Weekly Macro & Markets View

Highlights and View

- **Global Manufacturing PMI edges higher led by developed markets**

  This supports our view that the economic cycle is not about to end yet.

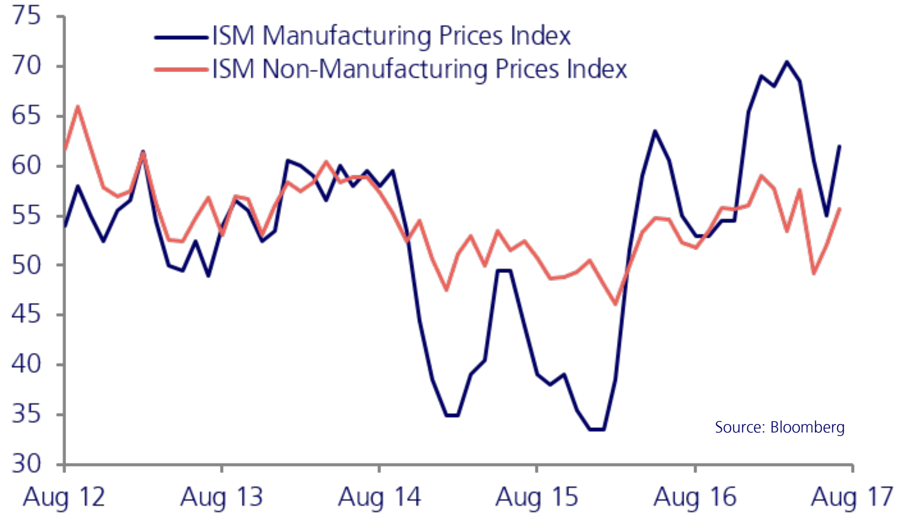
- **Japan's PM Abe reshuffles the Cabinet and LDP leadership**

  The new Cabinet should bring more stability to the government following recent turmoil.

- **UN Security Council unanimously approves restricting North Korea's commodity exports in condemnation of intercontinental ballistic missile tests**

  We believe the fact that China and Russia abandoned a veto and that politicians at the ASEAN security meeting in Manila urged North Korea on Sunday to resume dialogue should alleviate risks.

Rising input prices point to reaccelerating inflation



Despite business activity slowing somewhat, the latest ISM surveys show that the US economy has entered the second half of the year on a solid footing. The ISM Manufacturing Index receded from a three-year high to a still solid 56.3 in July, while momentum in the service sector has experienced a more pronounced slowdown to 53.9 from 57.4. New orders in both series are signalling a continuation of the positive growth trend. Interestingly, prices paid have risen in both series, indicating that inflation could have bottomed in July. PCE Core YoY remained at 1.5% in June, the same as the upwards revised rate in May. The labour market remains in healthy shape with 209'000 new payrolls added in July after 231'000 in June. The unemployment rate ticked down to 4.3% while the underemployment rate remained at 8.6%. Average hourly earnings growth accelerated in July at the fastest pace since last October, while the annual rate remained at 2.5%. The solid set of labour market data helped to lift the dollar, which gained more than 1% against the euro after the data were published. Sentiment against the dollar could prove to be too pessimistic as economic data are likely to improve further going forward. Finally, a positive earnings season is slowly coming to a close. With almost 85% of the S&P 500 companies having reported, the average earnings surprise is a decent 4.7% with earnings growth reaching a relatively strong 10.1%.

Eurozone: Growth remains strong with tentative signs that inflation is picking up too

Q2 GDP growth came in at 0.6% QoQ and 2.1% YoY, and the latest business survey and activity data suggest that the strong momentum has continued into Q3. The overall Eurozone composite PMI for July was 55.7, down from 56.3 in June, but still consistent with a well above trend pace of growth. It is also encouraging that growth is broad-based, with countries such as France and Italy now also participating in the recovery. Indeed, Italy's composite PMI jumped to 56.2 in July from 54.5 in June. There are signs that the stronger pace of growth is finally leading to a pickup in inflation. Eurozone core inflation was 1.2% in July, up from 1.1% in June and 0.9% in May. The Q2 corporate earnings season has also been encouraging, with Eurozone companies growing earnings at 11% YoY for those that have reported so far (source: JP Morgan). Overall, the latest data will give the ECB more confidence to reduce QE asset purchases in 2018, and we expect lead to core bond yields to gradually move higher.

