Ulster Bank Weekly Economic Commentary

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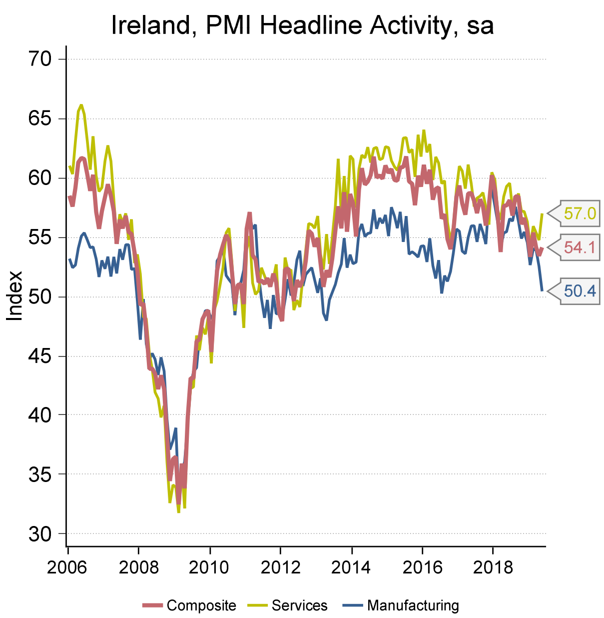
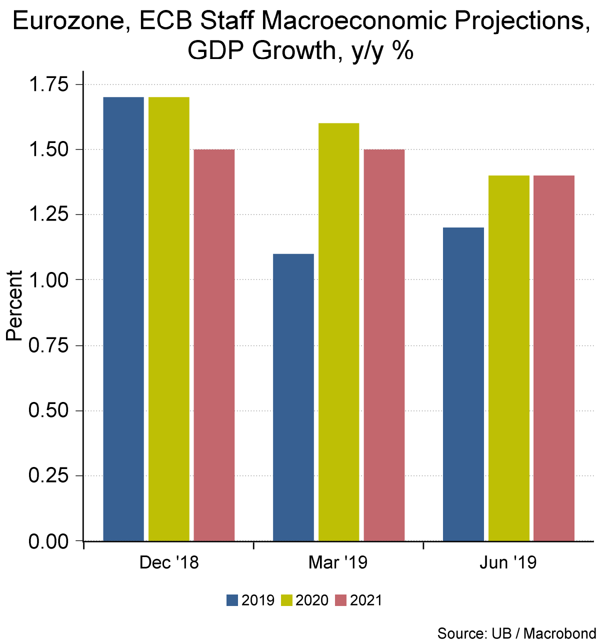
Ireland: PMI picks up as services activity accelerates markedly, but trends in manufacturing disappoint



Source: Macrobond

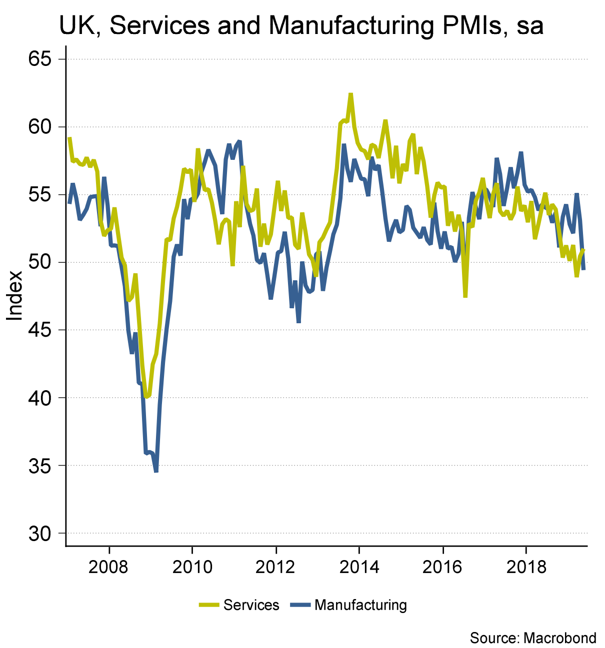
The latest PMI, unemployment and tax data indicate that positive trends in the Irish economy continued in May. The composite PMI – a very useful summary indicator of services and manufacturing activity – picked up in May, halting a three-month sequence of deceleration. Its reading of 54.1 leaves the headline index back at levels slightly above its long-run average and is pointing to ongoing healthy growth in the Irish private sector. There was a welcome and marked reacceleration in the services sector, with the PMI rising to six-month high of 57 in May, up from 54.7 in April. Such strength in a key sector offers important encouragement regarding the economy's resilience in the face of both high levels of uncertainty and of weaker trends (at home and abroad) in the manufacturing sector. This latter point was again evident in the latest manufacturing PMI figures, which showed the headline activity index at its lowest level since July 2016. Its reading of 50.4 is still pointing to marginal growth in the Irish factory sector, but the recent pattern of momentum loss has certainly got our attention. Elsewhere, the provisional estimates for May put the Irish unemployment rate at 4.4% in May, down from 4.6% in April and from the latest official estimate of 5% in Q1. It is certainly encouraging to see continued improvement in Q2, albeit that we continue to note that the monthly numbers need to be treated with caution as they are subject to revision. In any case, the latest tax receipts are also pointing to ongoing strong labour market performance, with income tax revenues up 7.8% in the year to May.

