

Weekly Macro & Markets View

Highlights and View

- **US President Trump announces the United States' withdrawal from the Paris climate accord**

China will be more than happy to fill the vacuum, as it is determined to play a dominant role in clean energy. The US move also bolsters cooperation between Europe, China and India in environmental policies.

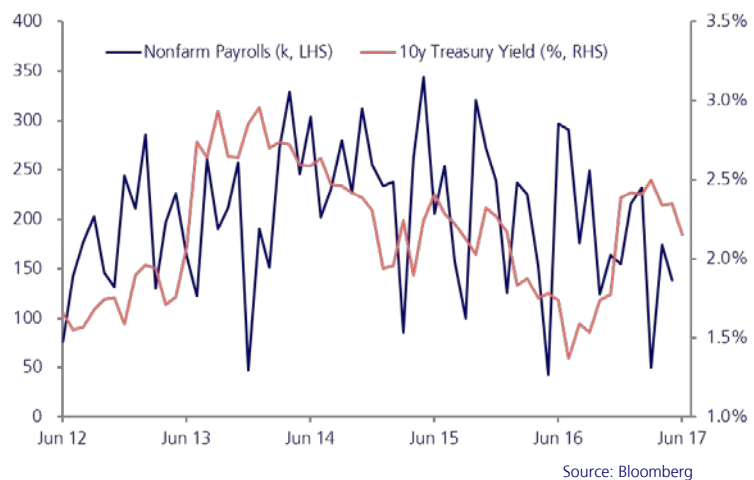
- **Banco Popular junior bonds fall sharply to nearly half their face value**

While this may prove to be an idiosyncratic event, we believe that generic junior debt pricing is somewhat sanguine around impairment risk, despite the loss absorbing language in the bonds.

- **The global manufacturing PMI edged down in June, mainly reflecting softer activity in Asia**

The global recovery remains in place, with both global new orders and export orders retaining strength.

Lower payrolls drag down Treasury yields



10yr Treasury yields dropped to the lowest since last November as investors focused on the weaker parts of last week's labour market data: below-consensus payroll numbers and modest wage growth. Nonfarm payrolls increased by 138'000 in May while April's number was revised down to 174'000 from 211'000. A slowdown in job growth at this stage of the cycle is not unusual. At the same time, other labour market data still indicate a healthy employment environment. Initial jobless claims remain close to their 40-year low while the ISM Non-Manufacturing's employment component jumped to the highest in almost two years in May, indicating increased hiring in the service sector. The unemployment rate fell to 4.3%, the lowest since 2001, helped by a lower participation rate. The broader underemployment rate dropped to 8.4%, quickly approaching the last cycle's lows. Despite the ever tighter labour market, average hourly earnings growth remained at 2.5% YoY. The ISM Manufacturing survey ticked up to 54.9 from 54.8, supporting our view of a reacceleration in business activity, in particular given that the new orders component rose to 59.5 from 57.5. Consumer confidence fell slightly in May, driven by the expectations component, but remains close to its post-recession highs.

Credit: Banco Popular junior bonds exhibit what can go wrong in junior debt

Banco Popular subordinated bonds fell sharply last week, and have now lost almost 50% of their value in three months. This is a demonstration of the sharp price falls that should be expected in junior bonds during times of stress. While Banco Popular is somewhat unique in a number of ways, such price action could become more common as the cycle is now in its late stage, and the new loss absorbing ability of bank debt gets closer to being tested. In a more positive development, the European Commission has reached an initial

agreement with the Italian government around the precautionary recapitalisation of Monte Dei Paschi, while further details are awaited in the coming weeks. The broader credit market continues to hold in well, supported by strong supply/demand technicals. Notably, some new issues were nearly priced at secondary market levels, while the US high yield market recorded inflows.

