Weekly Update

C0 | EXTERNAL PUBLICATION

Greece – Long Night's Journey into Day

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All data retrieved from Bloomberg on 17/08/2018.

On Monday August 20, Greece will finally exit the final stage of its third bailout programme since the Great Recession in 2009. The crisis hit the country particularly hard – its Gross Domestic Product (GDP) has shrunk 25% from pre-crisis highs – with the Greece's bourses being reclassified as emerging markets by MSCI. What is the outlook now that the €86bn bailout package is expiring?

The bailout packages supervised by the "troika" – the International Monetary Fund (IMF), the Eurogroup and the European Central Bank – were conditional on the implementation of a series of structural reforms. The main areas of concern were (1) the over-regulated job market, (2) the over-generous and fragmented pension system, (3) the barriers to competition in product markets, and (4) endemic tax evasion. In total, Greece has implemented over 400 policy reforms, with varying degrees of success. More still needs to be done, for example, to address inefficiencies in the public sector.

However, the reforms have enabled Greece to move its budget back into primary surplus – that is to say that government revenues outstripped expenditure by 3.8% of GDP in 2017 (source OECD), before factoring the cost of servicing the debt burden. In addition, the maturity profile of Greece's debt has been steadily extended in recent years, most recently via the June agreement to defer payments of interest and capital to the stability fund until 2033 and to extend the average loan maturity to 40 years. These measures mean that the effective interest rate on Greece's debt will remain manageable until at least 2022 at less than 2%.

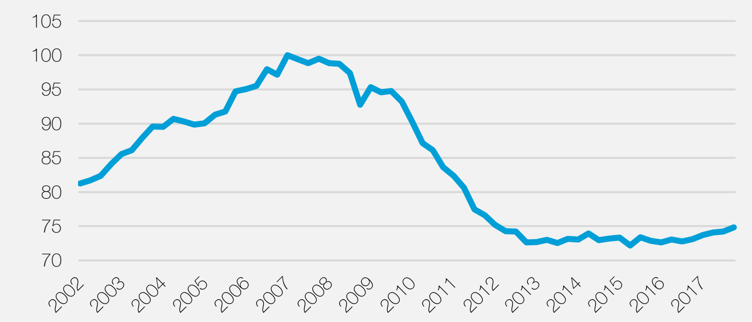
The June agreement with the Eurogroup also foresees additional stability mechanism disbursements – €15bn, including €9.5bn as a cash buffer – in exchange for a commitment from Greece to maintain a multi-decade primary surplus, of 3.5% of GDP until 2022 and then 2.2% on average until 2060. Given that Greece has already exceeded this target, staying with it should not prove recessionary. However, it does reduce fiscal policy flexibility for the foreseeable future.

All of these measures, although welcome, have done little to improve Greece's long-term debt sustainability. Since 2010, loans from the troika have added €289bn to Greek debt, the equivalent of 148% of GDP, taking the overall ratio to over 180%, an untenable level. In its most recent report, the IMF highlighted that more relief was necessary to return debt ratios to more sustainable levels. And this dynamic is reflected in Greece's low marks from rating agencies, none of which consider Greek bonds as investment-grade.

Bottom line. Greece has made great strides in recent years with GDP finally growing again, unemployment falling gradually and no short-term financing problems in sight. However, without more radical debt relief, the country is likely to remain a weak link in the eurozone. This means Greek bonds are vulnerable whenever problems emerge, as illustrated by the recent widening in yield spreads over German bunds as concerns have risen about Italy's forthcoming budget.

Greek GDP is still 25% below its 2007 level

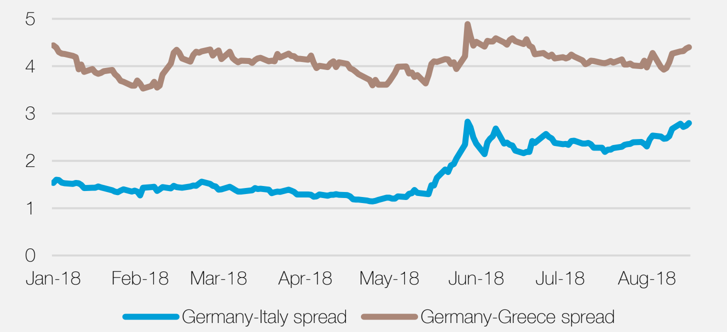
Real GDP (seasonally-adjusted, Q2 2007=100)



Sources: Bloomberg, National Statistical Service of Greece, Q1 2018

Eurozone worries likely to keep spreads wide

10-year government bond yield spread (%)



Source: Datastream, 16/08/2018

This week and next

EUROZONE

- GDP growth eventually printed at 0.4% QoQ in Q2 vs 0.3% on first estimate, as German GDP growth was revised up from 0.4% to 0.5%.
- Industrial production was declined 0.7% MoM in June, but remains up 2.5% YoY.
- French headline inflation rose to 2.6% YoY in July – the highest since March 2012 and continuing the uptrend initiated in 2015. Core inflation was up 1.0% YoY.

