MINERVA

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TWO-WEEK ECONOMIC MONITOR

Macro Research Division

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ECONOMIC GROWTH

The US economy grew 2.3% in real terms and 4.3% in current dollars in Q1 according to the advance estimate of the Bureau of Economic Analysis[1]. Growth stemmed from increases in non-residential fixed investment, personal consumption, exports, government spending and private inventory investment. If the estimate is correct, this was the slowest growth since Q1 2017 and is mainly due to deceleration in personal consumption, residential fixed investment, exports and government spending. Although an increase in imports is also to blame for the growth in Q1, it was also at a decelerated pace. It may be worth noting that there was an increase in private savings rate from 2.6% to 3.1% of disposable income since the last quarter which led to added savings of $462.1 billion in Q1. Further growth in 2018 may be boosted by increases in disposable income, due to lower taxes. The data are subject to further revision with preliminary adjustments expected late May.

In April it was recorded a development of Eurozone private sector: Flash Eurozone PMI Composite Output Index, that consider manufacturing and service sector production, remain stable at 55.2, against an expected 54.9. Flash Eurozone Manufacturing PMI decrease to 55.0, while Flash Eurozone Services PMI Activity Index increase to 56.0. A lecture over-50 of this index shows an expansion of the area, while an under-50 value reveals a contraction[4]. The best improvement has been marked in Germany and France, Markit chief economic Chris Williamson has comment April data as a good lecture, still encouraging, and that PMI index shows a GDP 2Q growth of 0.6%, in line with Reuters forecast. France economic growth has slowed down more than expected in the 2018 1Q, due to less investment and export regard to the first Insee evaluation. The second EU economy is increased of 0.3%, against a forecast 0.4%, in the first three months of 2018, the slowest growth rate from the 2016 3Q. UK economy has slowed down too, with a GDP 2018 1Q growth of 0.1%, the lowest in 5 years, against an expected 0.3%. Eurozone economy has grown at 2.5% annual rate in the 2018 1Q, in line with the expected values but recording a slowing down respect to the last trimester of 2018, when it grew at 2.7% annual rate. The economy is increased of 0.4% in 2018 first quarter. The BCE President, Mario Draghi, has declared that nevertheless the recovery has reduced speed since the begin of the year, there won't be change in the European monetary policy.

According to the preliminary data published from Istat, in the first quarter of 2018 the Italian GDP grew of 0.3%, replying the expansion observed in the previous trimester, in line with the analyst forecasts. In annual view the growth should go between 1.4% and 1.6% in the 2018 2Q. Nevertheless, the Istat noticed a slowing down respect to the first part of 2017, when the mean of GDP growth was 0.4%. However, downside risks are still present, principally linked with the evolution of the trade situation between USA and EU. These last data confirmed a 15 trimesters consecutive GDP growth, which has recovered the 4.4% since the 2014 3Q, when the uninterrupted growth is started, but from the pick of the 2008 1Q, the Italian economy has still lost the 5.5%[6].

UE Commission writes, in the Spring European esteems, that after the 2017 growth acceleration the Italian economy will continue to grow at that rhythm this year, strongly supported from the intern demand, but given that the output gap is closing the GDP growth will decrease at 1.2% in the 2019.

On Thursday 3th May, ASEAN Macroeconomic Research Office (AMRO) reported that East Asian economies (China, South Korea, Japan and the 10 countries in the Association of South East Asian Nations) will grow faster (5.4%) than previous expectations (5.1%) due to a strong domestic demand, solid exports and stable inflation. Consequently, AMRO warned about a future rapid tightening in the monetary policy on global financial conditions, capital flows and borrowing costs. While Asian Development Bank's outlook showed that next year (2019) the regional growth is expected to slow to 5.2%, United States-China trade war could worsen the situation. It will not only be a lose-lose status for both countries, but it will probably damage the rest of Asian economies because of the reciprocal production networks with China.

TRADE

The US trade deficit has decreased to $49 billion in March, from record high $57.7 billion the previous month. Exports increased 2% month-to-month reaching $208.5 billion, boosted by sale of civilian aircraft, soybean and corn as well as oil and its derivatives. Imports have decreased by 1.8% in March to $257.5 billion. The US is currently conducting trade talks with China. US team led by Treasury Secretary, Steve Mnuchin is pushing for China to decrease the trade deficit by $100 billion a year or by $200 billion by 2020. Although prospects of a trade agreement seem unlikely, the results of negotiations remain to be seen.

There has not been any significant progress on trade between the US and the EU. This week Angela Merkel, Emmanuel Macron and Theresa May have agreed, again, that the EU will retaliate if the US impose tariffs of European products. Trump has also said that "the EU was formed to take advantage of the US", signalling that the threat of a trade war is still very much alive. The EU's exemption from the US steel and aluminium tariffs was supposed to expire on the 1st May, but the decision was postponed to the 1st June. At the same time, the EU have reached agreements for free trade deals with Mexico and Singapore.

