is expected. However, we need to be aware that trade friction between the US and China underlies the deteriorating economic sentiment and the volatility of the stock market in current market phase.

In other words, current liquidity-driven rally is not simply driven by business cycle. Therefore, unless the US-China economic friction is resolved, bull market due to current liquidity-driven rally is unsustainable and it may take a long while to shift to economy-sensitive market. At the G20 Summit in Osaka on June 28 and 29, market focus will be on whether US-China summit meeting will be held or not. Stock market is expected to continue to "depend on US and China trade talks" for a while.

***Please note that this report is a translation of Japanese report written on June 11, 2019.**

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