Next week's key events	Per.	Prev.	Cons.
23 Aug PMI composite	Aug P	54.3	54.5
23 Aug Consumer confidence	Aug	-0.6	-0.6

UNITED KINGDOM

- The unemployment rate for the three months to June was below expectations, falling to 4.0% – the lowest level since 1975. However, average weekly earnings continued to ease lower from +2.5% to +2.4% YoY.
- Retail sales rose 0.7% MoM in July after -0.5% in June. The improvement is partly due to extended discounts at stores.
- For the first time in eight months, inflation ticked up, from 2.4% to 2.5% YoY in July, boosted by transport costs.

Next week's key events	Per.	Prev.	Cons.
14 Aug CBI industrial trends, total orders	Aug	11	9

UNITED STATES

- Industrial production rose 0.1% MoM in July after +0.6% the previous month.
- The New York Fed manufacturing survey hit a 10-month high at 25.6 in August, beating expectations.
- On first estimate, non-farm unit labour costs declined 0.9% QoQ in Q2 (on a seasonally-adjusted basis), reflecting a 2% increase in hourly compensation and a 2.9% increase in productivity (strongest rate in 3 years).
- Retail sales rose 0.5% MoM in July, beating expectations.

Next week's key events	Per.	Prev.	Cons.
23 Aug Manufacturing confidence	Aug P	55.3	55.2
22 Aug Existing home sales	Jul	5.4m	5.4m

ASIA & EMERGING COUNTRIES

- Japanese export growth declined from 6.7% to 3.9% YoY in July while imports surged from 2.6% to 14.6% sending the trade balance back into negative territory at ¥-231bn.
- In China, value added in industrial production remained unchanged at +6% YoY in July.
- China's M2 money supply beat expectations, bouncing from a record low of +8.0% to +8.5% YoY in July, a 5-month high.
- Against expectations, the central bank of Indonesia raised its key rate by 25bp to 5.5%, the third increase since April, in order to underpin the currency.

Next week's key events	Per.	Prev.	Cons.
23 Aug Japan: Manuf. confidence	Aug P	52.3	--
24 Aug Japan: Core inflation	Jul	0.8%	0.9%

Sources: Datastream, Bloomberg, 17 August 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets

	Thursday close	6mth target
EUR/USD	1.14	1.20
GBP/USD	1.27	1.35
EUR/CHF	1.13	1.18
USD/JPY	111	110
Brent	$71.3	$75
Gold	$1181	$1250

No change to our 6-month targets this week.

Question time

Past performance should not be seen as a guarantee of future returns.

EQUITIES
What outlook for Japanese equities?

After a strong 2017 (+22.2% in total return), the Topix index has lagged other developed markets this year. Cyclicals (Industrials, Materials, IT) and Financials have fared poorly while defensive sectors have registered positive returns.

However, receding trade concerns and expectations for stronger global economic growth after a weak H1 helped the market recover in July.

Japan is sensitive to global trade and is viewed as a cyclical market. Softer global manufacturing activity in H1 and trade disputes prompted analysts to slash their earnings expectations. The IBES consensus forecasts EPS growth at 4.1% this year and 9% next after +22% last year. Besides, Japan is still struggling to exit deflation. Growth forecasts have been cut, with real GDP expected to return below potential in 2020 and inflation still well below the BoJ's 2% target. Consumer prices rose 0.9% YoY in July and core inflation (excluding fresh food and energy) printed at 0.4%.

In this context, monetary policy should remain ultra-accommodative, with the Bank of Japan keeping its quantitative and qualitative easing unchanged. However, the BoJ did make a modest adjustment to its bond-yield objective at its end-July meeting, widening the fluctuation band around the zero target from +/-10bps to +/- 20bps. This is unlikely to do much to improve banks' net interest margins.

In the longer term, Japanese equities should benefit from structural economic reforms, improved corporate governance, sound corporate fundamentals (improved return-on-equity, low debt leverage and high cash levels) while offering attractive valuations.

Last year's uncoupling between Tokyo stock markets and the yen did not last. We expect USD/JPY to remain stable on a 6-month horizon but there is a risk of a spike in the yen should risk aversion return, a negative for the equity market.

All in all, we suggest a neutral stance on the Japanese equity market.