msme@zurich.com

UK: The BoE lowers its growth outlook

Business activity has recovered a little in July, reflected in a move higher by both the Manufacturing and the Services PMI. The former climbed to 55.1 from 54.2 in June, while the latter ticked up to 53.8 from 53.4. Importantly, input prices rose at the slowest pace in more than a year. The improvement in manufacturing was broad-based, but one of the key drivers was an acceleration of new export orders that saw the strongest rise since April 2010 – helped by a positive global growth environment and a weak currency. The expansion is more subdued in the service sector, reflecting the ongoing uncertainty with regard to the domestic economy. While new business expanded, it was the weakest improvement seen since last autumn. Encouragingly, firms keep increasing their payroll numbers. As expected, the BoE kept its policy unchanged and acknowledged the weaker economic environment by reducing their GDP growth forecast from 1.9% to 1.7% for 2017.

Asia: July PMIs deliver a mixed picture, with only ‘Greater China’ holding up well

Most of the Asian Manufacturing PMIs fell below their Q2 average in July, with the exception of China’s Caixin Manufacturing PMI, Taiwan’s Manufacturing PMI and Hong Kong’s Composite PMI. This suggests that manufacturing industries are losing some steam, which becomes even more obvious when looking at new export orders. They all seem to roll over, again with the exception of China’s Caixin version. The 2.4 fall in ASEAN below the level of 50 is particularly worth keeping an eye on. Electronics keep doing well, helping China, Taiwan and Vietnam, as well as Korea’s exports. Once again, a divergence is visible between China’s official NBS PMI, which fell slightly, and the Caixin PMI, which is more focused on enterprises that are not part of the big SOEs. The significant drop in India is being caused by the GST impact (see section below). While the Global Manufacturing PMI ticked up to 52.7, we need to watch whether the slowdown in Asia ex China/Taiwan/Hong Kong is a blip or a canary in the coal mine for the region.

Japan: New Cabinet and LDP leadership should regain public confidence

The approval rating for the Cabinet improved again over the weekend, with the average poll up 7 points to 41%, following PM Abe’s reshuffling of his Cabinet and the LDP leadership. Following several gaffes and scandals, PM Abe opted for more stability by selecting ministers with a proven track record. Core members of the Cabinet and LDP leadership kept their posts, including Finance Minister Aso, Chief Cabinet Secretary Suga and Secretary General Nikai. Abe needs not only to regain the confidence of the electorate, but also that of his own party. As the head of the LDP, he has to lead various factions like a lion-tamer. We note that Foreign Minister Kishida has moved out of the Cabinet to become LDP Policy Chief. Kishida is said to be Abe’s rival in the LDP party chief election next year, but the fact that several members of his faction have been appointed as ministers makes us believe that this was a smart tactical move to unite party factions. No relevant changes to economic policy are expected, and we expect both monetary and fiscal policy to stay accommodative.

India: The central bank delivers an opportunistic rate cut

The Reserve Bank of India (RBI) cut its policy rate by 25bps to 6%, diverging from the “on hold” strategy of most other Asian central banks. For the RBI, the historically low level of inflation, which stood at 1.5% YoY in June, below the 4% target, opened “easing space”. Going forward, the risks are slightly tilted to the upside for inflation, and the RBI is likely to hold fire. We see the last rate cut as opportunistic and are sceptical as to whether it will boost the economy. Admittedly, growth has stalled following the introduction of the Goods and Service Tax, but this weakness should be temporary. We do see a more structural economic obstacle in the sluggishness of private investment. Monetary easing is unlikely to help there since the root cause is the high level of stress in corporate and bank balance sheets. The RBI has recently been empowered to manage the clean-up of public banks, and this is a step in the right direction, but the situation commands more urgency.

What to Watch

- As there is not a lot of data being published in the US this week the focus will be on inflation, with both PPI and CPI expected to reaccelerate after their recent slowdown.
- We will focus on export and inflation data for July in China, while it will be interesting to see whether the Eco Watchers Survey for July will defend the 50 level in Japan.

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