Weekly Macro & Markets View

Highlights and View

- **Tropical storms cause devastating floods in Texas as well as Southern Asia, with a heavy toll on life**

  From an economic perspective, growth will be impeded. However, particularly for the US, the consequent investment in rebuilding should result in higher net growth in the medium term.

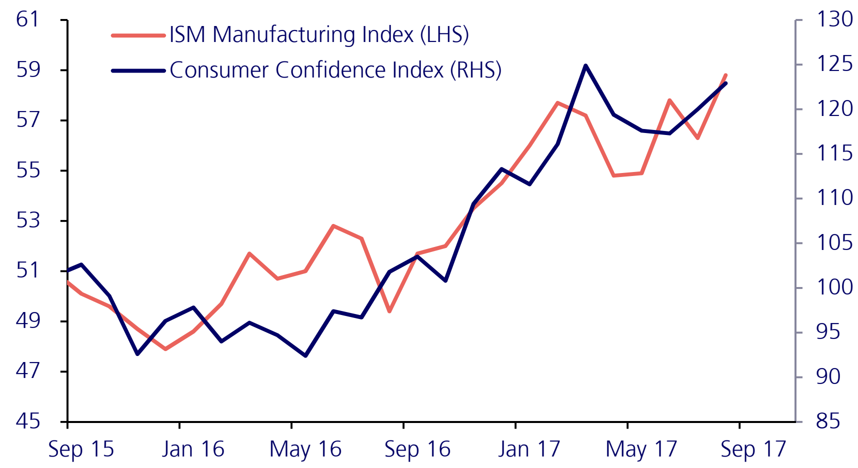
- **Tensions increase again after North Korea fires a missile over Japan and tests a hydrogen bomb**

  We believe that tensions will not abate, as North Korea will continue to test its limits, particularly this coming weekend, the DPRK national foundation anniversary.

- **Equity markets rebound on strong fundamentals, though volumes remain light**

  After a brief pull-back, equity markets bounced off critical support levels, as strong global economic data cheered investors. Further upside is expected, but geopolitics will spur volatility.

Economic data lift investor sentiment, new high for the NASDAQ



Source: Bloomberg

The Labour Day holiday in the US today marks the unofficial end to summer, with investors returning to their desks following the usual seasonally light trading volumes. The mood should be decent, geopolitics aside. Equities rebounded sharply last week, following slippage the previous few weeks, with small cap stocks leading the charge and lifting the Russell 2000 index by 2.6%, while the tech heavy NASDAQ hit a new record high.

Economic data remain largely supportive, though Friday's payrolls were a little on the light side at 156k and unemployment ticked up a tenth to 4.4%. We are not too concerned, given the recent strength, and we point to a slew of other economic releases that bode well for the continued expansion of the US economy. Q2 GDP was revised up to 3%, with the critical components of consumption and business investment particularly strong at 3.3% and 6.9% respectively. Personal income and spending readings for July proved to be robust, while manufacturing activity surged in August, with the ISM reading jumping to 58.8. With house price data and consumer sentiment also buoyant, the economy is in good shape. However, the tragic events in Texas will be disruptive to growth in the short term, particularly employment, though history suggests that the resulting reconstruction efforts will boost growth in the months ahead.

Bonds: 10yr Treasury yield rebounds from critical level

After a steady grind lower, yields rebounded on Friday, as the US manufacturing ISM surged. The 10yr Treasury yield ended the week at 2.17%, matching the prior week's close. There was significant volatility during the week though, and the 10yr yield broke through the critical 2.10% level on Tuesday, but rebounded and closed at a higher level, which was encouraging. Bund and gilt yields also edged up, but the 10yr JGB yield fell below 0% for the first time since November, despite slower QE purchases by the BoJ, and Swiss yields failed to rebound. This suggests that geopolitical events are weighing on global yields, but the diverging performance of equity and bond markets is puzzling, with strong global data boosting equity prices but failing to feed through to higher yields. Weak US inflation is a culprit, with investors showing little conviction in the Fed's view that the recent weakness is temporary. Last week's sluggish inflation and payroll earnings data highlighted that concern.

