

Weekly Macro & Markets View

Highlights and View

- **Populist parties do better than expected in Italian elections**

The result does not represent an existential threat to the euro, but does mean that prospects for further reform of the Italian economy are limited.

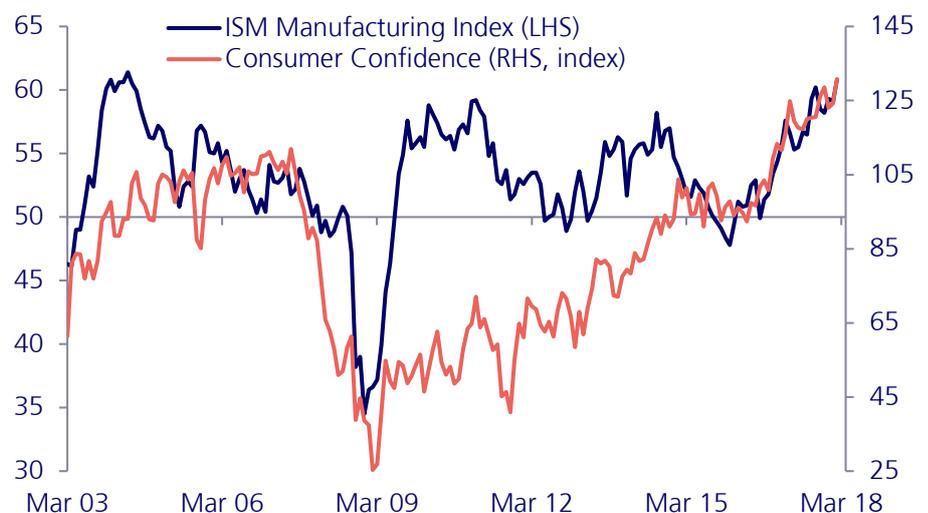
- **Sentiment data in the US signal continued strong economic momentum**

Investors overreact to Powell's testimony and Trump's tariff announcement, ignoring solid economic data that confirm continued support for the equity market.

- **The Asian Manufacturing PMI average softened in February, led by a fall in China's official PMI**

Asia PMI weakness likely indicates that the manufacturing cycle is taking a breather, not rolling over.

US firms and consumers are the most optimistic in over a decade



Source: Bloomberg

With a monthly performance of -3.7%, the worst since January 2016, February ended the 15-month long series of uninterrupted positive total return months. Despite a number of very solid economic data points, the S&P 500 entered March on a weak note as investors were spooked by President Trump's announcement of tariffs on steel and aluminium. While the tariffs' direct economic impact is expected to be minimal, the announcement increases the risk of retaliation from US trading partners. Economic data were mostly on the positive side, with the ISM Manufacturing index rising to 60.8 in February, a 14-year high, with new orders and employment indicating the continued strength of the US economy. Consumer confidence climbed to the highest level since 2000 while initial jobless claims fell to 210'000, the lowest level since 1969. Inflation data was in line with expectations, with the PCE Core accelerating to 0.3% MoM in January from 0.2%. This leaves the annual rate at 1.5%, the same as in December. Fed Chair Jerome Powell acknowledged the solid state of the US economy in his testimony to Congress but also noted that he does not consider the economy to be overheating, indicating that the positive outlook will not necessarily lead to an upward revision of the Fed's projected rate path at the next FOMC meeting.

Italy: Election shows strong support for populist parties

Both the Five Star Movement and the Northern League did better in the Italian elections over the weekend than polls had predicted. However, the Five Star Movement is still well short of an absolute majority. To form a majority government they would have to form a coalition with at least one of the other parties such as the Northern League, PD or Forza Italia, but none of these are obvious bed fellows. Alternatively, the centre-right coalition could try to govern as a minority government or form a broader coalition with the PD. Overall, we are likely to see months of

political wrangling before a new Italian government emerges. Whatever government does eventually emerge is also likely to be unstable and have limited room to enact new policies. While we think the chances of an existential threat to the euro from whatever government eventually emerges are very low, the prospects for further reform of the Italian economy have also diminished as a result of this election.

