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J.P.Morgan

Economic Research
July 14, 2017

Global Data Watch

- **The drumbeat of upbeat global growth indicators continues**
- **US core inflation continues to disappoint and is hard to explain**
- **China trade sends a positive message on domestic and global demand**
- **Next week: China data; ECB taper talk; BoJ inflation forecast down**

Strong and clear growth; low and puzzling inflation

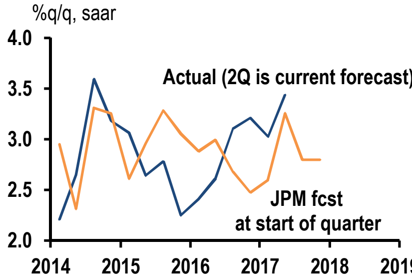
If our 2Q forecasts are right, the global economy has just completed a year of 3.2% GDP growth, equaling its best performance over the past six years. Importantly, the dynamics behind the past year's pickup validates our view that fading disinflationary drags are delivering more balanced income growth across sectors and regions. As EM demand and commodity industry drags abate, global profits have bounced out of two years of decline. Business spending is reviving and hiring has picked up as well, with global employment gains now running as strong as any time since the 1990s. As tail risks associated with imbalances decline, global risk appetite is on the rise. These developments temper the drag on consumption associated with the past year's inflation rise. In fact, global consumption gains have exceeded our expectations by accelerating modestly over the past year.

We forecast that this lifting phase is over and anticipate the global economy to settle at a modestly above-trend pace in the coming quarters. However, with 1H17 outcomes exceeding our expectations, our bottom-up forecast now incorporates a 2H17 downshift (Figure 1). For global GDP, the 2.8% pace projected for the coming quarters would represent a modest deceleration. A sharper slowing is expected in two key recent supports for global demand.

- DM capital spending is expected to grow at a 3% pace during 2H17, a sharp slowing from a 7.7% ar in 1H (Figure 2). A cooling in US energy sector investment—a significant source of recent swings in capex growth—is reasonable to expect. The recent moderation in global inflation is also likely to slow profit growth and weigh on spending. That said, the anticipated downshift projected in Euro area capex is harder to explain given the recent surge in business sentiment.
- Perhaps the biggest growth surprise in 1H17 came from consumers in EM, where retail spending accelerated to a nearly 8% annualized growth rate (Figure 3). EM consumer confidence has spiked higher, but much of this move is concentrated in China. EM household fundamentals have improved

Figure 1: Global real GDP

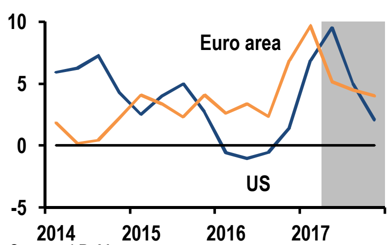
%q/q, saar



Source: J.P. Morgan

Figure 2: DM business fixed investment

% change over 2Q, saar



Source: J.P. Morgan

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Our Special Report "Introducing J.P. Morgan's EM nowcasters," was published on July 13, and is now available on our website.

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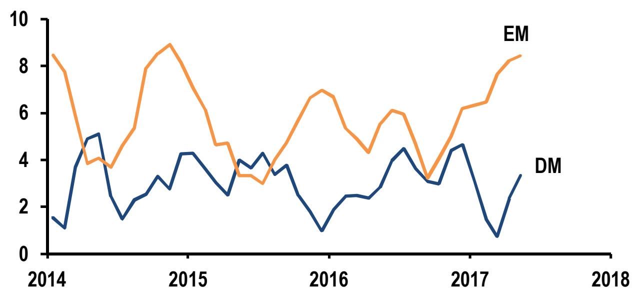
Figure 3: Global consumer goods spending
%3m3m, saar



Source: J.P. Morgan

only modestly—notably employment gains remain below the 2013-4 pace—and it looks likely that spending gains will moderate back below 5%.

Our top-down indicators do not suggest this downshift is underway at midyear. What's more, a key downside concern—that China slows more sharply than expected in the face of policy adjustments—is not materializing. As such, we see upside risk to an already upbeat global growth forecast.

Fed to move forward on balance sheet

While the signal from growth is strong and clear, inflation news remains low and is puzzling. Much of the recent disappointment on core inflation comes from the US, the DM economy most advanced in its expansion. The US core CPI rose 0.12% m/m in June, only a modest step up from the previous three months A positive spin could be applied to a month in which volatile lodging and airfare categories were down sharply while rental and health care inflation moved higher. However, with this report expected to translate into a 1.3%oya June core PCE increase, the outcome should further shake the Fed's confidence that the soft run of inflation news is transitory. We believe that inflation will turn up, and we take comfort from the dollar drop and the rise in import prices. However, our conviction on near-term inflation dynamics is low and we recognize that core inflation will need to turn materially higher for the Fed to deliver another rate hike this year. At the same time, this week's communications from Chair Yellen and Governor Brainard bolstered our confidence that the decision to begin balance sheet normalization is linked to growth. Low inflation is not likely to derail an expected announcement in September to commence balance sheet adjustment.

ECB tapering talk to begin next week

Euro area inflation remains subdued, but it is growth that is surprising the ECB this year. This week we revised our 2Q17 GDP forecast to 3% (q/q, saar) and see 2017 growth running well above the ECB staff forecast. Against this backdrop, next week's meeting is likely to signal a tapering decision in September. This could come with an opening statement that removes the "easing bias" on QE or points to upcoming forecasts as a guide to assessing asset purchases beyond this year. We remain comfortable with our view that the purchase pace will be reduced to €40bn/month in 1Q18, €20bn/month in 2Q18, and zero thereafter.

China

June activity is signaling that China is stabilizing after a slowdown early last quarter. The trade report pointed to a solid uptick in exports and only a small import drop following a May bounce. Over the past two months, process imports have recorded a double-digit gain, which speaks positively to global demand and future China export gains. New bank loans and total social financing also beat expectations in June. Against the backdrop of financial deleveraging, new credit has shifted toward bank loans and trust loans at the cost of other components (bond financing, entrust loans, and bank acceptance bills), and the share of medium- and long-term loans has increased. The shift in credit components could help to partially offset the slowdown in unmeasured credit components in TSF statistics (related to local government debt swap program and missing shadow credit). We look toward next week's key releases—2Q GDP and June IP and fixed investment—to reinforce this message that China is not a near-term global growth threat.

This weekend's National Financial Work Conference will likely lay out a strategy for the next phase of financial deleveraging. News reports indicated that the State Council will likely establish a Financial Coordinating Committee, with a permanent office in the central bank to strengthen regulatory coordination. We also expect the macro-prudential framework will be strengthened further, with the PBOC to take a leading role, and function-based regulation (on financial products) to be introduced. It could also lead to a shift to rely more on regulatory measures and less on PBOC liquidity tightening. With this in mind, we expect the seven-day repo rate to fall 20bp during 2H17.

UK: (Don't) whistle while you work

The UK data continue to suggest that consumer spending has slowed thanks to an exchange-rate driven squeeze on real incomes. But there are few signs to date that corporates are responding by reducing labor demand or cutting investment spending. Survey readings on employment and investment intentions have held in through 2Q, and the unemployment rate continues to nudge lower. Although uncertainties about growth are a source of debate, the balance of opinion at the MPC does not appear minded to sanction a rise in interest rates at the August meeting: We expect a rise in core CPI inflation next week (2.7%oya) that should entrench the position of hawks. But we doubt it will sway those in the middle ground given the recent weakness of pay growth.

The second round of Brexit negotiations takes place next week. Round one saw the UK concede that progress on withdrawal issues was a precondition for talks on trade. Round two moves on to a discussion of citizens' rights and the financial settlement. The EU is looking for the UK to recognize the need to "settle the accounts" at this point while leaving the finalization of what that means for later in the negotiations. On citizens' rights, the EU is seeking to protect acquired rights of individuals given a UK proposal that would see some of those rights removed. Neither issue is easy for the UK, but we expect enough progress to keep talks moving forward incrementally at this stage.

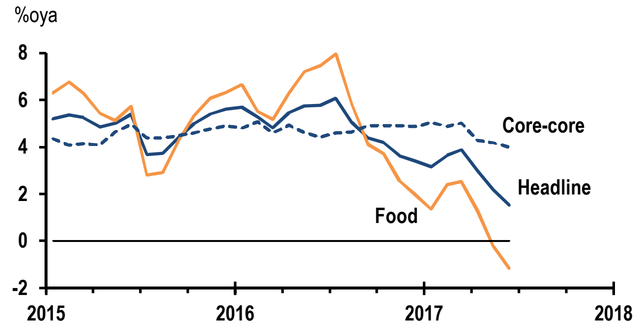
Core inflation is firming in the CEE

In contrast to most elsewhere, June CPI prints in CEE show a gradual firming in core inflation across the region. Although energy prices have pushed headline inflation rates lower, the year-ago rate of CE-4 core inflation is up 0.7%-pts over the past six months. With growth solid and labor markets tightening, reducing economic slack, we expect core inflation to continue to rise. In the Czech Republic core inflation is above the CNB's 2% target, and we expect the CNB to be the first mover in the region, hiking rates to 0.25% this September. In Romania, with wages increasing at a 15% pace and consumption growing at a 7.5% clip, we expect the NBR to shift to a more hawkish stance as core continues to run above its forecast. We expect it to narrow the interest rate corridor in October and raise interest rates in 1Q18 as inflation approaches the target. In Hungary, wages are also posting double-digit gains, but only recently has core inflation begun to show signs of life, with demand-sensitive inflation ticking up to 1.7% after plateauing at 1.5% in 2016. Polish core inflation has stabilized near 0.8%oya in the past few months as declines in core goods prices offset upward pressure in services, but it is still up 1%-pt since the start of the year. With inflation in Poland and Hungary likely to remain below respective targets for some time, we don't expect the NBP and NBH to hike rates in the next year.

India CPI dip paves way for August ease

This week's news from India bolsters confidence in our forecast for an August rate cut. The CPI fell for a third consecutive month in June, pushing annual inflation down to 1.5%. While food prices are a major catalyst for this decline, core-core inflation is stabilizing at 4%, the RBI's medium-term inflation target (Figure 4). At the same time, the May IP report provides additional confirmation that the post-demonetization recovery has been incomplete. Our baseline call is for just one 25bp RBI cut, but the latest news increases the odds of another ease before year-end. We are cautious to push the rate cycle further given the tone the MPC has adopted in the infancy of an inflation-targeting regime. But we will pay close attention to how their rhetoric shifts in light of the latest reports.

Figure 4: India consumer prices



Source: J.P. Morgan

Political turmoil to delay recovery in Brazil

There was positive news in Brazil this week as the Senate approved a labor reform bill allowing more flexibility to the labor laws. However, a tumultuous political backdrop suggests that is not an indication of things to come. The Lower House Constitution committee rejected a report this week that would allow the Supreme Court to put President Temer on trial. The final vote on the matter in the Lower House floor will only happen in early August, and a second charge may soon arrive. This will eat up precious time and divert attention from other elements of the reform agenda. We expect political turmoil to weigh on confidence and delay the economic recovery suggested by the April and May releases. The first June reports point in this direction.

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Global economic outlook summary

	Real GDP % over a year ago			Real GDP % over previous period, saar						Consumer prices % over a year ago			
	2016	2017	2018	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	4Q16	2Q17	4Q17	2Q18
United States	1.6	2.2	1.8	2.1	1.4	3.0	1.8	1.8	1.8	1.8	1.9	**1.6**↓	**2.1**↓
Canada	1.5	2.8	1.7	2.7	3.7	2.8	2.1	1.9	1.5	1.4	**1.3**↓	2.0	1.9
Latin America	-0.8	1.3	2.3	0.7	**3.0**↓	**1.1**↓	1.7	2.2	2.1	5.3	4.4	4.2	3.9
Argentina	-2.2	3.1	3.3	2.8	4.3	6.8	4.1	2.8	3.0	40.4	24.6	21.1	17.0
Brazil	-3.6	0.0	1.8	-2.2	4.3	-1.0	0.4	1.5	1.6	7.0	3.6	3.4	4.5
Chile	1.6	1.4	3.1	-1.4	0.7	2.4	3.1	5.2	2.0	2.8	2.5	2.5	2.6
Colombia	2.0	1.8	3.0	4.1	-0.9	3.0	3.5	3.5	3.0	6.1	4.3	4.2	3.5
Ecuador	-1.5	1.5	-1.2	7.0	**-2.2**↓	-3.0	-4.0	-4.0	-2.0	1.2	0.7	0.8	1.0
Mexico	2.3	**1.9**↓	2.2	2.9	2.7	**0.8**↓	1.6	2.0	2.2	3.2	6.1	6.0	3.4
Peru	3.9	2.6	4.4	-0.1	0.6	2.0	5.0	6.0	4.5	3.3	3.3	2.4	2.7
Uruguay	1.8	3.6	3.6	5.8	6.0	1.0	2.5	2.5	3.0	8.2	6.1	7.1	8.2
Venezuela	-15.0	-5.0	-1.5	-3.0	-3.0	-10.0	0.0	-3.0	-2.0	764.6	1167.1	751.3	289.7
Asia/Pacific	4.8	4.9	4.7	5.0	4.9	4.9	4.9	4.9	4.6	1.9	1.6	2.0	2.2
Japan	1.0	1.5	0.8	1.4	1.0	2.5	1.5	0.9	0.5	0.3	0.4	0.9	0.6
Australia	2.5	2.0	3.0	4.5	1.1	0.8	4.1	4.2	2.9	1.5	2.0	2.3	2.0
New Zealand	3.1	2.5	2.7	1.6	2.1	2.4	3.3	3.4	1.8	1.3	1.9	2.0	1.8
EM Asia	5.9	6.0	5.7	5.9	6.1	5.8	5.8	5.9	5.7	2.3	1.8	2.2	2.7
China	6.7	6.7	6.4	6.7	6.9	6.6	6.4	6.4	6.0	2.2	1.5	1.9	2.6
India	7.1	7.2	7.4	5.7	5.5	7.4	7.9	8.5	9.0	3.7	2.3	3.6	4.0
Ex China/India	3.4	3.7	3.4	4.1	4.2	3.1	3.4	3.3	3.5	1.8	2.2	2.2	2.1
Hong Kong	2.0	2.8	2.0	4.9	2.8	1.6	0.8	0.8	2.5	1.2	1.6	3.4	3.1
Indonesia	5.0	5.1	5.3	5.5	5.2	**4.7**↓	**4.9**↓	**5.1**↑	5.5	3.3	4.3	4.5	3.3
Korea	2.8	2.8	2.5	2.0	4.3	2.2	2.8	2.5	2.5	1.5	2.0	1.5	1.5
Malaysia	4.2	**5.4**↑	4.4	5.1	7.5	**4.5**↑	4.5	4.2	4.5	1.7	3.7	2.8	1.8
Philippines	6.9	6.4	6.6	7.3	4.3	7.2	6.7	7.8	5.3	2.5	3.2	2.8	3.0
Singapore	2.0	2.6	2.4	12.3	-1.3	2.6	1.4	1.4	2.6	0.0	1.0	1.5	1.6
Taiwan	1.5	2.3	2.0	1.4	3.8	1.0	2.4	2.2	2.3	1.8	0.5	0.3	1.7
Thailand	3.2	3.5	3.2	2.1	5.2	3.5	3.5	3.0	3.2	0.7	0.4	0.8	1.7
Western Europe	1.8	**2.1**↑	1.9	2.2	2.1	**2.7**↑	1.9	1.9	1.9	0.9	1.8	1.5	1.3
Euro area	1.7	**2.2**↑	2.0	2.1	2.3	**3.0**↑	2.0	2.0	2.0	0.7	1.5	1.1	0.9
Germany	1.8	**2.2**↑	2.0	1.7	2.4	**3.5**↑	2.0	2.0	2.0	1.0	1.6	1.1	1.4
France	1.1	1.7	1.7	2.1	1.9	2.3	1.8	1.8	1.8	0.7	1.0	0.9	1.1
Italy	1.0	1.3	1.1	1.4	1.8	1.3	1.3	1.3	1.0	0.2	1.6	1.2	0.7
Spain	3.2	3.1	2.7	2.8	3.3	3.5	3.3	2.8	2.5	0.8	2.0	0.9	0.9
Norway	0.8	1.8	1.9	1.5	2.6	1.8	1.8	1.8	2.0	3.6	2.0	1.7	1.9
Sweden	2.9	2.3	2.3	2.9	1.7	2.5	2.5	2.5	2.3	1.4	1.8	1.7	1.6
United Kingdom	1.8	1.6	1.6	2.7	0.9	1.5	1.3	1.3	1.5	1.2	2.8	3.0	2.6
EMEA EM	1.6	2.7	2.4	5.1	3.3	2.7	1.2	2.0	2.2	4.3	4.7	4.4	**4.2**↓
Czech Republic	2.6	3.1	2.8	1.8	6.3	2.8	3.0	2.9	2.8	1.4	2.1	2.1	2.3
Hungary	2.0	4.0	3.5	3.0	5.4	4.5	4.0	4.0	3.5	1.3	2.1	2.3	2.3
Israel	4.0	3.2	3.5	4.7	1.4	1.6	1.6	2.4	3.2	-0.3	**0.4**↓	**0.3**↓	**0.6**↓
Poland	2.7	4.0	3.5	7.0	4.5	3.5	3.5	3.5	3.5	0.2	1.8	1.4	1.7
Romania	4.8	5.0	3.5	6.2	7.0	3.9	4.1	2.6	4.3	-0.5	0.8	1.9	3.3
Russia	-0.2	1.4	1.4	1.1	1.7	3.5	0.3	1.8	1.0	5.7	4.1	4.1	4.8
South Africa	0.3	0.5	1.0	-0.3	-0.7	0.8	2.0	0.8	0.9	6.6	5.3	4.7	4.5
Turkey	2.9	3.8	3.1	14.4	5.8	1.2	-0.8	0.9	2.8	7.6	11.1	9.9	7.3
Global	2.6	3.1	2.9	3.2	3.0	3.4	2.9	2.9	2.8	1.9	2.0	**2.0**↓	2.2
Developed markets	1.6	2.1	1.8	2.2	1.7	**2.7**↑	1.9	1.8	1.7	1.3	1.7	**1.5**↓	**1.6**↓
Emerging markets	4.1	4.7	4.7	4.9	**5.1**↓	**4.5**↓	4.4	4.7	4.6	3.0	2.6	2.8	3.1
Global — PPP weighted	3.1	3.6	3.5	3.5	3.6	**3.9**↑	3.4	3.5	3.4	2.3	**2.2**↓	**2.3**↓	2.5

Note: For some emerging economies seasonally adjusted GDP data are estimated by J.P. Morgan. Bold denotes changes from last edition of *Global Data Watch*, with arrows showing the direction of changes. Underline indicates beginning of J.P. Morgan forecasts. Unless noted, concurrent nominal GDP weights calculated with current FX rates are used in computing our global and regional aggregates. Regional CPI aggregates exclude Argentina, Ecuador and Venezuela. Regional GDP aggregates exclude Venezuela. Forecasts for Argentina are based on JPMorgan's estimates of CPI. Source: J.P. Morgan

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G-3 economic outlook detail

				2016	2017				2018		
	2016	**2017**	**2018**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**
United States											
Real GDP	1.6	2.2	1.8	2.1	1.4	3.0	1.8	1.8	1.8	1.8	1.8
Private consumption	2.7	2.5	2.3	3.5	1.1	2.9	2.0	2.0	2.2	2.5	2.4
Equipment investment	-2.9	3.6	2.2	2.0	7.8	9.5	2.0	2.0	1.8	1.5	1.5
Non-residential construction	-2.9	11.8	3.9	-1.9	22.5	27.0	3.5	3.0	2.5	2.3	2.0
Intellectual property products	4.7	4.0	2.4	1.3	6.4	4.3	2.3	2.3	2.3	2.3	2.3
Residential construction	4.9	3.4	1.1	9.6	12.9	-3.1	1.0	1.3	1.5	1.5	1.5
Inventory change ($ bn saar)	22.0	5.0	27.8	49.6	2.6	-11.8	6.6	22.5	26.8	25.9	28.0
Government spending	0.8	0.2	1.3	0.2	-0.9	1.7	0.3	0.7	1.5	1.8	1.9
Exports of goods and services	0.4	2.5	1.3	-4.5	7.0	0.8	1.3	1.3	1.5	1.3	1.3
Imports of goods and services	1.1	4.1	4.1	8.9	4.0	2.3	4.0	4.0	4.0	4.5	4.5
Domestic final sales contribution	2.1	2.5	2.1	2.9	2.3	3.5	1.7	1.8	2.0	2.3	2.2
Inventories contribution	-0.4	-0.1	0.1	1.0	-1.1	-0.4	0.4	0.4	0.1	0.0	0.0
Net trade contribution	-0.1	-0.2	-0.4	-1.8	0.2	-0.2	-0.4	-0.4	-0.4	-0.5	-0.5
Consumer prices (%oya)	1.3	2.0	2.1	1.8	2.6	1.9	1.8	1.6	1.4	2.1	2.4
Excluding food and energy (%oya)	2.2	1.9	2.3	2.2	2.2	1.8	1.7	1.8	1.8	2.3	2.5
Core PCE deflator (%oya)	1.7	1.5	2.0	1.7	1.7	1.4	1.4	1.5	1.6	2.0	2.1
Federal budget balance (% of GDP, FY)	-3.2	-3.6	-3.2								
Personal saving rate (%)	5.7	5.3	5.5	4.9	5.1	5.4	5.5	5.5	5.4	5.7	5.6
Unemployment rate (%)	4.9	4.4	4.1	4.7	4.7	4.4	4.3	4.2	4.2	4.1	4.1
Industrial production, manufacturing	0.0	1.3	1.5	1.6	2.1	1.4	1.5	2.0	1.5	1.5	1.0
Euro area											
Real GDP	1.7	2.2	2.0	2.1	2.3	3.0	2.0	2.0	2.0	2.0	1.8
Private consumption	2.0	1.8	1.8	1.7	1.4	2.3	2.3	1.8	1.8	1.8	1.5
Capital investment	3.4	5.9	4.1	14.3	5.3	5.0	4.0	4.0	4.0	4.0	4.0
Government consumption	1.8	1.3	1.5	1.2	1.4	1.5	1.5	1.5	1.5	1.5	1.3
Exports of goods and services	2.9	4.3	2.7	6.8	4.8	4.0	3.0	3.0	2.5	2.5	2.5
Imports of goods and services	4.2	6.2	3.2	16.1	5.3	4.0	3.5	3.5	3.0	3.0	3.0
Domestic final sales contribution	2.1	2.4	2.1	3.9	2.2	2.6	2.4	2.1	2.1	2.1	1.9
Inventories contribution	0.0	0.4	0.0	1.6	0.3	0.3	-0.2	0.0	0.0	0.0	0.0
Net trade contribution	-0.4	-0.6	-0.1	-3.4	-0.1	0.1	-0.1	-0.1	-0.2	-0.2	-0.2
Consumer prices (HICP, %oya)	0.2	1.4	1.0	0.7	1.8	1.5	1.2	1.1	0.7	0.9	1.1
ex food, alcohol and energy	0.9	1.0	1.2	0.8	0.8	1.1	1.0	1.1	1.2	1.1	1.2
General govt. budget balance (% of GDP, FY)	-1.8	-1.6	-1.5								
Unemployment rate (%)	10.0	9.2	8.5	9.7	9.4	9.3	9.1	8.9	8.7	8.5	8.4
Industrial production	1.4	2.5	2.7	4.3	0.4	5.0	3.0	2.5	2.5	2.5	2.5
Japan											
Real GDP	1.0	1.5	0.8	1.4	1.0	2.5	1.5	0.9	0.5	0.3	0.3
Private consumption	0.3	1.0	0.7	0.1	1.1	1.8	0.9	0.7	0.6	0.5	0.5
Business investment	1.4	3.6	1.6	7.9	2.5	5.0	2.0	2.0	1.0	1.0	1.0
Residential construction	5.5	1.6	1.3	0.8	1.1	-4.0	-2.0	2.0	2.0	2.0	3.0
Public investment	-2.9	1.0	-2.0	-11.5	-0.6	15.0	10.0	2.0	-5.0	-8.0	-10.0
Government consumption	1.3	0.2	0.8	0.2	0.0	1.2	1.0	1.0	0.8	0.4	0.8
Exports of goods and services	1.1	6.1	2.6	14.1	8.7	-0.5	5.0	4.0	2.0	2.0	2.0
Imports of goods and services	-2.3	4.3	2.9	5.3	5.6	8.0	5.5	3.0	2.0	2.0	1.5
Domestic final sales contribution	0.7	1.3	0.7	0.8	1.0	2.6	1.4	1.1	0.5	0.2	0.2
Inventories contribution	-0.3	-0.1	0.1	-0.7	-0.5	1.3	0.2	-0.3	0.0	0.1	0.0
Net trade contribution	0.6	0.2	-0.1	1.3	0.5	-1.4	-0.1	0.1	0.0	0.0	0.1
Consumer prices (%oya)	-0.1	0.6	0.7	0.3	0.3	0.4	0.7	0.9	0.7	0.6	0.7
ex food and energy	0.4	0.0	0.4	0.1	-0.1	-0.2	-0.1	0.3	0.6	0.8	0.9
General govt. net lending (% of GDP, CY)	-3.7	-3.9	-3.9								
Unemployment rate (%)	3.1	2.8	2.6	3.1	2.9	2.8	2.7	2.7	2.6	2.6	2.5
Industrial production	-0.2	4.3	3.0	7.7	0.8	8.0	1.0	4.0	3.0	3.0	2.0
Memo: Global industrial production	1.3	2.5	2.4	3.5	2.3	2.7	2.3	2.6	2.2	2.4	2.2
%oya				2.0	2.4	2.4	2.7	2.5	2.4	2.4	2.3