msme@zurich.com

Eurozone: Lending data point to underlying strength in the economy

The euro spiked above 1.20 versus the USD early last week after ECB President Mario Draghi made no reference to being concerned about its strength at his Jackson Hole speech. However, the euro fell back below 1.20 on later reports that ECB policymakers were actually uneasy with its recent strength. This, in addition to the continued strong data coming out of the region, helped support Eurozone equities later in the week. The final manufacturing PMI increased to 57.4 from 56.6, with strong growth in new orders. Lending growth in the Eurozone also continues to grow at a decent pace, with lending to non-financial corporations increasing by 2.4% YoY in July, from 2.0% YoY in June. Core inflation is also picking up, albeit from low levels. Finally, the French government presented its labour market reforms last week. Encouragingly, the reaction from trade unions has not been too negative, suggesting that while there will be some protests in September, these will probably not be on the scale of previous street protests when governments have tried to launch ambitious reforms.

Switzerland: Diverging trends within the Swiss economy

Swiss data were mixed last week, as the broader KOF survey edged down, with construction and hospitality showing weaker dynamics. The UBS consumption indicator was unchanged and appears to have peaked on weak employment growth and a slowdown in car sales, and retail sales data also slumped in July. This confirms that the domestic economy is sluggish and lacking growth drivers. The manufacturing PMI, by contrast, rose further, approaching a cycle high, and is now a positive outlier globally. Though the underlying details were a bit softer, with a fall in new orders and employment intentions, the weaker currency is a tailwind, particularly as the global cycle is solid, and we expect the manufacturing expansion to continue. SNB sight deposits edged down last week following a rise the prior week, suggesting that the SNB is very cautiously tempering its forex reserves. As geopolitical uncertainties abound, we maintain our view that the SNB will remain active in forex markets, intervening when pressure arises.

Japan: Disappointing capex, but record high profitability

Two weeks ago we wrote "The fact that Japan has been the fastest growing G7 country in Q2 makes a nice headline, but we are aware that later revisions to the 4% annualised sequential growth rate may spoil the party." Indeed, there is a good chance that this will be the case when the first GDP revision is published this Friday. What has happened? The latest MoF business survey revealed that capital investment remains weak. Excluding software, capex was up only 0.6% YoY, significantly below consensus expectations of 8.2%. Investment was particularly weak in the manufacturing sector, where it fell 5.4% on a seasonally-adjusted sequential basis. On the positive side, sales and profits remain strong. Sales were up 6.7% YoY, showing a very solid performance in the service sector, while recurring profits were up 22.6%. The machinery, electronics and information/communication sectors experienced a surge in profits. Profit margins overall rose to a record high of 6.3%, with both sales and margins contributing. As for the expected downward revision to Q2 GDP growth, it has to be noted that growth remains above trend.

Asia: Manufacturing industries remain stronger for longer

The latest Asian manufacturing PMIs paint a rosy picture. Following a soft patch last month, most PMIs have rebounded, with the exception of Japan, the Philippines and Thailand, and all PMIs are above the boom/bust line of 50, except for Korea and Thailand. We are particularly impressed by the strong outcome in China and Taiwan, as well as the turnaround in many ASEAN countries. Korea's performance in the electronics sector is also encouraging, though other sectors are lagging. The uptick in new orders minus inventories suggests that the industrial production cycle has legs. New export orders are also gaining momentum again in most countries, with the notable exception of the low-end electronics assembly segment in the Philippines. While the employment sub-indices are showing a mixed outcome, the input price inflation sub-index is surging, which needs to be monitored. In China, the non-manufacturing PMI fell to its lowest level since May last year, though still at a healthy level of 53.4. We will wait for the Caixin Services PMI, published tomorrow, to see whether momentum is slowing in this important part of China's economy.

What to Watch

- The Monetary Policy Boards of the ECB, Australia's RBA and Malaysia's BNM will convene this week. No policy changes are expected.
- In Asia, we are keeping an eye on the August Services PMIs for Japan, China and Australia; export statistics in China, Taiwan and Malaysia; and the Eco Watchers survey and wages in Japan.
- Brazil, Russia, India and China are expected to commit to globalisation during the BRIC summit being held this Monday and Tuesday in Xiamen, China.
- Primary credit market activity is very important to watch this week, as it is often a barometer of supply and demand patterns into the end of the year.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL