Weekly Macro & Markets View

Highlights and View

- **Asian PMIs tick down in July for most countries**

  We expect Asian activity to soften in the coming months and then improve towards the end of the year as China's policy stimulus kicks in.

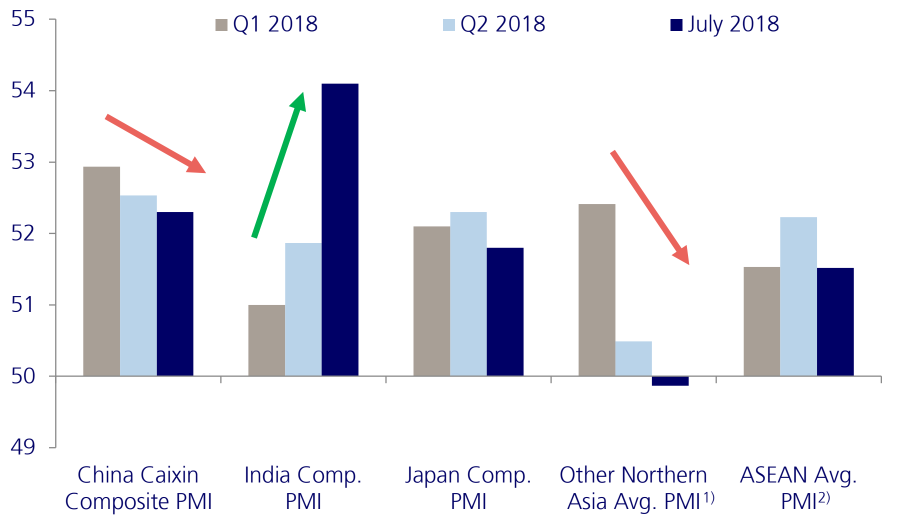
- **The Bank of England raises its benchmark rate to 0.75%, the highest level since 2009**

  While not urgent given the modest growth environment, the BoE reacts to ongoing inflationary pressure and uses the window of opportunity before Brexit uncertainty further burdens the outlook.

- **Supported by strong earnings, the S&P 500 shrugs off Trump's latest tariff threat**

  With earnings up more than 27% YoY in Q2, investors are ignoring the recent escalation of the trade dispute. However, the risk of further turbulence is increasing.

Asian PMIs signal activity softening



Source: Bloomberg, Note 1) Avg. of Mfg. PMIs of KR, TW & total HK PMI, Note 2) Avg. of Mfg. PMIs of MY, ID, PH, TH, VN & total SG

Business confidence deteriorated markedly across Asia. All but four of all Asian manufacturing and services PMIs declined in July. India stands as a bright exception as the composite PMI ticked up, reflecting a brisk recovery in domestic activity, which allowed the Reserve Bank of India to hike for the second time this year.

In the rest of Asia, new orders fell back, indicating softer domestic demand. Optimism towards the 12-month outlook for overall activity also worsened, while new export orders were mixed across countries. Chinese new export orders fell further below 50 reaching 48.4, their lowest point since June 2016. Chinese businesses expressed concerns around "tough market conditions, strict environmental policies and the potential impact of the US-China trade war". Indeed, Chinese onshore financial markets have continued to suffer following an escalation in tariff threats from the US. Bellicose rhetoric is likely to persist through autumn, with the US to announce whether it will impose tariffs on an extra USD 200bn of Chinese imports at the end of the month. Near term, we are turning more cautious on Asian activity. We expect data to soften in the coming months and then improve towards the end of the year as China's policy stimulus kicks in.

US: Business activity is slowing down from very strong levels

The S&P 500 Index managed to climb back into positive territory last week after a dip following Trump's threat to impose even higher tariffs on Chinese imports and despite the latest set of economic data indicating that the US economy is slowing down from its strong pace in Q2. The ISM Manufacturing Index fell to a still solid 58.1 in July, down from 60, while its Non-Manufacturing cousin dropped to 55.7 from 59.1, the largest monthly fall in almost two years. Consumer sentiment ticked up slightly, but the gap between households' perception of the present situation and their expectations has widened further, signalling a more cautious outlook for consumer spending. The employment situation remains healthy with the broader underemployment rate falling to 7.5% in July, the lowest since 2001. Despite the ever tighter labour market, earnings growth remained at a relatively modest 2.7% YoY. The change in nonfarm payrolls slowed to 157'000 from 248'000, but is in line with the late stage of the business cycle. PCE Core remained at 1.9% YoY in June, slightly below the Fed's target.