Note: More forecast details for the G-3 and other countries can be found on J.P. Morgan's Morgan Markets client web site. Source: J.P. Morgan

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Global Central Bank Watch

	Official rate	Current rate (%pa)	Change since (bp) 05-07 avg	oya	Last change	Next mtg	Forecast next change	Forecast (%pa) Sep 17	Dec 17	Mar 18	Jun 18	Sep 18
Global		2.21	-203	5				2.16	2.21	2.20	2.26	2.35
excluding US		2.59	-162	46				2.51	2.49	2.47	2.46	2.48
Developed		0.53	-285	19				0.53	0.65	0.65	0.77	0.91
Emerging		5.07	-193	-21				4.92	4.86	4.81	4.80	4.79
Latin America		8.01	-281	-132				7.35	7.11	7.11	7.12	7.18
EMEA EM		6.60	20	18				6.44	6.24	5.95	5.80	5.65
EM Asia		4.09	-162	-11				4.06	4.06	4.06	4.07	4.07
The Americas		2.28	-287	39				2.17	2.35	2.36	2.57	2.80
United States	Fed funds	1.25	-308	75	14 Jun 17 (+25bp)	26 Jul 17	13 Dec 17 (+25bp)	1.25	1.50	1.50	1.75	2.00
Canada	O/N rate	**0.75**	-288	25	**12 Jul 17 (+25bp)**	6 Sep 17	**Oct 17 (+25bp)**	0.75	1.00	**1.25**	**1.50**	**1.75**
Brazil	SELIC O/N	10.25	-519	-400	31 May 17 (-100bp)	26 Jul 17	26 Jul 17 (-75bp)	9.00	8.50	8.50	8.50	8.50
Mexico	Repo rate	7.00	-94	274	22 Jun 17 (+25bp)	10 Aug 17	Jan 19 (+25bp)	7.00	7.00	7.00	7.00	7.00
Chile	Disc rate	2.50	-200	-100	18 May 17 (-25bp)	13 Jul 17	Jul 18 (+25bp)	2.50	2.50	2.50	2.50	3.25
Colombia	Repo rate	5.75	-150	-175	26 May 17 (-25bp)	27 Jul 17	27 Jul 17 (-25bp)	5.25	5.25	5.25	5.25	5.25
Peru	Reference	**3.75**	-23	-50	**13 Jul 17 (-25bp)**	10 Aug 17	**14 Sep 17 (-25bp)**	3.50	3.50	3.50	3.75	4.00
Europe/Africa		1.05	-263	-15				1.02	0.98	0.92	0.89	0.91
Euro area	Depo rate	- 0.40	-330	-40	10 Mar 16 (-5bp)	20 Jul 17	4Q 18 (+15bp)	-0.40	-0.40	-0.40	-0.40	-0.40
United Kingdom	Bank rate	0.25	-467	-25	4 Aug 16 (-25bp)	2 Aug 17	3Q18 (+25bp)	0.25	0.25	0.25	0.25	0.50
Norway	Dep rate	0.50	-258	-75	17 Mar 16 (-25bp)	21 Sep 17	On hold	0.50	0.50	0.50	0.50	0.50
Sweden	Repo rate	- 0.50	-302	0	11 Feb 16 (-15bp)	7 Sep 17	3Q 18 (+10bp)	-0.50	-0.50	-0.50	-0.50	-0.40
Czech Republic	2-wk repo	0.05	-235	0	1 Nov 12 (-20bp)	3 Aug 17	Sep 17 (+20bp)	0.25	0.50	0.50	0.75	0.75
Hungary	3-m dep	0.90	-641	0	21 May 16 (-15bp)	18 Jul 17	1Q 19 (+20bp)	0.90	0.90	0.90	0.90	0.90
Israel	Base rate	0.10	-412	0	23 Feb 15 (-15bp)	29 Aug 17	3Q 18 (+15bp)	0.10	0.10	0.10	0.10	0.50
Poland	7-day interv	1.50	-317	0	4 Mar 15 (-50bp)	6 Sep 17	4Q 18 (+25bp)	1.50	1.50	1.50	1.50	1.50
Romania	Base rate	1.75	-719	-50	6 May 15 (-25bp)	4 Aug 17	Feb 18 (+25bp)	1.75	1.75	2.25	2.75	3.00
Russia	Key pol rate	9.00	N\A	-150	16 Jun 17 (-25bp)	28 Jul 17	Jul 17 (-25bp)	8.50	8.25	8.00	7.75	7.50
South Africa	Repo rate	7.00	-123	0	17 Mar 16 (+25bp)	20 Jul 17	Nov 17 (-25bp)	7.00	6.75	6.50	6.50	6.50
Turkey	Eff. fund. rate	11.94	-407	369	26 Apr 17 (+25bp)	27 Jul 17	Dec 17 (-50bp)	12.00	11.50	10.50	10.00	9.50
Asia/Pacific		3.16	-45	-11				3.14	3.14	3.13	3.12	3.12
Australia	Cash rate	1.50	-438	-25	2 Aug 16 (-25bp)	1 Aug 17	1Q 18 (-25bp)	1.50	1.50	1.25	1.00	1.00
New Zealand	Cash rate	1.75	-556	-25	11 Aug 16 (-25bp)	10 Aug 17	On hold	1.75	1.75	1.75	1.75	1.75
Japan	Pol rate IOER[1]	- 0.10	-33	-5	28 Jan 16 (-20bp)	20 Jul 17	On hold	-0.10	-0.10	-0.10	-0.10	-0.10
Hong Kong	Disc. wndw	1.50	-431	75	14 Jun 17 (+25bp)	-	13 Dec 17 (+25bp)	1.50	1.75	1.75	2.00	2.25
China	1-yr working	4.35	-175	0	23 Oct 15 (-25bp)	-	On hold	4.35	4.35	4.35	4.35	4.35
Korea	Base rate	1.25	-283	0	11 Jun 15 (-25bp)	31 Aug 17	On hold	1.25	1.25	1.25	1.25	1.25
Indonesia[2]	BI rate	4.75	-493	-175	20 Oct 16 (-25bp)	20 Jul 17	On hold	4.75	4.75	4.75	4.75	4.75
India	Repo rate	6.25	-56	-25	4 Oct 16 (-25bp)	2 Aug 17	3Q 17 (-25bp)	6.00	6.00	6.00	6.00	6.00
Malaysia	O/N rate	3.00	-20	-25	13 Jul 16 (-25bp)	7 Sep 17	On hold	3.00	3.00	3.00	3.00	3.00
Philippines[3]	Rev repo	3.00	-404	0	11 Sep 14 (+25bp)	10 Aug 17	On hold	3.00	3.00	3.00	3.00	3.00
Thailand	1-day repo	1.50	-219	0	29 Apr 15 (-25bp)	16 Aug 17	On hold	1.50	1.50	1.50	1.50	1.50
Taiwan	Official disc.	1.375	-114	0	30 Jun 16 (-12.5bp)	30 Sep 17	On hold	1.38	1.38	1.38	1.38	1.38

Source: J.P. Morgan. [1] BoJ sets the policy rate on IOER (O/N) and targets 10-year JGB yields as policy guidance

Bold denotes move since last GDW and forecast changes. Underline denotes policy meeting during upcoming week.

Aggregates are GDP-weighted averages. [2] The BI rate for Indonesia reflects announced recalibration effective August 19, 2016

[3] The Philippines introduced a recalibrated reverse repo rate effective June 3 at a level of 3.00%

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Nowcast global growth: 2Q17 Sustained strong momentum

The J.P. Morgan bottom-up forecast for 2Q17 global GDP growth remains at a strong 3.4%ar this week. We raised 2Q growth in the Euro area 0.5%-pt to 3.0%ar. We also revised higher our estimate of GDP growth in Malaysia to 4.5%ar. By contrast, we cut growth in Mexico almost in half to 0.8%ar. Going forward, we look for global growth to slow to a 2.9%ar pace in the current quarter. However, activity data into 3Q remained strong, and we flag upside risk to our forecast.

Table 1: Global real GDP

%q/q, saar (Current forecast shaded)

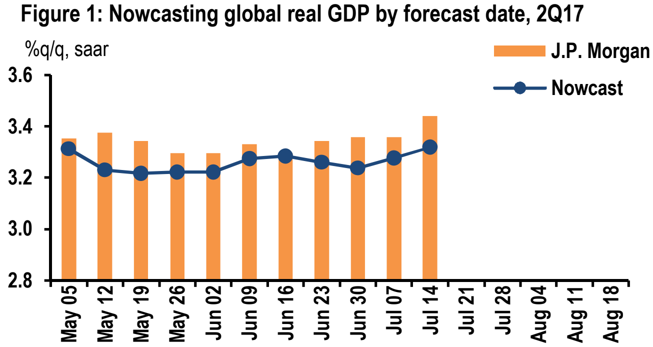
	1Q17	2Q17		
		Current	Last week	4 weeks ago
J.P. Morgan	3.0	**3.4**	3.4	3.3
Global Nowcaster	3.4	**3.3**	3.3	3.3
Global PMI model	3.1	**3.1**	3.1	3.1

Source: J.P. Morgan

The nowcast for 2Q17 global growth also remains unchanged this week at 3.3%ar, slightly below our bottom-up forecast. On the week, we extended out global auto sales aggregate through June as well as manufacturing output, retail sales, and capital goods imports through May. Generally these indicators remained strong last quarter with our tracking for industry growth near a 3.5% annualized pace. As for goods spending, we look for a 5%ar gain on the consumer side whereas we expect a bit more from businesses (6.6%ar).

In this regard, while the 2Q nowcaster is a touch below our 3.4% forecast, the strong momentum carrying through to June points to some upside risk to our call for global growth to moderate to 2.9% in the current quarter. Indeed, the monthly nowcast for June, which filters the June PMIs while making projections for the remaining missing data, is tracking 3.2%.

Figure 1: Nowcasting global real GDP by forecast date, 2Q17



Source:J.P.Morgan

Away from the hard activity data, our global business and consumer sentiment indicators held at the recent expansion highs in June. While confidence in the DM has been elevated since early last year, the improvement in the EM has been more recent. At the business and consumer level, China played a large role in the recent EM sentiment upswing. However, confidence also improved in Korea, Mexico, Russia, and Turkey.

Table 2: J.P. Morgan global aggregates

%ch, sa (ar for qet). PMIs are levels. Conf is st.dv from 2010-pres avg

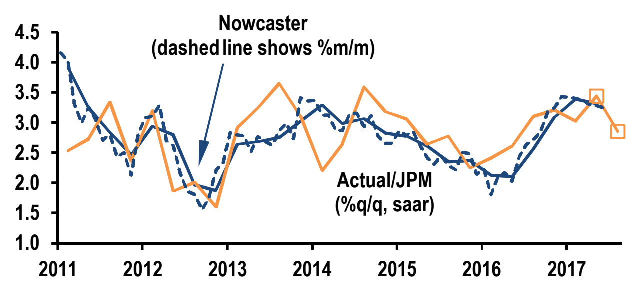
	1Q17	2Q17	Mar 17	Apr 17	May 17	Jun 17
PMI, mfg	54.0	53.5	54.2	53.6	53.5	53.3
PMI, serv	53.6	53.8	53.7	53.7	53.9	53.8
IP	3.2	3.4	0.1	0.4	0.1	0.3
Retail sales	3.1	5.1	0.5	0.6	0.2	0.3
Auto sales	-18.6	-2.9	-1.5	-2.3	2.2	1.2
Cap. shpmnts	4.0	6.8	-0.6	1.3	0.3	0.3
Cap. orders	5.8	-0.1	1.5	-1.8	0.6	0.3
Cap. imports	8.9	8.6	2.3	-1.1	3.3	-0.3
Bus conf	0.9	<u>1.1</u>	0.9	1.1	1.0	<u>1.1</u>
Cons conf	1.2	<u>1.5</u>	1.3	1.5	1.5	<u>1.5</u>
Nowcast	3.4	3.3	3.4	3.3	3.3	3.2

Note. Shaded values show forecasts computed by the Kalman filter estimates from the dynamic factor model. Underlined values are our estimates based on available data and our judgment. Source: J.P. Morgan, Markit, and national statistical agencies.

Next week, we look for China's June activity data on Monday including IP, retail sales, and 2Q GDP growth. We expect a solid 0.5% increase in manufacturing output while retail sales should deliver a stronger 0.9% increase. On GDP, our call is for a 6.6%ar gain, a 0.3%pt slowdown from 1Q. However, assuming June activity delivers as expected, there is modest upside risk to 2Q growth. Other reports to look for include Taiwan export orders for June on Thursday. This will help calibrate the extent of the momentum pickup in Asian trade into 3Q.

Figure 2: Global real GDP

%q/q, saar. Box shows J.P. Morgan projection for 2Q3Q, 17. Nowcst thru 2Q17



Source:J.P.Morgan

* *For a primer on our nowcast model see* [*link here*].

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Note: Research notes listed have been published in *GDW; Special Reports and Global Issues* are stand-alone features, but may also have appeared in some form in *GDW*.

The J.P. Morgan View

Where are the big misvaluations?

- **Asset allocation —** We are happy with our Goldilocks strategy of steady growth and low inflation, staying OW equities versus credit and govies, and OW EM and Euro area.
- **Economics —** Low US inflation lowers odds of a December rate hike, but keeps balance sheet normalization on calendar for September.
- **Fixed Income —** Modest step towards ECB taper; keep bearish proxies.
- **Equities —** Stay OW EM and Euro area.
- **Credit —** Remain long credit spread tighteners.
- **Foreign exchange —** Dollar remains in a low-volatility bear market.
- **Commodities —** Prospects of additional OPEC cuts appear distant.
- **Video this week.**

Both bonds and equities rallied this week, and the dollar weakened, on Fed signals that its future rate normalization will depend on the forecast normalization of inflation that remains missing in action, as again confirmed with this morning's soft US CPI reading. As discussed in recent weeks, the forecast remains that inflation will eventually react to tight labor markets, but the lag is long and variable, which means it is unreliable. In addition, as highlighted *last week*, surprises in both growth and inflation tend to repeat, which is why we are reluctant to put the inflation trade on.

We are not interpreting weak inflation as a sign of weak demand, but more as a reflection of the unreliable lag from demand to inflation. Inflation in turn can affect future demand, negatively by tightening profit margins, and positively by cheapening consumer goods. The net impact depends on how producers react relative to consumers. Activity data and surveys keep us optimistic on capital spending and global consumers but less so on US retail, as shown by this morning's soft reading. Overall, no change in forecasts, aside from another upgrade to Euro area Q3; still a slight upside risk on global growth in Q3; confidence that the FOMC announces the start of balance sheet normalization in September, as they are not making it conditional on inflation, with 1/3 odds they do this later this month; but now almost even odds that the next rate hike is postponed into 2018.

One question we are frequently getting from you is "Where are the large misvaluations in markets that a longer-term investor should by mindful of?" We see five major ones, all related to what is so different in this cycle. One caveat up front: we use the term misvaluation not in the sense of the market mispricing of today's fundamentals, as prices are generally in line with them. Asset prices move when the fundamentals change. We look instead at what asset prices are most different from historic norms, as today's fundamentals themselves are so different from the past. This is an important input into strategic allocations, both where valuation gaps reflect IRR differences, but also to the extent one can expect such misvaluations to correct over the long term.

The first macro deviation from historic pricing is that virtually **all asset prices are high** and their internal rates of return (IRRs) are low. We think this is due to high global savings rates, primarily from corporates, and in comparison low capital spending by both the private and public sector. The rise in the first and fall in the second have given us very high global asset prices and returns, but now low future expected returns.

The second misvaluation is that **DM government debt** has become very expensive in this cycle versus its main alternatives, credit and equities. The US equity risk premium versus bonds is around twice its historic mean, wide by some 2%. US credit spreads in this cycle have been trading around 1% wider than previous cycles. This is likely because of a dramatic rise in the demand for govies brought on by QE, EM FX reserves, and macro-prudential tightening of bank risk taking. Each of these three demand factors is in the process of fading and we should thus over the 1-2 cycles expect DM government debt to cheapen versus other asset classes.

A third mispricing is **inflation**, as reflected in the yield gap between nominal and inflation-linked bonds that remain well below the targets which DM central banks have set for themselves. These break-even rates are low because these central banks have not been able to achieve their objectives for a number of years now, leading to skepticism that they will over the coming years. We think the market is underestimating how determined these policy makers are and thus see good medium-term value in inflation linkers, even as we agree to be neutral at the moment, given the above mentioned tendency of inflation surprises to repeat.

A fourth mispricing is the **dollar** and related to that the **US-Euro bond yield spread**. As reviewed in this week's *Key Currency Views* (Meera Chandran, p. 34), the real trade-weighted US dollar is now 22% above its fair value determined by long-term macro fundamentals. Similarly, the 10-year UST yield spread at 1.75% above the German Bund, while much tighter than a few months ago, remains very wide against its near-zero average of the past 28 years. Both the dollar and the UST yield spread are in our mind a reflection of the unique character of this cycle where the US expansion has entered its 9th year while Europe, Japan and many large EMs, China excepted, had intermediate recessions. Other countries are now catching up to the aging US cycle and this should over the next few years permit the dollar and US yield spreads to narrow versus other countries.

Our last macro mispricing must be low asset price **volatility**, both delivered and implied. Marko Kolanovic and team, our economists and we have written plenty on this topic, relating it to the record low volatility of growth. At some point, politics and/or policy will gear into action in an attempt to boost income growth and will then pull us out of our Goldilocks world, for the better or the worse.

Deviation from long-term valuations, which we have termed mispricings, are important inputs into strategic allocations, and should be constantly monitored by tactical investors as to when the price reversion is about to take off. For us, as tactical investors, it keeps us UW govies vs credit and equities; keeps us biased to be short duration; UW the dollar versus EM, and medium term versus Europe; looking to go OW inflation linkers again, even as we are neutral now; but still low macro volatility and not yet OW Cash, as we do not yet see signs of a start of global asset price deflation.

Fixed Income

Bonds rallied this week, retracing some of their losses in recent weeks, with the US outperforming following comments by Yellen that were perceived by markets as dovish as well as a fourth consecutive downside surprise on CPI. The continued weakness in inflation prints will likely sow some seeds of doubt at the Fed over whether the soft run is temporary. That said, recent speeches have appeared to draw a distinction between balance sheet normalization, relating to economic growth that has held up, and rate hikes that are dependent on a shift in the inflation trajectory. As such, we still expect the Fed to start to its balance sheet normalization process in September, but the weaker inflation prints increase risks to our call for a further 25bp hike in December.

Ahead of the ECB meeting next week, Draghi looks set to take another step on the road towards an eventual September tapering announcement to reduce the pace of purchases in 1Q18 from €60bn/m to €40bn. We expect only modest tweaks in the opening statement at the press conference, e.g. via a removal of the easing bias for QE or a more explicit reference to a reassessment of QE parameters at the September meeting, likely accompanied by an emphasis that the inflation outlook still warrants accommodative policy. The domestic news flow remains upbeat, with our economists having revised up their 2Q17 Euro area GDP growth forecasts higher by 0.5% to 3% q/q annualized and momentum into 3Q looks strong. But the continued weakness in US inflation data, and the positive serial correlation in inflation releases and consensus forecasts highlighted last week, keeps us cautious on outright duration. **We keep carry-efficient bearish proxies via 10s/30s Germany steepeners and stay short 10y Bunds vs. USTs** on continued macro momentum divergence.

In the Antipodean economies, **we retain our long standing cross-market OWs via 3y Australia and 5y NZ vs. the US**. Last week's RBA meeting delivered if anything a modestly dovish shift as it acknowledged that the recent slowdown in growth can only partially be attributed to temporary factors. More recent data on housing finance also show a significant slowdown following new macro prudential measures, while consumer data reinforce a modest outlook for domestic demand. We thus remain comfortable with our view that a further 50bp of rate cuts in 1H18 in will be needed to close the output gap, while markets price in more than half of a full 25bp hike by mid-2018. Similarly, a soft patch in NZ data continues, with housing data pointing to significant correction in house prices as macro-prudential measures and higher bank funding costs bite. We see clear downside risks to RBNZ policy rates while markets price in nearly a full hike by mid-2018.

Equities

Equity markets rallied to record highs this week led by EM and European equities. The rally in bonds acted as a drag for Defensive sectors and Banks, but it helped other sectors due to a weaker dollar and expectations of dovish central banks.

Our global equity Strategists remain **Overweight EM** and the **Euro area**, on a currency unhedged basis to also benefit from currency gains. Not only do these two regions benefit from macro data outperformance vs the US or Japan but also from flow outperformance.

Sectorally we have been **favoring Defensives** and **Banks** and these positions suffered over the past two weeks. Although we recognize that persistent negative inflation surprises and their impact on bond markets act as a headwind for these sectors, we still see equity markets underappreciating central bank balance sheet normalization risks. We thus find it prudent to own these sectors as a hedge against our overall equity market overweight. The latter would most likely suffer over the coming months if central banks prove more hawkish than markets currently think.

The Q2 reporting season is still likely to be robust, but 2H earnings delivery could be more challenging (Matejka et al., *Equity Strategy*, Jul 10).

Credit

Credit spreads tightened across sectors this week along with stocks on rising odds that the Fed will postpone a December rate hike. The soft US CPI this morning validated such downside risk as both Yellen's Congressional testimony and recent Fed rhetoric suggest inflation as the precondition for another rate hike. HY and EM spreads outperformed this week on an improved risk sentiment while HG spreads compressed further on continued strength in investor demand.

Our index team launched a new suite of CEMBI+ indices: CEMBI IG+ and CEMBI HY+, which cater to investors with rating sensitive mandates and are more diversified compared to the existing CEMBI Broad IG or HY sub-indices. The CEMBI+ indices provide diversification at both the country and issuer level, where the diversified country weights are based on the amount outstanding within a credit bucket, which for example increases Brazil and Russia' weights in CEMBI IG but lowers their weights in CEMBI HY, and issuer cap aligns better with most investors' risk tolerance. This is in response to a rapidly rising number of investors, now about 2/3 of EM corporate mandates who are rating sensitive, nearly doubled in the last 6 years (Kim et al., *Introducing the JPMorgan CEMBI+ suite of indices: CEMBI IG+ and CEMBI HY+*, Jul 13).

Foreign exchange

Today we published the monthly *Key Currency Views* detailing the rationales for our global FX forecasts. There are numerous forecast changes this month for country-specific reasons, but they aggregate to a trade-weighted dollar that would be stable -- at best -- this summer. The EUR/USD forecast for Q3 is raised from 1.08 to 1.15 but the Q4 raised only from 1.14 to 1.15. We always expected the Bund selloff to lift the euro in 2017 even as the Fed hiked, but we expected US yields to rise more this summer. USD/CAD forecasts for Q3 (1.33) and Q4 (1.31) are lowered to 1.28 and 1.30 given JPM's revised view for Bank of Canada hikes once a quarter through 2018. The USD/CNY end-2017 target is lowered marginally from 6.94 to 6.88 on a more stable economy. We still expect USD/MXN to rise to 18.50 by year end since the peso appears too strong on our short-term fair value models. These pairwise moves, which account for the majority of the JPM trade-weighted index, would stabilize the broad dollar around its current level of 118-119 (ticker JBDNUSD)

Beyond this near-term outlook is a deeper story of a dollar that remains in a low-volatility bear market as non-US central banks follow the Fed out of the easy-money era. This pattern is not unusual: currencies are about relative fundamentals, so Fed tightening would only be USD-positive if the Fed were moving alone, and we never expected 2017 to be that sort of year. The JPM view entering this year was that other central banks like the ECB would start the process of ending their easy-money programs, and since non-US bond yields were further below fair value than US ones, non-US yields like those in Germany could move more than Treasury yields, thus pushing the dollar lower in some cases. So, while some of the rate moves coming out of non-US economies have been a genuine surprise to us (Bank of Canada), others have not (ECB, Riksbank). Other shifts we simply do not expect given cyclical risks (Bank of England); hence they lack much shape in the GBP/USD forecast.

For EM currencies, Fed hikes are only threatening to low-yielders (parts of Asia) or those that appear somewhat overvalued/over-owned on our preferred valuation and positon measures. The forecast spot moves are in the low single-digits percentagewise, however, and in many cases less than implied by the forwards.

Commodities

After slumping to close to $46/bbl at the end of last week, **Brent futures prices** have recovered back to levels seen at the end of June around $48/bbl. In part, this reflects that fact the US posted another draw in inventories in the weekly EIA report; however, continued reports that the upcoming Joint Ministerial Monitoring Committee between OPEC and non-OPEC governments (July 24) would seek to agree additional production cuts also supported prices. Similarly, reports of a meeting of OPEC governors on Monday 17 July were also seen as potential forum for additional cuts. However, prospects for such an agreement appear distant at this juncture, in our view. This month's assessments of OPEC compliance have deteriorated across the board for June output levels. Meanwhile, even if official assessments of Iraqi and Iranian output remain close to target production levels, a growing chorus of comments point to additional barrels being produced by both countries which we expect to weigh on producer solidarity in the coming months. Lastly, comments from OPEC secretary general Barkindo that OPEC would seek to hold more consultations with shale producers in 2h'17 seem more hope than substance. Ultimately, we see the oil price as the only effective measure for restraining shale production growth and more particularly, the ability of producers to hedge future production.

