

Weekly Macro & Markets View

Highlights and View

- **ECB prepares the ground to cut interest rates and restart QE**

While some investors were disappointed that the ECB did not ease policy last week, it gave a strong indication that it will do so in September

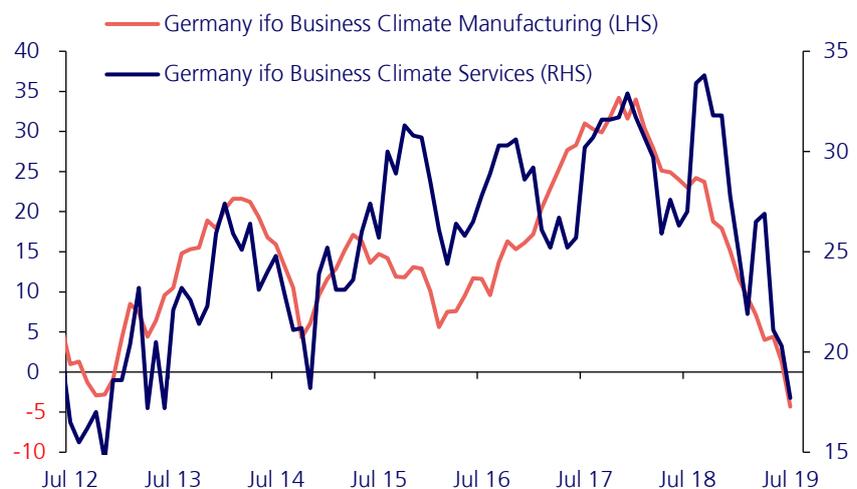
- **Eurozone flash PMIs and German ifo survey fall sharply in July**

Weakness in the Eurozone manufacturing sector is spreading to the service sector adding pressure on governments to do more to support growth

- **Boris Johnson is the UK's next Prime Minister, vowing to leave the EU with or without a deal**

Given uncompromising positions on both sides of the Channel the probability of early elections and a hard Brexit is rising

ECB promises more stimulus as business confidence plunges



Source: Bloomberg

ECB President, Mario Draghi, promised more monetary stimulus last week, in an effort to boost Eurozone growth and inflation. He said that the ECB was considering a range of policy measures, including cutting the deposit rate further into negative territory, tiering interest rates on excess reserves held by banks at the ECB to reduce the negative impact on bank profits, and restarting QE asset purchases of government and corporate bonds. He indicated that the ECB would make a formal announcement on these measures at the September 12th meeting. There was some disappointment in financial markets that Draghi did not announce a cut in interest rates at last week's meeting and was not more explicit in terms of the size of another asset purchase programme, but overall it seems that the ECB is preparing to act.

The Eurozone economy continues to suffer from uncertainty around trade and protectionism, which is affecting business investment and demand for capital goods. Indeed, latest data show a sharp fall in business confidence. However, we doubt how much more monetary stimulus can do by itself to boost the Eurozone's prospects, without also a significant boost from fiscal policy, and a material improvement in trade tensions. In particular, the pressure is now on Eurozone governments to do more, though it may take greater economic pain before they are willing to act decisively.

Eurozone: Business confidence takes another hit

Data from the Eurozone were concerning, with signs that weakness in the manufacturing sector is spreading to the service sector. The flash Eurozone composite PMI fell to 51.5 from 52.2, consistent with modest growth at best. Manufacturing confidence slumped further into contractionary territory (i.e. below 50), to 46.4 from 47.6, its lowest level in almost seven years. Forward-looking indicators were also soft, with manufacturing new export orders falling to the lowest level since 2011,

for example. Meanwhile, the German ifo business climate indicator had its biggest monthly fall since February 2009, with falls in both manufacturing and service confidence. On a more positive note, lending growth and demand is still holding up for now, as confirmed by the latest ECB Eurozone lending data. However, without aggressive action from policymakers on both the fiscal and monetary side, we suspect Eurozone data will continue to weaken over the next few quarters, increasing the risk of recession.