During the last two weeks there have been many talks on trade between U.S. and China delegations that culminated with "an agreement to keep on discussing". United States focused on the need to reduce their deficit in goods that reached 375$ billion in 2017. The United States pretend China to start reducing their support for high-tech industries and cut trade deficit by more than 200$ billion between 2018 and 2020. On the other side, China represented by Vice Premier Liu He asked the U.S. to stop investigation into Chinese intellectual property abuses and to drop 25% extra tariffs on Chinese goods. China also put U.S. on guard that American companies may be excluded from its domestic market if Trump does not agree to treat China equally to other countries. Asian neighboring countries are little concerned about those disputes that could have large damage on the global economic efficiency and remain positive that diplomacy and reciprocal agreements will find a proper solution.

UNEMPLOYMENT AND INFLATION

The latest report compiled by the Labour Department shows unemployment at 3.9%, a level not seen since December 2000. The US economy added 164,000 jobs in April, lower than 195,000 forecasted. Most jobs were added in mining related industries and motion picture, while credit intermediation, scenic and sightseeing transportation, communications equipment, manufacturing and textile production suffered major cuts. Moreover, jobless claims came in at 211,000 lower than the expected 220,000 to 230,000 range. Despite obviously unsustainable levels of unemployment in the medium or longer run, there has been no significant increase in inflation. Wages rose 2.6% year to year, or 0.1% on a monthly basis, both lower than expected. The price index for gross domestic purchases rose 2.8% in Q1, compared to an increase of 2.5% in Q4. One of the possible reasons for the apparent disappearance of the Phillips curve might be that despite technological change, there have been no major advances in productivity, which would have enabled companies to increase profits more efficiently, while paying workers more.

It is likely that unemployment will float around 4% as demand for labour stays strong in sectors that depend on consumption in the foreseeable future.

FED decided to leave rates unchanged in the 1.5-1.75 range on May 2nd as expected. The financial community is now divided about the appropriate course of action, given slower growth in Q1 and poor wage growth. However, the perception of most is that the next rate hike will take place in June with more gradual adjustments before yearend for a total of either three or four.

Germany unemployment rate remain unchanged in April at 5.3% in line with the expected rate, according to the Statistisches Bundesamt's report[5].

In March, Italian unemployment rate, as published from Istat, was stable at 11% against a forecast 10.9%. Better news for the young unemployment rate (15-24 years) that touch its minimum level since December 2012, at 31.7%. Employment rate was increased in March regard to February one, moving from 58.1% to 58.3%. These last data confirm the employment recovery in the current year, after the drastic stop tackle in 2017. During the latest policy meeting, the ECB has confirmed that the underlying determinants of inflation have remained subdued. According to projections, Eurozone inflation will not be higher than 1.7% in 2020. On Friday 27th April, the ECB's Survey of Professional Forecasters, an important indicator for monetary policy, showed that inflation is expected to be 1.6% in 2019 and 1.7% in 2020, both 0.1% down compared to January. Only in 2022, inflation might be 1.9%.

Inflation data for April showed a decrease to 1.2% from 1.3% in March, reinforcing fears of a cooling economy. There are also speculations that the ECB might not stop its bond purchasing programme in September, which prompted an increase in European stock prices.

Last Thursday 3rd May data for 2018 Q1 showed more jobless people seek financial assistance in South Korea. The National Pension Service registered 129,000 unemployed people (up 12% more than the previous year) applying for the "unemployment credits" between January and March 2018. The unemployment rate in the fourth-largest Asian economy stood at 4.5% in March, only lower than the 5.1% registered in 2001 on the same month. South Korean applicants are estimated to receive 1.38$ billion in unemployment benefits in the next three months. In 2017, the Philippines

was one of Asia's fastest-growing economies with a strong domestic demand and steadily high government spending. In the Philippines consumer prices increased in April at the fastest pace in five-year time. The central bank projected CPI in April to be within 3.9 % to 4.7 % and rising inflation could soon result in a monetary policy tightening.

