Weekly Macro & Markets View

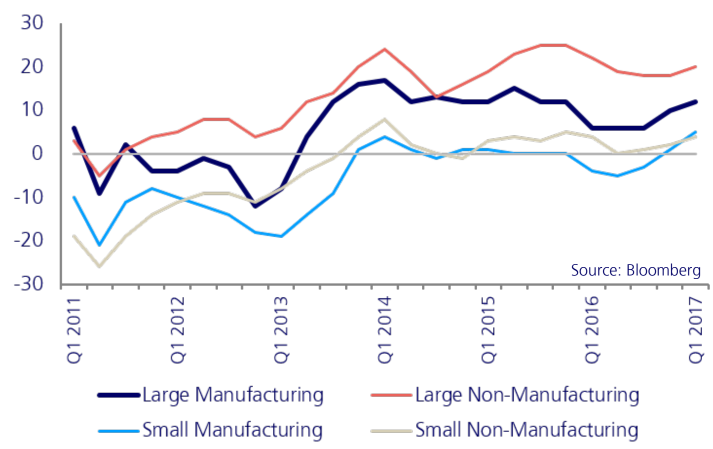
Highlights

- Nine months after the Brexit referendum, Theresa May has activated Article 50 to leave the EU
- German Ifo business climate index reaches its highest level since 2011
- Both the Tankan and economic indicators for February and March are painting a mixed picture of the Japanese economy

Our view

- The clock is now running, we expect tough negotiations and setbacks
- The Ifo index confirms the recent trend of strong survey data and suggests hard data will follow
- February saw strong industrial production and encouraging plans for March and April; private consumption remains lacklustre

Japan's Tankan provides a mixed picture



Today's Tankan release, the BoJ's quarterly corporate survey, can be interpreted as Japan's economic glass being half full or half empty. Overall, business sentiment improved across the board, indicating a broad-based improvement in the economy. Capex plans look particularly encouraging. Even though initial capex plans for the current fiscal year, which just started, show a projected overall decline of 1.3%, we interpret the outlook for large companies, at +0.6%, and particularly that of large manufacturers, at +5.3%, as very promising. These plans are the best initial forecasts in ten years. Capex plans tend to be revised upwards as the fiscal year proceeds. The BoJ will also be encouraged to see that capacity usage continues to rise and that price pressures seem to be intensifying for both input and output prices. Credit conditions have not tightened further.

On the negative side, the headline large manufacturing index improved less than consensus had expected, particularly compared to the stronger Reuters Tankan reading for March. Companies seem to be overly cautious at the start of this fiscal year, as the outlook indices fell below current levels in all major categories, particularly in the small business surveys. The predicted USDJPY rate stands at 108.43 for this fiscal year, about three yen below the current level. We suspect that companies remain suspicious about yen depreciation, which is negatively impacting their profit outlook.

ABS: Subprime auto defaults near crisis highs

US auto subprime loans delinquencies and defaults have reached levels close to crisis era peaks. Even the delinquencies in prime auto loans are steadily rising and the tightening lending standards indicate more delinquencies are likely to be on the way. Unlike during the financial crisis, given strong credit enhancement in ABS structures, investors remain better protected from losses while banks may not be significantly affected. However, with interest rates now rising and lenders beginning to tighten credit standards and limit loan affordability, vehicle sales could come under pressure along with used car prices, which can lower recoveries and increase losses.

What is quite intriguing is that this is occurring in a good economic environment, with a low unemployment rate and household debt-to-income ratios. While this could simply be a result of poor underwriting, it warrants further monitoring to assess whether this is one of the first warning signs of a turn in the credit cycle.

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US: Consumers cheer, but refrain from spending

The stock market quickly recovered from the initial disappointment of the failed attempt to repeal Obamacare. After a negative start, the S&P 500 finished the week in positive territory, climbing 0.8%. Investors now hope for a boost from corporate tax reform, although details of any legislation are still some way off and the extent of any potential tax cuts could be less than currently priced in by the markets. Economic data mostly remain robust. The third revision puts GDP growth for Q4 at 2.1%, driven by solid consumption growth. Consumers remain upbeat with the Conference Board Consumer Confidence Indicator surging to its highest since 2000. However, hard data keep lagging sentiment, as confirmed by personal spending rising a meagre 0.1% in February and falling for the second month in a row if adjusted for inflation.

Eurozone: Sharp fall in Eurozone inflation in March

Headline inflation fell from 2.0% in February to 1.5% in March, while core inflation fell from 0.9% to 0.7%. As expected, one reason for the decline in headline inflation was less upward pressure from energy. However, the late timing of Easter has also impacted holiday-related inflation. While the Easter distortion should unwind over the next couple of months, the bigger picture is that with energy price base effects diminishing, headline inflation will gradually move back closer in line with core inflation the rest of this year. The survey data continued to indicate a strong pace of growth in Q1, with the German Ifo survey hitting a multi-year high as businesses reported robust current conditions.

The strength of the economic data, but weakness in inflation creates a dilemma for the ECB in terms of monetary policy. Reports this week suggest that the ECB is considering the sequence and timing of an eventual reduction in monetary accommodation, but that it does not feel the need to act quickly on this front and is content to continue with its planned 60bn euros of QE asset purchases a month for now.

Switzerland: The SNB turns more optimistic as data continue to surprise on the upside

Survey data continue to surprise on the upside, confirming that the economy is expanding at a steady pace. Stronger domestic demand components, including construction, finance and consumption, drove a further rise in the KOF indicator in March, which is now tracking well above its long-run average. The manufacturing sector is also showing strength, with activity at its briskest pace since 2011 according to the PMI survey, reflecting both strong current output and firm new orders. ZEW investor sentiment is also solid and the leading consumption indicator maintains its steady pace upwards.

The SNB's quarterly report has also shifted tone, recognising the strength in the economy, while also revising down the real effective exchange rate, implying a smaller overvaluation of the franc than previously estimated. While political risk remains, justifying the SNB's current policy stand, the economy is clearly gaining strength amid the global recovery.

Mexico: Moving to the beat of its own drum

Despite political noise and external shocks, Mexico's economic data are putting the kibosh on naysayer's projections. It was an amazing week with the first non-oil trade surplus in 21 years, and rising exports and plunging imports due to a weaker currency. That very same currency experienced its largest quarterly appreciation over the past two decades, allowing the central bank to hike by only 25bps for the first time since December 2015 instead of the previous reactionary 50bps rate hikes. Unemployment reached a new nine-year low and loan growth is reaccelerating. Economic activity was quite strong at 3% YoY and way above its 12-month average. Accompanying these rather supportive macro data, there was improved news flow with a more constructive draft of the NAFTA revision than initially feared.

What to Watch

- US data, including the ISM surveys, vehicle sales and labour market figures, will reveal whether the economy maintained its momentum towards the end of Q1.
- In Japan, we will focus on wage growth for February, consumer confidence and the Services PMI for March
- In Asia, March PMIs are being disclosed. We expect the central banks of India and Australia to stand pat.
- The Final PMIs are likely to confirm a robust pace of growth in Eurozone, while the polls after the second French presidential debate will be closely watched

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