Eurozone: ECB ready to act but not pre-emptively



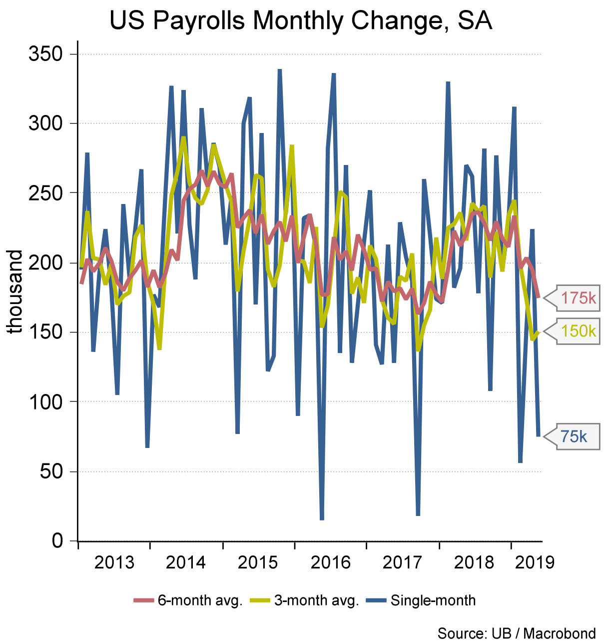
In an important policy update, the ECB announced yesterday that interest rates are now expected to remain on hold at least through the first half of 2020, extending previous guidance by six months. Moreover, one important aspect of President Draghi's post-meeting press conference was his repeated indication that the ECB is prepared to act "in case of adverse contingencies". Indeed, adding to a slightly strengthened language in his introductory statement, Draghi has also enumerated in some detail the current policy ammunition at the disposal of the ECB, which includes interest rate cuts, restarting the asset purchase programme and a further extension to forward guidance. Draghi also admitted that the possibility of policy easing was already raised by "several members" at this meeting, amidst increased and prolonged global uncertainty, while downside risks have gained prominence in his view. But despite the extra emphasis on ECB's readiness to act if needed, our impression is that for now, this is best seen as careful preparation to scenarios which might involve weaker-than-expected economic performance, with the ECB for now not showing willingness to act pre-emptively as Draghi continues to sound broadly constructive on the economy. The ECB remains confident on its growth outlook, which continues to project healthy, albeit slightly slower, growth of 1.4% in both '20 and '21 (down from 1.6% and 1.5% in March, respectively). The ECB staff projections also continue to envisage a gradual pick up in inflation, with the end-point reading of the inflation forecast left unchanged at 1.6%.

UK: PMIs signal steady albeit subdued growth, but provide evidence of manufacturing weakness