Entering July, micro indicators in the Chinese physical base metals markets started turning more negative, pointing towards peaking conditions and prompting us to **enter short recommendations in both copper and zinc** as we believe both metals will face increasing fundamental headwinds in the coming months. On the other hand, we **remain bullish aluminum, and have maintained our long trade recommendation** as we believe compliance with supply reform in China this year will be stronger than the market expects as the Chinese government seems to be quite serious about addressing overcapacity. While we have confidence in our fundamentally-based view and our accompanying trade recommendations, risks prevail to our outlook. Among them, we are most concerned about macro themes such as better liquidity conditions and stronger-than-expected growth in 2H in China and more micro factors such as a rally in ferrous metals, strikes at copper mines, large cancellations of zinc warrants and restarts of aluminum capacity (*Metals Weekly*, Jul 12).

Source: J. P. Morgan

Forecasts & Strategy

Interest rates		Current	Sep-17	Dec-17	Mar-18	Jun-18
United States	Fed funds rate	1.16	1.15	1.40	1.40	1.65
	10-year yields	2.33	2.40	2.65	2.70	2.75
Euro area	Refi rate	0.00	0.00	0.00	0.00	0.00
	10-year yields	0.60	0.55	0.80	1.00	1.15
United Kingdom	Repo rate	0.25	0.25	0.25	0.25	0.25
	10-year yields	1.31	1.15	1.40	1.65	1.80
Japan	Overnight call rate	-0.10	-0.10	-0.10	-0.10	-0.10
	10-year yields	0.08	0.05	0.05	0.10	0.10
Emerging markets	GBI-EM - Yield	6.20		6.64		
Credit Markets		**Current**		**Dec-17**		
US high grade (bp over UST)		132		135		
Euro high grade (asset swap sprd)		62		65		
USD high yield (bp vs. UST)		450		425		
Euro high yield (bp over Bunds)		284		325		
EMBIG Div (bp vs. UST)		308		300		
EM Corporates (bp vs. UST)*		259		275		
Foreign Exchange		**Current**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**
EUR/USD		1.15	1.15	1.16	1.15	1.18
USD/JPY		113	110	107	107	105
GBP/USD		1.31	1.29	1.29	1.28	1.33
USD/CNY		6.78	6.85	6.88	6.93	6.98
JPM USD Index		117.7	119.4	119.7	120.7	120.5
DXY		95.1	94.9	94.2	94.9	92.7
EMCI		69.0	68.0	67.5	66.9	67.0
				Quarterly Averages		
Commodities		**Current**	**17Q3**	**17Q4**	**18Q1**	**18Q2**
Brent ($/bbl)		49	50	52	48	43
Gold ($/oz)		1229	1250	1230	1240	1260
Equity Markets		**Current**		**Dec-17**		
S&P 500		2459		2400		
Stoxx Europe 600		387		410		
FTSE 100		7378		7500		
Topix		1625		1650		
MSCI EM ($)		1041		1100		

YTD Equity Sector Performance*	US		Europe		Japan		EM$	
Energy	-12.4%	OW	-7.9%	OW	-4.4%	N	3.1%	N
Materials	11.6%	OW	8.3%	N	12.8%	UW	16.4%	N
Industrials	11.0%	N	14.6%	UW	7.8%	N	20.5%	N
Discretionary	11.3%	UW	7.2%	N	2.0%	OW	25.3%	OW
Staples	6.8%	UW	12.3%	N	11.6%	OW	14.2%	UW
Healthcare	16.6%	OW	9.9%	N	2.3%	N	10.6%	UW
Financials	8.4%	OW	15.0%	OW	0.5%	N	19.3%	OW
Information Tech.	21.3%	N	16.1%	N	18.3%	UW	40.8%	OW
Telecommunications	-12.7%	N	4.9%	OW	8.5%	N	11.1%	UW
Utilities	8.1%	N	11.0%	N	2.9%	N	13.5%	UW
Overall	**11.0%**		**10.6%**		**7.8%**		**22.6%**	

*Levels/ returns as of July 13, 2017

Investment themes

Goldilocks has not left the room yet
World economy is cruising at just above potential pace. Inflation is behind the curve allowing central banks to do the same. This improves cycle longevity, setting us up to break the 10-year record expansion length from the 1990s, carrying us through 2019.

Equity rally unlikely to remain straight line and we thus reduce at the margin
The summer months have bad seasonals, long positions and the risk of policy disappointment.

Stay with high-income strategy, on weak nominal gains, but reduce vulnerability to the Fed, ECB
Add to credit, but hedge the duration risk, creating holdings that are negatively correlated to any Fed and ECB balance sheet tantrum. In equities focus on preferreds instead of high-dividend and REITs that are most vulnerable to a bond sell off. Stay significantly long EM local bonds, currency unhedged.

Macro momentum remains strong to EM and Euro area
Remain long their equities and FX against US, while staying long USTs vs Euro bonds.

Global Asset Allocation:
Lower EQ to +5% OW and move capital to Credit, up to +10%. Keep low-yielding Government Bonds, Cash and Commodities at -10%, -3% and -2%, respectively.

Source: J.P. Morgan

Tactical overview

	Direction	Country	Sector
Asset allocation	Longer cycle	Europe, EM	High Income
Equities	Long and OW	Euro area and EM	Preferreds; Defensives
Bonds	UW, flat duration	EM, AU, NZ	Flat inflation
Credit	OW	USD	HY
FX	Short USD	EM	
Comd's	UW		OW Oil; Indu. metals

Source: J.P. Morgan

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Economic Research Note

Macron and beyond: The EU's reform agenda

- **Hopes for Euro area reform grow, as Macron proposes a budget, parliament, and finance minister for the region**
- **German proposals for a European Monetary Fund do not clearly head in the same direction**

A number of forces are combining to generate renewed optimism on EU institutional reform. These include Macron's victory in the French presidential and parliamentary elections, the likelihood that Merkel will remain German chancellor after September's election, and a broad-based regional upswing in growth. Macron's ability to deliver on his domestic reform agenda will be important in establishing his credibility in the eyes of EU leaders (see "France: Macron labor reform to kick in this autumn", *GDW*, July 7, 2017). While Merkel appears minded to look favorably on at least some reform ideas, the outcome of the September election and the resulting coalition government will influence her room for maneuver (see "Merkel to have "a think" about Macron's Euro area reforms", *GDW*, June 23, 2017). And more broadly, the economic and political challenges in addressing EU and Euro area shortcomings are significant (see "Setting the scene for the Merkel Macron push" *GDW*, July 7, 2017).

Against this backdrop, here we look at the reform ideas emerging from two sources: from Macron and from the ongoing work at the European Commission. In both cases there is a conspicuous lack of concrete detail at this point, reflecting a desire to make progress in discussions without such detail generating an adverse reaction from other parties. At this stage, it is not clear to us that underlying differences in French and German attitudes (and others) can be breached in a manner that generates transformative reform. Thus, we expect the resultant changes to be incremental.

Macron's Big Picture

Macron has argued that EU needs to reform if it is to prosper, suggesting that the euro could fail within a decade without institutional change. He has proposed "conventions" across the whole of the EU in an attempt to involve citizens in a debate about the region's priorities. And as the UK leaves the EU, he has argued that its 72 seats in the European Parliament should be set aside for candidates on a pan-European list. He also has argued that the EU should play a more assertive role in areas such as defene, migration, and managing the effects of globalization. The latter includes proposals to limit non-EU firms' access to government procurement contracts, and limits on foreign takeovers in strategically important sectors. On migration, Macron argues for a more coherent EU-wide approach where the burden of absorbing non-EU migrants is shared more evenly across countries. Macron has also sought a tightening in the regime on "posted workers": this allows individuals working abroad to pay social contributions in their home country, contributing to the ability of workers from eastern EU countries to undercut the pay of local workers in France. The response to some of Macron's ideas has been lukewarm from the Commission and outright hostile in some eastern EU states.

On the issue of Euro area reform, Macron has proposed that the region should have its own budget, finance minister, and a parliament, with the latter drawing on both European and national parliaments. Beyond broad statements, however, he has provided little detail, either during the election campaign or immediately afterward. But these ideas appear to draw heavily on the thinking of Jean Pisani-Ferry, who became Macron's "Director of Programme and Ideas" in January 2017. In turn, Pisani-Ferry's ideas have been expressed in a stream of contributions during the crisis and after, including his 2011 book and subsequent papers for the Hertie school of Governance, Bruegel, and France Strategie.

Table 1: Alternative models for the future of the Euro area

	Discipline	Solidarity	Governance	Legitimacy
Full decentralized model	Strict no bail-out, maximum exposure ceiling for banks	No Euro area-specific solidarity	Insolvency procedures for sovereigns	No specific accountability
Federal model	Rules and procedures for fiscal and macroeconomic surveillance	Countercyclical transfers and conditional assistance financed by common budget	Federal institution (presumably Commission) as Euro area executive	Accountability to European parliament
Hybrid model	National rules consistent with common principles, network of national institutions	Graduated mutual support mechanism	Euro area coordination executive	Parliamentary body built out of national parliaments and the EP

Source: "Rebalancing the governance of the Euro area", Jean Pisani-Ferry, 2 May 2015

Pisani-Ferry (hereafter P-F) has offered a number of versions of how the Euro area could be reformed. In "Rebalancing the governance of the euro area" he describes a choice between three competing models for the future governance of the region: a fully decentralized model, a Federal model, and a hybrid of the two (Table 1). P-F argues that full decentralization would not reflect the political quid pro quo implicit in the creation of the euro that mutual support would be available, and also that debt levels of individual sovereigns are too high for a strict "no bail out" rule to be credible. But there is no political appetite for a fully Federal model. As a result P-F proposes that a hybrid model should contain elements of both centralization and decentralization with a number of potential features:

- **National fiscal and competitiveness councils to streamline and decentralize governance.** Rather than the convoluted procedures associated with the current regional fiscal governance regime, P-F argues that independent national fiscal councils should implement the regime at the local level, with responsibility for the production of fiscal forecasts. These councils would effectively implement the EU fiscal regime at the local level subject to a degree of oversight from the center.
- **More graduated financial support via the ESM.** P-F argues there is too much discontinuity between the "normal" situation and a "program" situation, where a country has to accept harsh conditionality for support. He hence advocates that the ESM develops a broader set of instruments, ranging from low-conditionality lending through to a formal bankruptcy and restructuring procedure. He suggests that an EU veto on the budget should be in place for states that draw on any guaranteed borrowing buffer.
- **Fiscal capacity**. In some versions of his work that emphasize the need for more fiscal autonomy at the national level, P-F limits the role of shared fiscal capacity to a backstop for the ESM and banking union. Elsewhere, P-F has investigated the properties of various proposals for shared fiscal capacity, including transferring fiscal responsibility to the center, a more limited "stabilization fund," and changes to procedures for issuing debt. P-F has advocated the idea of a "cyclical stabilization fund" wherein countries contribute to a central fund on an ongoing basis, and payments from the fund are made when growth in individual countries falls well below the regional average.
- **Reform of central governance.** P-F argues that where funds for Euro area stabilization come from national sources outside of the EU budget, governance should take the form of representation from both national parliaments and EU institutions. He has also argued for reform of the Eurogroup to increase its legitimacy, potentially with a full-time president and supporting staff.

EU ideas: A safe asset and fiscal capacity

Macron's reform ideas are of course not the only ones getting attention among European policymakers. The European Commission has also sought to reinvigorate the process of institutional reform with a series of "reflection papers," including one on deepening the monetary union that has spawned a work program focusing on two issues: the creation of a "safe asset" and a fiscal capacity for the euro area. The Commission is sensitive to the fact that any safe asset idea that alludes to debt mutualization will not be supported in Germany and elsewhere. Nevertheless, the intention is to explore whether permutations of tranching and pooling of debt, possibly alongside changing regulatory treatment of bank holdings of debt, could create a new, liquid asset to serve as a regional benchmark. On the fiscal capacity side, the commission "will encourage a discussion on the specific design of a function," with protection for regional investment spending, unemployment reinsurance, or a "rainy day fund" potential parts of that scheme.

To complete the set of reform ideas under discussion, we should also mention the notion of the ESM being transformed into a "European Monetary Fund." The ESM was set up as an intergovernmental arrangement rather than part of the EU system of governance established via Treaty. The need to bring the ESM more formally into EU treaties has been raised on a number of occasions. However, Merkel and Schäuble reportedly favor broadening the ESM's role to become a "European Monetary Fund," with it building technical expertise and taking responsibility for ongoing fiscal surveillance of member states. How this would relate to the Commission's role in fiscal governance is not clear. But, there is at least an implicit suggestion that the Commission's role may be challenged, reflecting a German view that the Commission has been too lenient in its application of the region's fiscal rules.

So what happens next?

Merkel and Macron have agreed on the need to develop a medium term roadmap for deepening the EU and the Euro area. And both leaders have stated that they are prepared to consider treaty reform if that is necessary to implement changes through time. This week's meeting of the joint Franco-German Ministerial Council saw a new commitment to cooperate to build military aircraft, and continuing exploration of whether corporate tax regimes could be aligned. Further progress on these and broader issues will likely be slow ahead of the German elections in September, while Macron's focus will be on delivering labor market reform at home. But the widespread expectation is that EU reform will be on the agenda as soon as a new German government is in place. On the EU side, Commission president Juncker has stated his intention to present a first set of conclusions on the roadmap at the December 2017 meeting of the European Council.

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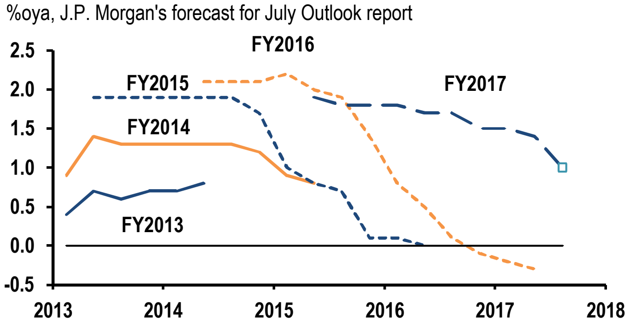
Economic Research Note

BoJ: Kuroda or not matters when critics persist

- **BoJ to stay on hold for long as inflation forecast revised down and major central banks tilt to normalize**
- **We think the BoJ needs to be more realistic in its inflation forecast and improve its communication**
- **Domestic policy discussions outside the BoJ appear to skew to normalization, not further easing**
- **We expect Kuroda to be reappointed as governor after April 2018, but political developments are a wild card**

At the Monetary Policy Meeting (MPM) on July 20, we expect the BoJ will maintain its policy of quantitative and qualitative monetary easing (QQE) with yield curve control (YCC). At the same time, we expect board members to revise down their inflation forecast in the Outlook report. The consensus view is no policy change as growth is solid and markets widely recognize that ammunition for further easing is limited. Market participants have been skeptical of the BoJ's inflation forecast; another downward revision without any policy change should not be a surprise (Figure 1).

Figure 1: Revision of BoJ board members' core CPI inflation forecast
%oya, J.P. Morgan's forecast for July Outlook report



Source: BoJ, J.P. Morgan

Despite weak inflation, there is some market speculation that the Bank will be forced to raise its 10-year yield target given the upward pressure on JGB yields from the rise in long-term yields in the US and Europe, although not necessarily next week. Moreover, there are persistent critics of the BoJ's current policy as a whole who argue that 2% inflation is unrealistic in Japan, so the target should be more flexible, if not lowered to perhaps 1%. From another angle, some politicians and media are urging the BoJ to start discussing its exit from unconventional policy as the side effects or costs could be substantial when it eventually raises policy rates.

In our view, the BoJ can and will defend its current YCC target while dismissing the critics. Indeed, we think the QQE with YCC policy is powerful and durable as the bank has sufficient tools to support it, such as fixed-rate purchase operations and fixed-rate funds-supplying operations for a period of up to 10 years. And Governor Kuroda strongly believes that the current policy is desirable for Japan and that the BoJ can successfully manage the exit when the time comes. Based on our view that the BoJ's policy regime remains unchanged, we think that the current policy framework will be in place for a long time (see the special report "BoJ exit: Slow, unique, and very challenging," June 12, 2017). Note that this assessment includes the reappointment of Kuroda as governor next April. Another candidate could be appointed, especially if the political environment changes, though we think this is unlikely.

BoJ needs to improve its communication

In our view, the Bank's continued unrealistic inflation forecast is counterproductive. We think that the BoJ's original aim in maintaining a high inflation forecast was to raise the general public's inflation expectations, but repeated forecast errors have eroded the Bank's credibility. Moreover, the BoJ appears to have failed to communicate the inflation target and its benefits. Indeed, the latest Opinion Survey on the General Public's Views and Behavior showed that 40.2% of respondents had never heard that the Bank has set the "price stability target" at 2% CPI inflation. The ratio was 38.9% at the end of 2013 and has been at similar levels since then. Moreover, 78.9% regard price increases as "rather unfavorable" (only 4.2% responded "rather favorable") and 40.0% see price declines as "rather favorable" (34% say "rather unfavorable"). We think that the BoJ needs to be more realistic in its inflation forecast and improve its communication to the general public.

Persistent critics of the BoJ

BoJ watchers' views on the Bank's next moves are mixed and complicated. Recent inflation weakness may warrant more easing, especially if the BoJ sticks to achieving its 2% inflation target as soon as possible. However, calls for further easing are limited both inside and outside the BoJ. Indeed, according to the latest survey by Japan's Center of Economic Research, only three out of 39 respondents predict the next policy action will be easing and only one predicts it will be this year (the other two predict later than June next year). The others cite the solid economy and tight labor market as reasons for the central bank not to ease further at this stage, especially with limited ammunition such as negative policy rates and more asset purchases. The hurdle for further easing is high, a view widely shared in the markets.

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On the other hand, the majority of survey respondents (22 out of 39), including us, predict the next policy change will be a tightening after June 2018. To be sure, the survey asks what the likely next action will be, not what should be done. But, our observation is that the policy recommendations outside the BoJ skew to normalization, not further easing. Major central banks' recent hawkish turn appears to have reinforced this mood. We often hear from domestic clients that the 2% inflation target is unrealistic given low growth expectations (or potential growth rate), so the BoJ's aggressive intervention in the JGB and ETF (equity) markets is only harmful, damaging market functioning.

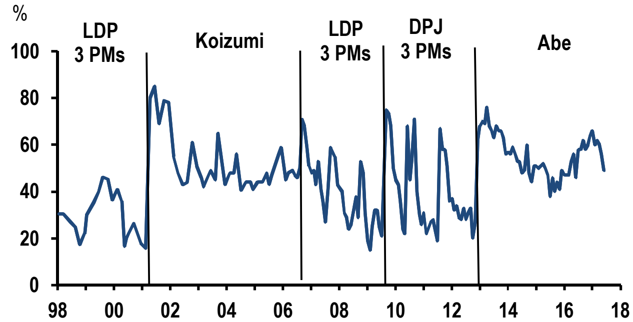
The BoJ disagrees with these critics, arguing that 2% inflation is achievable and desirable for the economy. While recognizing potential costs and side effects—such as BoJ losses (negative capital), damage to financial sector profits, and the loss of fiscal discipline, the Bank claims that achieving 2% inflation has more benefits than costs as it would reestablish the power of monetary policy. We think this stance is unlikely to change under Governor Kuroda and Prime Minister Abe, who appoints the BoJ governor.

Kuroda likely to be reappointed, but…

We have relatively high conviction in the BoJ exit sequence that we described in the special report referenced above, although there is some risk to our CPI forecast (the timing may be delayed). However, our call assumes that the BoJ's policy regime (policy principle) will be unchanged. In this regard, it is important who will be appointed as governor and deputy governors from April next year. Our baseline view is that Kuroda will be reappointed and that Masayoshi Amamiya, current executive governor of the Bank, will be one of the deputy governors. The other deputy governor appointed could be an academic. Both Kuroda and Amamiya are well regarded by Abe's administration. In addition, we don't expect that failure to achieve 2% inflation target would prompt political objections to Kuroda. In our view, no inflation is in fact welcome from a political perspective because the general perception of inflation is unfavorable, as noted above.

However, Kuroda will be 73 years old in October this year. Although Chief Cabinet Secretary Suga mentioned in April that age would not be a factor in reappointing Kuroda (the BoJ's 31st governor), he would be 78 when his second term ends in 2023, older than 28th governor Hayami who ended his term in 2003 at 77 (though younger than Alan Greenspan who was 79 at the end of his term as Fed chair). Moreover, the BoJ governor is a political appointment. Recently, Abe's popularity plunged after his perceived mishandling of scandals related to the establishment of a new college in the special economic zone amid seeming complacency in the LDP ruling party (Figure 2). Consequently, in the Tokyo metropolitan congressional election at the beginning of this month the LDP lost decisively against the new local party, "Tokyo first."

Figure 2: Approval rate of Cabinet



Source: Nikkei Newspaper

As we see no viable alternatives inside or outside the LDP in national politics at the moment, we continue to think that Abe will stay in power until 2021. But he may prefer to appoint a new face at the head of central bank. The potential candidates for governor we know of at this stage are the following:

- *Hiroshi Nakaso* (age 64 next April): current deputy governor, BoJ staff since 1978. No clear public view on fiscal policy.
- *Masayoshi Amamiya* (62): current executive governor, BoJ staff since 1979. No clear public view on fiscal policy.
- *Hiroshi Watanabe* (68): former MoF official and Vice Minister of Finance for International Affairs (2004-2007), a candidate for deputy governor in 2008 but rejected by the Upper House. Appears to be an advocate for VAT hike.
- *Etsuro Honda* (63): current ambassador to Switzerland, friend and advisor of Abe, former MoF official, advocate for the combination of easy fiscal and monetary policy.
- *Takatoshi Ito* (67): Professor of economics at Columbia University, a candidate for deputy governor in 2008 but rejected by the Upper House. Advocate for VAT hike.

Since the new term will begin in April, the formal appointment by the Cabinet and approval by the Diet likely will be in early 2018. But market speculation should be noisy by the end of this year. We think all candidates except Honda would maintain the basic policy regime, but market participants likely would take the appointment of anyone other than Kuroda as a sign that normalization will be front-loaded.

We think Honda's selection is unlikely at this stage because a recent scandal involved another friend of Abe, and his tendency to favor friends has long been criticized. But if Honda were chosen, even as a candidate for deputy governor, the initial market reaction could be significant—based on his public views, his selection would signal aggressive fiscal policy with more monetary easing, which is likely to be regarded as outright helicopter money policy.

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Economic Research Note

2018 Brazil election: Opening remarks

- **Attention has turned prematurely to the 2018 General Elections**
- **Among several possible candidates, some support pension reform, some do not, and some we don't know yet**
- **The polls show former president Lula ahead, with at least five other solid candidates**
- **However, these results are of little use for predicting next year's election outcome right now, in our opinion**
- **Volatility should remain high, as the election result is crucial for the fate of the reforms and, thus, for the country**

With the current administration facing political and legal challenges, and given the urgency of structural reforms in the country, attention has turned prematurely to Brazil's 2018 elections. Although we are approximately 16 months away from the event, a few polls have surfaced showing different scenarios for the various possible candidates.

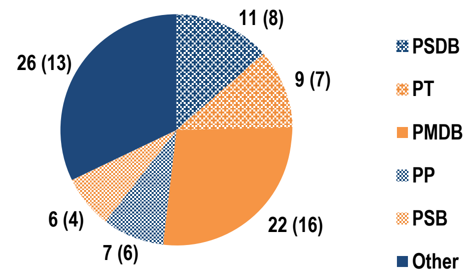
In this initial note, we discuss what is at stake in this election and tentatively build a calendar leading up to the event next year. We briefly profile each of the best-known possible candidates, but highlight that it is too early to predict the election outcome in the current volatile political environment. Even so, we maintain our view that the current political uncertainty over President Temer's mandate, as well as the rapid onset of election-year political positioning, will likely prove to be an obstacle to approval of pension reform before next year's voting.

First things first: What is at stake

In October next year, there will be general elections in Brazil, which means that the political actors' positions will be significantly reshuffled in 2018. The population will elect the president, all 513 members of the Lower House, 54 out of 81 members of the Senate, and the governors and state assembly members of 27 states for a four year term. Mayors and municipal assembly members were elected in 2016 (for more information on this, see "Brazil: PT lost ground in the first round of mayoral elections," October 4, 2016).

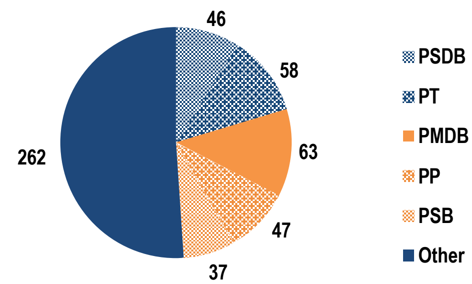
The composition of the assemblies—including the federal Lower House and the Senate—will be determined in the first round vote, likely to be held October 7. Currently, Temer's PMDB is the party with the most seats in both houses (Figures 1 and 2), but this depends on a large coalition of 14 parties to reaching a significant majority. The composition of the next Congress is key, as the new representatives will vote on the reform agenda—the pension reform for instance requires a minimum of 60% support in Congress. The president and governors will be elected in a second-round vote if none of the candidates have more than 50% of the valid votes in the first round.