CREDIT RISK

On May 4th new data about employment were published, showing a growth rate in jobs and salaries smaller than the expectations. This news strengthens analysts' views on a gradual increase in the level of the interest rate by the Fed. Therefore, US Treasury Bonds yield remained almost unchanged at the same levels of past weeks. The Federal Reserve indeed left the rate unchanged since it expects that in the medium-term inflation rate will be very close to the 2% target.
It is however interesting to notice a report recently published by Morgan Stanley about the US bond market. Analysts say that the 10-year bond yield is "unlikely to climb back to its recent highs", because a weaker global growth will sustain the demand for bonds.
On Friday 27th April, both Standard & Poor's and Fitch have said that Brexit remains a threat to the United Kingdom's credit worthiness, confirming their negative outlook (and AA ratings). The United Kingdom risks serious economic damages in case of a disorderly Brexit where British firms lose access to frictionless trade with the rest of the EU.
Asian fixed-income segment showed resilience during the recent increase of volatility in the financial markets. While local currency bonds were flat, the performance of U.S. bonds was slightly negative and so marginally weaker. Asian bonds are now much more attractive than others from developed economies due to higher real yields for the same credit profiles. At the same time, in a context of rising interest rates, the maturity of existing issues may be lower in Asia (three years or less). In the last weeks it was registered a rising divergence between investment grade and high-yield Asian dollar bonds. Since better credit protection and high premiums are requested, we expect that issuances for Asian US dollar bonds to remain abundant in the entire year, especially for Chinese corporate bonds. Even if People's Bank of China is expected to raise interest rates in 2018 to maintain the policy rate differential with United States, we do not think yields will suffer changes.

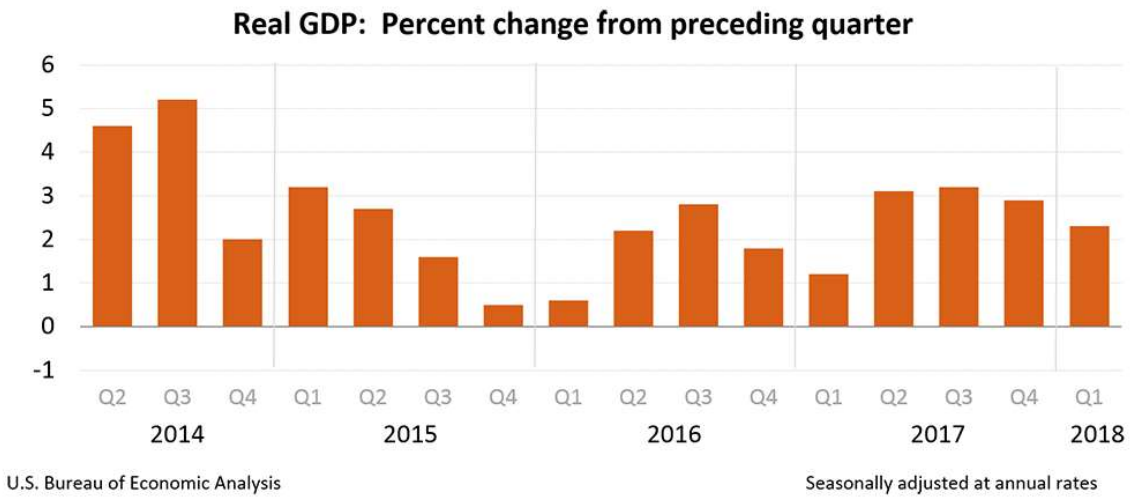
CURRENCY

Many analysts are pointing out that the Dollar has in the last few days hit the highest levels against the Euro (EUR/USD exchange rate is currently around 1.2) and, according to some, the exchange rate still has room for appreciation. This is due mainly because of the lower than expected growth rate for countries in the European Union, with investors who are therefore looking for opportunities overseas. Many banks and asset managers (among which Amundi and Bank of America – Merrill Lynch) are suggesting buying Dollars and short Euros.

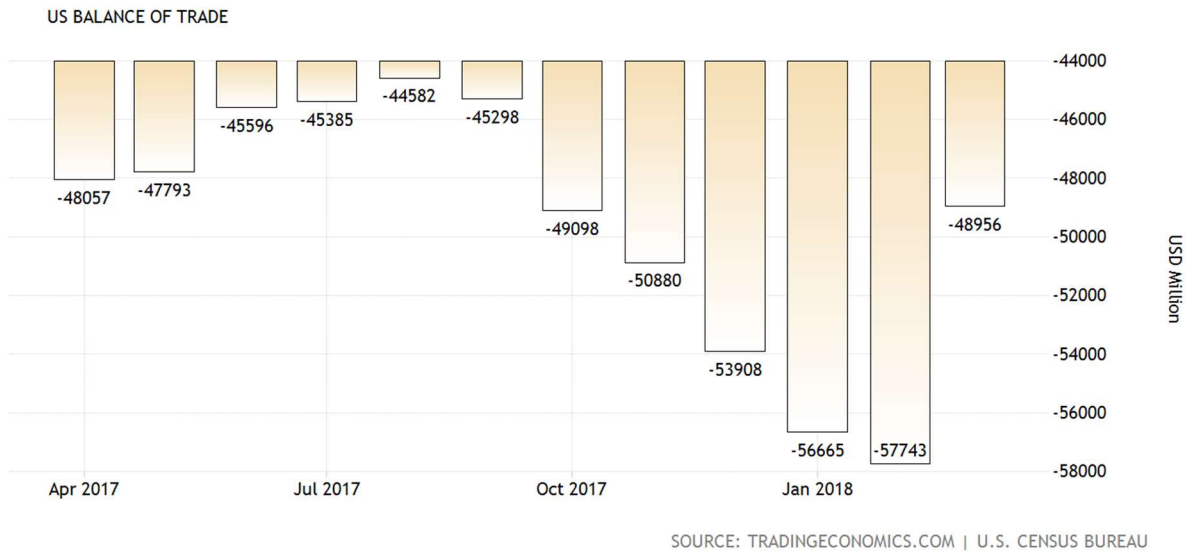
During these weeks, the Euro has performed poorly as the ECB maintained a dovish tone in the policy meeting (and might even keep quantitative easing alive) and fears about a US-EU trade war have not eased. EUR/USD support level of 1.20 was also broken last week, reaching the lowest rate since January. However, starting from Friday 27th April, the Euro recovered against the Pound, as a consequence of disappointing data about the UK's growth (0.1% quarter-on-quarter, 0.3% expected). Considering that the Bank of England expected a GDP growth of 0.4%, our doubts about an interested rate rise in May are reinforced[3]. Given the latest economic data and sentiment, we expect the US dollar to keep strengthening against both the Euro and the Pound.

