

The Bulletin

April 2017

ECB not for turning yet

Overview The UK PM's surprise decision to call a general election for June 8 prompted a jump in sterling to a 9-month high of 83.5p against the euro, although it gave up some of these gains following the result of the 1st round of voting in the French presidential election. This showed the independent centrist candidate, Emmanuel Macron, ahead on 24% of the vote and, according to the polls, on track to defeat Marine Le Pen in the 2nd round run-off on May 7. Markets were reassured by the outcome, judging by their initial reaction, with European equities rallying, French bond yield spreads over Germany narrowing, and the euro strengthening. Despite an uncertain political backdrop, the Euro area economy appears to have gained momentum in the opening months of 2017, with the (flash) composite PMI rising to a 6-year high in April. The ECB has acknowledged the improving outlook, but has also reiterated its view that substantial monetary support (via QE and continued low interest rates) remains necessary to underpin the recovery and help inflation get back to target on a sustainable basis. In the US, growth slowed in the opening quarter of the year, but that did not prevent continuing solid job gains pushing the unemployment rate down to a pre-global crisis low of 4.5% in March. This keeps the Fed on track to raise interest rates further over the coming months, which should be accompanied by a renewed strengthening of the dollar against the euro albeit remaining within its recent trading range. Meanwhile, with Brexit negotiations getting underway soon and evidence that the UK economy is starting to slow, sterling may lose some ground against the euro in the period ahead (though remaining within its recent range).

Euro Area PMI at a 6-year high

UK growth slows in first quarter

GDP in US up 0.2% in Q1

Diary

	Euro Area	UK	US
Central Bank Meetings	Jun 7	May 11	May 3
GDP	May 3	May 25	May 26
Inflation	May 17	May 16	May 12
Labour Market	May 2	May 17	May 5

Forecasts

	End Jun 2017	End Sep 2017	End Dec 2017	End Mar 2018
Exchange Rates (<i>Economic Research Unit</i>)				
€/\$	1.07	1.05	1.05	1.06
€/£	0.86	0.88	0.88	0.88
£/\$	1.24	1.19	1.19	1.20
5-Year Swaps (<i>Indicative Market Forward Rates</i>)				
Euro Area	0.24	0.30	0.36	0.42
UK	0.82	0.85	0.89	0.93
US	1.98	2.04	2.09	2.14

Euro Area PMI at a 6-year high

The pace of economic growth in the Euro area appears to have strengthened in the opening months of 2017, judging by the high frequency data. In particular, the composite PMI has risen steadily since the start of the year, and reached a 6-year high of 56.7 in April according to the flash reading, with activity in both manufacturing and services picking up over this period. The IMF has revised up its forecast for GDP growth this year a touch to 1.7%, and expects the economy to expand by 1.6% in 2018. The labour market also continues to improve and the unemployment rate is down to a near 8-year low of 9.5% (February). Having fallen in March, following a sharp rise over the previous three months, the annual inflation rate picked up to 1.9% in April with the core rate rebounding to 1.2%. The ECB acknowledged the improving outlook for the economy at its April meeting, but again said that a very substantial degree of monetary policy support is needed to ensure that inflation returns to its target (of just under 2%) on a sustainable basis.

UK growth slows in first quarter

According to preliminary estimates, GDP growth in the UK eased to 0.3% q-o-q in Q1 2017 from 0.7% in Q4, mainly due to slowing growth in the services sector. This in turn partly reflects weaker household spending, with separate data showing retail sales fell by 1.4% (q-o-q) in Q1. Incomes are being squeezed by higher inflation, which at 2.3% is running slightly ahead of the rate of increase in earnings (ex bonuses), while employment gains have slowed, both of which are weighing on spending. The IMF expects GDP to increase by 2.0% in 2017 – though the pace of growth is forecast to moderate over the course of the year – and by 1.5% in 2018. The Bank of England left policy on hold in March and again said interest rates can respond in either direction to changes in the economic outlook as they evolve. Meanwhile, PM May's announcement of a June election prompted a 1.5p jump in sterling (to 83.5p) against the euro, though it subsequently gave up some of these gains.



GDP in the US up 0.2% in Q1

GDP growth in the US slowed to 0.2% q-o-q in Q1 2017 (from 0.5% in Q4), with an easing in the pace of consumer spending only partially offset by stronger investment and exports. The economy expanded by 1.9% on an annual basis in Q1, and the IMF expects full-year growth to average 2.3% in 2017 before strengthening to 2.5% in 2018. Job gains remained solid in the first quarter and the unemployment rate fell to a pre-global crisis low of 4.5% in March. Annual PCE inflation picked up in February to 2.1%, slightly above the Fed's 2% target. As it had well flagged in advance, the Fed raised interest rates by 25bps in March and 'guided' a further two quarter-point increases this year. The Trump administration has provided a broad outline of its tax plan, which includes cuts in the standard corporate tax rate and top personal income tax rate as well as a profit repatriation tax, though it does not contain a border-adjusted tax (BAT).

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Forward rates are sourced from Bloomberg and are calculated from live prevailing market interest rates and reflect market pricing as at 28/04/2017.

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