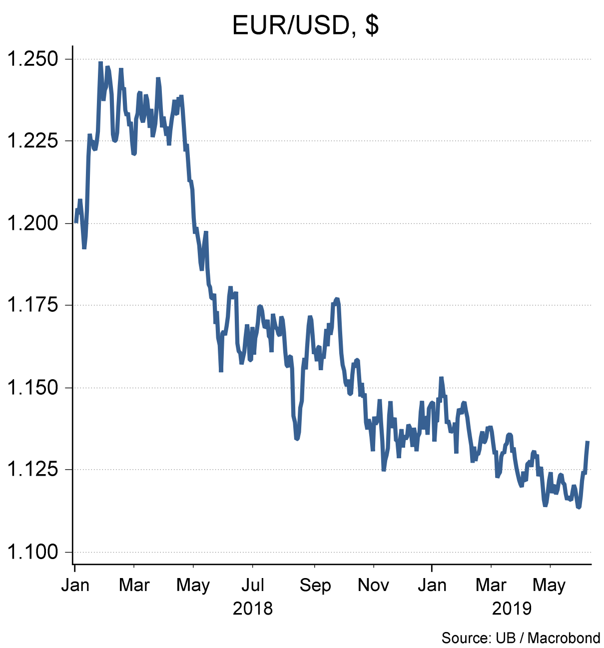
The latest UK PMI surveys indicated that the UK private sector economy continued to experience steady, albeit subdued, activity growth in May. However, a broadly unchanged all-sector headline index masks distinct trends at a sectoral level. The key services sector regained some momentum, with the Services PMI picking up to a 3-month high in May, though the rate of expansion remains modest. Moreover, forward-looking elements were also mildly encouraging, with new orders, hiring and future expectations all rising to multi-month highs. However, this was offset by deterioration of business conditions in both manufacturing and construction. Both PMIs dropped in May to levels below the 50 breakeven level, signalling contraction in both manufacturing and construction activity. The decline in manufacturing is particularly noteworthy, with the 4.7pt drop recorded in May amongst the largest monthly declines recorded over the survey's 28-year history. This was enough to leave the Manufacturing PMI at its lowest level since July 2016. And here, forward-looking indicators aren't pointing to near-term improvement. Therefore, after having benefitted from a Brexit-related step-up in stock-building in recent months, the May PMI results tentatively signal that the UK factory sector is now catching up with the generally weaker trends globally. In that context, it is encouraging that the services sector is for now holding a bit better, but such trends in the manufacturing sector certainly don't discourage the view that UK growth seems poised to remain weak if not weaken further in the short term.

US: Payrolls growth eases in May reinforcing current market focus on Fed easing



Recent escalation in trade tensions and concerns about global economic prospects have certainly contributed to recent financial markets' angst about the US economic outlook. For that reason, there was additional focus on the ever-important employment report, which revealed a weaker-than-expected pace of US jobs growth. Only 75k jobs were added in May, well below the Bloomberg consensus which was for a 175k gain. Moreover, downward revisions to the two prior months of 75k added to the disappointment around the jobs element of the data. But this still leaves recent readings looking solid, with 224k jobs added in April and 153k in March. Thus, in our view, it makes sense to view today's downside surprise in the context of solid readings in recent months. We also continue to caution against placing too much weight on the signal from a single observation of a volatile series such as payrolls. In that regard, underlying trends in employment continue to look broadly healthy (the 3, 6 and 12 month averages are all in a 150-195k range). So we are inclined to downplay some of the signal from the monthly payrolls change, particularly as other key indicators of recent labour market and growth performance, such as jobless claims and the latest ISM survey results, continue to look healthy. However, at the margin, today's weaker-than-expected headline payroll figure slightly reinforces current market focus on the possibility of interest rate cuts from the Fed, particularly as the earnings component of the report has also disappointed. Annual earnings growth dropped to 3.1% in May following 3.2% in April.

Financial Markets: Eur/USD at a 3-month high as bets of Fed rate cuts gain momentum



Powell's early-week speech only briefly touched on the near-term economic or policy outlook, with Powell mentioning on passing that the Fed is "closely monitoring" trade uncertainty and that it "will act as appropriate to sustain the expansion.". While this doesn't clearly signal that the Fed is gearing up for a dovish tilt in policy, it does suggest that the Fed is increasingly mindful of downside risks. Moreover, the fact that Powell didn't push back on the very dovish market pricing at the moment appears to have been taken by investors as a nod to current market narrative. This set the scene for a further move lower in US interest rates, with 2-yr swap rates down a further 10bps this week, while futures market are currently priced for nearly 75bps of easing by the end of '19 (up from 55bps a week ago). Increased expectations around a dovish tilt from the Fed also supported this week's recovery in investor risk appetite, with the S&P up ca. 4.5% from last Friday's close. For fx, this meant dollar weakness, with the greenback ending the week around 1.5% and 1% down vs. the euro and sterling respectively. The euro also rose against sterling, an indication that yesterday's announcements from the ECB perhaps fell short of market expectations. The ECB showed readiness to act if needed, but the hurdles to specific policy actions still look significant, while forward guidance was extended but the ECB didn't add an explicit mention to the possibility of lower rates in the policy guidance. With the ECB meeting out of the way, attention now turns to next week's US-Mexico tariff deadline and to the 19th June Fed policy meeting.

