

Weekly Macro & Markets View

Highlights and View

- **The EU elections fail to show a surge in support for populist parties in Europe as a whole**

While populists have done well in individual countries, there has been no surge in support EU-wide. This should provide some relief for investors near term, but the main determinant of risk appetite is still likely to be the ongoing trade tensions.

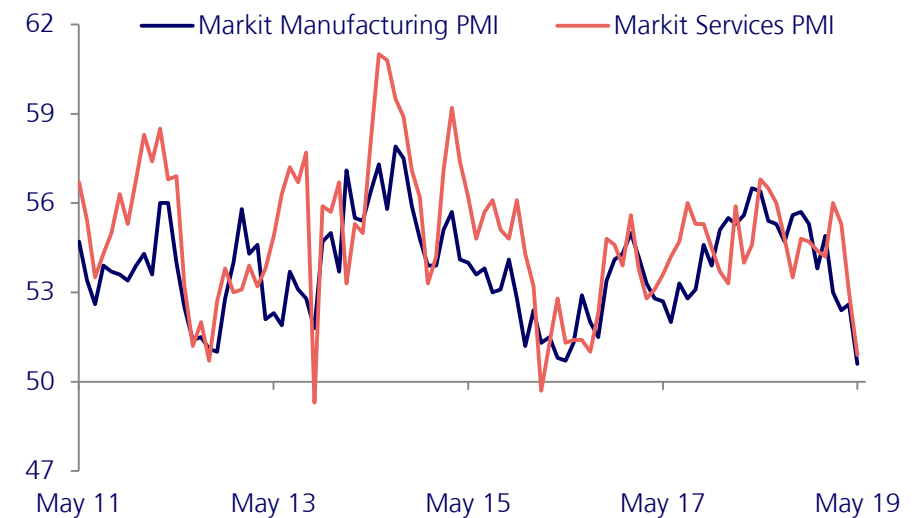
- **Theresa May steps down as Prime Minister and leader of the Conservative Party**

While May's successor is likely to enjoy stronger support within the Tory party, negotiations with the EU will be challenging and the risk of a no-deal Brexit remains significant.

- **The G3 flash manufacturing PMIs weakened further in May, this time led by the US**

Global growth is fragile and needs a resolution to the US-China trade dispute.

US business activity is slowing down



Source: Bloomberg

The S&P 500 ended the third week in a row with a negative performance, falling 1.2%, as trade worries linger on and economic data remain mixed. Markit's US Manufacturing PMI dropped to 50.6 in May, down from 52.6 the month before. While this still signals a slight improvement in operating conditions, it's the weakest upturn since September 2009. In particular, new orders declined for the first time since August 2009 as overall demand conditions are weak and clients are reluctant to place orders given the uncertain outlook. While the service sector has been holding up reasonably well so far, it now also shows a marked slowdown, with the Services PMI falling to 50.9 from 53.0 in April. New orders increased only slightly while outstanding business fell for the first time this year and employment growth dipped to a 25-month low. Clearly, the weak global growth environment, further undermined by the ongoing trade dispute between China and the US, is taking its toll. Current PMI levels are in line with an annualised GDP growth rate of only 1.2%, marking a significant slowdown from the first quarter. Durable goods orders also reflect the moderation in economic momentum, with core orders unchanged in April after falling in March. Importantly, capital goods orders were negative in April (-0.9% MoM) while March numbers were revised down to a mere +0.3% (from 1.4%).

Credit: Cracks emerge but unlikely to be broken yet

Last week continued to see more fragilities emerge in credit, especially in the US, although we doubt that this marks a sustained turn lower yet. There were some anecdotal reports of panic selling, especially on Thursday, when pockets of the credit market experienced a gapping out of spreads. Furthermore, the US primary market, a core barometer for investor demand in our view, saw primary issuance drop precipitously, with demand somewhat tepid for several deals. Europe in contrast had sizeable supply from banks, although most of it was also issued in

the early part of the week, with some deals clearly seeing a struggle to price and perform. Flows were mixed, with US investment grade seeing outflows after quite a while. Given tight spreads and weak fundamentals, idiosyncratic risk is increasing day by day, with retail, energy, TMT and a number of single names seeing substantial moves. We are watching for signs that the last bolster of credit strength, namely strong demand from pent up cash positions, is finally giving way, but we don't think it will occur imminently.