Eurozone: Q2 growth comes in below expectations, but other data suggest recovery is in tact

Eurozone Q2 GDP growth came in below expectations at 0.3% QoQ (2.1% YoY) versus expectations of 0.4% QoQ (2.2% YoY). However, the quarterly GDP data can be volatile and have recently been susceptible to upward revision in later estimates. Other data suggest underlying growth remains strong in the Eurozone. For example, unemployment continues to fall and was at 8.3% in June, compared to 8.7% in January and 9.6% in January 2017. Business confidence has declined since the beginning of the year, but is also still consistent with an above trend pace of growth. Lending to companies is running at a healthy pace and credit standards are not unduly tight. Finally, the Q2 earnings season has been encouraging. With more than half of Eurozone companies having reported, earnings growth is running at around 10% YoY, which should support Eurozone equities. However, one risk is the 2019 Italian budget, which is currently being prepared and could be a potential flashpoint for markets over the autumn depending upon how aggressive the new government is with its spending plans.

UK: The BoE hikes its benchmark rate to 0.75%

As expected, the BoE lifted its benchmark rate from 0.5% to 0.75%, the highest since 2009. While there was no real urgency to hike rates given the modest growth outlook, the BoE used its window of opportunity after the economy rebounded from a weak first quarter and before the outlook is likely to be burdened even more by an uncertain future as the Brexit date approaches. The latest PMI surveys reveal a slowdown of business activity, with the Manufacturing PMI ticking down to 54.0 in July from 54.3 while the more relevant Services PMI fell to 53.5 from 55.1. Key challenges for service sector companies are tight labour market conditions and rising wage pressures, both of which contributed to the slowest pace of job creation since August 2016. Firms are increasingly worried about the availability of skilled candidates to fill open positions. Input cost pressure remains elevated but has eased in a number of sectors. Consumer confidence has dipped back slightly in July to levels last seen in February this year.

Japan: Monetary policy will be conducted in a more flexible manner

As we suspected last week, the Bank of Japan has tweaked its monetary policy rather than announcing any dramatic changes. Asset purchases will now be done in a more flexible way. The unofficial range for the 10yr JGB yield has been expanded to ±0.2%, which should improve JGB liquidity. We believe market speculation about another widening sometime soon is unfounded. The BoJ also introduced forward guidance for policy rates and specifically referred to the consumption tax hike planned for October 2019, which suggests that rate targets will be maintained at least until spring 2020 when a new comprehensive assessment may be necessary. In addition, the BoJ lowered its inflation outlook. While its believes that growth will move back to trend after the current fiscal year, it cut its median 'CPI excluding fresh food' projection by 20-30bps to 1.1% for this fiscal year, 1.5% for FY2019 and 1.6% for FY2020. These projections remain below the 2% target, which was not, however, abandoned. Finally, ETF purchases will become more flexible and will be tilted toward Topix-linked products.

Credit: Lag to equities continues, with European financials weaker

Credit continued to lag equities, with the latter part of the week seeing divergent price action between equities and credit, particularly in the US. European financials were weaker, as bank earnings got a lacklustre reception from both stocks and credit. It is notable that European bank stock indices have now cumulatively underperformed broader European stock indices by over 13% year-to-date. Last week's results showed continuing evidence of things that worry us, such as underperformance of European investment banking franchises, while the non-repeatable boosts to profits were quickly discounted by investors. The spread widening in Italian BTP yields also weighed on sentiment in financial credit as did the weakness in EM assets, which aren't showing signs of stabilisation yet. On the brighter side, new issue order books were strong and discounts were tighter, although this occurred when supply was low due to seasonal factors. Fund flows have been more encouraging over the last four weeks, aiding the supply/demand technicals somewhat.

What to Watch

- We expect Bangko Sentral ng Pilipinas to hike its policy rate and the central banks of Australia and Thailand to stand pat.
- No holidays when it comes to Asian data: Following the slump in Q1, Japan's Q2 GDP growth data are expected to be robust. In China, Taiwan and the Philippines export data for July will be published, as well as industrial production data for Malaysia and India. China, Taiwan, Australia and the Philippines will release inflation data for July.
- Industrial production data from various Eurozone countries should give a further indication as to the state of the recovery in the region.

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