Weekly Macro & Markets View

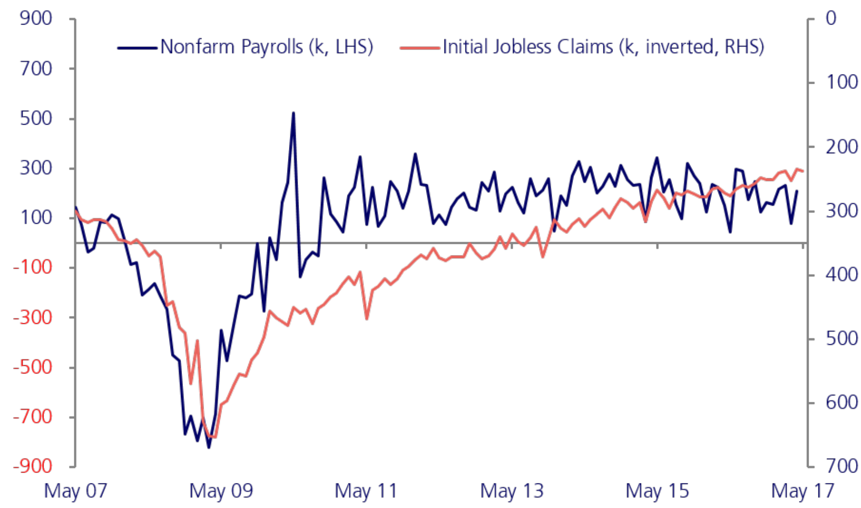
Highlights

- US nonfarm payrolls rebound to 211’000 in April after a revision down to 79’000 in March
- Puerto Rico filed for bankruptcy on Wednesday after negotiations with creditors failed
- Macron wins the French presidency with 66% of votes

Our view

- Most indicators continue to signal a healthy employment situation in the US
- Puerto Rico’s case is unique and won’t derail global municipal market performance and credit fundamentals
- The sizeable win gives Macron legitimacy to govern and reduces tail risks in the region

The US labour market is showing strength



Source: Bloomberg

The latest batch of data confirmed the economy’s loss of momentum in the first quarter. Personal income grew by only 0.2% in March and spending was flat for the second month in a row, underlining the soft patch in household spending.

While we expect a reacceleration in consumer spending, early indicators point towards a relatively muted start into the second quarter. Vehicle sales picked up less than consensus predicted in April. As expected, nonfarm payrolls have recovered from last month’s drop, rising by 211’000 in April. The unemployment rate fell to 4.4%, reaching the last cycle’s lows, helped by a slightly lower participation rate. The underemployment rate dropped markedly to 8.6%, indicating that slack in the labour market has been further reduced. Initial jobless claims continue to hover around the lowest levels in four decades. Despite the further tightening, wage growth remains muted, with the annual rate slowing down to 2.5%, the lowest in almost a year and hardly above the inflation rate.

The Fed ascribed both the loss of economic momentum as well as the slowdown in core inflation as transitory and is on track to increase interest rates in June. The FOMC’s optimism is supported by the ISM surveys signalling a promising business environment, with solid new orders in both manufacturing and services.

Eurozone: Macron wins comfortably, economic data remain robust

Emmanuel Macron’s landslide win in the French elections with a larger than expected vote shows a rejection by most of the French electorate of the anti-euro/EU policies proposed by his opponent Marine Le Pen. International investors will be reassured that an important risk to financial stability in the region has been reduced. We expect investor flows over the coming months to favour the Eurozone given the encouraging macro and earnings outlook and reduction in tail risks. From a political point of view, the focus is now on the parliamentary elections in June and whether Macron can secure a majority for his government, either with his own party by itself or in coalition with another mainstream party. Economic data last week continued to indicate robust growth in the Eurozone. Q1 GDP came in at an above trend pace of 0.5% QoQ, and 2016 Q4 growth was revised up from 0.4% QoQ to 0.5% QoQ. The PMI surveys were also stronger than expected and particularly the forwarding looking components such as new orders remained at multi-year highs.