UK: Theresa May resigns

Theresa May announced that she will step down as the Conservative Party leader on June 7th, with the search for her successor to formally begin the following week. May will continue to act as the Prime Minister until a new Conservative leader has been found, which is expected to take a few weeks. It is likely that May will be followed by a pro-Brexit Tory who will try to renegotiate the withdrawal agreement with the EU. This could prove to be tricky as the EU has so far categorically refused to reopen the talks on the exit deal. While May's successor may be

able to get a few concessions from the EU and is likely to have more support amongst Tory MPs, the risk of a no-deal Brexit is significant. As expected, the Tories suffered a major defeat in last week's EU elections. Nigel Farage's Brexit Party garnered the most votes, with 32%. However, the pro-EU Liberal Democrats and Greens combined received roughly the same number of votes, mirroring the rift that divides the UK electorate regarding Brexit.

Eurozone: Continued mixed data, but some improvement in new orders in PMIs

Business surveys from the Eurozone confirmed a still subdued growth outlook. The overall Eurozone composite output PMI was almost unchanged in May at 51.6 compared to 51.5 in April. However, both the manufacturing and services indices declined slightly. In particular, manufacturing conditions in Germany remain depressed with a reading of 44.3 in May compared to 44.4 in April. On a brighter note, new orders in both Germany and the wider Eurozone manufacturing PMI survey remained below 50, but at a higher level than the month before, a tentative sign

of stabilisation. However, some of the survey was conducted before the latest escalation in trade tensions between the US and China, it will therefore be important to watch how business confidence reacts in the next couple of months as well. Separately, the German ifo survey showed a further decline in business confidence, led by the service sector, while the French national business confidence survey showed a pickup in sentiment, led by manufacturing. Overall, a mixed set of data, with underlying growth still only around trend at best in our view.

European Elections: Mainstream parties will continue to form the majority in the EU parliament

The centre-right European People's Party (EPP) and centre-left Socialists & Democrats (S&D) lost their two party majority, but a wider amalgamation of mainstream parties will still have a majority in the European parliament. The EPP gained 179 seats compared to 217 in the previous EU elections and they are still the largest party in the European Parliament. The S&D fell to 150 seats from 187. However, other pro-EU parties, such as the Greens (70 seats from 52) and ALDE (107 from 68) did better than in the previous EU election, guaranteeing a majority for mainstream/pro

EU parties. (The total number of seats in the EU parliament is 751, so 376 are needed for a majority.) In Italy, the Lega party gained almost 35%, a big increase compared to the 17% gained in general elections in 2018, but the Five-Star Movement fell to 17% from 33% in the general elections. This reflects a surge in support for Lega rather than populism in general in Italy. Overall, the populist surge that some analysts had been worried about has failed to materialise at an EU-wide level, providing some relief for investors.

Asia: Mixed economic data

Japan's GDP grew 2.1% on a sequential annualised QoQ basis in Q1, which was a positive surprise to consensus expectations of a slightly shrinking economy. But there is no reason to cheer when digging deeper into the details. The inventory build-up contributed positively, but may have been involuntary due to a lack of demand. The positive contribution from net-exports was based on lower imports, which again suggests that domestic demand was lacklustre. However, Q1 ended two months ago. Looking into leading indicators, we note that the Reuters Tankan diffusion

index for May was up four points to +12 for manufacturers, the first rise in seven months, and three points to +27 for non-manufacturers, the third rise in a row. This is in line with more favourable corporate production and machinery order plans. In Taiwan, it is remarkable that export orders and industrial production both were stronger than expected, while in Korea, exports during the first 20 days of May were still down a disappointing 11.7% YoY. Overall it seems that Asian economies are slowly improving, be it at a tepid pace.

What to Watch

- In Japan, the usual end-of-the month economic data bonanza will occur, with the release of the latest labour market data, Toyo CPI, industrial production, retail sales, consumer confidence, housing starts and construction orders. In Australia, it will be interesting to see whether the slowdown in building approvals will start to moderate. In China, the NBS PMI for May will be released. India's GDP growth is expected to have slowed further in Q1. We expect policy rates to remain stable when the Bank of Korea's MPC convenes on Friday.
- The EC business and consumer confidence surveys and the ECB's bank lending data will provide more information as to the state of the Eurozone recovery.
- Swiss GDP will show whether the economy continued to expand in Q1, despite the weak global growth environment.

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