Eurozone: Unemployment continues to fall as the recovery broadens

The Eurozone unemployment rate continues to fall at a steady pace, hitting its lowest levels in seven years in April at 9.3%. Comparatively, a year earlier it was 10.2% and at its recent peak in mid-2013 was 12.1%. What's more, improvements in labour market conditions now appear more broad-based with, for example, France and Italy also seeing better unemployment indicators recently, whereas previous falls in the Eurozone unemployment rate had been driven by Germany and Spain. However, there is little evidence so far that inflation is picking up as a result of better labour market conditions,

suggesting that there is still slack in the Eurozone economy. Other data released last week, such as the lending data, confirmed that the steady Eurozone recovery continues. Lending to households was unchanged at 2.4% YoY in April, while growth of loans to non-financial corporations edged up to 2.4% YoY from 2.3% in March, the fastest pace of growth since 2009, though still well below levels of lending growth seen at the peak of previous cycles. Finally, Q1 GDP growth was revised up for both Italy and France in the second estimate.

Switzerland: GDP rebounds on investment and exports

Swiss GDP grew by 0.3% QoQ in Q1, with investment and exports the key drivers of growth. There was a large drag from an inventories drawdown, and the underlying pace of expansion is likely to have been a touch stronger. The prior data were also revised up, leaving the annualised growth rate at around 1% over the past two quarters. This is still sluggish compared to business surveys, which were strong in Q1, but in line with our view that the economy is expanding at a modest, though below trend pace. The latest survey data show a notable

slowdown, however, with both the manufacturing PMI and the KOF down in May. While the details of the PMI report were encouraging, with a pickup in new orders and a stocks drawdown, the KOF survey was more worrying, as it showed a broad-based slowdown, particularly in services. We think some of the weakness will prove erratic, and anticipate the recovery to be maintained, underpinned by healthy demand from the Eurozone.

Japan: Economic data are promising, while the market is focused on the USDJPY rate

The latest set of economic data have been very encouraging. While consumption had given a bigger boost to growth in Q1, retail sales rose more than expected in April. Industrial production increased by a firm 4% MoM and 5.7% YoY. Even though companies project a setback for May, we believe that production should show a firm increase in Q2. The Manufacturing PMI inched even higher in May and, at 53.1, remains firmly in expansionary territory. Small business confidence is also improving. The MoF quarterly business survey indicates stronger

capex growth in Q1, while sales and profits have kept rising. Labour market conditions remain favourable, with the job-to-applicant ratio marking a 33-year high, with wage growth slowly creeping higher, confirming that weak data in March were just a blip. However, even though the Nikkei 225 index has moved above the psychologically important level of 20,000, the equity market remains highly susceptible to the USDJPY rate and thus the US 10yr yield. We are not applauding the fall of the USD below the 110 mark versus the JPY.

Asia: Softer, but still decent PMIs

Asian Manufacturing PMIs were mostly weaker, retreating from their recent peaks. However, most PMIs are still in expansionary territory above the critical 50 line. Only Malaysia and the Philippines dipped below 50, while Korea's Manufacturing PMI fell slightly, staying below 50 for the tenth month in a row. Korea's PMI needs particular attention due to its big manufacturing industries. We are not concerned, as manufacturing sentiment remains solid and exports are brisk. Taiwan's PMI slipped, but stayed in firmly expansionary territory, with

the new order and new export order components even rising. China's PMIs give a mixed picture. The official NBS Manufacturing PMI was unchanged, while the Caixin Manufacturing PMI, which focuses more on SMEs rather than SOEs, fell below the 50 line. This, however, does not indicate contraction, but rather weaker momentum. Both service related PMIs even moved higher again.

Australia's AiG Manufacturing Index fell nearly five points, but it tends to be volatile, and still stands at a firm 54.8.

What to Watch

- In the UK, the Tories' lead in the polls has narrowed in recent weeks, but Theresa May is still expected to secure a majority of seats in this Thursday's general election.
- The ECB meeting is likely to see a change of language as downside risks have diminished. The first round of French parliamentary elections on June 11 is expected to result in strong showing for the party of the new French president, Emmanuel Macron.
- In Asia, the focus will be on export data for May in China and Taiwan, the Eco Watchers Survey in Japan, the NAB business survey in Australia and inflation data in China. In India, the RBI is expected to keep policy rates unchanged.

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