

Weekly Macro & Markets View

Highlights and View

- **The G20 reaffirms a unanimous commitment to use all available policy tools to strengthen growth**

Differences in views were most clearly seen on climate change, where only 19 countries reaffirmed their commitment to the Paris Agreement, which they now state is irreversible.

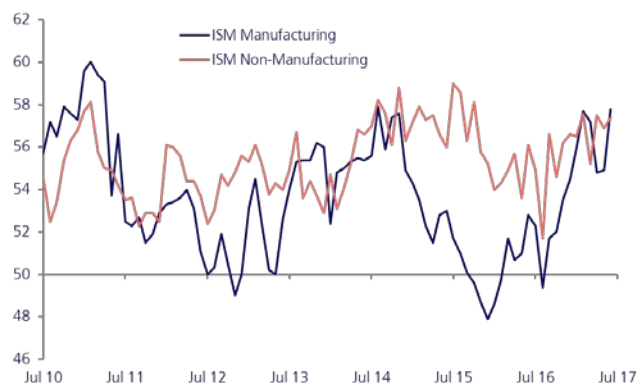
- **The EU and Japan agree on a landmark economic and strategic partnership**

US President Trump's protectionist stance gives other countries a fresh impetus to proceed with bilateral and multilateral trade agreements, which should benefit world trade.

- **The EU approves the precautionary recapitalisation of Monte Dei Paschi**

While this is a welcome development, at a 21% price of bad loans and with about €1 trillion bad loans on European bank books, it seems premature to conclude that the worst is behind us for the sector.

The ISM Manufacturing survey climbs to a three-year high



Source: Bloomberg

The US economy enters the third quarter on solid footing as shown by the latest ISM surveys. The ISM manufacturing index climbed to 57.8, the highest level in almost three years, with both the new orders and the employment component showing strength. The service sector is in a good shape too, with the ISM Non-Manufacturing index rising to 57.4, new orders at 60.5 and the employment component a still decent 55.8. The positive business environment was also reflected in another set of solid labour market data. Firms added 222'000 new payrolls in June, while May's number was revised up to 152'000, lifting the three-month moving average to 194'000. The unemployment rate ticked up to 4.4%, but this was mainly due to the rise in the participation rate, while average weekly hours increased as well. Wage growth has reaccelerated slightly to an annual rate of 2.5% but remains relatively modest given the tighter labour market. Nevertheless, the latest batch of data show that more people are working, and they are working longer on average and earning more per hour, all of which is a good basis for household spending going forward. No major news was provided by the Fed minutes as most of the information was already published in the statement right after the meeting. The FOMC seems to be setting the stage for an announcement regarding the beginning of the balance sheet reduction at its September meeting.

Bonds: The worst excesses have been removed from bond markets

The sell-off in government bonds continued at a more modest pace last week. Bunds led the way, with the 10yr yield, which has risen by 33bps over the past two weeks, breaching 0.5% on Thursday, for the first time since January 2016. With the exception of Japan, most regions saw similar moves, as central banks shifted tone, emphasising that they are willing to look through soft inflation when considering policy normalisation. The Bank of Japan, which came under pressure last week to defend its yield target, issued a statement

that it would undertake unlimited JGB buying to reinforce the 0.1% soft ceiling on the 10yr yield. This was seen as credible by investors and took some steam out of the global sell-off. Sluggish US wage inflation and lower oil prices also softened the move, with inflation expectations remaining weak. As the worst bond market excesses have now been removed, stronger inflation data are needed for a further rise in yields to be sustainable.

Eurozone: Economic data continue to point to robust growth

The final estimate of the Eurozone composite PMI for June was revised up compared to the initial estimate and is still consistent with a well above trend pace of growth. What's more, the latest so called 'hard data' are improving. Industrial production in both Germany and France was strong in May, rising 5% and 3.2% YoY respectively. The minutes from the most recent ECB meeting showed that it considered taking out the reference to the possibility of QE being expanded should economic conditions deteriorate, as it felt the likelihood of this happening was now small. In

the end, this part of the statement was left unchanged at the June meeting, but the direction of change is clear. The ECB will gradually change its language over the course of the next few policy meetings, recognising the improved economic outlook in the region, and we expect it will announce a reduction in the size of monthly asset purchases from 2018 at either the September 6 or October 27 monetary policy meeting.

Switzerland: Data rebound on strong manufacturing activity

After a sluggish May, the data strengthened again in June, indicating that the recent soft spot was temporary. The PMI spiked to 61, which is the highest level since 2011, consistent with growth in the manufacturing sector well above trend. The rise was broad-based, with a steady increase in new orders and a reacceleration in employment dynamics. This is welcome, as the labour market is sluggish, spilling over into subdued confidence and consumption spending. The KOF leading indicator also spiked higher, reportedly on strong manufacturing activity,

while other sectors were sluggish. As the upswing is mainly driven by manufacturing, its sustainability is still in question, particularly as the trade-weighted franc is moving higher, led by dollar weakness. This supports our view that stronger activity will not be a cause for the SNB to remove stimulus, particularly as the CPI print weakened yet again.

Asia: Robust Manufacturing PMIs in June

Asian manufacturing PMIs remained surprisingly resilient in June. We are particularly encouraged by the strong readings in China, Taiwan and Korea, as these show the closest correlation to the industrial production cycle. China's Caixin Manufacturing PMI recovered and moved back above 50, as did South Korea's PMI, while Taiwan's PMI crept higher to a solid level of 53.3. The only negative readings came from Indonesia, where the PMI slipped back below 50, and Malaysia, where it fell 1.8 points to 46.9.

We are also encouraged by the very firm reading of new export orders. New order export indices rose in all Asian countries and remain above the 50 'boom/bust' line, with the exception of Korea. This may be related to a soft patch in Korean auto exports, while Korean semiconductor exports remain very strong. Global trade growth keeps benefitting Asian exports, and we believe the iPhone cycle should be supportive for the major Northern Asian suppliers for the time being.

Japan: The EU and Japan agree on a landmark economic and strategic partnership

Shortly before the G20 Summit in Hamburg, the leaders from the European Union and Japan reached a political agreement at the 24th EU-Japan summit in Brussels to finalise a broad free trade agreement. The President of the European Commission, Juncker, made clear that "there is no protection in protectionism", indirectly criticising the Trump administration and adding momentum to previous remarks from China's President Xi. Tariff cuts will be implemented over the next few years, which should benefit Japanese car producers, though we note that

about 70% of Japanese cars sold in Europe are already produced by Japanese subsidiaries within the EU. On the other hand, EU food and pharma companies should find it easier to penetrate the Japanese market. The EU accounts for about 11% of Japan's exports and 12% of imports. In addition, reducing or scrapping non-tariff barriers will be even more important in boosting bilateral trade and foreign direct investment. The broader strategic partnership covers aspects like the environment, energy, technology and security.

What to Watch

- In the US, the focus will be on inflation data as another weak print would make it harder for the Fed to justify its relatively hawkish rhetoric. Both small business optimism and consumer sentiment are expected to remain high.
- We expect the central banks of Korea and Malaysia to stand pat. Important Asian economic indicators will be published in Japan, China and Australia.

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