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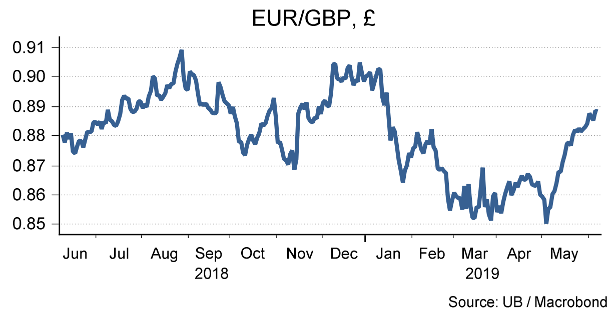
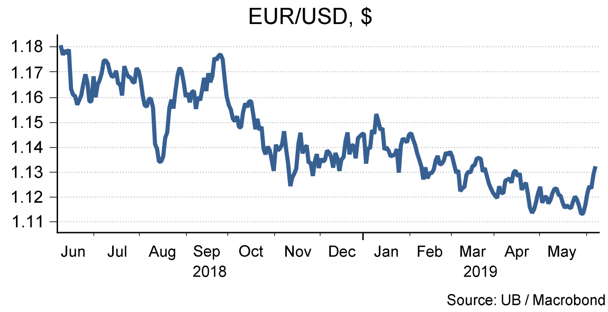
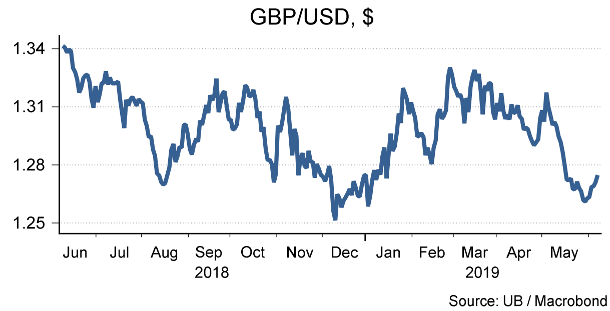
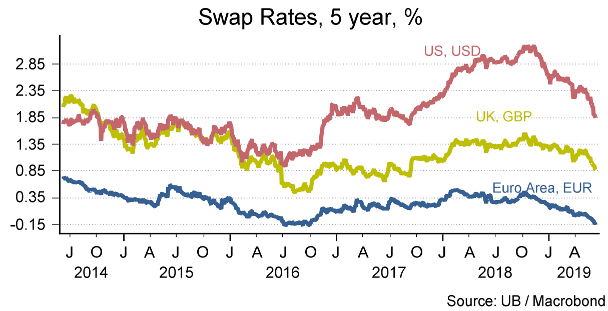
Currency and interest rate market trends









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Market Monitor

Foreign Exchange Markets

	Latest	weekly Δ, %
EUR/GBP, £	0.889	0.5
GBP/EUR, €	1.125	-0.5
EUR/USD, $	1.134	1.5
GBP/USD, $	1.276	1.0
EUR/JPY, JP¥	122.5	1.2
GBP/JPY, JP¥	137.8	0.7
USD/JPY, JP¥	108.0	-0.2
EUR/CHF, CHF	1.119	0.1

Stocks & Commodities

	Latest	weekly Δ, %
ISEQ	6,186	1.8
STOXX Europe 600	378	2.5
FTSE 100	7,346	2.6
S&P 500	2,880	4.6
Dow Jones	26,061	5.0
Nasdaq	7,764	4.2
NIKKEI	20,885	1.4
OIL (London Brent)	62.4	-3.3
Gold	1,345	3.1

Interest Rate Markets

		Latest (%)	weekly Δ, bps
EUR	3 Month Euribor	-0.323	-0.1
	2 Year Swaps	-0.30	-3
	5 Year Swaps	-0.16	-6
	10 Year Swaps	0.25	-9
GBP	3 Month Libor	0.783	-1.3
	2 Year Swaps	0.80	-8
	5 Year Swaps	0.86	-9
	10 Year Swaps	1.02	-9
USD	3 Month Libor	2.451	-5.2
	2 Year Swaps	1.88	-10
	5 Year Swaps	1.85	-7
	10 Year Swaps	2.05	-3

Note: the data in the tables are indicative only and are sourced from Bloomberg. Latest data are updated as at the time of publication. “weekly Δ” refers to the change from the previous week’s closing levels.