Figure 1: Senate composition (selected parties)
number of representatives, in parentheses those that will be replaced or reelected



Source: J.P. Morgan and Congress website

Figure 2: Lower House composition (selected parties)
number of representatives



Source: J.P. Morgan and Congress website

The election process is likely to be lengthy, even though the actual campaigns can only start three months prior to the vote. The press, market participants, and the general population will closely monitor all the steps—from the selection of candidates to the crucial vote at the end of October. The official election dates probably will be set only by 1Q18. Yet, we have built a tentative calendar for 2018 mostly based on Law 13.165, approved in 2015 (Table 1). However, we reiterate that this is only a tentative calendar as the Congress can approve new legislation that would be effective for the next electoral cycle up to 12 month before the election date.

According to existing law, to participate, candidates must be affiliated with a party 180 days before the election; thus, by the beginning of April the candidates need to be registered in a party. By August 15 next year, parties will have to have registered their candidates. Then, the advertisement period starts, the polls will be more frequent, and the debates will start to take place. The first round of the elections will probably be October 7 while the second round, if any, should be October 28.

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Table 1: Tentative 2018 Election Calendar*

Tentative Date	Event
January 1, 2018	Polls need to be registered in the Electoral Court
Beginning of March	Supreme Electoral Court last day to inform about the 2018 Elections proceedings
April 10, 2018 (180 days before the elections)*	Deadline for candidate to be affiliated to a party
Beginning of July	Candidates can start campaign inside the party (TV, radio, or outdoors are prohibit-ed)
July-August	Period for Party Primaries to officially choose candidates
August 15, 2018*	Deadline for candidate registration
August 15, 2018*	Electoral advertisement starts
August 31, 2018*	Mandatory advertisement on TV and radio starts
Beginning of October	Mandatory advertisement on TV and radio ends
Beginning of October	Electoral advertisement ends
October 7, 2018	**First round**
October 28, 2018	**Second round**

*Based on the laws that regulate elections; the official calendar will be informed by the TSE by 1Q18
Source: Supreme Electoral Court and J.P. Morgan

Getting to know key likely candidates

For now, we do not know who the candidates will be, as the electoral law allows formal candidacies only at mid-August. Polls have included names of candidates that look likely to run, either because they ran in past elections or because their names are in the spotlight. We present brief profiles of each candidate included in the polls so far, including our assessment of their political orientation, regardless of their actual chances of appearing in the ballot (note that we have included information on three names from PSDB, but each party can only have one candidate):

1. Luiz Inácio Lula da Silva

- Professional Background: Ironmaster
- Age: 71
- Party: Worker's Party (PT)
- Orientation: Left
- Position about the pension reform: Against (see "Lula encerra ato de trabalhadores com críticas a reformas de Temer", *UOL*, March 15)
- Current public position: None
- Previous public positions: President (2003-2010), Congressman (1987-1991)
- Previous presidential elections (position): 1989 (runner-up), 1994 (runner-up), 1998 (runner-up), 2002 (elected), 2006 (elected)

2. Marina Silva

- Professional Background: Activist
- Age: 59
- Party: *Rede Sustentabilidade;* ran for the Socialist Party (PSB) in 2014
- Orientation: Center-Left
- Position about the pension reform: Favors the reform, but not as it was proposed (see "Reforma da Previdência é necessária, mas não da forma como está sendo proposta pelo governo", *Rede Sustentabilidade website*, March 14)
- Current public position: None
- Previous public positions: Minister of Environment (2003-2008), Senator (1995-2011) and Congresswoman (1991-1995)
- Previous presidential elections (position): 2010 (third place), 2014 (third place)

3. Jair Bolsonaro

- Professional Background: Army Captain
- Age: 62
- Party: Social Christian Party *(PSC)*
- Orientation: Right / Conservative
- Position about the pension reform: Against (see "Não é a imprensa ou o STF que vai falar o limite pra mim, diz Bolsonaro", *Folha de S. Paulo*, March 13)
- Current public position: Congressmen (1991-2018)
- Previous public positions: Congressmen (1991-2018)
- Previous presidential elections (position): None

4. Geraldo Alckmin

- Professional Background: Physician
- Age: 64
- Party: Brazilian Social Democracy Party *(PSDB)*
- Orientation: Center-Right
- Position about the pension reform: Supportive (see "Alckmin defende reforma da Previdência, mas diz que Temer precisa 'explicar melhor' as mudanças", *O Globo*, May 1)

- Current public position: Governor of São Paulo State (2001-2006, 2011-2018)
- Previous public positions: Congressmen (1987-1995), Vice-Governor of São Paulo (1995-2001)
- Previous presidential elections (position): 2006 (runner-up)

5. Aécio Neves

- Professional Background: Economist
- Age: 57
- Party: Brazilian Social Democracy Party *(PSDB)*
- Orientation: Center-Right
- Position about the pension reform: Supportive (see "Um debate franco e honesto precisa pautar mudanças na Previdência", *Folha de S. Paulo*, January 16)
- Current public position: Senator (2011-2018)
- Previous public positions: Congressmen (1987-2002), Governor of Minas Gerais (2003-2010)
- Previous presidential elections (position): 2014 (runner-up)

6. João Dória

- Professional Background: Entrepreneur
- Age: 59
- Party: Brazilian Social Democracy Party *(PSDB)*
- Orientation: Center-Right
- Position on the pension reform: Supportive (see "Doria defende reformas do governo Temer e diz que 'maioria da população' é favorável", *O Globo*, April 24)
- Current public position: Mayor of São Paulo (2016-2020)
- Previous public positions: Municipal Secretary of Tourism (1983-1986)
- Previous presidential elections (position): None

7. Ciro Gomes

- Professional Background: Lawyer
- Age: 59
- Party: Democratic Labor Party *(PDT)*
- Orientation: Left
- Position about the pension reform: Against (see "Ciro Gomes ataca reformas propostas pelo governo de Michel Temer", *Valor Econômico*, May 14)
- Current public position: None
- Previous public positions: Minister of Finance (1994), Governor of Ceará (1991-1994), Congressmen (2007-2011)
- Previous presidential elections (position): 1998 (third place), 2002 (fourth place)

8. Joaquim Barbosa

- Professional Background: Judge
- Age: 62
- Party: None
- Orientation: Unknown
- Position about the pension reform: Unknown
- Current public position: None
- Previous public positions: Supreme Court Judge (2003-2014)
- Previous presidential elections (position): None

Poll evidence could shift radically

A recent poll from Datafolha (see "Lula lidera, e 2º lugar tem empate de Bolsonaro e Marina, diz Datafolha," *Folha de S. Paulo*, June 26), one of the most respected institutes of the country, showed that former president Lula is ahead with 30% voter support (Table 2). Of note, Lula was convicted in one of the accusations related to the Car Wash probe. This conviction does not bar Lula from running next year, but creates uncertainty about his participation as a confirmation of the conviction by a higher instance is needed, which, according to specialists (see "TRF-4 não deve decidir sobre Lula em menos de um ano, dizem advogados", *Folha de S. Paulo*, July 13), could take more than a year to transpire. Marina Silva, a candidate in the last two elections, follows with 15%. At the same time, the poll shows Lula with a high disapproval rate—46%—followed by Geraldo Alckmin with 34% and Jair Bolsonaro with 30% (Figure 3). In addition, the polls suggest that the general public is familiar with most of the candidates, except for João Dória and Jair Bolsonaro (Figure 4).

Table 2: 2018 Elections Polls – July 2017
% of total votes

Possible candidates	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Lula (PT)	30.0	30.0	30.0	29.0
João Dória (PSDB)	-	10.0	-	9.0
Marina Silva (Rede)	15.0	15.0	15.0	15.0
Geraldo Alckmin (PSDB)	8.0	-	8.0	-
Jair Bolsonaro (PSC)	16.0	15.0	15.0	13.0
Ciro Gomes (PDT)	5.0	6.0	-	-
Joaquim Barbosa (No party)	-	-	11.0	10.0

Source: Datafolha

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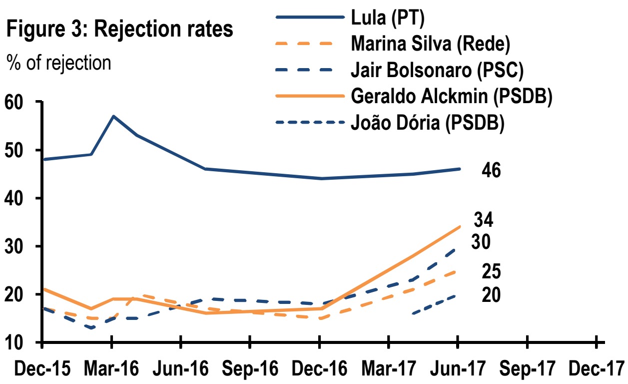
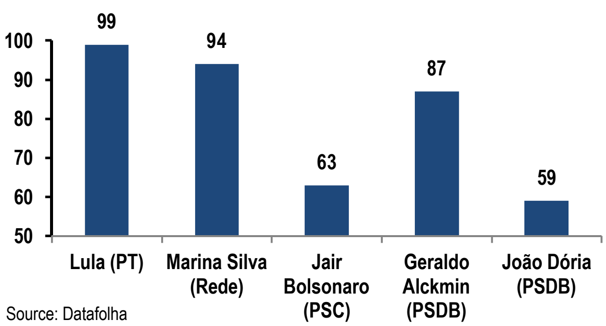
Candidates with higher voter support tend to have run in previous elections. Meanwhile, candidates with high disapproval rates tended to have been in politics for a while, and perhaps were connected in voters' minds to recent probes, or controversial ideas in the past. We thus think that the polls are a useful guide to the candidates during the few next months, but voter preference may shift significantly.

Figure 3: Rejection rates
% of rejection



Source: Datafolha

Figure 4: Share of voters that know the candidates
% of those who answers that know the candidate



Source: Datafolha

These numbers' usefulness in predicting the election outcome is very limited, in our opinion. First, given the breakneck pace of recent events, a lot could happen before the election. Second, an economic recovery would likely affect the vote. Finally, recent history has proven that the actual election results differ significantly from poll results this far in advance.

The last two elections are instructive on the evolution of candidates' name recognition, initial polling, and final results. In the 2010 election, Rousseff was first elected as the successor after two terms of Lula's administration. The August 2009 poll, 14 months before the election, indicated she would have only 17% of the votes in the first round, but she won more than twice that number (Table 3). Before the election, 35% of the population did not know Rousseff, according to a May 2009 poll. The polls also did not capture the fact that Brazil was growing fast under the PT government. Her adversary, José Serra, was the favorite in the poll with 38% of the votes, as he had already run for president. He lost the election by a margin of 6% of valid votes.

Table 3: 2010 Elections - First poll 1.5 year before election vs. result
% of total votes

Candidates	Aug-09	2010 Elections Result
Dilma Rousseff	**17.0**	**35.1**
José Serra	**38.0**	**24.4**
Marina Silva	3.0	14.5
Plínio Arruda	-	0.7
Has not participated on the election but was in the poll		
Ciro Gomes	14.0	-
Heloísa Helena	12.0	-

Source: Datafolha and TSE

In June 2013, 16 months before the 2014 election, polls showed former president Rousseff winning in the first round (Table 4). At the time, unemployment was at historical lows, there were no prospects of a recession, and the protests of 2013 had not yet taken place. Two candidates in the poll did not run, and three that were not included in the poll participated in the election. In the end, the result was a very tight election, with Rousseff winning in the second round by a narrow margin.

Table 4: 2014 Elections - First poll 1.5 years before election vs. result
% of total votes

Candidates	June-13*	2014 Election Result
Dilma Rousseff	**49.0**	**30.3**
Aécio Neves	**12.0**	**24.4**
Marina Silva	14.0	15.5
Luciana Genro	-	1.1
Pastor Everaldo	-	0.5
Eduardo Jorge	-	0.4
Did not participate in the election but was in the poll		
Joaquim Barbosa	8.0	-
Eduardo Campos	5.0	-

*Before the protests that marked the month
Source: Datafolha and TSE

Lack of visibility on the election will remain for while

As we have shown, history suggests that it is too early to have much visibility over next year's election. Given what is at stake for the future of the reforms and, therefore, the country, we believe that we will continue to face a very volatile environment in Brazil. In the next 16 months, regardless of the outcome of the most recent political crisis, the political distractions are—and should continue to be—costing precious time for the approval of difficult initiatives, in particular the pension reform. As a result, we do not forecast approval of the pension bill before the 2018 election. However, we still expect other reforms that do not require a constitutional majority (60% of the votes in both houses) to pass this year. For instance, on July 11 the Senate approved the labor reform with 50 votes. From now on, we think the government will be able to move forward with the agenda of privatizations and public concessions, and the financial reform on BNDES, by adopting the new benchmark rate called TLP (Long Term Rate).

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A market friendly outcome requires the next government to demonstrate willingness and ability to move forward with the reform agenda. That said, we reiterate that the approval of the pension reform likely will be key to ensure fiscal sustainability ahead. Our forecasts show that without this reform, the spending cap is unfeasible, and deterioration of the fiscal outlook would trigger an increase in premium risk that could raise Brazil's debt-to-GDP ratio to previously unseen levels up to 97% by 2026.

Even under these assumptions, confidence indicators turned down significantly in June, in line with our view that political uncertainty would take a toll on the economic recovery. We expect a flat GDP print this year, following a more than 8%-pts cumulative GDP contraction in the last couple of years, adding a grain of salt to the election outlook. Lower economic growth and falling inflation should allow the Central Bank to continue lowering its policy rate to 8.5% this year.

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Economic Research Note

Liquidity indicators of China's financial tightening

- **We construct a liquidity indicator that tracks China's financial market liquidity**
- **Liquidity has tightened since 2H16, but less severely than in 2011 and mid 2013**
- **Impact on financial market is noticeable**
- **Impact on monetary policy operations is indirect**

China's most important policy development this year arguably is the government's stepped-up financial deleveraging efforts. Markets have reacted strongly, raising questions about the likely impact of these efforts on credit policy and by extension the macroeconomic outlook (see "Impact of China's financial stability tightening on markets: Measures may keep commodity price volatility high but are unlikely to drive a broad market decline," May 22).

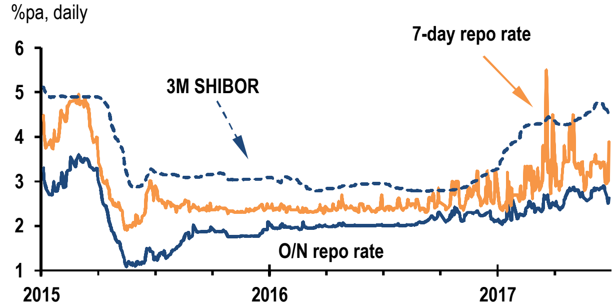
The PBOC has reiterated that financial stability tightening is not equivalent to monetary tightening, and financial deleveraging aims to crack down on irregular shadow banking activity and foster long-term financial stability. Nonetheless, the notable change in banks' business model in recent years, especially regional banks' increasing reliance on wholesale funding, could generate some passthrough between financial stability and monetary policy operations. Hence, assessing the liquidity conditions of financial institutions has important market and policy implications.

A summary indicator of liquidity conditions

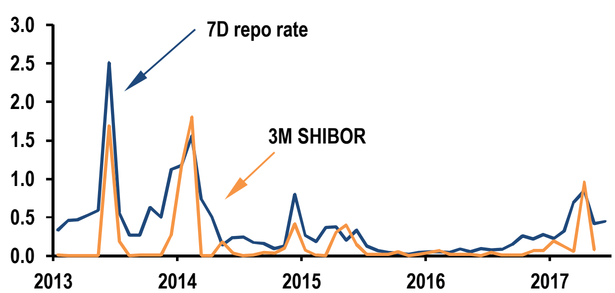
The PBOC's liquidity management has changed significantly in recent years. In the past decade, FX reserve accumulation was a major component of money creation, and the PBOC used central bank bills and reserve requirement ratios (RRR) to manage liquidity. Since 2014, FX reserves have contracted and the PBOC has created a number of liquidity facilities (e.g., SLF/MLF/PSL) to supplement open market operations (OMOs) and RRR in liquidity management ("China: The PBOC's weaponry," April 29, 2015). The frequency of OMOs changed from twice a week to daily in February 2016. Also, the PBOC introduced the interest rate corridor mechanism, using the 7-day repo rate as a key interest rate.

With the changes in liquidity operations, tracking liquidity conditions has become more challenging. Excess reserve used to be a good indicator of banks' liquidity, but it seems to be less relevant given its low frequency (only available every quarter) and, more importantly, the PBOC's preference for other liquidity facilities over RRR adjustments. A number of indicators have been used to track China's liquidity conditions and fixed income markets, including net liquidity injection/withdrawal by the PBOC, repo rates (7-day, 1-day, and 14-day), SHIBOR rates (1-month, 3-month, 6-month, 9-month, and 1-year), CGB yields (from 1-year to 10-year), and swap rates (Gu, Ying: "China: Tracking China's liquidity conditions and fixed income markets," May 15).

We propose a summary indicator of liquidity conditions, using the principal component of four variables: (i) 7-day repo rates (monthly average), the most important interbank rates for financial institutions, including non-bank financial institutions; (ii) 3-month SHIBOR (monthly average, Figure 1); (iii) the standard deviation of 7-day repo rates in each month (Figure 2); and (iv) net liquidity injection/withdrawal by the PBOC via OMOs and other liquidity facilities (SLF, MLF, PSL) reported by the PBOC every month (Figure 3). This list includes the two most important money market interest rates in China, volatility, and a quantitative measure of PBOC's liquidity operations. We exclude other market interest rates because their movements either synchronize with or follow the key market interest rates.

Figure 1: Money market interest rates
%pa, daily


Source: CEIC

Figure 2: Volatility in money market interest rates
%, std dev in each month


Source: CEIC; J.P. Morgan

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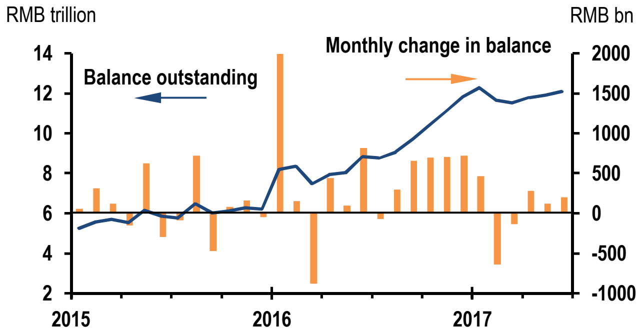
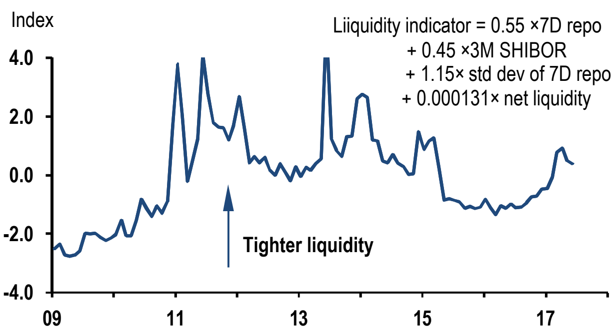
Figure 3: PBOC liquidity facilities (OMO/SLF/MLF/PSL)



Source: PBOC; J.P. Morgan

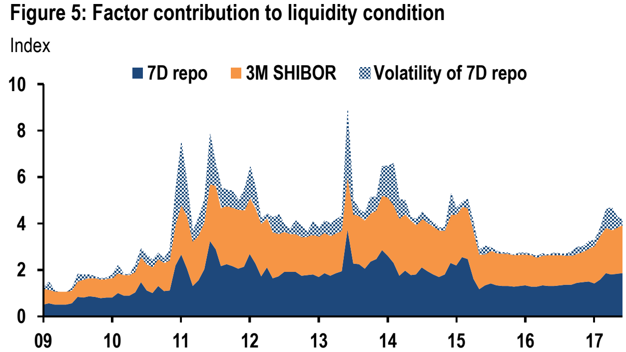
Our results show that China's liquidity conditions have tightened notably since 2H16, though less severely than in 2011 and mid-2013 (Figure 4). The tightening has been mainly via an increase in key market interest rates and higher volatility in short-end market interest rates. Central bank liquidity operations' contribution to overall liquidity has been negligible (Figure 5), and the sign of its coefficient suggests that in many cases a liquidity injection does not necessarily ease liquidity but instead offsets increases in market interest rates.

Figure 4: China's liquidity condition



Source: J.P. Morgan

Figure 5: Factor contribution to liquidity condition

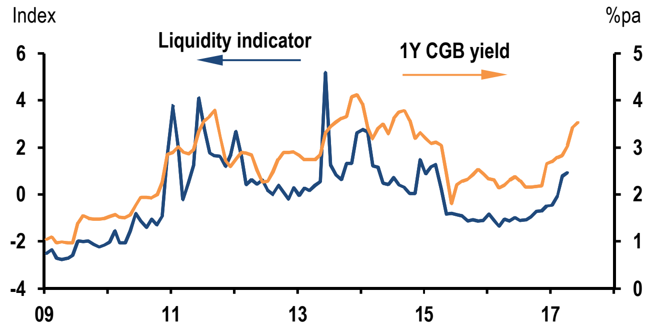


Source: J.P. Morgan

Market impact

The liquidity stance obviously has an impact on the financial markets. For instance, liquidity conditions naturally will affect the fixed income market. The liquidity tightening since 2H16 has raised the 1-year CGB bond yield about 140bp (Figure 6), the 5-year CGB bond yield about 100bp, and the 5-year AAA-rated corporate bond yield about 150bp. The rising cost of bond financing prompted a collapse of corporate bond financing in total social financing from late 2016.

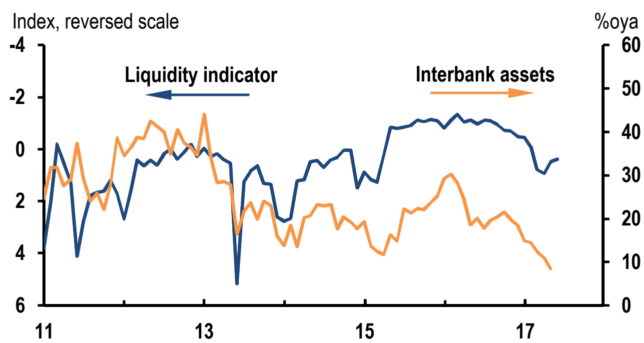
Figure 6: Impact on bond yields



Source: CEIC; J.P. Morgan

Moreover, the liquidity tightening together with regulatory tightening on shadow banking activity has slowed interbank activity significantly (Figure 7). Interbank asset growth fell from 20%oya in 4Q16 to 8.4% in May. In particular, bank claims on non-bank financial institutions slumped from 54%oya in 4Q16 to 16% in May.

Figure 7: Liquidity conditions and interbank business



Source: J.P. Morgan

Monetary policy impact

To assess liquidity policy's impact on monetary policy, one first needs to understand the transmission mechanism of China's monetary policy. Our research suggests that the PBOC's supply of excess reserves to banks is an effective immediate instrument, which has strong countercyclical Taylor-rule type properties ("A Taylor rule for China," June 9). Excess reserves growth operates through intermediate policy instruments, as summarized in a monetary condition indicator constructed from credit growth, the real lending rate, the real effective exchange rate, and excess reserves ("China's monetary conditions," March 26, 2014).

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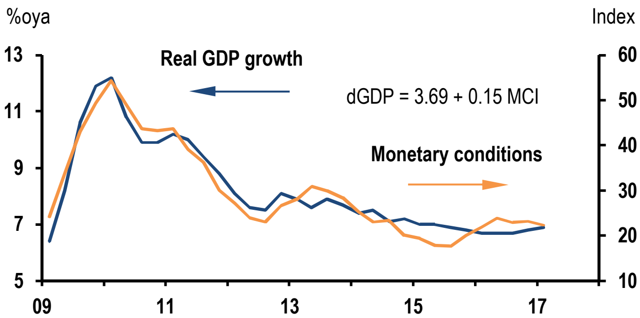
An updated analysis of China's monetary conditions suggests that REER and excess reserves have become less important, and TSF growth and the real lending rate jointly determine China's monetary conditions and, by extension, affect growth dynamics (Table 1 and Figure 8). TSF growth dominates, with a 1%-pt decline in TSF growth reducing GDP growth by 0.25%-pt. This suggests that China's monetary policy operations rely mainly on quantitative measures, and the role of interest-rate based transmission mechanism needs to be developed further.

