The week ahead

Active is: Keeping an eye on capital markets

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"Exit"

Once again, geopolitics are shaping developments on the capital markets. Exits (or at least exit plans) from long-standing policies seem to have become a new fashion trend. Just think of the US exit from the Iran nuclear agreement or of developments in Europe.

While the UK and the rest of the European Union (EU) are still haggling over the BREXIT details, the spectre of another "exit" has entered the scene: the "Italexit" or Italy's leaving the euro area. This possibility has been in the headlines during the last few days, as Italian politicians are trying to form a government, and caused considerable nervousness. The jitters are quite evident if we look at the spreads of peripheral government bonds over Bunds. They have widened considerably, and not only for Italian, but also for Greek, Spanish and Portuguese debt. (Interestingly, Irish bonds were not affected.) The message is clear: Investors will demand higher premiums if fiscal discipline slips. Nevertheless, let us step back and take a calm look at the situation for a moment. Any new expenditure and debt plans must be adopted by parliament, where the potential coalition has only a small majority. In addition, President Mattarella has already indicated that he plans to veto any laws which undermine Italy's economic and fiscal sustainability.

The legal and political hurdles for an Italexit are even higher. The EU Treaties do not provide for the situation that a country wants to leave EMU, but remain a member of the European Union (EU). Moreover, the Italian people cannot vote directly on the question of "in or out" unless Article 75 of the Italian constitution is amended. Any amendments to the constitution must be adopted with an absolute majority in both chambers of parliament.

Alternatively, the government might hold a referendum on a constitutional amendment. This would require voting first on an amendment to Article 75 and, in a second round, on an "Italexit" – or, in other words, a referendum before the actual referendum. Right now, however, almost 60% of the Italians want to remain members of the euro area (source: Eurobarometer). Nevertheless, the markets are nervous. And Italian government bonds ("BTPs") remain vulnerable.

The Week Ahead

The data calendar for the coming week is quite full, with sentiment indicators taking centre-stage.

In the US, the conference board consumer confidence index and the Dallas Fed manufacturing index are due on Monday. On Wednesday, we will get the second GDP growth estimate for Q1. And the Chicago PMI and the ISM PMI are due on Thursday and Friday, respectively. While consumers are still very optimistic, the two PMIs recently declined from high levels.

The same applies to euro-area sentiment (the index will be released on Wednesday), and it will be interesting to see whether the index for Italy, for example, deviates from the general trend. (Core) Consumer price inflation will get some attention, too, as it might have an impact on the European Central Bank's (ECB's) monetary policy course. Overall, it is likely that inflation will move towards the 2% target so that the government bond purchases can be phased out.

In China, the NBS PMIs for the manufacturing and non-manufacturing sectors will be released on Thursday. They should remain above the expansion threshold of 50.

Following better export data, industrial output in Japan might have picked up (the series will be released on Thursday) and make a positive contribution to growth in Q2.

Active is:

While geopolitical uncertainties remain, the economic data should support the equity markets. Technicals are likely to provide tailwinds, too.

Wishing you easy access to returns

Hans-Jörg Naumer

Upcoming political events 2018

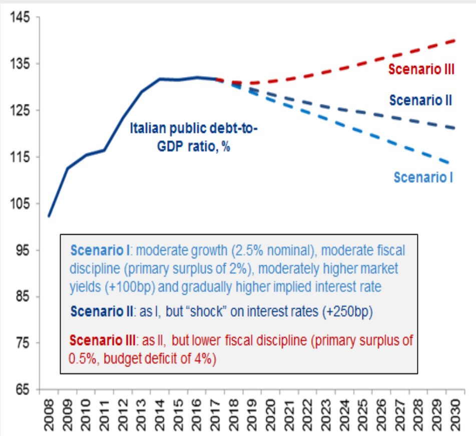
8-9 Jun: G-7 Summit, Quebec, Canada

12-13 Jun: FOMC meeting and economic projections

Overview political events 2018
(click here)

Chart of the week:

Debt scenarios: A deteriorating deficit would have a more immediate effect on debt dynamics than a pick-up in yields[1]



1) The long average maturity of Italian public debt of > 7 years and low implied interest rate of ~2.9% should protect Italian public finances against rises in market rates, at least in the near future. Past performance is not an indicator of future results.
Sources: Datastream, AllianzGI Global Economics & Strategy. Data as of 22 May 2018.