Ulster Bank Cost of Funds Rate (365 day count) = 0.38%
Euro rates are quoted in 360-day convention.
To convert to 365 day count, divide by 360, & multiply by 365

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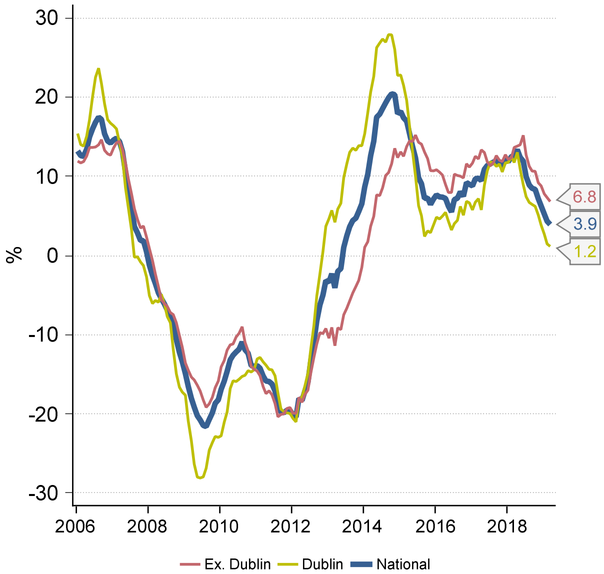
Highlights for the week ahead: Inflation in focus at home and abroad

Ireland, CSO Residential Property Prices, y/y %



Source: UB / Macrobond

A busy week ahead on the Irish calendar includes the April reading of the CSO's Residential Property Price Index where we wouldn't be surprised to see some further modest easing in the rate of price inflation from the 3.9% y/y pace registered in March. We also get April figures on goods trade, and a timely update on construction activity (via the UB Construction PMI for May) and on inflation trends (via the May CPI/HICP release). Inflation figures will also be in focus in the US. The consensus is anticipating that core CPI inflation posted a solid m/m gain of 0.2% in May, enough to leave the annual figure steady at 2.1%. At the margin, this would offer some further validation to the Fed's view that recent declines in core inflation were at least partly reflecting temporary factors. Meanwhile, May retail sales and industrial production figures are expected to point to a bounce back in growth following disappointing starts to Q2. But of course, next week's timely business (NFIB for May) and consumer (University of Michigan for June) survey will also likely be particularly scrutinised as data watchers assess whether recent escalation in trade tensions is leaving a mark on economic sentiment. In the UK, we will pay close attention to next week's GDP and labour market figures for April following signs of softer growth momentum taking hold at the end of Q1 (particularly so in the case of GDP). Finally in the Eurozone, an otherwise light data docket includes official industrial production figures for April and initial surveys for June, in the form of the Sentix measure of investor confidence.

Economic calendar for the week commencing Jun 10th

Ireland / Eurozone	UK	US
Monday		
01.01 – Ulster Bank Construction PMI (May) 11.00 – New Vehicles Sales (May)	09.30 – GDP Monthly Estimate (Apr)	15.00 – JOLTS Job Openings (Apr)
Tuesday		
11.00 – EHECS (2018 - Final) 09.30 – EZ Sentix Investor Confidence (Jun)	09.30 – Labour Market Data (Apr)	11.00 – NFIB Small Business Optimism (May) 13.30 – PPI Inflation (May)
Wednesday		
11.00 – Inbound Tourist Spend (Q1)		13.30 – CPI Inflation (May)
Thursday		
11.00 – House Price Inflation (Apr); Consumer Price Inflation (May) 10.00 – EZ Industrial Production (Apr)	00.01 – RICS House Price Balance (May) 09.30 – UK Finance Mortgage Approvals (May)	13.30 – Initial Jobless Claims
Friday		
11.00 – Merchandise Trade (Apr)		13.30 – Retail Sales (May) 14.15 – Industrial Production (May) 15.00 – U. of Michigan Consumer Sentiment (Jun)

The Calendar uses Irish local time

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