Global

A midsummer month's dream

- **The economic calendar is fairly light in August since Q2 growth figures have already been released for the United States, the UK and the eurozone. All that is left is Japan. This month the main statistics will be employment figures for the US and the UK.**
- **The only major central bank that will meet in August is the Bank of England, which is expected to unveil the details of the monetary easing move announced at the July meeting.**
- **The political agenda will be much busier with the US presidential campaign, suspense over the formation of the next Spanish government, and the design of UK objectives before negotiations start the European Union.**
- **At a time of shallow liquidity, it is wise to remain vigilant to any news, especially the unexpected ones…**

This is the last issue of EcoWeek before September and the end of the summer holidays, which seems like a good opportunity to review the events worth watching during the month of August. In terms of statistics, August is a fairly quiet month: the preliminary estimates of Q2 GDP growth have already been released for the eurozone, the UK and the United States. Of the major developed countries, this leaves Japan, which will not report on its Q2 economic performance until August 15th. We expect GDP to contract mildly, after 0.4% growth in the first 3 months of the year. One factor that must be taken into account is the impact of the earthquake in the Kumamoto region.

Detailed national accounts for the eurozone and the UK will be released later in the month (on August 12th and 26th, respectively). So far, we know that the European Monetary Union (EMU) reported Q2 growth of 0.3%, but aside from France, we do not know the breakdown of the components of demand. In the UK, where growth was more upbeat than expected between April and June (+0.6%), we know that services and the industrial sector were the main driving forces (quarterly growth of 0.5% and 2.1%, respectively), while construction made a negative contribution to growth (-0.4%).

The figures for the UK cover the pre-referendum period, before the British voted to leave the European Union. Prior to the June 23rd referendum, data pointed to a slowdown in activity, and the UK probably entered the third quarter at a milder pace than in Q2. The first survey data for July signals a sharp slowdown. The Markit Flash PMI declined 4.7 points in a month to 47.7, the lowest level since the 2008-09 recession. It was pulled down by services (47.4 vs. 52.3 in June) as well as the manufacturing sector (49.1 vs. 52.1). On August 17th, the first post-referendum data will be released with the jobless claimant count. Although Brexit is certainly bound to strain employment eventually – faced with all the uncertainty over relations with the EU, companies are tending to freeze hiring (and investment projects) – there is no reason to expect redundancies to increase so soon after the vote.

Quarterly GDP growth (%)

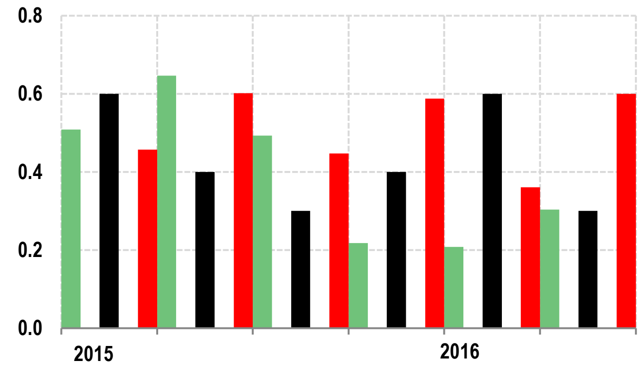

Chart 1 Sources: BEA, Eurostat, ONS

Employment will also be the focus of attention in the United States with the August 5th publication of the July jobs report. This will mainly be of interest to identify the underlying trend after May's disastrous jobs report was followed by an impressive rebound. Based on weekly initial claims, the US job market seems to be fairly similar to what it has been since early 2015: redundancies continue to trend downwards. The big suspense is over the size of gross job creations, which are linked to future prospects more than to current economic conditions. In this respect, the strong rebound recently in ISM surveys is good news, and the US jobs report for July could be surprisingly strong.

As for central banks, the Bank of England will be in the spotlight. At the July meeting of the Monetary Policy Committee (MPC), members preferred to maintain the monetary status quo, noting that even though they lacked official economic statistics covering the post-referendum period, economic agents seemed to be losing confidence, companies were likely to postpone hiring and investment projects, and prospects for construction activity were deteriorating. The conclusion was obvious: the UK economy was set to sharply slow in the short term. The need for monetary support would have also seemed to be the obvious solution. Yet before adjusting policy, the Bank of England preferred to take the time to assess more precisely the consequences of the vote to leave on growth (downside risk) and inflation (upside risk), as well as its effect on the external value of Sterling. On August 4th, the Bank of England will publish its inflation report, updating the BoE's economic projections. There can be no doubt about the Bank of England's policy bias, with its promise to ease monetary policy in August as expressed in its July press release ("*most members of the Committee expect monetary policy to be loosened in August*"). What remains to be seen is the nature of the instruments used, in what combinations, and lastly, the scope of the easing trend.