Table 1: The impact of monetary condition on growth
Dependent variable: Real GDP growth (%)

	Regression 1		Regression 2		Regression 3	
Constant	3.157	(6.2)	3.688	(11.1)	3.18	(10.3)
Real lending rate (%)	-0.185	(3.1)	-0.151	(2.8)		
TSF growth (-1)	0.254	(17.7)	0.25	(18.9)	0.25	(17.1)
REER (%oya)	0.0016	(0.1)				
Excess reserve ratio (%)	0.267	(1.4)				
R^2	*0.93*		*0.93*		*0.92*	

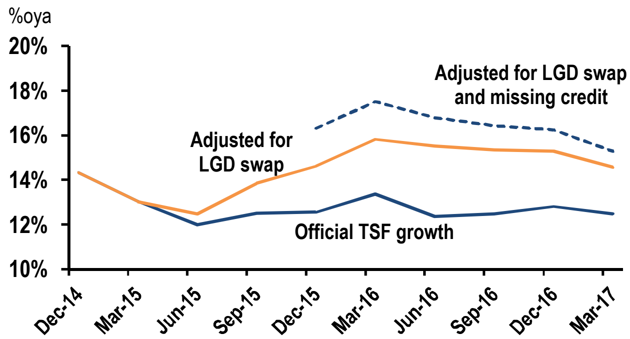
Note: t-statistics in parenthesis.
Source: J.P. Morgan

Figure 8: Monetary conditions vs. real GDP growth


Source: J.P. Morgan

The impact of the liquidity stance on monetary policy transmission is most likely indirect, in our view. In the above regression, adding the liquidity indicator does not help explain growth dynamics (the coefficient is insignificant). However, liquidity tightening likely will slow credit growth, and by extension restrain economic activity.

We have argued that financial deleveraging may have slowed TSF growth in China, not via the officially measured TSF components but likely via unmeasured shadow credit ("China Macro & Financials: Impact of shadow bank tightening on credit growth," May 24). Official TSF growth has been quite stable in the past 12 months (between 12% and 13%) and registered 12.8% in June ("China: June bank loans and TSF beat expectations," July 12). By contrast, actual TSF growth in China, adjusted for local government debt swaps and unmeasured shadow credit, slowed from 17.5%oya in 1Q16 to 15.3% in 1Q17 on our estimates (Figure 9) and should ease further to 14.4% in 4Q17 ("China Financials & Macro: linking banks' balance sheet, TSF and M2 growth," June 20). The shift in credit policy amid financial deleveraging efforts is a key argument behind our forecast of a modest growth slowdown throughout 2017, from 6.9%q/q, saar to 6.4% in 2H17.

Figure 9: TSF growth


Source: NBS: PBOC; J.P. Morgan

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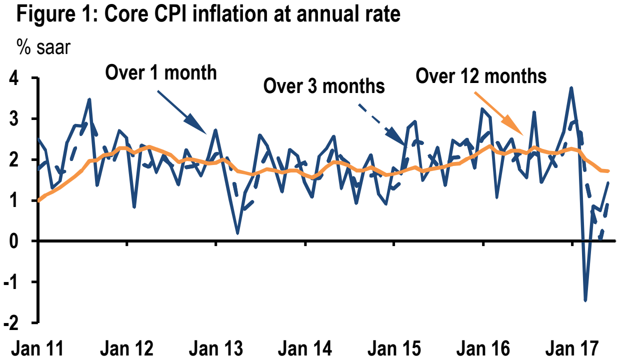
United States

- **June core CPI inflation moved up from recent disappointments but continues to run soft**
- **We continue to track 2Q GDP growth around 3.0% and forecast 1.75% in 3Q**
- **A downward drift in sentiment measures continues to trim upside risks, and labor market data were mixed**
- **Our call for a December Fed hike requires further firming in inflation over the next five months**

Our forecast calls for the Fed to announce the beginning of balance sheet normalization at the September FOMC meeting and raise rates another 25bp in December. We have always said that achieving this forecast would require inflation to firm relative to the 0.05% annualized growth in core CPI seen from March to May, a view that has been corroborated repeatedly in recent Fedspeak. And it has been our forecast that this firming in inflation would indeed occur by December.

On net, this week's news did little to shift our views on these issues. Most notably, the core CPI rose 0.12% in June, 0.01%-pt shy of our forecast. Although this increase corresponds to an annual rate of just 1.4%, it is a step up relative to the previous three months of data (Figure 1). And it remains our view that tight labor markets and firm upstream prices will tend to push these figures up further in the coming months. This week's data on initial claims, the PPI, and JOLTS hiring and openings were all consistent with this view. Our forecast thus continues to look for run-rates on core CPI inflation to move back above 2% by 4Q.

Figure 1: Core CPI inflation at annual rate



Source: BLS, J.P. Morgan

Meanwhile, the week's light data calendar did little to shift our views on growth. June retail sales disappointed our forecasts, while industrial production beat them. Sentiment measures have drifted down in recent readings but remain at high levels. We continue to see a bit of upside risk to our 3.0% 2Q GDP growth forecast, and our nowcaster continues to see 3Q a bit above 2%, suggesting only modest upside to our 1.75% 2H growth forecast. If the economy indeed unfolds in line with these expectations over the next five months, we continue to think the Fed will be on track for a December hike.

Inflation having a cool summer

Core CPI continued its weak run in June, increasing only 0.12%. The headline number was unchanged and also short of expectations. In the details, energy prices declined 1.6%, which was close to expectations. More surprising was the flat reading on food prices, which before this report had been showing some pickup in the prior few months. Core service prices increased 0.19%, faster than the prior three months but below the trend that had prevailed prior to the spring. One relative bright spot was rental inflation, which firmed 0.3% in both the tenants' and owners' equivalent measures. Medical services increased 0.3% last month, the most in almost a year (though the separately-derived PCE measure of health care service prices looks soft again in June). Coming in on the soft side were prices for the volatile lodging away from home (-1.9%) and airfare (-2.7%) categories. Prices for core goods declined 0.1% last month, the fifth consecutive down month. Declines were registered in a number of categories including appliances, apparel, and new and used vehicles.

This week's separate PPI report was firmer, however. The headline index ticked up 0.1% in June, a touch above expectations, and is up 2.0%oya. The core PPI is up 1.9%oya and the core goods PPI up 2.1%. These firm upstream prices support our view that consumer price inflation should rebound in 2H17. So too do the Michigan survey measures of inflation expectations, which both ticked up in their preliminary July reading this week. And the mixed changes in the May JOLTS report, alongside a tick down in initial claims this week, support the view that the labor market remains healthy and should continue to contribute to wage cost pressures.

Nonetheless, folding in both the CPI and PPI, our forecasts for the June PCE inflation print are quite weak. We look for core PCE prices to rise 0.02% in June and be up just 1.33%oya. These numbers will likely further shake the Fed's confidence that the soft run of inflation news is transitory, but it shouldn't derail them from their first order of business: commencing balance sheet normalization. Commentary this week from both Janet Yellen and Lael Brainard suggested that the decision to begin balance sheet normalization will be more closely linked to the growth outlook and less dependent on near-term inflation data, and we continue to expect a normalization announcement at the September meeting. Getting another rate hike in 2017 is more of an open question and will importantly hinge on the second half CPI reports.

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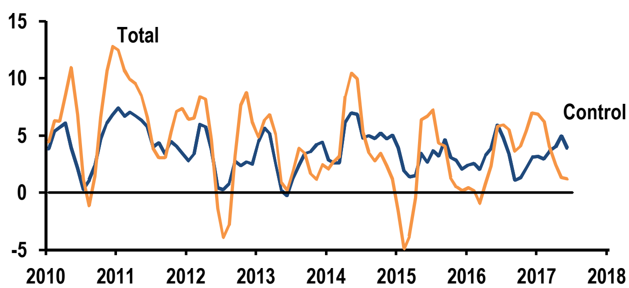
Growth data tracking our forecasts

Of course, our forecast for inflation to pick up in the second half hinges on our forecast that GDP growth will remain above potential. The week's relevant data were mixed and did little to alter our forecast on this point.

June retail sales came in below expectations, with total sales down 0.2% and sales in the control group (retail sales ex-autos, gas, and building materials) down 0.1% (Figure 2). The headline number was held down by a 1.3% decline in sales at gas stations. The non-store retail category, which includes internet sellers, saw a relatively modest 0.4% sales gain last month. Outlays in this category should rebound this month thanks to a large sales promotion. Sales at department stores continue to bleed lower, falling 0.7% last month.

Figure 2: Retail sales
%3m/3m, saar



Source: Census, J.P. Morgan

One of the benefits of a weak CPI print is that each dollar of nominal spending translates into more real spending, and so, even with a decline in nominal sales in the control category, we still anticipate a modest 0.1% increase in real consumer spending in June. For Q2 overall, real consumption still looks to have increased at a solid 2.9% annual rate.

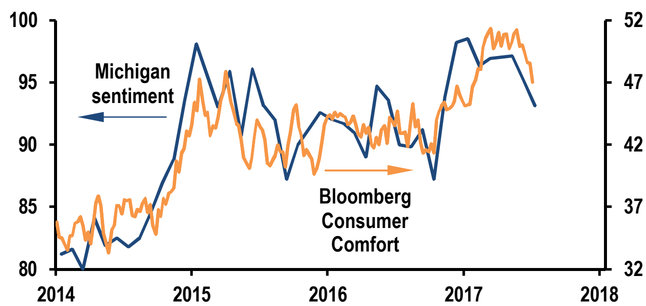
Meanwhile, industrial production fared better than expected in June, with overall output increasing 0.4% and manufacturing output rising 0.2%. Manufacturing IP was up 1.4% saar in 2Q, which was the third straight quarter of decent growth following a weak run for the data. We do expect some moderation over the summer in part based on auto production schedules.

Folding in these numbers (along with some small revisions to the inventory data), we continue to see modest upside risk to our forecast for 3% GDP growth in 2Q. That said, the weak trajectory of consumer spending at the end of 2Q adds some challenges to the 3Q consumption outlook, which reinforces our view that growth will step down modestly in the current quarter. We continue to project GDP expanding at a 1.75% pace in 3Q.

Sentiment drifting down from high levels

The sharp move up in many measures of consumer and business sentiment since the November election has been a key source of potential upside risk to our growth forecasts this year. But a number of these sentiment measures have drifted down in their recent readings. The weekly Bloomberg consumer comfort index has been moving steadily lower from a local peak of 51.2 in late May to 47.0 this week (Figure 3). And the NFIB measure of small business confidence has edged down from its expansion high of 105.9 in January to 103.6 in this week's June reading. Similarly, the preliminary July reading of the University of Michigan consumer sentiment index fell to 93.1 from a January peak of 98.5.

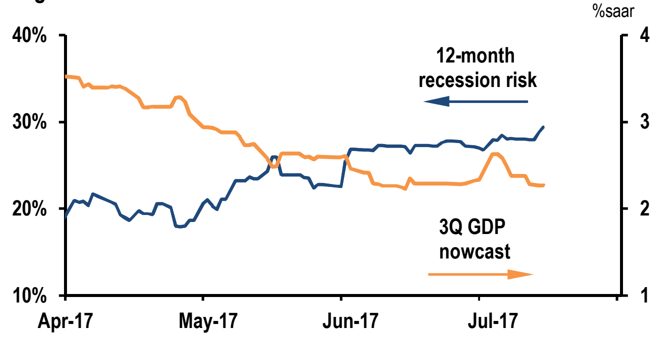
Figure 3: Measures of consumer sentiment: Michigan and Bloomberg
Index, both scales



Source: University of Michigan, Bloomberg, J.P. Morgan

As the measures remain at high levels, we view these declines as trimming upside risks to the forecast rather than marking a shift to downside risk. Indeed, our "nowcaster" of 3Q GDP growth, which incorporates these data, has moved down to 2.3% from numbers above 3% as recently as April (Figure 4). Similarly, our model estimate of the risk of recession beginning within 12 months has drifted up on recent sentiment disappointments but continues to hover in the narrow range under 30% that it has inhabited since early June. Next week's quiet calendar will bring the first of the business surveys for July.

Figure 4: Recession risk and nowcaster



Source: J.P. Morgan

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Data releases and forecasts

Mon
Jul 17
8:30am

Empire State survey

Diffusion indices, sa

	Apr	May	Jun	Jul
General bus. conditions	5.2	-1.0	19.8	14.0
New orders	7.0	-4.4	18.1	
Shipments	13.7	10.6	22.3	
Unfilled orders	12.4	-3.7	4.6	
Prices paid	32.8	20.9	20.0	
Prices received	12.4	4.5	10.8	
Composite	55.4	52.4	56.1	

We look for the Empire State manufacturing survey's headline to decline from 19.8 in June to 14.0 in July. The survey improved significantly between May and June, with a 21-pt jump in the headline figure along with increases in many of the key underlying details. The June report was strong, but we think that the manufacturing sector will cool off during the summer months, and we expect moderation in the upcoming report.

Tue
Jul 18
8:30am

Import prices

%m/m, nsa, unless noted

	Mar	Apr	May	Jun
Import prices	-0.2	0.2	-0.3	-0.2
%oya	4.1	3.6	2.1	1.2
Ex-fuel import prices	0.2	0.3	0.0	0.0
%oya	0.9	1.0	0.8	1.0

We forecast import prices moved down 0.2% in June (+1.2%oya). Crude oil prices fell between early May and early June (import prices are collected at the beginning of the month), so we think imported fuel prices moved lower last month (-2.3%). Away from fuels, we think prices of imports were unchanged over June, which would still lift the year-ago rate from 0.8% to 1.0%. Based on analysis of spot prices, we expect food prices moved up 0.3%. Within the industrial supplies (ex fuels) category we think prices were mixed. We believe prices of unfinished metals edged up 0.1%, while prices of finished metals moved down 0.4%. Meanwhile, we anticipate prices of materials associated with non-durable supplies moved lower a second consecutive month (this category tends to follow fuel prices with a lag). We also think prices of imported building materials declined in June. Away from industrial supplies, we think prices of autos edged up 0.1%. Finally, we forecast prices of other consumer goods and capital goods were unchanged.

Tue
Jul 18
10:00am

Homebuilders survey

Sa

	Apr	May	Jun	Jul
Housing market	68	69	67	67
Present sales	74	75	73	
Prospective buyer traffic	52	51	49	

We look for the NAHB survey's headline to hold at 67 between June and July. This limited data we have on recent housing market conditions are mixed and do not suggest much change in homebuilder sentiment. If our forecast is correct, the NAHB survey would stay off its recent peak (71 in March) but would remain at a solid level.

Wed
Jul 19
8:30am

Housing starts

Million units, saar

	Mar	Apr	May	Jun
Starts	1.19	1.16	1.09	1.14
Single-family starts	0.82	0.83	0.79	0.80
Multifamily starts	0.36	0.33	0.30	0.34
Permits	1.26	1.23	1.17	1.22

We forecast that housing starts increased 4.4% to 1.140mn saar in June while housing permits rose 4.0% to 1.215mn saar. The trends in the series have weakened lately, with starts declining in each of the past three reported months and permits declining in each of the past two. And these declines have been spread across the data on both single-family and multifamily units. We think that the housing market has turned softer lately following strong growth in 4Q16 and 1Q17, but also that the recent declines in the starts and permits data likely overstate any underlying weakness. We therefore expect to see a partial reversal of the recent declines, with increases in starts and permits reported for June.

Thu
Jul 20
8:30am

Jobless claims

Thousands, sa

	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless,%
May 6	236	244	1899	1946	1.4
May 13[1]	233	241	1924	1931	1.4
May 20	235	236	1919	1916	1.4
May 27	255	240	1929	1918	1.4
Jun 3	245	242	1936	1927	1.4
Jun 10	238	243	1942	1932	1.4
Jun 17[1]	242	245	1945	1938	1.4
Jun 24	244	242	1965	1947	1.4
Jul 1	250	244	1945	1949	1.4
Jul 8	247	246			
Jul 15[1]	240	245			

1. Payroll survey week

We believe that initial jobless claims declined 7,000 to 240,000 during the week ending July 15, which is the reference week for the July employment report. The claims data for the weeks around July 4 are often influenced by temporary auto plant shutdowns that occur around this time of year. We think that there will be fewer claims associated with the shutdowns during the week ending July 15 relative to comparable weeks in recent years, which should lead to a decline in the claims data.

Sources: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Department of Labor, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

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Thu
Jul 20
8:30am

Philadelphia Fed survey
Diffusion indices, sa

	Apr	May	Jun	Jul
General bus. conditions	22.0	38.8	27.6	22.0
New orders	27.4	25.4	25.9	
Shipments	23.4	39.1	28.5	
Inventories	17.8	1.4	5.8	
Prices paid	33.7	24.2	23.6	
Prices received	16.6	15.3	20.6	
Composite	60.2	59.0	59.0	

We believe the Philadelphia Fed manufacturing survey's headline declined from 27.6 in June to 22.0 in July. The survey has been very strong throughout much of the year so far, but we think that the manufacturing sector is due to cool off and that this softening should also be evident in the related survey data.

Review of past week's data

NFIB Small-Business Optimism survey
Index, 1986=100, sa

	Apr	May	Jun	
Optimism Index	104.5	104.5		*103.6*
Capex plans	27.0	28.0		*30.0*
Hiring plans	16.0	18.0		*15.0*
Planned price increase	18.0	21.0		*19.0*

Producer price index (Jul 13)
%m/m, sa, unless noted

	Apr	May	Jun	
Final demand	0.5	0.0	~~0.0~~	*0.1*
%oya (nsa)	2.5	2.4	~~1.9~~	*2.0*
Core	0.4	0.3	*0.1*	
%oya (nsa)	1.9	2.1	~~2.0~~	*1.9*
Energy	0.8	-3.0	~~2.5~~	*-0.5*
Core goods	0.3	0.1	~~0.2~~	*0.1*
Services	0.4	0.3	~~0.1~~	*0.2*
Construction	0.4	0.1	~~0.0~~	*0.2*
Intermed. processed gds	0.5	0.1		
Core intermed. processed	0.5	0.2		

The producer price index (PPI) ticked up 0.1% in June, a touch above expectations. The year-ago rate decelerated from 2.4% to 2.0%. The energy PPI continued to cool, moving down 0.5% in June. The decrease was driven by declines in gasoline and liquefied petroleum gas prices. Food prices meanwhile increased 0.6%, in contrast to our expectations of a modest decline.

The core PPI moved up 0.1%, in line with our expectations but a bit below consensus (0.2%). The year-ago rate slowed a touch from 2.1% to 1.9%. Core goods prices moved up a modest 0.1%. Gains in the core goods PPI have moderated in the latest two readings, but the index is still up 2.1% from a year ago. Within the category, gains in pharmaceuticals prices accelerated, rising 0.9% in June. Vehicle prices were softer by comparison; prices of light trucks increased 0.5%, while prices of passenger cars were unchanged. Core services prices rose 0.2% in June following a 0.3% increase in May. The deceleration can be traced to trade services, which edged down 0.2%, but this follows a 1.1% gain in May. Trade services, which measure margins for wholesalers and retailers, tend to be volatile. Prices elsewhere in the core PPI meanwhile were firmer. The transportation and warehousing PPI edged up 0.1%, while other services prices rose 0.3%. Finally, construction prices moved up 0.2%. Overall, the PPI ex. food, energy, and trade services is up 2.0% from a year ago.

Based on details from PPI release we anticipate a 0.1% increase in the June PCE medical care deflator.

CPI (Jul 14)
%m/m, sa, unless noted

	Apr	May	Jun	
Total	0.2	-0.1	*0.0*	
%oya (nsa)	2.2	1.9	~~1.7~~	*1.6*
Core	0.07	0.06	~~0.13~~	*0.12*
%oya (nsa)	1.9	1.7	*1.7*	
Core services	0.1	0.2		*0.2*
Core goods	-0.2	-0.3		*-0.1*
Food	0.2	0.2	~~0.2~~	*0.0*
Energy	1.1	-2.7	~~1.4~~	*-1.6*
Housing	0.3	0.2		*0.1*
Owners' eq.rent	0.23	0.20	~~0.22~~	*0.28*
Rent	0.30	0.35	~~0.31~~	*0.35*
Lodging away from home	2.1	0.1	~~0.3~~	*-1.9*
Apparel	-0.3	-0.8	~~0.3~~	*-0.1*
New vehicles	-0.2	-0.2	~~0.1~~	*-0.3*
Used vehicles	-0.5	-0.2	~~0.1~~	*-0.7*
Airfares	-0.6	-2.7	~~0.8~~	*-2.7*
Communication	-0.6	-0.2	*-0.3*	
Medical care	-0.2	0.0	~~0.1~~	*0.4*

Core CPI continued its weak run last month, increasing only 0.11%. The headline number also fell short of expectations as it was unchanged. While the June increase in the core index was firmer than in each of the prior three months, it was still well short of what would be consistent with the Fed's inflation objective (we estimate the latest inflation numbers translate into a 0.02% monthly increase in the Fed's preferred core PCE price gauge, or 1.33% on a year-ago basis). The CPI report will likely further shake the Fed's confidence that the soft run of inflation news is transitory, but it shouldn't derail them from their first order of business: commencing balance sheet normalization, we believe at the September meeting. Getting another rate hike off in 2017 is more of an open question and will importantly hinge on the second half CPI reports.

In the details of the CPI report, energy prices declined 1.6%, which was close to expectations. More surprising was the flat reading on food prices, which before this report had been showing some lift in the prior few months. Core service prices increased 0.19%, better than the prior three months but below the trend that had prevailed prior to the spring. One relative bright spot was rental inflation, which firmed 0.3% in both the tenants' and owners' equivalent measures. Medical services increased 0.3% last month, the most in almost a year (though keep in mind the separately-derived PCE measure of health care service prices looks soft again in June). Coming in on the soft side were prices for the volatile lodging away from home (-1.9%) and airfare (-2.7%) categories. Prices for core goods declined 0.1% last month, the fifth consecutive down month. Declines were registered in a number of categories including appliances, apparel, and new and used vehicles.

Sources: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Department of Labor, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

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Retail sales (Jul 14)
%m/m, sa

	Apr		May		Jun	
Total	~~0.4~~	*0.3*	~~0.3~~	*-0.1*	~~0.1~~	*-0.2*
Ex autos	~~0.4~~	*0.3*	-0.3		~~0.1~~	*-0.2*
Ex autos and gas	~~0.5~~	*0.4*	0.0		~~0.3~~	*-0.1*
Building materials	~~0.6~~	*-0.1*	~~0.0~~	*-0.6*	~~0.4~~	*0.5*
Control group[1]	~~0.6~~	*0.5*	0.0		~~0.4~~	*-0.1*
Ex. autos and building	~~0.4~~	*0.3*	-0.3		~~0.1~~	*-0.3*

1. Total ex. gasoline, automotive dealers, building materials, and food serv.

June retail sales came in well below expectations. Total retail sales were down 0.2%, while sales in the control group (retail sales ex-autos, gas, and building materials) declined 0.1%. Revisions to prior months were modest. For Q2, real consumption still looks to have increased at a solid 2.9% annual rate, and we continue to see overall GDP up at around a 3% rate last quarter. That said, the weak trajectory of consumer spending at the end of Q2 adds some challenges to the Q3 consumption outlook, which reinforces our view that growth will step down modestly in the current quarter, and we continue to project GDP expanding at a 1.75% pace in Q3.

The headline retail sales number was held down by a 1.3% decline in sales at gas stations. The non-store retail category, which includes internet sellers, saw a relatively modest 0.4% sales gain last month. Outlays in this category should rebound this month, thanks to a large sales promotion. Sales at department stores continue to bleed lower, down 0.7% last month. One of the benefits of a weak CPI print is that each dollar of nominal spending translates into more real spending, and so, even with a decline in nominal sales in the retail "control" category, we still anticipate a modest increase in real consumer spending in June, up 0.1%.

Industrial production (Jul 14)
%m/m,sa, unless noted

	Apr		May		Jun	
Industrial production	~~1.1~~	*0.8*	~~0.0~~	*0.1*	~~0.1~~	*0.4*
Manufacturing	~~1.1~~	*1.0*	-0.4		~~0.1~~	*0.2*
Motor vehicles & parts	4.1		~~2.0~~	*-2.2*	~~1.2~~	*0.7*
High-tech	~~1.3~~	*2.1*	~~0.0~~	*0.7*		*0.8*
Mfg ex motor vehicles	~~0.9~~	*0.7*	~~0.2~~	*-0.3*	~~0.2~~	*0.1*
Business equipment	1.5		~~0.7~~	*-0.9*		*0.1*
Capacity utilization (%,sa)	~~76.7~~	*76.4*	~~76.6~~	*76.4*	*76.6*	
Manufacturing	~~75.8~~	*75.7*	~~75.5~~	*75.3*	~~75.5~~	*75.4*

Industrial production fared better than expected in June, with overall output increasing 0.4% and manufacturing output rising 0.2%. Manufacturing IP was up 1.4% saar in 2Q, which was the third straight quarter of decent growth following a weak run for the data. We do expect some moderation over the summer in part based on auto production schedules.

Consumer sentiment (Jul 14)
Michigan preliminary

	May	Jun		Jul	
Univ. of Mich. Index	97.1	95.1		~~94.5~~	*93.1*
Current conditions	111.7	112.5			*113.2*
Expectations	87.7	83.9			*80.2*
Inflation expectations					
Short-term	2.6	2.6			*2.7*
Long term	2.4	2.5			*2.6*
Home buying conditions	145	~~148~~	*143*		*147*

The preliminary July reading on the University of Michigan consumer sentiment index disappointed, with the headline figure declining from 95.1 in June to 93.1 in July. This latest figure is still solid, but the index has lost some ground since the recent peak of 98.5 reported back in January. Several other surveys have also cooled off lately following a strong run late last year and early this year. The Michigan survey also showed ticks up in both of its main measures of inflation expectations. For example, the median five-year-ahead inflation expectation rose to 2.6%, which is still a low figure by historic standards but on the high end of the range reported over the past year.

