April 24, 2017

Weekly Macro & Markets View

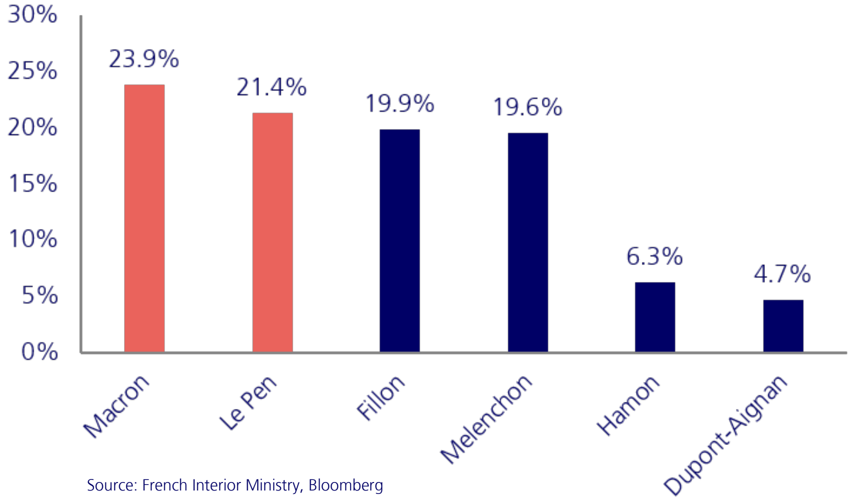
Highlights

- Macron wins the first round of the French presidential election
- Theresa May announces early elections to take place on June 8
- The Venezuelan political crisis escalates with protests ending in numerous deaths

Our view

- Macron's win reduces tail risks but the election is still fluid
- The expected election victory should strengthen May's position for the Brexit negotiations
- Despite the looming risk of a civil war, the country keeps paying its debt at maturity

First round of the French Presidential election results in line with opinion polls



Source: French Interior Ministry, Bloomberg

The result of the first round of the French Presidential elections was more or less as predicted by the opinion polls in the final few days before the vote. Centrist candidate Emmanuel Macron and far-right, anti-EU candidate Marine Le Pen made it through to the second round run-off with 23.9% and 21.4% of the votes respectively (according to the latest official estimates, with 97% of votes counted).

The second round takes place on the 7th of May, with the one TV debate between the two likely to be a crucial test for both candidates. Emmanuel Macron is the clear favourite to win the presidency, scoring between 60-65% in opinion polls versus Marine Le Pen on 35-40%, when electors are asked who they would vote for between the two in a second round. Macron should also benefit from the quick endorsement by his rivals on the mainstream right and left. Francois Fillon, a conservative, and Benoit Hamon, the Socialist party candidate, have both said they will vote for Macron in the second round, though Melenchon has not yet said who he will endorse. However, it is worth noting that around 50% of the French voters voted for anti-establishment and anti-EU candidates in the first round, including Marine Le Pen (21.4%), Melenchon (19.6%), Dupont-Aignan (4.7%) and other minority candidates. This shows the high level of disenfranchisement amongst French voters, and there is the possibility that the poll gap between Macron and Le Pen will narrow ahead of the final vote in the second round.

UK: Theresa May announces early elections

Despite repeatedly having argued against such a move, Theresa May announced early elections will take place on June 8. With a 20-point lead in the polls, the Conservative Party is expected to increase its majority in Parliament. This would give the Prime Minister more leeway in the Brexit negotiations with the EU as she will be less susceptible to pressure from within her own party. In addition, calling for elections now removes the risk of increased political uncertainty at the end of the two-year deadline to finalise a deal with the EU as the next elections will not be due until 2022, well after the UK is supposed to have left the EU. All in all, the latest development increases the chance of a less disruptive Brexit. Sterling strengthened accordingly. With the Brexit clock ticking, the economic impact becomes more and more visible. Retail sales fell 1.8% in March, ending the weakest quarter in seven years and confirming that consumers increasingly feel the headwind of falling real wages.

