Monthly Letter

June 2017

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Economic environment

The downtrend of commodity prices since January is having an impact on consumer prices. In fact, after peaking at the beginning of the year, inflation is falling almost everywhere. Meanwhile, global economic activity remains moderate and the uncertainty regarding the scenario of an accelerating world economic activity is growing, with the notable exception of the Eurozone.

Indeed, the latest statistics show that GDP in the Eurozone grew by 0.6% q/q in Q1 2017, driven by household consumption and business investment. The unemployment rate continued to decline and reached 9.3% in April, the lowest since 2009. However, despite this improvement, part of the new jobs created are so-called low-quality jobs and part-time employment, which puts downward pressure on wage growth. Yet, the ECB is cautious about wage inflation. It is nervous about underemployment and potential structural changes within the labor market resulting in a slower recovery in wages. In fact, normalization of core inflation is highly unlikely without a rise in wage inflation. If the ECB recently upgraded its economic forecasts with risks to the growth outlook now seen as broadly balanced, core inflation forecasts for 2018 and 2019 were revised lower by 0.1pp to 1.4% and 1.7%. Overall, the ECB is expected to remain accommodative for quite a while.

The upward risk regarding economic growth in the Eurozone contrasts with a possible disappointment in the US. While GDP is likely to rebound in Q2 2017 after the poor performance of the Q1, the latest indicators show a mixed picture. While the unemployment rate continues to decline, job creation is at its lowest level since 2012 and the ISM manufacturing index has lost some momentum after peaking at the end of 2016 / beginning of 2017. Core PCE inflation rate reached 1.5% in April, a low since 2015. In addition, inflation expectations of households and investors have been declining for several months now. These factors suggest that Fed members may have to lower their projections for rate increases. This uncertain environment might explain the decline in interest rates as well as the reduction in the spread between the 10-year US and the 10-year German bonds, thus favoring the euro against the dollar.

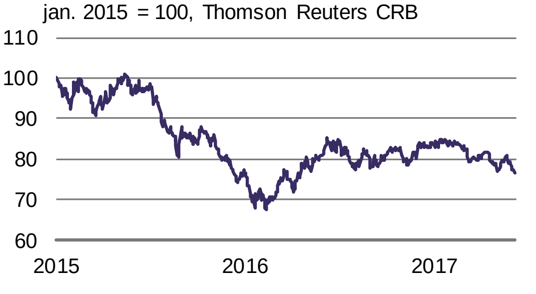
In the UK, the election has delivered a hung parliament with 319 Conservative – 326 is needed for a majority – and 261 Labor. Theresa May's snap election gamble has backfired and while at this stage it looks likely that a Conservative led administration will take shape, with Democratic Unionist Party (DUP, 10 seats) support, the thin majority suggests it is unlikely this parliament will serve its five year term. What's more, there's now speculation about whether Mrs May will hang onto the Conservative leadership. The uncertainty could last several weeks, which could put a strain on Brexit's

Performances in local currency

	Price as of 05/31/17	1 month % change	2017 % change
Equity markets			
CAC 40	5 284	0.3%	8.7%
Eurostoxx 50	3 219	1.1%	6.9%
S&P 500	2 412	1.2%	7.7%
Nikkei 225	19 651	2.4%	2.8%
Currencies			
1 € = ...USD	1.12	3.3%	6.6%
1 € = ...JPY	124.40	2.2%	0.8%

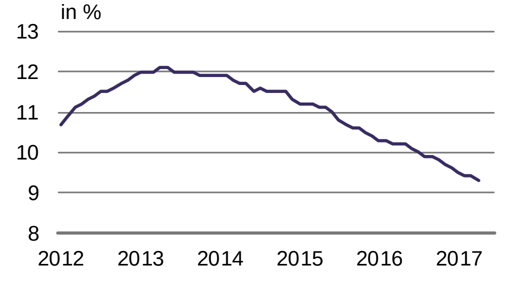
		Price as of 05/31/17	1 month bp	2017 bp
Government bonds				
3 M	Euro zone	-0.60%	-4	31
3 M	United States	0.97%	18	47
10 Y	Euro zone	0.30%	-1	10
10 Y	United States	2.20%	-8	-24

World – Commodity index



Sources Bloomberg, Rothschild Asset Management

Eurozone – Unemployment rate

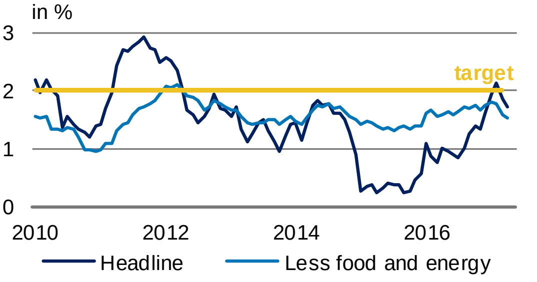


Sources Datastream, Rothschild Asset Management timetable as talks with the EU were set to start on 19 June. In the wake of these election results, the pound depreciated by about -2% against the dollar and the euro, further weakening the purchasing power of households and consequently economic growth.

The latest signals from emerging countries are mixed. The lower inflation rate in Russia favors the recovery of domestic demand. In Brazil, GDP rebounded in Q1 2017 – after 8 consecutive declines – must be interpreted with caution because it is in part explained by a very favorable harvest. The Brazilian unemployment rate is close to 14% – compared with only 6% just two years ago – due to the sharp deterioration in the country's economic situation. Political uncertainty remains high as Brazil faces a constitutional crisis caused by a corruption scandal. Former President Dilma Roussef was dismissed about a year ago and her replacement Mr Temer must also face justice.

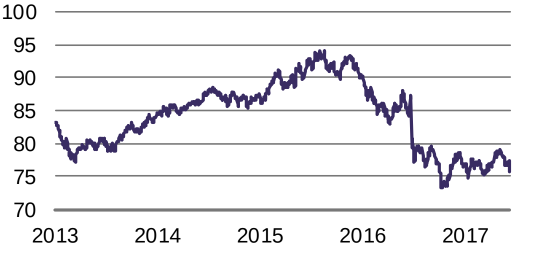
India's GDP has slowed, revealing the effects on the economy of the demonetization launched last November. In South Africa, GDP fell by -0.7% q/q, hitting a technical recession as this was the second consecutive quarter of decline. This entry into recession could further weaken the current President, who is also confronted with suspicions of corruption. The ratings agencies Fitch and Standard and Poor's had degraded the country's speculative grade in March, precisely because of political uncertainty and its impact on the country's growth.

United States – Inflation rate PCE



Sources Datastream, Rothschild Asset Management

United Kingdom – Effective exchange rate



Sources Datastream, Rothschild Asset Management