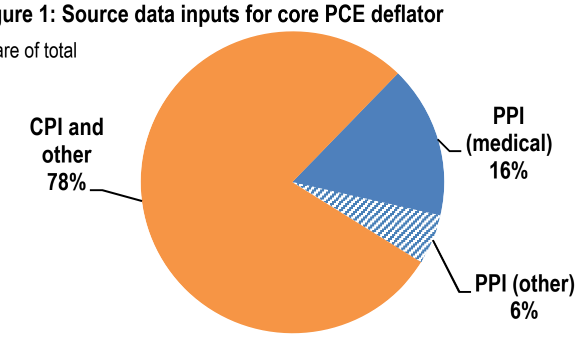
Sources: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Department of Labor, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

Focus:Translating the PPI into the core PCE deflator

We expect the core PCE price index be about unchanged in June (0.0%) based on related inputs that have already been released for the month. The source data for the PCE measures vary across categories: for the core deflator, we estimate that PPI source data account for about 22% of the index while CPI data (and a few other miscellaneous series) account for the remaining 78% (Figure 1). While the CPI clearly is more important in determining PCE inflation, the PPI data should not be ignored; markets seem to focus on changes in the core PCE index with a high level of precision given that it is the Fed's preferred measure of underlying inflation.

Figure 1: Source data inputs for core PCE deflator

Share of total

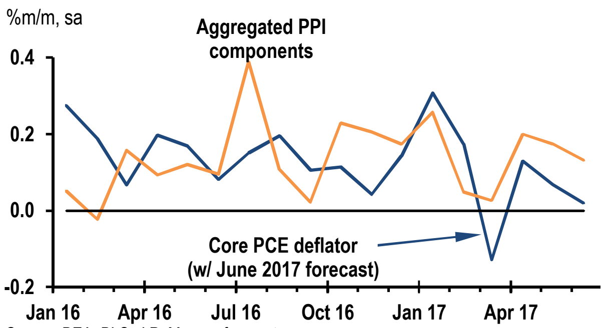


Source: BEA, J.P. Morgan

For June, specifically, we believe that the net price change in the core PCE index derived from PPI will be 0.13%, a decent amount above our expected change in the overall core deflator (Figure 2). Although the core CPI increased 0.12% in June, we think that the PCE inputs derived from the CPI data will be softer on net because some of the CPI components that were firm in June are either excluded from the PCE methodology or have a smaller weight in the PCE data than in the CPI.

Figure 2: Core PCE deflator

%m/m, sa

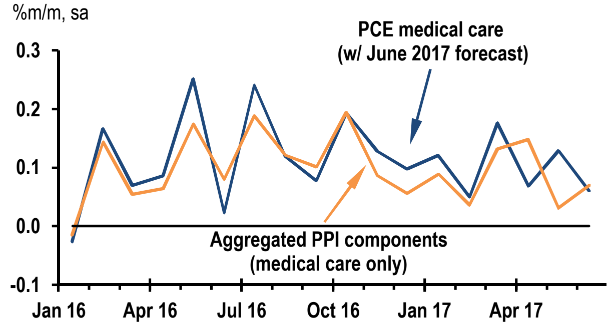


Source: BEA, BLS, J.P. Morgan forecast

The PPI is most important regarding medical care pricing in the PCE deflator. The medical care deflator accounts for almost 20% of the core PCE index, and close to 85% of the medical care index is derived from PPI inputs. So after the PPI is released, we have a strong sense of where the broader medical care index is going to end up. For June, we think that the medical care PCE price index will increase a low-side 0.1%, coming out very close to our aggregation of the related PPI data (Figure 3).

Figure 3: Measures of medical care pricing

%m/m, sa

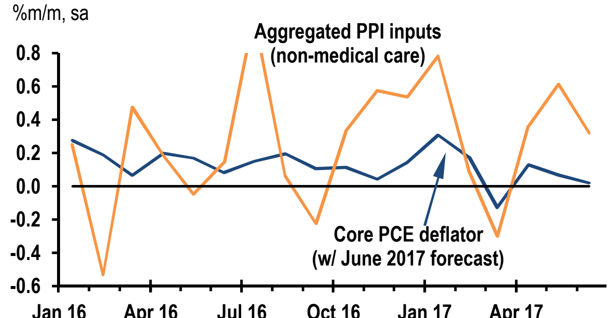


Source: BEA, BLS, J.P. Morgan forecast

While many of the PPI inputs are related to medical care, the PPI is also used as source data for several other categories in the PCE price index, including various measures of insurance and financial services costs. For these inputs that are not related to medical care pricing, inflation has been firmer than the aggregate core measure for much of the past year (Figure 4). These components account for only about 6% of the core PCE deflator, so they do not have a significant influence on the broader core index. But with every tenth counting on inflation, we should still monitor these PPI measures.

Figure 4: Core PCE deflator with aggegated PPI components

%m/m, sa



Source: BEA, BLS, J.P. Morgan forecast

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Euro area

- **ECB to stay on hold next week but to set the scene for a tapering decision in September**
- **Tapering likely to be formally discussed for first time**
- **Nervousness about tighter financial conditions suggests cautious communication but should not prevent tapering**
- **We revise up 2Q17 GDP growth to 3%q/q saar**

The focus at next week's ECB meeting will be on any signal for the more important meeting in September when new staff forecasts will be published and when the ECB is widely expected to make an announcement on QE tapering. The ECB's current commitment is to purchases at a €60bn pace until December, and, according to the recent minutes, a step down in purchases beyond December has not yet been discussed. But the outlook as a whole is clearly seen to have improved and the removal of the "easing bias" on QE has already been broached. Hence, recent ECB commentary has been very consistent with a reduction in the QE purchase pace in January, even if it has been much less clear about what this will look like in practice.

Tapering is likely to be discussed at next week's meeting, and hence more concrete signals may emerge. But the ECB is unlikely to say anything definite that would tie its hands ahead of the September meeting. One option is another incremental tweak of the forward guidance by removing the reference to a faster QE purchase pace from the "easing bias" (i.e., tweak the "we stand ready to increase our asset purchase programme in terms of size and/or duration"). Another option is to point explicitly to the September meeting along the lines of: "In September, the Governing Council's assessment about the required size and duration of net asset purchases beyond the end of this year will benefit from the new staff macroeconomic projections." Technical committees could also be tasked to calibrate some options. Any explicit reference to September could be accompanied by a reference to inflation, for example: "As measures of underlying inflation remain subdued, any adjustment in the size and/or duration of the net asset purchases will seek to preserve a substantial degree of monetary accommodation." In this context, Draghi may also point to the large QE stock, the reinvestments, and the fact that that policy rates would still be very low.

Whether such statements will be formally incorporated in the opening policy statement or whether they will emerge only during the Q&A session is not entirely clear. But we expect the overall message from the meeting to shift the debate toward tapering and to open the door to a September announcement. This should be reinforced by the macroeconomic discussion, which will likely acknowledge the strong growth signals in the "soft" and "hard" data and the increased confidence that this brings for an eventual pickup in wage growth and underlying inflation.

Two other points are worth making about how the ECB may be thinking about the threat of an "unwarranted" tightening in financial conditions and about the "easing bias" on QE.

How problematic are financial conditions for tapering?

The minutes of the June meeting revealed a significant nervousness about triggering a large tightening in financial conditions. Nervousness may have increased further given the rise in bond yields and the currency since Draghi's speech in Sintra. We doubt this will be a big hurdle, however.

- First, bond yields and the currency fell after the June meeting and then rose after the Sintra speech. Hence, relative to the technical assumptions made in the ECB staff forecasts in June, bond yields and money market rates have increased only around 10bp while the trade-weighted currency is 3.5% higher. Hence, in terms of levels, only the currency move is significant. This impacts headline inflation quickly via imported energy prices, but any impact on core inflation would be small (less than 0.1%-pt per year) or even zero (as the stronger currency is coinciding with stronger growth, so that excess capacity may actually be diminishing).

- Second, the ECB is likely to be tolerant of some market adjustment. The June minutes noted that "as the economic conditions and fundamentals of the euro area improved further… some tightening in financial conditions…was to be expected." Benoît Cœuré made the same point in an interview after markets had already reacted significantly to Draghi's Sintra speech, suggesting some acceptance of the repricing. And, this line of thinking also ties into Draghi's and Praet's recent argument that a given pace of QE purchases has an increased effect when growth is stronger as expected returns will be higher, so that a reduction in the purchase pace does not necessarily tighten the policy stance.

- Third, some governors may still worry about the speed of the recent market moves. But, we suspect that strong growth will go some way to calming their nerves, as could increased emphasis on dovish aspects of the forward guidance. Certainly, on growth, strong surveys are being matched by strong "hard" data, and revisions to recent quarters are already pushing the staff's 2017 GDP forecast up from 1.9%oya to 2.1%oya. A likely upward revision to 2Q17 could add another tenth and further reinforce a sense of resilience.

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Does the "easing bias" on QE need to be removed in July?

In June, the ECB had a long discussion about whether to remove the "easing bias" on QE together with the easing bias on rates. In the end it did only the latter but said that "as the economic expansion proceeded and if confidence in the inflation outlook improved further, the case for retaining this bias could be reviewed." This raises the question of whether this "bias" needs to be removed in July before tapering can be considered in September. In our view, this is not the case.

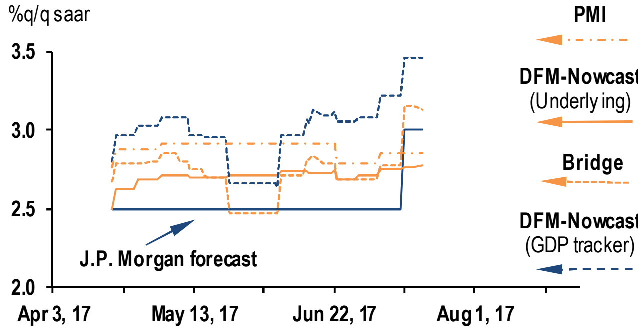
As we noted after the June minutes, the meaning of the "easing bias" on QE is very unclear. The ECB seems unable to decide whether it is an easing bias or just a description of the reaction function (i.e., a statement of how the ECB would respond to a hypothetical slowing in growth or tightening in financial conditions). It is also unclear why the minutes spoke as if there is only one easing bias on QE, whereas it actually comes up twice in the policy statement. But we doubt that any of this will be a problem. First, we can even imagine the easing bias on QE continuing during the whole tapering period, as an expression of optionality and data dependence. Second, it is hard to imagine the ECB not reducing the taper pace at all in January, considering that it already took one taper step last December when the macro outlook was still weaker and more uncertain.

The bottom line is that we do not think we specifically need to see a removal of the easing bias on asset purchases next week to stick with a view that a step down to €40bn will be announced in September, provided we get at least some signal from the ECB that it is moving in that direction.

Revising up 2Q17 growth to 3%q/q saar

As we had flagged already last week, national IP reports for May have pushed up our tracking estimate of 2Q17 GDP growth. This week, we changed our Euro area 2Q GDP growth forecast from 2.5%q/q saar to 3.0%, and we raised our German forecast by 1%-pt to 3.5%. We did not change our forecast for the other main Euro area countries, leaving France at 2.25%, Italy at 1.25%, and Spain at 3.5%. But risks to French growth are on the upside, and the bottom-up summation of the country forecasts is not far off 3%q/q saar for the Euro area as a whole. In addition, our two top-down tracking-based nowcasters are signaling 3.25%q/q saar on average, so our new 3% forecast is halfway between the top-down and bottom-up approaches (Figure 1). For 2017 as a whole, we now expect Euro area GDP to expand 2.2%y/y compared to 2.1% before and 1.5% at the start of this year.

Figure 1: Tracking Euro area 2Q17 GDP growth over time

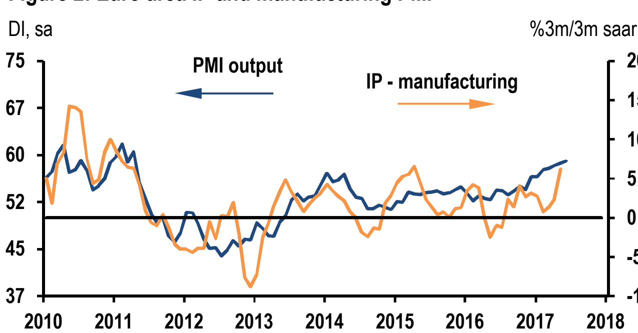


Source: J.P. Morgan

Three other remarks are worth making. First, we did not change our 3Q17 forecast, but given the powerful momentum in the surveys through June and the strong tone of the recent "hard" activity data, the risk to our 2%q/q saar 2H17 forecast is on the upside. Second, if 2Q17 prints in line with our new forecast (or even just close to it), it would be well ahead of the ECB staff's assumption in June of around 2.2%q/q saar. Third, the strength in the 2Q data appears very broad based across the various indicators (IP, retail sales, trade, etc.).

In particular, Euro area IP was very strong in May. It rose 1.3%m/m in total, and the April/May average is 4.7% ar above the 1Q17 level. Within the total, manufacturing output also rose 1.3%m/m in May and is up even more so far in 2Q (5.5% annualized). Within manufacturing, the gains are very broadly spread across sectors. The IP report also means that the very upbeat Euro area manufacturing PMI and the official IP data are now very closely aligned (Figure 2). This increases confidence in the signal from the surveys, which remained very strong in June and is likely to carry over into 3Q17.

Figure 2: Euro area IP and manufacturing PMI



Source: Eurostat, Markit, J.P. Morgan

Separately, car registrations fell 1.9%m/m in June but were up 5.7%q/q, saar in 2Q17, having already surged 14%q/q, saar in 1Q17. And nominal goods exports rose 1.2%m/m in May and are up 4.3% ar so far in 2Q17. This rise reinforces our sense that the pickup in growth is very broad based across sectors and countries.

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Data releases and forecasts

Week of Jul 17 - 21

Output and surveys

Construction output

		Feb	Mar	Apr	May
Wed	**Euro area**				
Jul 19	%m/m, sa	5.5	-1.1	0.3	
10:00am	%oya, sa	3.9	3.8	3.8	

Consumer confidence (prelim)

		Apr	May	Jun	Jul
Thu	**Euro area (European Commission survey)**				
Jul 20	% balance of responses				
4:00pm	Consumer confidence	-3.6	-3.3	-1.3	<u>-1.5</u>

Euro area consumer confidence increased very sharply in May to a high level. In July, we expect this to be consolidated, reinforcing the sense of a solid trajectory in consumer spending. Declines in sequential inflation are likely helping the consumer in the middle of this year.

Inflation

Consumer prices

		Mar	Apr	May	Jun
Mon	**Euro area (final)**				
Jul 17	HICP (%m/m, nsa)	0.8	0.4	-0.1	<u>0.0</u>
11:00am	HICP (%oya, nsa)	1.5	1.9	1.4	<u>1.3</u>
	HICP (%oya, core-XX)[1]	0.7	1.2	0.9	<u>1.1</u>
	HICP (%m/m, ex-tob.)	0.8	0.4	-0.1	<u>0.0</u>

1. Excluding food, alcohol, tobacco and energy.

Source: European Commission, Eurostat, ECB, FSO, Bundesbank, IFO, INSEE, ISAE, Istat, INE, CBS, BNB, Markit, and J.P. Morgan forecasts

Review of past week's data

Output and surveys

Industrial production

	Mar		Apr		May	
Euro area						
Ind production (%m/m, sa)	~~0.2~~	*0.4*	~~0.5~~	*0.3*	~~*1.1*~~	*1.3*
%oya, sa	~~2.2~~	*2.3*	~~1.4~~	*1.2*		*3.9*
Manuf prod (%m/m, sa)	~~0.7~~	*0.8*	~~0.1~~	*0.0*	~~*0.9*~~	*1.3*

	Mar		Apr		May	
Italy						
Ind production (%m/m, sa)	0.4		~~-0.4~~	*-0.5*		*0.7*
%oya, sa	~~2.7~~	*2.8*	1.2			*2.9*
Manufacturing (%m/m, sa)	~~1.2~~		-0.8	*-0.7*		*0.9*

See essay for details.

External trade and payments

Foreign trade

	Mar		Apr		May
Euro area					
€ bn, values, sa					
Trade balance	~~22.2~~	*21.5*	~~19.6~~	*18.6*	*19.7*
year earlier	23.5		~~24.6~~	*24.7*	*24.7*
Exports	~~182.7~~	*183.1*	~~178.9~~	*180.0*	*183.7*
%m/m	~~2.2~~	*2.3*	~~-2.1~~	*-1.7*	*2.1*
Imports	~~160.5~~	*161.6*	~~159.3~~	*161.4*	*164.0*
%m/m	~~0.1~~	*0.4*	~~-0.8~~	*-0.1*	*1.6*

	Mar	Apr		May
Germany				
€ bn, values, sa				
Trade balance	19.8	19.8		*20.3*
year earlier	23.3	23.1		*21.6*
Exports	105.4	106.3		*107.9*
%m/m	0.4	0.9		*1.4*
Imports	85.5	~~86.5~~	*86.6*	*87.6*
%m/m	2.1	1.2		*1.2*

German exports and imports were very strong in May. Nominal exports of goods rose 1.4%m/m, while imports rose 1.2%m/m. Both are tracking around 10% gains annualized so far in 2Q17. In volume terms, exports of goods rose 1.7%m/m and imports rose 2.4%m/m in May. This leaves the April/May average up 9.3% annualized for exports and 14.6% annualized for imports. And this comes after already strong outturns in 1Q17. Given that orders and IP were also very strong in May and given that forward-looking indicators suggest that momentum should be maintained for now, it looks as if 2Q17 will see a large increase in German GDP. As a result, we raised our tracking estimate from 2.5%q/q, saar to 3.5%q/q, saar.

Inflation

Consumer prices

	Apr	May	Jun
Germany (final)			
%m/m, nsa	0.0	-0.2	<u>*0.2*</u>
%oya, nsa	2.0	1.5	<u>*1.6*</u>
HICP (%oya)	2.0	1.4	<u>*1.5*</u>

	Apr	May	Jun	
France (final)				
%m/m, nsa	0.1	0.0	<u>*0.0*</u>	
Index ex tobacco, nsa	101.23	101.28	~~*101.31*~~	*101.30*
%oya, nsa	1.2	0.8	<u>*0.7*</u>	
HICP (%oya)	1.4	0.9	<u>*0.8*</u>	

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	Apr	May	Jun
Italy (final)			
%m/m, nsa	0.4	-0.2	*-0.1*
%oya, nsa	1.9	1.4	*1.2*
HICP (%oya, nsa)	2.0	1.6	*1.2*

	Apr	May	Jun
Spain (final)			
%m/m, nsa	1.0	-0.1	*0.0*
%oya, nsa	2.6	1.9	*1.5*
HICP (%oya, nsa)	2.6	2.0	*1.6*

[1.] Excluding food, alcohol, tobacco and energy.

Source: European Commission, Eurostat, ECB, FSO, Bundesbank, IFO, INSEE, ISAE, Istat, INE, CBS, BNB, Markit, and J.P. Morgan forecasts

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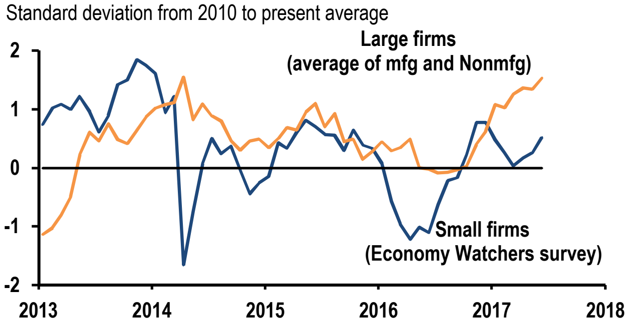
Japan

- **Consumption weakened in May after a jump in April, while machinery orders declined further in May**
- **Consumer goods prices declined in June PPI**
- **Next week: BoJ expected to stay on hold with revision up on growth and down on inflation forecast**

This week's mixed data did not change our assessment that growth is solid but inflation remains weak. The Cabinet Office (CAO) real private consumption index indicated that consumption increased around 2% annualized in 2Q after a 1.1% gain in 1Q. And business surveys send an upbeat message about 2Q: small firms' business sentiment in the Economy Watchers survey improved more than we expected in June after the solid gain in large firms' sentiment already reported (Figure 1). However, machinery orders were weak through May, challenging our relatively upbeat view on business investment. The weakness was concentrated in the nonmanufacturing sector, especially transportation (see the Japan focus on machinery orders in this *GDW*). With a jump expected in core capital goods shipments, we continue to project that GDP-based capex accelerated in 2Q. But a pickup in orders is necessary to support our view that the firm increase in capex continues in 2H of this year. Next week's May construction spending (source data for public investment) and June customs trade data will give us more color on 2Q GDP.

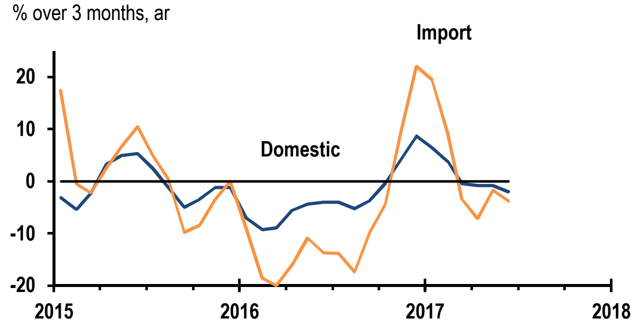
Figure 1: Business sentiment
Standard deviation from 2010 to present average



Source: Reuters, Cabinet Office, J.P. Morgan

While we are confident that the economy as a whole is solid, even given the feeble machinery orders, prices look somewhat weaker than we had expected. In the June PPI, consumer goods prices fell relative to three months ago (Figure 2). This weakness, along with recent anecdotal evidence, including the fall in energy prices and price cuts announced by a large wireless company and a retailer, add downside risk to our 0.9%oya CPI inflation forecast for 4Q this year.

Figure 2: PPI consumer goods
% over 3 months, ar



Source: BoJ

BoJ preview: No policy change is easing

At the Monetary Policy Meeting (MPM) next Thursday, we expect the BoJ will revise down its inflation forecast in the Outlook report but maintain current policy with an unchanged baseline view that annual CPI inflation will reach around 2% in FY2018. The BoJ has a bullish view on economic growth, so it will likely revise up its growth forecast. However, the weakness of the BoJ's preferred core CPI measure (ex. fresh food and energy) and the recent decline in energy prices point to weak core CPI inflation (including energy). We expect the BoJ to revise down its FY2017inflation forecast relatively significantly, from 1.4%y/y to 1.0%, and the FY2018 projection slightly, from 1.7% to 1.6%, leaving its outlook far above our own forecast (Table 1).

Table 1: Median forecasts of BoJ board members
%oya

	J.P. Morgan's fct of new BoJ forecast		Previous BoJ fct: Apr 17		J.P. Morgan's own forecast (latest)	
	Real GDP	Core CPI	Real GDP	Core CPI	Real GDP	Core CPI
FY2017	1.6	1.0	1.6	1.4	1.5	0.6
FY2018	1.4	1.6	1.3	1.7	0.5	0.8
FY2019	0.8	1.9	0.7	1.9	n.a.	n.a.

1. Fiscal year starts April 1.
2. Core CPI forecast excludes the impact of a hike in consumption tax rate
Source: BoJ, J.P. Morgan forecast

Note that the unchanged policy means wider interest differential between Japan and other major countries, which likely would weigh on the JPY, other things equal. Although we do not think the Bank intends to use JPY depreciation as its main tool to achieve 2% inflation, it is essential the JPY does not appreciate, because prolonged above-potential growth is needed to raise domestic inflation. So far, since the introduction of yield curve control in September last year, the BoJ has been successful in easing financial conditions even after reducing JGB purchases from ¥80tn annualized to around ¥60tn. We continue to believe that the BoJ will maintain its current policy for a long time (see research note "BoJ: Kuroda or not matters when critics persist" in this *GDW*).

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Data releases and forecasts

Week of July 18 – 21

Tue
Jul 18
2:00pm

Construction spending

%oya

	Feb	Mar	Apr	May
Public (%oya)	-4.2	-0.8	6.4	
%m/m, sa by J.P. Morgan	0.6	2.3	4.4	
Private residential (%oya)	4.9	4.5	4.5	
%m/m, sa by J.P. Morgan	-0.2	0.1	1.8	
Private nonresidential (%oya)	10.2	12.2	17.8	
%m/m, sa by J.P. Morgan	0.5	0.8	5.3	

April public construction spending rose 4.4%m/m, sa. We expect that it accelerated in 2Q due to a boost from the second FY2016 supplementary budget, which passed the Diet at the end of last year.

Wed
Jul 19
8:30am

Reuters Tankan survey

Diffusion index

	Apr	May	Jun	Jul
Manufacturing	26	24	26	28
Nonmanufacturing	28	30	33	34

We expect both the manufacturing and non-manufacturing DIs increased slightly in July. We look for the machinery sectors' sentiment to have improved in June reflecting firm external demand, pushing up the manufacturing DI. Also, nonmanufacturing sector sentiment should improve due to the rise in retail sectors' sentiment.