Eurozone: Lending and unemployment data show growth at a still robust pace

After recent falls in Eurozone business confidence, last week's data were reassuring, confirming that the region continues to grow at a robust pace. The latest bank lending data, for example, showed that lending to non-financial corporations grew 3.4% YoY in January up from 3.1% YoY in December, while lending to households stood unchanged at 2.9% YoY. Eurozone unemployment also continued to fall at a steady pace, to 8.6% in January, well below its recent peak of 12.1% in mid-2013. The final estimate of the Eurozone January Manufacturing PMI survey,

while confirming the declines in business confidence in France and Germany, was revised up slightly, and also showed confidence in other countries falling less. Companies' investment intentions across the region are also holding up well. Overall, the robust economic growth in the Eurozone looks set to continue, which should support corporate profit growth this year as well.

Switzerland: The economy accelerated sharply in 2017, but let's not get carried away

The Q4 GDP release shows sluggish growth of only 1% in 2017, which was in line with our view. However, a solid 0.6% QoQ expansion in Q4 and upwardly revised growth of 0.7% in Q3 imply that there was a sharp acceleration in H2 when the Swiss economy was boosted by strong global demand and a broadening out of the domestic recovery. Household consumption remains weak though, expanding by only 0.2% QoQ in Q4, as secular headwinds persist. Construction was strong, confirming that the housing market slowdown is bottoming out, but there

is limited scope for strong growth in this sector to last. We therefore leave our 1.8% GDP forecast for 2018 unchanged. This is below the consensus view but still implies a solid expansion. The PMI ticked up in February, boosted by rising inventories and prices, while most other components edged down. The KOF leading indicator also rose after a sharp decline in January, with construction a key driver, so momentum remains solid for the time being.

Japan: Ugly economic data – but it is too early to panic

Various economic data for January were weak and clearly below consensus expectations, including those for industrial production, retail sales and housing starts. Companies had been forecasting a pullback in production, but the 6.6% MoM fall was steep. Enterprises are now expecting a strong 9% MoM rebound in February, followed by another, smaller setback in March. In all cases there were special factors behind the bad numbers. In retail sales and housing starts the negative impact mainly came from severe winter weather conditions. Less tourists from China and Korea before

Lunar New Year had a negative impact on department store sales, but that looks like it will have reversed again in February. The MoF Corporate Survey revealed solid capex and sales data in Q4, but recurring profit growth rose only marginally. Again, this was not caused by operating earnings, but from less dividend income from overseas subsidiaries than a year ago. Putting it all together, even if Japan were to struggle to show a sequential ninth quarter of growth in Q1 based on the January setback, there is no reason to get too bearish.

China: All eyes on the NPC

The National People's Congress (NPC) opened in China today. Premier Li presented the 'Government Work Report'. As widely expected, the GDP growth target for this year was confirmed at ~6.5%. Unlike last year, the phrase 'or higher if possible' did not augment the numeric target, which suggests that the party's focus has indeed shifted from growth to quality. The fiscal deficit target has been reduced from 3% to 2.6%, and while the target tends to be missed, it is an indication that spending cuts are in the offing, as tax cuts will also be implemented. Next weekend,

the NPC is expected to wave through a decision made earlier this year, but only revealed recently. The Communist Party has decided to amend the constitution to allow its president and vice-president to serve for more than two consecutive terms, which should strengthen President Xi's position even further. On the economic front, weaker NBS PMIs for February showed a different direction than the Caixin PMIs, suggesting that large companies related to heavy industries are doing worse than more export dependent smaller companies.

What to Watch

- The MPCs of the ECB, BoJ, RBA and BNM will convene this week. We do not expect any major changes in monetary policy in the Eurozone, Japan, Australia or Malaysia.
- The ISM Non-Manufacturing index is expected to remain high, while labour market data will reveal whether wage growth has stabilised after last month's acceleration.
- The focus in Asia will be on export data for China, Taiwan and Malaysia, as well as CPI data for China, Taiwan, Korea and the Philippines. In Japan, the Eco Watchers Survey for February and the Household Survey and wage data for January will be published.

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