To face more properly falling currencies and uncertain economic growth, Asian Central Banks are intervening in the currency markets. In some countries the real challenge is to stabilise currencies not raising interest rates to inject cash in the economy. Local monetary policies are hostage to market conditions and the trade-off that should be solved deals with the balance between solid growth and currency stability. Indonesian rupiah fell 5% in three months and its Central Bank has sold dollars and is buying bonds to protect the national currency in absence of inflationary pressures. At the same time, India is liberalizing rules concerning foreign investments to attract capitals and South Korea will release funds into the market by stimulating positively the bond issuance in next six months.

APPENDIX:



1 *Source: Bureau of Economic Analysis*



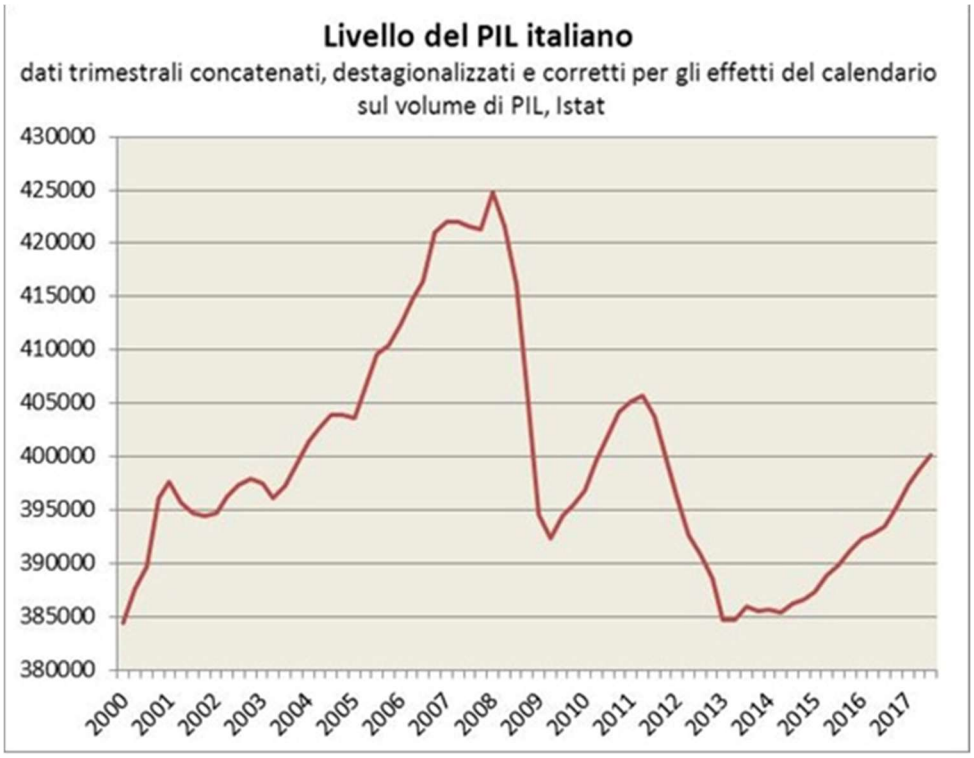
2 *Source: tradingeconomics.com*

3 *Source:Yahoo Finance*

4

GERMANY UNEMPLOYMENT RATE

5 *Source: Investing.com*



6 *Source: http://www.programmazioneeconomica.gov.it/*

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