Market performance

Past performance should not be seen as a guarantee of future returns.

Interest rates

	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	0 bp	➡	1 bp	-1 bp	0 bp
3mth Euribor (EUR)	-32 bp	0 bp	➡	1 bp	1 bp	1 bp
3mth Libor (USD)	232 bp	-2 bp	⬇	0 bp	63 bp	101 bp
3mth Libor (GBP)	80 bp	0 bp	➡	18 bp	28 bp	52 bp
10-year US Treasury bond	288 bp	-6 bp	⬇	-24 bp	47 bp	65 bp
10-year German bond	32 bp	-6 bp	⬇	-30 bp	-11 bp	-5 bp
10-year French bond	60 bp	-1 bp	➡	-25 bp	-6 bp	-14 bp
10-year UK bond	128 bp	-7 bp	⬇	-26 bp	6 bp	12 bp

Credit

	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.0%	➡	0.7 %	0.1 %	0.6 %
BAML EURO Corp HY	-0.3%	⬇	-0.2 %	-0.2 %	1.1 %
BAML GBP Corp IG	0.4%	⬆	1.5 %	-0.6 %	0.1 %
BAML US IG	0.3%	⬆	2.0 %	-2.0 %	-0.5 %
BAML US HY	-0.2%	⬇	1.7 %	1.5 %	3.3 %
JPM Global EM Sov. Plus	-1.2%	⬇	-1.3 %	-6.1 %	-3.6 %

Exchange rates

	Last	1wk		3mth	YTD	12mth
EUR/USD	1.14	-1.3 %	⬇	-3.6 %	-5.3 %	-3.3%
EUR/CHF	1.13	-1.0 %	⬇	-4.1 %	-3.1 %	-0.2%
GBP/USD	1.27	-0.8 %	⬇	-5.7 %	-5.8 %	-1.3%
USD/JPY	111	-0.2 %	⬇	0.5 %	-1.6 %	0.6%
USD/BRL	3.91	2.8 %	⬆	6.3 %	18.0 %	23.9%
USD/CNY	6.88	0.9 %	⬆	8.0 %	5.8 %	2.9%
USD/RUB	66.8	0.2 %	⬆	8.3 %	15.9 %	12.5%

Government bonds*

	1wk		3mth	YTD	12mth
United States (3-7yr)	0.3 %	⬆	1.5 %	-0.7 %	-1.6 %
United Kingdom (3-7yr)	0.3 %	⬆	1.1 %	0.0 %	-0.6 %
Germany (3-7yr)	0.2 %	⬆	1.3 %	0.8 %	0.5 %
Japan (3-7yr)	0.1 %	➡	-0.1 %	-0.2 %	-0.1 %

Equities*

	Last	1wk		3mth	YTD	12mth
MSCI AC World	511	-1.9 %	⬇	-0.4 %	1.4 %	10.2 %
Eurostoxx 50	3 378	-3.3 %	⬇	-4.0 %	-0.6 %	0.4 %
DAX	12 237	-3.5 %	⬇	-5.8 %	-5.3 %	-0.2 %
CAC 40	5 349	-2.8 %	⬇	-2.7 %	3.5 %	6.7 %
S&P 500	2 841	-0.4 %	⬇	4.9 %	7.6 %	17.3 %
FTSE 100	7 556	-2.2 %	⬇	-1.0 %	1.4 %	6.0 %
SMI	8 998	-1.6 %	⬇	0.3 %	-0.9 %	3.0 %
Topix	1 687	-3.0 %	⬇	-6.1 %	-6.1 %	6.6 %
IBOV Brazil	76 819	-2.5 %	⬇	-11.2 %	0.6 %	12.0 %
MICEX Russia *	2 261	-2.1 %	⬇	-3.3 %	7.2 %	16.4 %
MSCI EM	1 022	-5.3 %	⬇	-10.3 %	-10.0 %	-1.0 %
SENSEX 30 India	37 664	-0.9 %	⬇	7.2 %	12.4 %	19.9 %
Hang Seng (H-K)	27 100	-5.2 %	⬇	-11.2 %	-7.1 %	2.6 %
Shanghaï Composite	2 705	-3.2 %	⬇	-14.7 %	-18.2 %	-16.7 %

Commodities

	Last	1wk		3mth	YTD	12mth
Brent	$71	-1.4 %	⬇	-9.0 %	7.0 %	40.1 %
Gold	$1 181	-2.7 %	⬇	-8.3 %	-9.4 %	-7.3 %
Silver	$14.8	-4.3 %	⬇	-9.4 %	-13.0 %	-12.8 %

Source: DataStream, on 17/08/2018. 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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