Publications

"Active Management"

The debate about the advantages and disadvantages of active and passive management has for years been one of the liveliest in the investment industry. Just what is the best approach to investment? "Active" or "passive"?

"The case for alternatives"

After a 30-year bull market in bonds and a strong, multi-year recovery in equities, investors wonder what lies ahead for financial markets. The current low interest-rate environment and the search for marketneutral solutions is increasingly prompting investors to rethink their allocation decisions with regard to alternative investment strategies.

"Added value or a mere marketing tool? What does ESG mean for investments?"

"Sustainability", in the broadest sense of the term, has long ceased to be a new concept for investors. It encompasses, among other things, "corporate social responsibility" (CSR) and "environmental, social and governance" (ESG) criteria. But what does all this mean for investing? Part 1 of this study explains the concepts and examines how ESG has become increasingly important in the investment world..

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Calendar Week 22:

Monday			Consensus	Previous
GE	Import Price Index YoY	Apr	0.80%	-0.10%
IT	PPI YoY	Apr	--	2.40%
UK	Nationwide House Prices YoY	May	--	2.60%

Tuesday				
EC	M3 Money Supply YoY	Apr	--	3.70%
FR	Consumer Confidence	May	--	101
IT	Consumer Confidence Index	May	--	117.1
IT	Economic Sentiment	May	--	105.1
JN	Jobless Rate	Apr	--	2.50%
US	Conf. Board Consumer Confidence	May	128.0	128.7
US	Dallas Fed Manf. Activity	May	--	21.8

Wednesday				
EC	Economic Confidence	May	--	112.7
EC	Business Climate Indicator	May	--	1.35
EC	Industrial Confidence	May	--	7.1
EC	Services Confidence	May	--	14.9
FR	Consumer Spending YoY	Apr	--	2.30%
FR	GDP QoQ	1Q P	--	0.30%
GE	Unemployment Change	May	--	-7k
GE	Umemployment Rate	May	--	5.30%
GE	CPI YoY	May P	--	1.40%
JN	Retail Sales MoM	Apr P	--	-0.70%
JN	Consumer Confidence Index	May	--	43.6
US	ADP Employment Change	May	185k	204k
US	Wholesale Inventories MoM	Apr P	--	0.30%
US	GDP Annualized QoQ	1Q S	2.30%	2.30%
US	Personal Consumption QoQ	1Q S	--	1.10%

Thursday				
CH	NBS Non-manufacturing PMI	May	--	54.8
CH	NBS Manufacturing PMI	May	--	51.4
EC	Unemployment Rate	Apr	--	8.50%
EC	CPI Core YoY	May A	--	0.70%
EC	CPI Estimate YoY	May	--	1.20%
FR	PPI YoY	Apr	--	2.50%
FR	CPI YoY	May P	--	1.80%
IT	Unemployment Rate	Apr P	--	11.00%
IT	CPI YoY	May P	--	0.60%
JN	Industrial Production YoY	Apr P	--	2.40%
JN	Vehicle Production YoY	Apr	--	0.20%
JN	Construction Orders YoY	Apr	--	-4.00%
UK	GfK Consumer Confidence	May	--	-9
UK	Mortgage Approvals	Apr	--	62.9k
UK	M4 Money Supply YoY	Apr	--	2.20%
US	PCE Core YoY	Apr	--	1.90%
US	Personal Income MoM	Apr	0.30%	0.30%
US	Initial Jobless Claims	May 26	--	--
US	Personal Spending MoM	Apr	0.40%	0.40%
US	Continuing Claims	May 19	--	--
US	PCE Deflator YoY	Apr	--	2.00%
US	Chicago Purchasing Manager	May	58.0	57.6
US	Pending Home Sales NSA YoY	Apr	--	-4.40%

Friday				
CH	Caixin Manufacturing PMI	May	--	51.1
IT	Markit Manufacturing PMI	May	--	53.5
JN	Vehicle Sales YoY	May	--	0.50%
UK	Markit Manufacturing PMI	May	--	53.9
US	Change in Nonfarm Payrolls	May	183k	164k
US	Unemployment Rate	May	3.90%	3.90%
US	Average Hourly Earnings YoY	May	--	2.60%
US	Construction Spending MoM	Apr	--	-1.70%
US	ISM Manufacturing	May	57.8	57.3