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Switzerland: Growth is peaking, but a sharp slowdown is not on the cards

Data ticked down in April and both the manufacturing PMI and the broader KOF survey came in weaker than expected. Though momentum is fading, the prints still imply growth above trend. The broadening out of the recovery is also encouraging, as domestic demand continues to catch up with the external sector, helped by labour market stabilisation and better sentiment. The UBS real estate bubble index ticked up in Q1, led by higher house prices, confirming our view that housing is gaining some ground, though the upside is limited given weak nominal growth. Forex reserves rose by 12bn in April, taking the increase so far this year to CHF 50bn, or 8% of GDP. This is a large move, but we do not expect it to trigger a policy change from the SNB, particularly as safe haven flows are receding. The SNB will closely watch this week's CPI data, however. A further upside, which we do not anticipate, would signal a less deflationary outlook and make a stronger case for policy normalisation.

Asia: Strong regional activity, despite softer Chinese momentum

The equal-weighted Manufacturing PMI across Asia and Australia came in at 52.5 in April, marginally up from 52.4 in March. New orders eased slightly but remained decent at 53.4, while new export orders edged up to 52.9 from 52.5. We think that the PMIs confirm the solidity of manufacturing activity in Asia, despite disparities across countries. China, which has played a decisive role in lifting regional trade, is seeing a slowdown in momentum. April import growth eased both in volume and value terms, as commodity prices softened and restocking is almost complete for some products. In China, the tightening of interbank liquidity conditions and the crackdown on shadow banking by the authorities are, in our view, not alarming at this stage. They occur at a time of solid nominal growth. For the APAC region, other positive drivers are taking over. Indeed, European, American, and Japanese demand for Asian products is solid. Additionally, some countries like Japan and Australia are experiencing a nascent recovery in capex.

China: Policy tightening starts to bite

China's PMIs for April appear to have topped out, though they remain at a healthy level above the 'boom/bust line' of 50. Both the NBS and the Caixin Manufacturing PMIs have been weaker than consensus had anticipated. We are not surprised, as recent credit and property market tightening measures were expected to take their toll on the domestic economy following a very strong first quarter. We believe growth will slow in the next few months, though it will remain brisk. Potential hard landing fears will once again be overdone, particularly considering that the government will be focused on a stable economic environment heading into the 19th Communist Party Congress in Q4. The PBoC, the MoF and four other central government agencies published a new policy guideline for local government financing to address systemic risks following a recent clamp down on shadow banking products. Tighter policy has had an impact, pushing iron ore and domestic 'A'-share prices lower. Tighter control, however, is not comparable to the austerity measures experienced three years ago.

Credit: Oil and Puerto Rico fail to dampen sentiment

Global credit markets were firm last week, although CDS spreads tightened more aggressively than cash spreads. Financial spreads continued to tighten, driven by peripheral and French credits. That said, against a backdrop of positive bank earnings, Monte dei Paschi reported another loss as revenues fell while asset quality showed no tangible improvement.

Away from financials, despite a sharp drop in the oil price, the energy sector has been quite resilient in credit, and Puerto Rico's filing for creditor protection had little impact on broader sentiment. We believe that the strong supply/demand technicals are likely to keep spreads firm in the short term. Indeed, credit funds continue to see strong inflows, especially in high grade, while supply has not been excessive. That said, we don't see outsized gains in credit given current tight spread levels.

What to Watch

- Japan will see the peak week of the FY3/17 earnings reporting season, following the 'Golden Week' holidays. 67% of all companies will report, while 22% have reported so far.
- A new president will be elected in Korea tomorrow, Tuesday. Polls show Moon Jae-in of the Minjoo Party as the frontrunner.
- In China, foreign trade and inflation data for March will be published.
- Q1 GDP data for Germany, France and Italy should confirm growth is robust, while the ZEW survey is also expected to be strong.

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