

Weekly Macro & Markets View

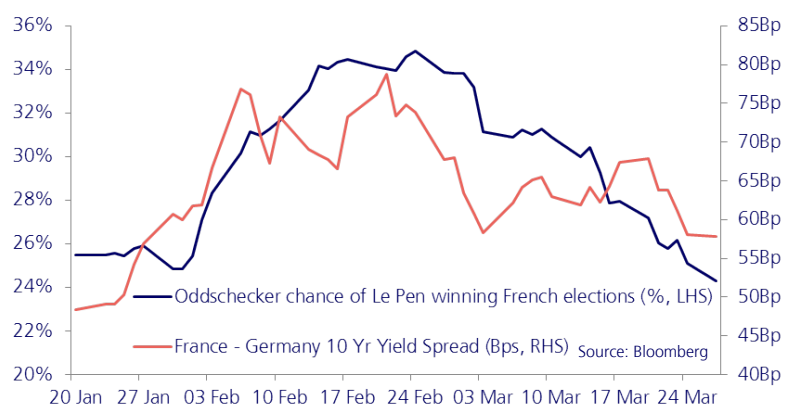
Highlights

- US equities declined by over 1% on Tuesday, marking the first such drop in 109 days
- There was heavy demand in the ECB's last TLTRO II operation, with 474 banks borrowing €233bn
- US House Republicans fail to gather enough support to repeal the Affordable Care Act

Our view

- Equity market softness is overdue and should not be extrapolated
- The ending of TLTRO II by the ECB removes a policy backstop that benefited European banks
- The failed vote is a setback for the Trump trade but markets will now focus on tax reform plans

French election still uncertain despite Macron's progress



With less than a month to go before the first round of the French presidential election on April 23, investors are likely to increasingly focus on the result. Centrist candidate Emmanuel Macron has recently taken a small lead with around 26% of the vote versus far-right anti EU candidate Marine Le Pen at 25%. Meanwhile, right-wing candidate Francois Fillon, the favourite just a few weeks ago, is languishing in third place with around 18%, dogged by various scandals and an ongoing criminal investigation. The two candidates with the most votes will go through a second round run-off on May 7. There has recently been a close relationship between the perceived odds of Marine Le Pen winning the French presidency (as implied by betting markets) and the France-Germany 10yr yield spread. However, polls also show that around 43% of voters have not yet decided on a candidate and 37% intend to abstain from voting in the first round. This suggests that the election remains fluid and still highly uncertain. In particular, the first round result could surprise versus current polling.

Political uncertainty is high in Italy too, with the anti-establishment 5-star movement doing well in the polls recently. Elections are likely to be held by early 2018 at the latest. Fortunately, the political uncertainty does not appear to have impacted business confidence so far. French and Eurozone flash composite PMIs showed further increases to fresh six-year highs in March. Finally, the Eurogroup meeting last week regarding Greece's bailout was inconclusive. Greece needs to make large debt repayments in July and the issue merits careful monitoring.

US: Failed House vote casts doubt on Trump's ability to deliver on election promises

The S&P 500 ended its worst week since Trump's election victory on a negative note as Republicans in the House of Representatives failed to gather enough votes to pass a bill intended to repeal Obamacare. The failure to repeal the Affordable Care Act raises doubts about President Trump's ability to follow up on other campaign promises and is a setback for the Trump reflation trade that lifted markets in the past few months. Accordingly, Treasury yields, the US dollar and small cap stocks took a hit. Markets will now focus on tax reform where the outlook

for lower taxes has helped push US stock markets to new highs and which could have a significant impact on economic growth and corporate profitability. While some common ground for business-friendly policies should be found in the end, the political process is not a one-way street and setbacks are likely. On the economic front, both the Markit Manufacturing and the Service PMI fell in March to 53.4 and 52.9 respectively, indicating a loss of economic momentum towards the end of the quarter.

Japan: It's 'shunto' time again

The first round of 'shunto', or the 'spring wage offensive', indicates a base salary hike of only 0.43%. Adding bonuses and seniority based components brings the average monthly pay rise to 2.06%, roughly in line with last year's outcome. This is the fourth year of wage rises in a row. However, this encompasses only the negotiation outcome between the Keidanren, the representative body of large companies, and the Rengo, the Japanese workers trade union, representing less than one fourth of all workers. Fortunately, wages are rising the fastest

among small- and medium-sized companies, which represent the majority of corporate employment. Furthermore, full-time employment is now rising at a faster pace than temporary staff employment, clearly indicating a labour shortage. Full-time employees enjoy higher wages, as well as welfare and retirement benefits, increasing total employment income more than is visible by purely looking at the average 'shunto' outcome. We believe this should help to spur higher consumption, which is still lacklustre.

UK: Inflation soars with Theresa May about to trigger Art. 50

With the triggering of Art. 50 and the beginning of exit negotiations now imminent, even more focus will be put on economic data in the watch for traces of Brexit uncertainty. These traces are clearly visible in the inflation data published last week. CPI inflation rose 0.7% in February, lifting the annual rate to 2.3% from 1.8% last month. The retail price index accelerated even more, rising 1.1% in February, which brings the annual rate to 3.2%. While households will increasingly feel the drag on their purchasing power, there is more to come. Although the annual producer price inflation rate has

slightly receded to 19.1% from 20.1% last month, price increases will continue to feed through the value chain. After falling for two months in a row, the pickup in retail sales in February is a welcome relief. However, over the last three months consumer spending has been weakening with retail sales falling by a combined 1.2%. Households will remain under pressure as real wages continue to fall.

Latin America: Bumps in the road for Andean growth

After posting its lowest annual growth since 2009 at 1.6%, Chile might disappoint again despite the recent rate cuts. The recent strike at the Escondido copper mine, the longest-ever private sector mining strike in Chile, might dent recovery expectations. The mine represents 20% of the country's copper production and 7% of global copper output. The strike has cost around \$850M in export value for the country.

a toll on growth. For the first time in a while, the central bank in Argentina is turning hawkish due to wage negotiations.

The Colombian monetary authority eased again by 25bps to 7% with a focus on Q1 economic activity that seems rather weak and could imply downside risks for the annual growth target.

In Peru, heavy rains brought chaos due to a localized coastal el Nino and will probably take

Asian Trade: Momentum intact in 2017

Asian trade continues to recover, as visible in data from Korea, Thailand, India, and Japan, while industrial production in Taiwan and Singapore remains strong. Semiconductors and electronic components, as well as petroleum products are leading. China and Asia contribute the most to the growth in demand. The pickup in Western imports of Asian machinery is also encouraging. The trade rebound has boosted fiscal windfalls, which is especially helpful in countries struggling with tight budget targets, such as Indonesia, Malaysia, and Australia. Export

strength should partly spill over to domestic demand via fiscal spending, for example in Taiwan, where an infrastructure investment plan equivalent to ~5% of GDP has been approved. In Malaysia, we see job creation in the manufacturing sector edging up. We will watch March trade and manufacturing data carefully to see if momentum persists after the impact of Chinese New Year statistical distortions and commodity price base effects fade. If that is the case, the scenario of a cyclical recovery, led by capex and domestic demand, should become more credible.

What to Watch

- Nine months after the Brexit referendum, British Prime Minister Theresa May is expected to activate article 50, initiating the process to leave the European Union.
- In Japan, retail sales, labour market and inflation data will be published for February/March. In China, PMIs for March are expected to remain brisk, while we will also keep an eye on Korea's business survey and retail sales statistics in Hong Kong.
- The flash estimate of Eurozone CPI inflation is expected to show a small drop in headline inflation as base effects from energy prices diminish.

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