Thu
Jul 20
8:50am

Customs-cleared international trade

	Mar	Apr	May	Jun
Balance (¥bn sa)	139.3	157.6	133.8	175.4
Exports %m/m	-4.0	-0.3	0.0	1.3
Imports %m/m	3.5	-0.6	0.3	0.7
Balance (¥bn nsa)	610.3	481.1	-203.4	443.1
Exports %oya	12.0	7.5	14.9	9.0
Imports %oya	15.9	15.2	17.8	14.7
BoJ real export index	-2.3	-1.4	1.9	
BoJ real import index	4.4	1.7	-1.3	

We expect the trade balance surplus expanded in June. Real exports increased 1.9%, sa in May. While shipments to Asia have moderated, exports to the EU and the US accelerated, leading overall exports. We look for exports to have remained firm in June reflecting the firm demand from the Euro area.

Source: BoJ, CAO, EJCS, JADA, JCSA, JDSA, JFA, JLMVMA, Markit, METI, MHLW, MILT, MoF, Reuters, Shoko Chukin bank, Statistics Bureau, J.P. Morgan forecast

Review of past week's data

Bank lending (Jul 10)

%oya

	Apr	May	Jun	
Bank lending	3.0	3.3	~~3.2~~	*3.3*
%m/m, sa by J.P. Morgan	0.4	0.5		*0.1*

Bank lending slowed its monthly gain to 0.1%m/m, sa (by J.P. Morgan) in June from 0.5% in May, but the 2Q gain was strong, rising 4.1%q/q, saar, the fastest increase since 1Q09 when liquidity demand surged with the financial crisis. The oya increase was 3.3% in June, unchanged from May but the highest since May 2009. The acceleration in lending is mainly due to the faster increase in city banks' loans.

Balance of payments (Jul 10)

¥bn sa

	Mar	Apr	May	
Current account	1797	1807	~~1596~~	*1401*
Trade balance	348	262		*269*
Services	-153	75		*-194*
Primary income	1721	1595		*1472*
Secondary income	-119	-124		*-146*
Current account (nsa)	2981	1952	~~1994~~	*1654*

1. Formerly "income account"
2. Formerly "current transfers"

The current account surplus narrowed to JPY1,401 billion, sa (3.1% of GDP) in May from 1,807 billion (4.0% of GDP) in April, less than we had expected (3.6% of GDP). The May drop was due mainly to declines in the service and income balance. As for the service account, the volatile miscellaneous category balance plunged after the April jump, reflecting temporary movements in charges for the use of intellectual property and R&D services from overseas. Within the income balance, the direct income balance continued declining after a surge at the beginning of this year. The trade balance surplus expanded slightly due to the increase in export volume and decline in import volume in May. We expect that the current account surplus will recover in June after the dip in May, and we maintain our view that it will stay around 3.6%-3.7% of GDP during 2017 with the stable trade and primary income surplus.

Machinery orders (Jul 10)

%m/m, sa

	Mar	Apr	May	
Core domestic orders[1]	1.4	-3.1	~~2.0~~	*-3.6*
Manufacturing	0.6	2.5		*1.0*
Core nonmanufacturing	-3.9	-5.0		*-5.1*
Foreign	-2.8	17.4		*-5.2*

1. Domestic private sector, ex for ships and from utilities

Core domestic machinery orders unexpectedly declined for the second consecutive month in May, likely leaving two consecutive quarters of contraction. These weak orders are puzzling as capex plans in the BoJ Tankan show a decent gain in FY2017 and core capital goods shipments are projected to increase rapidly in 2Q. Moreover, profits have firmed, and business sentiment in both manufacturing and nonmanufacturing is relatively upbeat. We are inclined to regard this weakness as transitory and expect a recovery, while recognizing downside risk to our capex forecast in 2Q (+5.0%q/q, saar after 2.5% in 1Q).

Core domestic private machinery orders (excluding orders from electric utility companies and for ships) fell 3.6%m/m, sa in May even after a 3.1% decline in April. May's print was much weaker than we had expected (J.P. Morgan: 2.0%, consensus: 1.7%) due to weak nonmanufacturing sectors. Nonmanufacturing orders fell 5.1% in May on top of a 5.0% decline in April with a large decline in transportation and construction (subtracting 3.6%-pts and 2.8%-pts, respectively). We think that the decline in the construction sector was temporary, and the trend of

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this sector is upward in response to the materialization of the past fiscal stimulus and the 2020 Olympic Games. However, the transportation sector, which rose solidly during 1H16, has turned to a downtrend since mid 2016, which we think is unlikely to reverse in the near future.

On the other hand, manufacturing orders have been increasing gradually, reflecting the improvement in machinery sectors. Orders increased 1.0% in May after a 2.5% gain in April. Within manufacturing sectors, machinery industries such as electronic machinery and information and communication electronics equipment increased, probably reflecting continued firm external demand. In addition, material industries such as chemical and petroleum and coal products increased in May.

Economy Watchers survey (Jul 10)

DI

	Apr	May	Jun	
Current conditions (sa)	48.1	48.6	~~48.8~~	*50.0*
Households (sa)	46.9	46.9		*48.1*
Business (sa)	48.5	51.5		*52.5*
Employment (sa)	54.8	54.2		*57.2*
Current conditions (nsa)	50.4	50.1		*50.1*

In the Economy Watchers' survey (business sentiment survey to small firms that are sensitive to economic conditions), the current conditions DI (seasonally adjusted) improved further in June, reaching the 50.0 neutral level. The level was higher than our expectation (48.8) and the highest since December 2016. The fall in 1Q was somewhat puzzling, but the trend in sentiment clearly turned upward. With fairly upbeat business sentiment in other surveys, the print supports our view that the economy strengthened in 2Q.

The improvement in June was broad based; the household-related DI rose 1.2pts to 48.1 in response to the improvement in retail business. According to the commentaries, department store sales increased due to firm domestic consumption reflecting the good weather as well as foreign visitors' consumption (inbound demand). Auto sales also increased due to the introduction of new models. The business-related sector DI also improved 1.0pt to 52.5 with the improvement in both manufacturers and non-manufacturers. The commentaries showed increased orders in construction sectors and increased capex demand especially in the electronic sector. The employment-related DI rose 3.0pt to 57.2 in June, and commentaries pointed to increased job offers, especially in the medical and welfare sectors.

Producer prices index (Jul 12)

%oya, nsa, 2015-based

	Apr	May	Jun	
Domestic PPI	2.1	2.1	2.1	
(%m/m)	0.2	0.0	0.0	
Export prices	3.0	4.4		*5.6*
Import prices	11.2	12.5		*11.9*

1. Excluding additional charges for electric utility rates in the summer months

The June Producer Price Index was unchanged m/m for the second consecutive month and a 2.1% year-on-year change, the highest since January 2014, continued for the third month in a row. In 2Q, the PPI slowed to 1.8%q/q, ar from 6.2% in 1Q mainly due to the slow energy price rise.

On an oya basis, the upward pressure to domestic prices from international commodity prices has eased, but the downward pressure to corporate goods prices excluding commodity prices has also moderated. Consumer goods (excluding petroleum and coal products) rose 0.1%oya in June, the first gain in more than a year. However, the momentum looks soft as the q/q change turned to -0.6% in 2Q from 0.9% in 1Q.

Meanwhile, import prices in JPY terms declined 1.6%m/m, nsa in June while export prices fell 0.8% with the USD/JPY declining 1.2%. In oya terms, import price inflation remains relatively high at 11.9% but no longer accelerating while export prices accelerated to 5.6% in June from 4.4% in May and 3.0% in April. The slowdown in import price inflation was attributed to the yen appreciation with a lagged effect as well as the lower energy prices. These moves in imported prices put downward pressure on consumer goods inflation.

Index of tertiary sector activity (Jul 12)

	Mar	Apr	May	
%m/m, sa	-0.3	1.4	~~-0.8~~	*-0.1*

Tertiary sector activity index fell only 0.1%m/m, sa in May after a 1.4% jump in April. We had expected larger negative payback (-0.8%). As a result, we estimated real GDP by using IP (the April and May average rose 8.7%, saar from 1Q), and this activity index (April and May average rose 4.4%, saar from 1Q) shows 7.2%q/q saar growth in 2Q, which is much stronger than our 2.5% 2Q GDP forecast. While the outcome may be overestimated, the direction supports our bullish view on 2Q growth.

The trends of both personal and business services have been firm. Within personal services, discretionary services, such as restaurant and amusement services, rose with an increase in domestic and foreign visitors' consumption, and non-discretionary service also improved due to the increase in life insurance services. As for business services, manufacturing-dependent services increased in positive payback for a plunge in wholesaler-related mineral and metals in 1Q. In addition, information & communication services (such as web marketing and operations) in nonmanufacturing-dependent services jumped in April and remained firm in May.

Source: BoJ, CAO, EJCS, JADA, JCSA, JDSA, JFA, JLMVMA, Markit, METI, MHLW, MILT, MoF, Reuters, Shoko Chukin bank, Statistic Bureau, J.P. Morgan forecast

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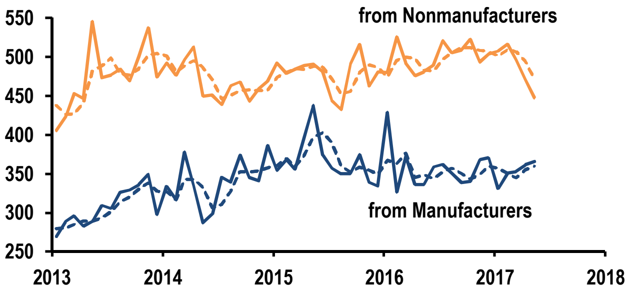
Japan focus: Machinery orders

Core domestic private machinery orders (excluding orders from electric utility companies and for ships) declined for the second consecutive month in May, falling 3.6%m/m, sa after a 3.1% drop in April. This weakness is attributable to orders from nonmanufacturing sectors, which declined for a third consecutive month (Figure 1). As a result, the April-May average stood 13.2%q/q, saar below the 1Q average, likely resulting in the second consecutive quarter of contraction.

Figure 1: Core machinery orders

billion yen, sa, dotted lines show 3-month moving average

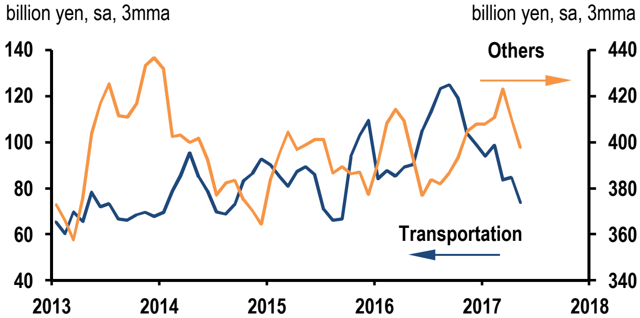


Source: CAO, J.P. Morgan

Within nonmanufacturing, the decline was broad based but most notable in the transportation sector, which boomed in 1H16 (Figure 2) when, in response to increases in online shipping, several logistics firms accelerated investment in warehouses with labor-saving machinery and equipment. This sector's investment has fallen sharply since October 2016. As a result its orders, which made up 20% of total nonmanufacturing orders in 2016, plunged nearly 30% ar in 2H16 from 1H, subtracting 6.5%-pts from total orders in 2H, which declined 5.1% overall.

Figure 2: Breakdown of nonmanufacturing sector

billion yen, sa, 3mma | billion yen, sa, 3mma

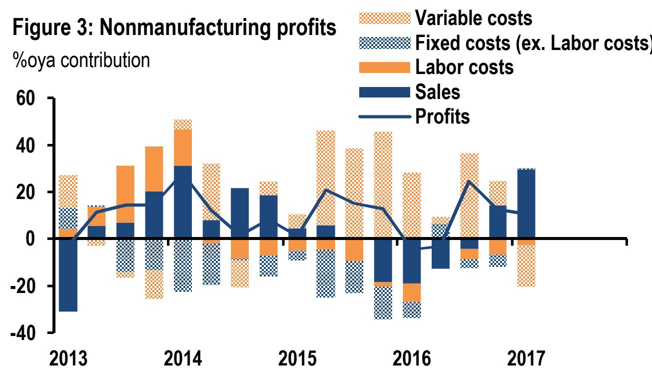


Source: CAO, J.P. Morgan

We are relatively optimistic on prospects for investment and machinery orders. The environment for nonmanufacturing has improved since the end of last year as firmer domestic demand has increased sales, pushing up profits, in contrast to 2015, when a fall in variable costs, mainly in energy prices, was the main profit driver (Figure 3). Although a gradual increase in labor costs and energy prices likely will be a drag, profits driven by sales gains instead of cost declines should improve firms' confidence more materially and lead to an increase in capex.

Figure 3: Nonmanufacturing profits

%oya contribution

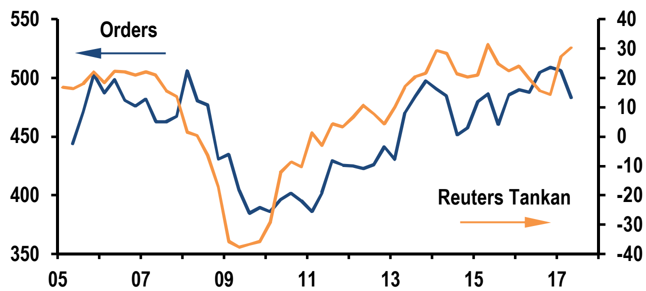


Source: MoF, J.P. Morgan

In fact, the Reuters Tankan survey shows that sentiment in the nonmanufacturing sector has improved since the end of 2016 (Figure 4). However, changes in nonmanufacturing orders tend to follow sentiment swings with a lag. The recent decline in orders from this sector likely reflects deterioration in sentiment after the 2016 sales drop-off. We thus project orders will pick up ahead. The next machinery orders release is due August 10 and will include 3Q projections.

Figure 4: Nonmanufacturing orders and sentiment

billion yen, sa, figure for 17/2Q is Apr- May average | DI



Source: CAO, BoJ, J.P. Morgan

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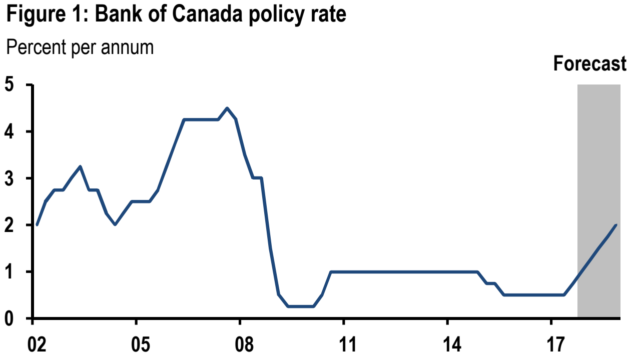
Canada

- **Bank of Canada hiked policy rate 25bp to 0.75% as expected**
- **We expect the Bank to hike another 25bp in October when it releases its next Monetary Policy Report . . .**
- **. . . and continue with 25bp hikes at the next four Monetary Policy Report announcements in 2018**
- **Fresh high for home prices in June**

The Bank of Canada delivered to our expectations this week with its first policy rate hike since September 2010. Moreover, since the Bank seemed to put less emphasis on just removing the 50bp of "insurance cuts" after the oil price shock, we no longer expect a pause in the hiking cycle between October 2017 and April 2018. Based on the Bank's upbeat tone in the Monetary Policy Report, we now expect 25bp hikes at each Monetary Policy Report through the end of next year (Figure 1). At an expected 2% policy rate in October 2018, this would still leave rates below the Bank's estimated neutral policy rate range of 2.5%-3.5%. While the Bank gave no forward guidance on future adjustments to the policy rate (as is their custom), Governor Poloz noted that there is reason to expect that future interest rates will be higher than they are right now.

Figure 1: Bank of Canada policy rate

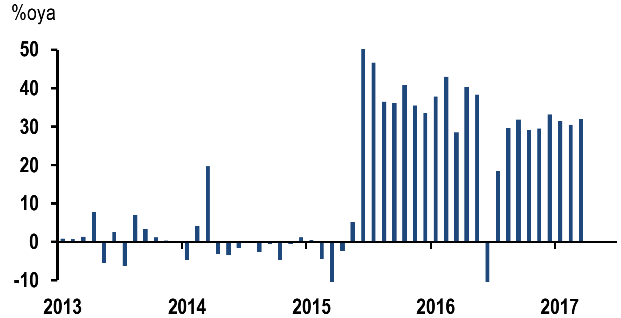


Source:Bank of Canada, J.P. Morgan

The Bank projects that the output gap will close around the end of 2017, so the more rapid absorption of excess capacity made a hike appropriate based on the recognized lag between monetary policy and future inflation. The banks credited stimulative fiscal policy, in the form of the Canada Child Benefit and infrastructure spending, with helping the economy achieve potential growth sooner than previously expected (Figure 2).

With the withdrawal of accommodation expected to be relatively gradual, we don't expect any material effects on growth. Our nowcaster currently projects robust 3.6% saar GDP growth in 2Q, signaling upside risk to our 2.8% forecast. For 3Q, our nowcaster currently predicts 3.0% growth.

Figure 2: Canada Child Benefit



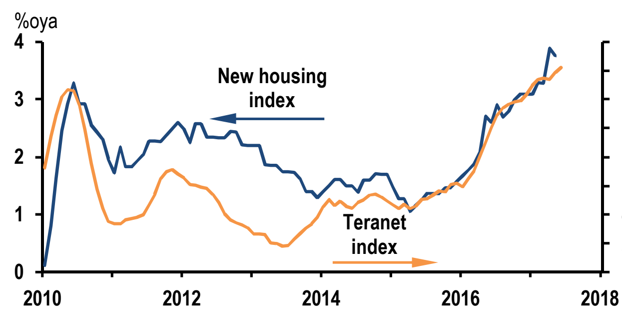
Source: DOF, J.P. Morgan

The Bank's growth forecast is very close to our own for 2017 and 2018. The Bank raised its 2017 growth forecast 0.2%-pts to 2.7%Q4/Q4, slightly above our estimate, and by 0.1%pt to 1.8% for 2018. On inflation, the Monetary Policy Report included a box discussing the reasons for the recent softer outturns. Among the temporary forces holding back inflation were the recent declines in crude oil prices, the reduced cost of electricity in Ontario, and the recent sharp decline in auto price inflation. All are expected to drop out over time. The Bank lowered its forecast of CPI inflation in 2017 to 1.6%Q4/Q4, but it expects inflation to be at the 2% target around mid 2018.

House prices continued to climb in June

Both the Teranet-National Bank Composite House Price Index and the New Housing Price index posted fresh cycle highs in June with the surge in both indexes largely attributed to gains in the Toronto area (Figure 3).

Figure 3: Teranet 11-city index and NHPI



Source: Teranet-National Bank, Statistics Canada, J.P. Morgan

Regional reports suggest that the package of measures targeting non-resident foreign buyers introduced in April have curbed demand somewhat only very recently. While the Ontario government expects the measures to have the desired cooling effect on house price gains, the Ontario premier said she's open to do more. The government of British Columbia introduced similar measures to curb demand in the Vancouver area nine months ago, which resulted in a temporary slowdown in demand. Renewed strength in price gains suggests activity began to heat up again in May and June.

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Data releases and forecasts

Week of July 17 – 21

Wed
Jul 19
8:30am

Manufacturing report

%m/m, sa, unless noted

	Feb	Mar	Apr	May
Sales	-0.2	0.8	1.1	0.8
New orders	1.1	2.0	0.4	0.9
Unfilled orders	0.7	1.5	1.0	1.1
Inventories	1.6	1.3	0.9	-1.5
Inventory-shipments ratio	1.34	1.35	1.35	1.32

Fri
Jul 21
8:30am

Consumer price index

%m/m nsa, unless noted

	Mar	Apr	May	Jun
Total CPI	0.2	0.4	0.1	-0.1
%oya	1.6	1.6	1.3	1.0
CPI-common (%oya)	1.3	1.3	1.3	
CPI-median (%oya)*	1.7	1.6	1.5	
CPI-trim (%oya)*	1.4	1.3	1.2	
Ex food & energy	0.3	0.0	0.2	0.0
%oya	1.7	1.5	1.4	1.3

Fri
Jul 21
8:30am

Retail sales

%m/m sa, unless noted

	Jan	Feb	Mar	Apr
Total	2.6	-0.3	0.5	0.0
%oya	7.0	5.2	6.8	6.1
Ex autos	2.5	0.1	-0.1	-0.3
%oya	6.8	6.2	6.1	4.5
Ex autos & gasoline	2.6	0.8	-0.1	0.0
%oya	4.3	4.1	4.0	3.5
Real retail sales	1.7	0.2	1.1	0.6
%oya	4.6	2.7	5.2	5.9

Review of past week's data

Housing starts (Jul 11)

Sa

	Apr		May		Jun	
Total (000)	~~213.5~~	*214.8*	~~194.6~~	*195.0*	~~205.5~~	*212.7*
(%m/m)	~~-15.2~~	*-14.6*	~~-8.8~~	*-9.2*	~~5.6~~	*9.1*
(%oya)	~~13.2~~	*13.9*	~~4.1~~	*4.2*	~~-6.3~~	*-3.0*

New house prices (Jul 13)

nsa

	Apr	May	Jun	
Total,%m/m	0.2	0.8	~~0.1~~	*0.7*
%oya	3.3	3.9	~~3.1~~	*3.8*

Source: Statistics Canada, Richard Ivey School of Management, CMHC, Markit, Teranet/National Bank of Canada, CREA, CFIB, Bank of Canada, J.P. Morgan forecasts

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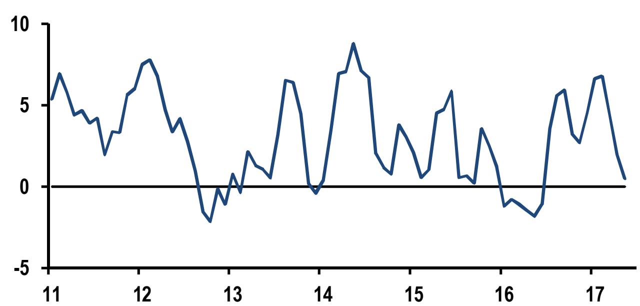
Mexico

- **Weak IP data prompt cut to our 2Q GDP forecast**
- **We now see 2Q growth at 0.8% saar instead of 1.3%**
- **We still expect activity to reaccelerate in 2H**
- **Moderate wage pressures warrant close watching**

Prior to this week's data releases we had stressed downside risks to our past-quarter GDP growth forecast but refrained to act on that bias given the prevailing strength in factory output. This week's May IP report was, in this regard, largely disappointing. Factory output not only failed to rise as we expected but actually contracted 0.3%m/m, dragging the 3m/3m annualized run rate down to just 0.5%. This compares to a 5% ar average in the three quarters through 1Q17 (Figure 1).

Figure 1: Manufacturing output

%3m/3m saar



Source: INEGI

It was natural to expect some moderation in manufacturing momentum, though not to the extent witnessed this week. Manufacturing seems on track to expand only around 2% ar this quarter, provided that our expectations for a swift pickup in June materialize. The weak May manufacturing performance virtually offset positive readings in mining and construction, which nevertheless remain on track to fall in 2Q. As a result, IP edged up 0.1%, coming in below expectations.

The message in the May IP print is twofold, in our view. On its own, the weaker IP print points to a slightly weaker GDP trajectory than we expected. But outside the headline figure, the composition of IP growth in May is troubling. Manufacturing had been one of the bright spots in the economy in the past few quarters, and although we maintain an upbeat outlook, its deceleration will weigh on activity more broadly. The tight link between manufacturing activity and externally-driven services suggests that gains in the latter are likely to be capped in the middle month of last quarter, notwithstanding the sharp exports pickup in May. Domestically-driven services have been resilient but are losing steam as the inflation squeeze on consumer spending becomes more evident.

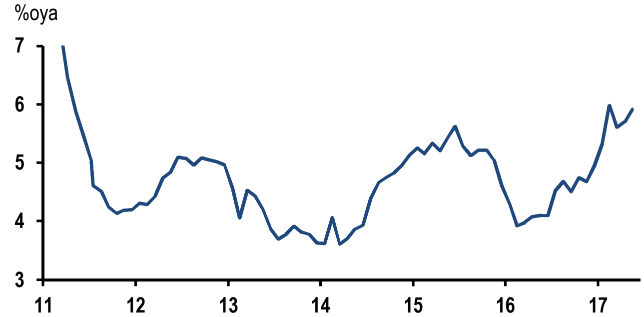
We thus think that, even allowing for a modest pickup in externally-driven services and resilience in domestically-led services, activity is somewhat too weak for our forecast to remain viable. Against this backdrop, we now see 2Q GDP growth at 0.8% saar, down from our 1.3% earlier forecast. We keep our 2H outlook unchanged as we see the moderation in manufacturing as transitory. However, weaker carryover means full-year GDP growth is likely to be a touch lower than our 2% prior forecast; we now see it at 1.9%.

Manufacturing likely to regain its footing

The moderation in manufacturing last quarter is a bit puzzling, and both hard and soft data suggest it should be transitory. The fall in factory output in May was clearly at odds with the sharp pickup in manufacturing exports. Furthermore, the IMEF manufacturing PMI surged in June and, based on its historical relationship with actual output, points to manufacturing growing in excess of 5% annualized through June. We tend to attach little value to the signal conveyed by the PMI. We faded the signal when it pointed to falling factory output throughout last year—precisely when manufacturing was booming—and we also downplay the strong signal this time around. But the fact that hard data point in the same direction is encouraging. Employment gains in the manufacturing sector are accelerating, driving most of the increase in formal employment in recent months. Formal employment in the manufacturing sector is up nearly 6%oya in June (Figure 2). Auto data were also robust in June.