US: Manufacturing remains under pressure

The S&P 500 rose to a new all-time high last week following a number of solid corporate earnings reports. Meanwhile, economic data remain mixed, particularly with regard to the manufacturing sector. Markit's manufacturing PMI receded to 50 in July, indicating stagnation and a continuation of recent headwinds. The service sector is faring better, with the PMI at 52.2, but the overall situation is still only at levels last seen in the first half of 2016 according to the composite PMI. Actual numbers confirm this with GDP growth slowing to 2.1% QoQ in Q2 from 3.1% in the

first quarter. While consumer spending rebounded from the weakness observed at the beginning of the year, investment was a drag. On a more positive note, durable goods orders have picked up in June with an acceleration in capital goods orders raising hopes for a pick-up in investment later this year. However, a sustainable recovery in investment seems unlikely as long as the US-China trade dispute lingers on and weighs on the global economic outlook.

UK: Boris Johnson becomes the next PM

As expected, Boris Johnson was elected to be the new leader of the Conservative Party and as such becomes the next PM of the UK. Johnson vows to leave the EU by October 31st with or without an agreement, increasing the risk of a hard Brexit. Underlining his willingness to confront the EU and lead the UK out of the bloc, Johnson promoted a number of his pro-Brexit allies to his cabinet and announced to step up efforts to prepare for a hard Brexit. His call to renegotiate the withdrawal agreement, particularly the backstop solution for the border between

Northern Ireland and the Republic of Ireland, was immediately dismissed by the EU. Given that the EU claims that it wants to avoid a hard border in Ireland there should be room for concessions on both sides. However, given the short time available to reach an agreement and the uncompromising rhetoric on both sides, the risk of the UK leaving the EU without a deal is rising. As MPs have stepped up plans to stop a no-deal Brexit Johnson may try to win a majority for his Brexit plans by calling for early elections.

North Asia: Mixed economic data, financial reforms in China, the impact of Hong Kong's protests

Japan's manufacturing PMI notched up 0.3 points to 49.6, but is still hovering below the boom-bust line of 50. The output index contributed two-thirds of the rise, with the employment index accounting for the rest. The new export index, which is not part of the PMI, rebounded for the first time in four months by 1.5 points to 47.6, but we expect this to prove transitory. Export indicators for June/July in Korea, Taiwan and Hong Kong were disappointing and did not match hopes for a rebound. We are concerned that the

escalating protests in Hong Kong will have a negative impact on Mainland tourism to Hong Kong – a major driver of certain categories of retail sales. In that respect, we note that tourist arrivals in Macau have plunged in June, though from the record levels set in the prior six months. Last but not least, China's State Council has unveiled eleven new measures to encourage more foreign participation in its financial markets, a move we applaud.

ASEAN/Australia: Global headwinds continue to take their toll

Singapore's industrial production fell 6.9% YoY in June, its largest drop in four years, with electronics contracting 18.8%. In line with the global trend of muted inflation, June CPI slid lower from 0.9% to 0.6% due to falling oil prices and private transport costs. Thailand experienced a record trade surplus of USD 3.2bn. A thorough look shows that a 127% YoY surge in jewellery shipments compensated a sharp decline in the agriculture and electronics segments. Thailand, as one of three largest gold markets in Asia, benefitted substantially as global risk

appetite shifted towards safe havens. However, given the decline in core commodity exports, this does not reflect a sustainable export profile. It also puts pressure on the Thai baht, which in turn takes a toll on tourism and export prices. Meanwhile, Australia's data were resilient with the flash composite PMI down 0.7 points to 51.8. It suggests the expansionary trend will remain but with weaker momentum. We believe global headwinds will continue to weigh on the region.

What to Watch

- The Fed is expected to initiate its easing cycle with a 25bp rate cut this week although a dovish surprise cannot be ruled out. The ISM survey results, labour market data and consumer confidence will give important insights into the current state of the economy.
- In the Eurozone, the first estimate of Q2 GDP and the final July manufacturing PMIs are likely to confirm subdued growth, with manufacturing under particular pressure
- In a heavy week for Asian data, we will focus on China's July PMIs, Hong Kong's June retail sales, Malaysian June exports, and June industrial production data in Japan and Korea. Australia will release Q2 CPI data, July house prices as well as June building approvals and retail sales. We don't expect the Bank of Japan's MPC to make major changes to its monetary policy on Monday/Tuesday.

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