US: Positive trend in housing continues

The latest economic data show further proof of a slowdown in momentum. The Markit Flash Composite PMI fell to 52.7 in April, a seven-month low, driven by a fall in both manufacturing and services activity. The survey also indicated pressure on profit margins as input price inflation reached its highest level since June 2015, while firms continued struggling to increase prices. The latest housing data show that the positive trend remains intact. Housing start fells in March, but building permits picked up and the NAHB home builder sentiment index remains close to the 12-year high reached last month. After April's weak payroll number, more focus is currently being put on initial jobless claims as an important real-time indicator for the labour market. At 244'000, claims remain close to post-recession lows, indicating that the employment situation remains solid. Finally, industrial production rebounded in March, driven by utilities, but manufacturing suffered from weakness in the automotive sector.

Japan: Encouraging macro data

Japan's Manufacturing PMI rebounded to 52.8 in March, remaining above the 'boom-or-bust' line of 50 for the eighth month in a row, with all major constituents contributing positively. It is interesting to note that both output and input prices jumped to a three-year high. Indeed, output prices may move to a nine-year high in Q2, which would be very encouraging news for the Bank of Japan as its prime monetary policy objective is to spur an inflationary environment. Following the slightly disappointing quarterly Tankan Survey for Q1, we are pleased to see both the manufacturing and non-manufacturing diffusion index rise again in April, according to the monthly Reuters Tankan. 'Inbound' tourism from abroad keeps surging, even though foreign tourists are tending to spend less than last year. Exports continued to surge in the region, showing double-digit percentage YoY gains in March for Japan and China, as well as in the first twenty days of April in Korea. Taiwan's March export orders were firm as well.

China: The economic trend remains very solid

The economic data set for March remains very encouraging. Industrial production, fixed asset investment, exports and retail sales grew quicker than consensus had expected. Investment growth is broad-based, with infrastructure, manufacturing and property investment growth contributing. Fiscal policy remains proactive. Nominal retail sales growth picked up steam, driven by strong auto, household electronics and furniture sales, while online sales growth remains brisk. Real GDP was up 6.9% YoY in Q1, clearly above the full-year target of 6.5%. However, we are suspicious about China's GDP statistics, as the sequential annualised growth rate slowed to 5.3%, which seems incompatible. We would also warn against extrapolating the current strong economic momentum into the future, as tightening measures in the housing sector and financial deleveraging are increasing, suggesting a slowdown (though no hard landing) later this year. Property prices are now rising at a faster pace in smaller cities than in bigger cities, which may reflect the impact of tightening in the latter.

Australia: Iron ore prices correct as Chinese re-stocking stalls

After gaining ~80% in 2016, and reaching a high of USD 94.9 per ton last February, iron ore prices have collapsed to USD 68.2. China, which absorbs 60% of global demand, imported 850m metric tons (MT) in 2016, as the government prioritised infrastructure spending and loose fiscal policy to revive the economy. Domestic supply was cut in favour of cheaper and better quality ore from Australia and Brazil. Today, Chinese inventories are up ~60% compared to the lows of 2015. Higher prices should trigger more supply: an extra 139m MT through 2019, according to Bloomberg Intelligence. Projecting the demand side is more delicate. If China's restocking is likely to pause, other drivers like the ambitious "One Belt, One Road" project could boost demand. If the global recovery continues, leading to a rebound in investment, iron ore demand would benefit. For Australia, the recent price move does not threaten the positive shock on nominal growth. The main Australian mining companies have slashed costs to below USD 24 per ton, enabling them to maintain decent margins even with prices at USD 60-70.

What to Watch

- In the US, the focus will be on GDP data for the first quarter, while the Conference Board Consumer Confidence Survey should give an indication of the current household mood.
- The ECB meeting will likely see Mario Draghi emphasise the continued need for a loose monetary policy stance, but investors and analysts will question how much longer QE will be necessary given the improved economic outlook and the diminished risk of an upset in the French elections. Indeed, data such as the Ifo and PMI surveys are likely to indicate that growth remains strong.
- This week will see the usual month-end economic data bonanza in Japan. In addition, the MPC of the Bank of Japan will convene on Wednesday and Thursday. Taking into account the latest comment by BoJ Governor Kuroda, we do not expect any changes in monetary policy.

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