The political agenda will be much busier than the economic calendar. This week, the Democrats officially nominated Hillary Rodham Clinton as their candidate for the November 8th presidential elections. A few days earlier, the Republicans chose Donald Trump as their candidate. The presidential campaign is now officially underway, although the first debate will not be held until late September. The candidates will then have the opportunity to spell out or express their programmes, and we will be able to analyse them.

In Spain, negotiations are still underway to form a new government. The People's Party was the big winner of the June 26th elections, as it picked up 14 more parliamentary seats compared to the December 2015 election. Even so, it failed to obtain an absolute majority, which would have enabled it to rapidly form a new government. Discussions have resumed between the various parties as they seek to form a coalition and reach an agreement. Before the latest elections, all parties were determined to pull the country out of a political impasse, but the outcome has been slow in the making. Felipe VI has no official deadline by which to designate a political leader, and Mariano Rajoy remains the head of the care-taker government while negotiations are pending. Although technically this situation could persist, it is also the recipe for doing nothing. This factor may have influenced the European Commission's decision to recommend abandoning sanctions against Spain as part of excessive deficit procedures, a move that also benefited Portugal.

The other big political issue this summer is Brexit, the UK's decision to leave the European Union. The Conservative party pulled itself together very rapidly, and David Cameron ended up handing over power nearly two months ahead of the initial timetable. Theresa May quickly named a new government and assigned David Davis the role of conducting negotiations with the EU. A few weeks later, the European Commission appointed a Frenchman to oversee its negotiations: Michel Barnier, former European Commissioner for the interior market and services under the presidency of José Manuel Barroso. We should now learn more about the UK government's objectives. This means following the trips of Theresa May, both at home and with neighbouring countries, as well as the statements made by various leaders. For the moment, between wanting to reassure Ireland and Scotland, and make changes to its immigration policy (greater flexibility, notably by abandoning the previous government's quota system), the UK clearly seems keen on preserving maximum access to the Single market, even though the cost – in terms of its contribution to the European budget and the free movement of people – will not be politically neutral.

The failed coup in Turkey is a good reminder that we cannot anticipate everything. In August 2015, the surprise announcement of the yuan's devaluation had sparked panic, with a decline in most emerging market currencies, higher risk premiums and another drop in commodity prices. As a result, the Fed decided to postpone its first key rate increase. The question the FOMC members were unable to answer with any certainty was the chain of events: was the panic in the financial markets due to adjustments, which once again were all the more abrupt because of August's shallow liquidity? Or was it the symptom of some yet-to-be-identified illness? In December, the FOMC definitively leaned towards the first response, and launched the normalisation of its monetary policy. Did they immediately regret their decision? Possibly, given the resurgence of market turmoil. Although the Fed initially planned to raise key rates four times in 2016, it has since maintained the monetary status quo. Now that a certain calm has returned to the financial markets, and in the absence of any panic following the UK referendum, the Fed is likely to be reassured, and even more so by any good news on the US economic front. Yet a key rate increase in September is only one of several options…

Effective exchange rate (Jan 2014 = 100)

USD; EUR; -- GBP

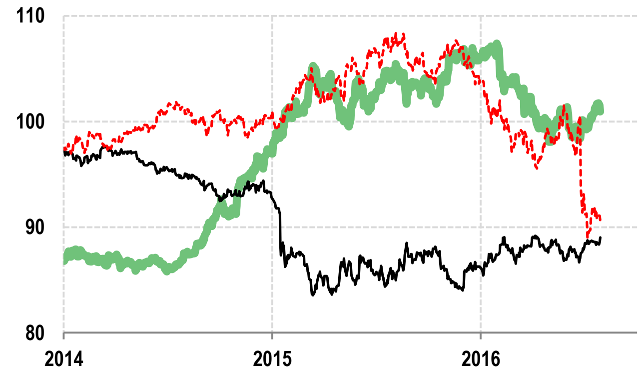

Chart 2 Source: Bank of England

Yield curve (July 27th, 2016, %)

United States; France; -- UK

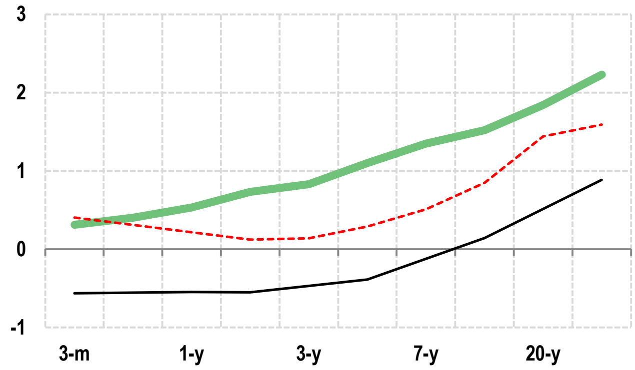

Chart 3 Sources: BoE, Banque de France, ECB, Fed