Figure 2: Formal employment - manufacturing

%oya



Source: IMSS

Thus, while we believe manufacturing activity slowed last quarter, the positive stream of data through June, a still-weak currency, and healthy US manufacturing growth prospects suggest that manufacturing activity should snap back in 2H. As we have argued before, strong manufacturing output should help compensate for slowing in domestically-driven sectors, particularly services, allowing the economy to grow at a moderate pace this year and not downshift markedly.

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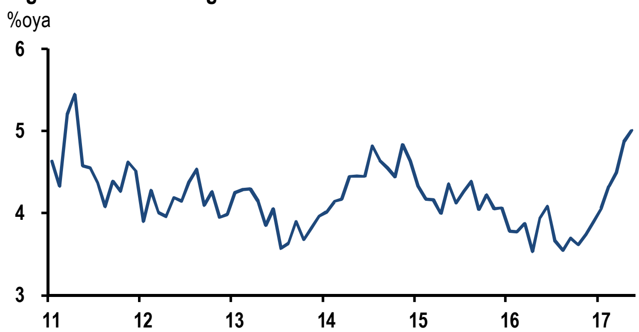
Moderate wage pressures emerging

Ministry of Labor data showed nominal wage growth at 5.2%oya in June, marking the steepest increase since December 2009. There are reasons to fade the signal from this single data point. The increase in wages was boosted by large gains in lodging and restaurant services, which likely were related to the holiday season. At the same time, it is important to note that wage negotiations reported by the MoL encompassed just over 120,000 employees and are thus far from representative.

While these are valid reasons not to read too much into the June reading, a number of factors caution us not to dismiss it. First, and foremost, the labor market does appear tight by several measures, one of them being the unemployment rate, which is well below its historical average. With the labor market tight and inflation well above the central bank target, it appears reasonable that nominal wages should accelerate. This is in fact the message from the more encompassing series on wage growth in the formal economy, which covers about 19 million workers. Average wage growth in the formal sector has accelerated noticeably throughout the year, climbing to 5%oya from a 3.8% average rate in 2016 (Figure 3).

Figure 3: Nominal wages in the formal sector



Source: IMSS

Finally, pay in the manufacturing sector, where we have witnessed very strong job creation and activity in the past few quarters, has led the broader wage pickup. Although the pace of wage gains is not extremely concerning, it might make some Banxico board members uneasy. We continue to think that the hiking cycle is over, and the next likely move is toward a lower policy rate. But Banxico will certainly tread carefully in the foreseeable future. Rising nominal wages could generate inertial persistence in inflation and prevent it from falling as rapidly as we currently expect. Additionally, the general election in mid 2018 could trigger financial volatility, something the central bank will likely keep a wary eye on. Against this backdrop, we still think Banxico will stay on the sidelines next year, and if risks for rate cuts were to materialize, they would probably only come in the latter half of 2018.

Oil auction rounds yield first results

Two years after the poorly received Round 1.1 auction, in which only 2 of 14 fields were allocated, a consortium of three firms from Mexico, the US, and the UK announced an oil find in the Zama-1 offshore well in the Gulf of Mexico. Zama-1 is the first exploration well drilled by a private company in Mexico's modern history, and its estimated resources are close to 2 billion barrels of oil equivalent, well above initial expectations.

Subsequent rounds (Rounds 1.2, 1.3, and 1.4; Rounds 2.1, 2.2, and 2.3) have been more successful in terms of allocation, but finds are yet to come. Projected investment in allocated fields is close to US$65 billion in the long term, but most of it should be frontloaded. Accordingly, the participation of the energy sector in domestic and foreign direct investment will increase meaningfully in the medium term. We maintain our forecast for FDI to average US$30 billion in 2017-2019.

Part of this well-received progress can be attributed to a learning process but also to the government's eagerness to show results before the end of the current administration (2018), particularly since concerns have emerged regarding the potential victory of a candidate who may try to slow the implementation of the energy reform. We believe the kind of results announced this week should make it costlier for any new government to backtrack or slow energy reforms.

Data releases and forecasts

Week of July 17 – 21

Fri	**Labor market report**				
Jul 21	% of labor force				
9:00am		**Mar**	**Apr**	**May**	**Jun**
	Unemp. rate	3.2	3.5	3.6	3.5
	sa	3.5	3.6	3.5	3.5

Review of past week's data

Industrial production
%oya, unless noted

	Mar	Apr	May	
%oya nsa	3.2	-4.2	~~-0.1~~	*1.0*
Manufacturing	8.5	-1.5	~~4.6~~	*5.0*
%m/m sa	-0.1	-0.2	~~0.2~~	*0.1*
Manufacturing	-0.3	0.6	~~0.4~~	*-0.3*

Source: INEGI and J.P. Morgan forecasts

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Brazil

- **Labor reform was approved in the Senate**
- **Former President Lula was convicted in the Car Wash probe**
- **The charge against President Temer was rejected in the Lower House Constitution committee**
- **Economic growth (IBC-Br) disappointed in May**

Attention is still focused on politics in Brazil. On the positive side, the Senate approved the labor reform by 50 to 26, a wide margin as only a simple majority was needed (half of those present, with 81 senators in total). The bill is important to lower labor costs, mainly those derived from lawsuits, and reduce the rigidity of Brazil's labor laws, even though it may not be a big boost to unemployment in the short term (see "Brazil: Labor reform was approved in the Lower House with an eye on pension reform negotiations," April 27).

Also, former President Lula was convicted on one of the charges related to the Car Wash probe this week. Recent polls have put him ahead in the presidential race by a large margin, even though candidacies are not official at this point. This conviction does not bar Lula from running next year—the election will be held in October 2018—but it creates uncertainty about his participation as confirmation of the conviction by a higher court, which may take about 12 months after the eventual appeal, could impede his candidacy.

Finally, the rapporteur on the charge against President Temer in the Lower House Constitution committee (CCJ) delivered his report this week in favor of allowing the Supreme Court (STF) to start the trial. However, the CCJ voted against it, leading to the delivery of a new report, this time against the charges. This did not terminate the process. The Lower House floor will have the final say on the matter on August 2 after the Congressional recess (it takes 342 votes out of 513 deputies to allow the STF to put the president on trial). After that, the STF also has to decide to start the trial. If a trial starts, President Temer would have to step down from office for up to 180 days, and the speaker of the Lower House, Deputy Rodrigo Maia, would become interim president (see "Brazil: The aftermath of the accusations against President Temer," June 27).

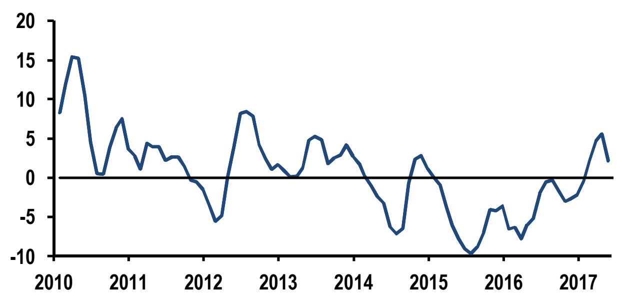
One negative aspect of the recess is that the matter will remain unresolved until the Congress reconvenes in August. The situation could be complicated further if the Prosecutor General sends another charge to the Lower House. The second charge would be analyzed in parallel to the first and would demand extra attention from the deputies, harming the efforts to deal with other initiatives.

Economic activity tumbled 0.5% in May

According to the Central Bank's economic activity index (IBC-Br), economic activity contracted 0.5%m/m sa in May, following a 0.1% uptick in April and another weak 0.5% drop in March. This result disappointed our expectations for a 0.3% increase and the 0.2% market consensus call. The Central Bank does not release a breakdown, but since services and IP grew in May (0.1% and 0.8%, respectively), and only retail sales contracted, it appears that agriculture played a significant role in this May IBC-Br decline. With that, economic growth decelerated to 2.1%3m/3m saar from 5.6% in April and 4.7% in 1Q (Figure 1).

Figure 1: Monthly activity index growth (IBC-Br)

%3m/3m saar

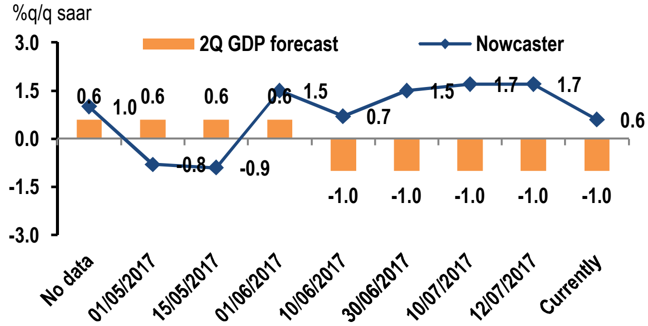


Source: BCB

After the release of the IBC-Br, our Brazil nowcaster with hard data through May and soft data through June points to 0.6% ar growth in 2Q, down from 1.7% yesterday (see methodology here: "Introducing J.P. Morgan's EM nowcasters," July 13), which is still above our call for a 1%q/q saar contraction in 2Q GDP (Figure 2). However, we think that there will be another down leg in activity in June on the back of the confidence dive related to the political events of May 17. With that in mind, we reaffirm our belief that 2Q GDP will decrease 1%q/q saar, followed by a slow recovery in 2H17.

Figure 2: Brazil nowcasting 2Q17 GDP growth

%q/q saar



Source: J.P. Morgan

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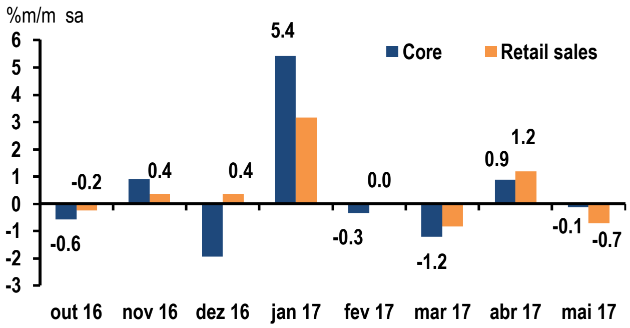
Retail disappointed in May; services volume was roughly stable

Contrary to our expectation of a 0.5%m/m expansion, retail sales contracted 0.7% in May, with core sales down by 0.1% (Figure 3). As we emphasized regarding the last industrial production report (see "[Brazil: Strong IP in May, but June is the question](#)," July 4), the main focus to gauge economic growth performance in 2Q will be the June figures, which we expect to reflect the fallout from the most recent political crisis. In fact, consumer confidence declined almost 2 points in June. In this context, retail sales are highly likely to reflect a significant slowdown from 1Q to 2Q even in a scenario of a less downbeat June report. In May, headline sales ran at 3.1%3m/3m saar, down sharply from the 13.7% surge in 1Q. If sales remained stable in June, headline sales would be near flat in 2Q, confirming the slowdown.

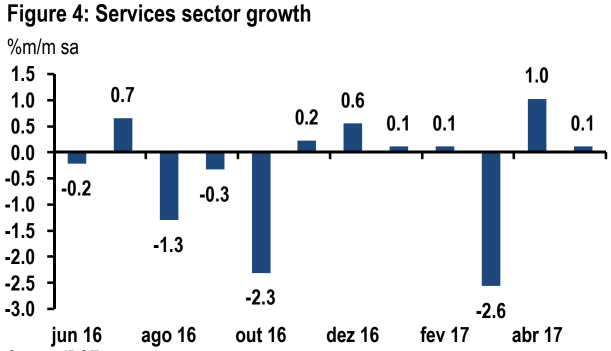
Figure 3: Retail sales growth



Source: IBGE

Following a solid report for April, services volume inched up only 0.1%m/m, sa in May (Figure 4). As a result the sequential trend contraction accelerated 6.8%3m/3m, saar from a 4% drop in April reflecting the negative carryover from 1Q into 2Q. And prospects for the sector are not very encouraging: sentiment declined significantly in June. We think service sector growth is also likely to decelerate significantly in 2Q.

Figure 4: Services sector growth



Source: IBGE

Data releases and forecasts

Week of July 10 – 14

Mon	**Wholesale prices (IGP-10)**				
Jul 17		**Apr**	**May**	**Jun**	**Jul**
7:00am	%m/m	-0.8	-1.1	-0.6	<u>-0.91</u>
	%oya	3.9	2.1	0.1	<u>-1.87</u>

Thu	**Consumer prices (IPCA-15)**				
Jul 20		**Apr**	**May**	**Jun**	**Jul**
8:00am	%m/m	0.2	0.2	0.2	<u>-0.12</u>
	%oya	4.4	3.8	3.5	<u>2.84</u>

Fri	**Current account balance**				
Jul 21		**Mar**	**Apr**	**May**	**Jun**
9:30am	Current account (CA)	1.4	1.2	2.9	<u>1.4</u>
	CA, 12-month sum	-20.6	-19.8	-18.1	<u>-14.3</u>
	CA, 12-month sum, %GDP	-1.1	-1.1	-1.0	<u>-0.7</u>
	Foreign direct investment	7.1	5.6	2.9	<u>2.5</u>

Review of past week's data

Retail sales

	Mar	Apr	May	
Core %m/m, sa	-1.2	*0.9*	~~0.4~~	*-0.1*
Core %oya, nsa	-3.2	*1.7*	~~3.6~~	*2.4*
Broad %m/m, sa	-0.8	*1.2*	~~0.2~~	*-0.7*
Broad %oya, nsa	-1.9	*-0.5*	~~6.3~~	*4.5*

Economic activity

	Mar	Apr	May	
%m/m, sa	*-0.5*	*0.1*	~~0.3~~	*-0.5*
%oya, nsa	*0.9*	-1.7	~~2.7~~	*1.4*

Source: BCB, IBGE, FGV, and J.P. Morgan forecasts

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Argentina

- **National CPI rose 1.2%m/m in June, 20bps below market expectations**
- **BCRA kept the policy rate unchanged following CPI release, emphasizing core inflation persistence**
- **The monetary authority is likely to hold the policy rate stable through the end of August**
- **We maintain our year-end inflation projection at 21% and policy rate at forecast 22%**

This week's events prompted us to reassess the monetary policy path ahead. First and foremost, the statistics bureau introduced its new national CPI index, the main input for any inflation targeter. On top of that, we had the immediate monetary policy reaction to the national CPI (NCPI) release, as the BCRA held its bi-weekly monetary policy meeting. Following the debut of the NCPI and the policy reaction, we changed our base-case scenario a bit, as the BCRA looks mostly focused on core inflation.

The national CPI rose 1.2%m/m and 11.8% ytd in June. The new national CPI index (NCPI) expands the Greater Buenos Aires Area (GBA) CPI to include five other regions, and is the inflation index relevant for monetary policy going forward. Importantly, the methodologies have been standardized across regions, which was a source of uncertainty for the first print (see *GDW*, June 30). The new index has been calculated starting January 2017, so the first official over-year-ago print will be available in December 2017. As expected, the divergence between the National and the GBA CPI series has not been material. Indeed, both monthly and YTD GBA-CPI came in 20bps above the national print at 1.4%m/m and 12%, respectively. The monthly GBA-CPI print is slightly above the 1.3%m/m increase reported in May and below market's expectations (Bloomberg consensus: 1.4%m/m; JPM forecast: 1.3%m/m).

Breaking down by region, GBA-CPI contributed the most to the m/m headline CPI increase with 0.6%-pt. The GBA region is assigned a 44.7% weight in the national CPI index. The Pampean (Pampeana) region came second, with a 0.3%-pt monthly contribution and a 34.2% weight. Interestingly, on a month-on-month basis, the Northeast region saw prices increasing 1.4%m/m, in line with the GBA region (Table 1). On the opposite side, prices in the Northwest region rose the least, just 0.9%m/m.

Table 1: National CPI breakdown by region

		Jun-17		YTD	
	Weight (%)	%m/m	%-pt cont.	%YTD	%-pt cont.
National CPI		**1.2**	**1.2**	**11.8**	**11.8**
GBA	44.7	1.4	0.6	12.0	5.4
Pampeana	34.2	1.0	0.3	11.4	3.9
Northeast	4.5	1.4	0.1	11.9	0.5
Northwest	6.9	0.9	0.1	12.7	0.9
Cuyo	5.2	1.0	0.1	12.4	0.6
Patagonia	4.6	1.1	0.1	11.7	0.5

Source: INDEC
Note: GBA includes the City of BA and 24 adjacent districts; Pampeana: the rest of PBA province, Cordoba, Entre Rios, La Pampa and Santa Fe; Northeast: Corrientes, Misiones, Chaco and Formosa; Northwest: Catamarca, Jujuy, La Rioja, Salta, Santiago del Estero, and Tucuman; Cuyo: Mendoza, San Juan and San Luis; Patagonia: Chubut, Neuquen, Rio Negro, Santa Cruz, and Tierra del Fuego.

Breaking down the National CPI by component, services prices have dominated the charts, increasing 1.5%m/m at the national level, underscoring the persistence of core inflation, a dimension highlighted by BCRA as discussed below.

More important to gauge the inflation trend going forward, core CPI printed 1.3%m/m at the national level and 1.5%m/m for GBA (Table 2). The latter decelerated with respect to the 1.8%m/m YTD average (through May). On an annualized basis, the National Core CPI (NC-CPI) is currently running at 16.8% ytd, still above the 15.5% rate that the BCRA has stated is consistent with the 17% headline inflation target ceiling. Please note that BCRA's inflation targets are defined over the broadest index publicly available, so the targets will now be measured over the new national index.

Table 2: June CPI breakdown by sub-indices

%m/m	Nation	GBA	PA	NE	NW	C	PG
Headline	1.2	1.4	1	1.4	0.9	1	1.1
Seasonal	0.9	1.4	0.7	-0.4	1.4	-0.5	0.2
Core	1.3	1.5	1.1	1.6	1	1.4	1.3
Regulated	0.9	1	0.7	1.8	0.5	0.7	0.9
Goods	1	1.1	0.9	1.2	1	1	0.9
Services	1.5	1.8	1.3	1.8	0.7	1	1.4

Source: INDEC; PA: Pampeana; NE: Northeast; NW: Northwest; C: Cuyo; PG: Patagonia

Completing the analysis, regulated prices continued to decelerate in June absent relevant regulated prices adjustments. Regulated prices rose 0.9%m/m (National) and 1.0% (GBA), after a 1.2%m/m increase in May. Worth noting, regulated prices increased 16.7%YTD at the national level, with the highest level increase in the Northwest region. On the other hand, seasonal prices increased 0.9%m/m in June with seasonal deflation observed in the Northeast and Cuyo regions.

We still see convergence to the 2017 inflation targets as unlikely. National core inflation runs at 10.7% YTD (Fig-

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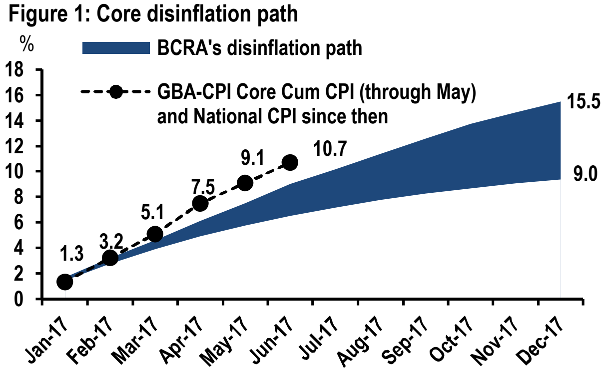
ure 1), implying that it would have to decelerate to 0.7%m/m on average during the remainder of the year for BCRA's target to be met. This sharp a slowdown seems unlikely, especially in light of expected upside pressure on the CPI in July from seasonal increases in fuels, medical services, housing expenses, and cigarettes) which are likely to pass through to core prices. Moreover, in November and December we should see another round of regulated price adjustments which should push up headline inflation, although we expect less pass-through to core prices than in February-April.

Figure 1: Core disinflation path



Source: BCRA

BCRA focuses on core inflation persistence and levels

The BCRA kept the policy rate unchanged at 26.25% following the June National CPI (NCPI) print, but was cautious on core inflation performance. June's 1.2%m/m NCPI print proved a sort of breather for the monetary authority, after fearing an acceleration of prices in the last two weeks of the month. Indeed, the BCRA reaffirmed that inflation has resumed its downward trend after deviating in the period February-April. Yet, the policy statement shows a very cautious Board, in particular in regards to core inflation. While the authority acknowledges that core inflation decelerated in June from the previous months, the emphasis is on the persistence of core CPI inflation at rates that year-to-date have been above those consistent with the headline inflation targets as we highlighted above.

Furthermore, the BCRA also pointed out sticky inflation expectations in the latest BCRA survey. In the BCRA's June expectations survey, median GBA inflation expectations for 2017 were unchanged at 21.6% and the core inflation forecast increased 20bp to 19.5%, well above the 15.5% the BCRA sees as consistent with its inflation target. A pickup in inflation in July could push inflation expectations even higher.

We believe the BCRA will keep the policy rate stable at 26.25% through the end of August. With the BCRA emphasizing core inflation persistence and levels, and some upward pressures on prices this month (e.g. potential FX pass-through to prices, and gasoline prices pass-through to core goods and services prices), we believe the monetary authority will hold the policy rate stable at least until the end of August, until it gathers more information in regards to core inflation behavior at a national level. **In all, we maintain our December 2017 inflation forecast at 21% and our policy rate forecast at 22% by year-end.**

Data releases and forecasts

Week of July 17 – 21

Thu	**Fiscal balance**				
Jul 20		**Mar-17**	**Apr-17**	**May-17**	**Jun-17**
	% of GDP	0.4	0.6	0.9	1.7

Review of past week's data

Policy rate

	Jun-13	**Jun-27**	**Jul-11**	
%	26.25	26.25	~~26.25~~	*26.25*

GBA-CPI (through May), National CPI (since then)

	Apr-17	**May-17**	**Jun-17**	
%m/m	2.6	1.3	~~1.3~~	*1.2*

Source: BCRA, INDEC, and J.P. Morgan

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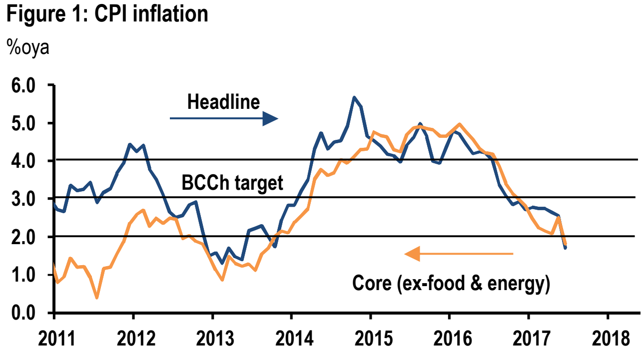
Chile and Peru

- **Chile: CPI dropped 0.4%m/m in June, driving 12-month inflation below BCCh's CPI target floor**
- **We revise December 2017 inflation lower to 2.4% (from 2.7%) and December 2018 to 2.6% (from 2.8%)**
- **BCCh kept the policy rate unchanged, waiting for more data to reassess its base case scenario**
- **Peru: BCRP cut the policy rate 25bp this month amid activity underperformance and political hurdles**

Chile: Inflation nosedived in June

In June the headline CPI dropped 0.4%m/m, well below expectations, driving annual inflation to 1.7%oya, below BCCh's CPI 2% target floor (Figure 1). Deflation was generalized on the month, as evidence by the various core CPI metrics that INE reports. Indeed, IPCX and IPCX1 declined 0.2% and 0.3% on the month, respectively, while CPI ex food and energy dropped 0.4%m/m (Table 1).

Figure 1: CPI inflation



Source: BBCh

Table 1: Inflation by major subcomponents

%m/m	June 2017	May 2017	Difference
Headline	**-0.39**	**0.13**	**-0.51**
Core	-0.37	0.31	-0.69
IPCX	-0.23	0.24	-0.47
Fruits & vegetables	-5.55	-2.61	-2.94
Fuels	0.05	-0.11	0.16
IPCX1	-0.32	0.22	-0.55
Tradables	-0.67	0.15	-0.82
Non-tradables	-0.04	0.10	-0.14

Source: BCCh and INE

Inflation behavior in June is definitely more consistent with the cyclical phase of the economy than May's outcome was. Last month, we flagged that the headline inflation experienced in May was at odds with cyclical activity behavior and that the core inflation pickup mainly reflected an atypical increase in tourism-related services prices (see note). In June, the pay-back of tourism-related prices placed headline CPI in line with the domestic demand feebleness that we have observed.

Following the June CPI downside surprise, we revised our December 2017 inflation forecast lower to 2.4% (from 2.7%) and December 2018 to 2.6% (from 2.8%). Base effects should drive headline inflation higher from the current 1.7%oya to 2.4% by year-end, but the risk is clearly asymmetric, to low inflation for longer.

BCCh on hold, as expected

The central bank kept the policy rate unchanged at 2.5%. We expected the BCCh to stand pat this week despite June's hefty downside inflation surprise, on the view that the Board would wait for more data to reassess its base-case scenario. The Board recognized June's CPI surprise in the statement, though it is seen as strongly influenced by the behavior of fresh fruits and vegetables, as well as other specific products prices. The statement also acknowledged that shorter term inflation expectations have declined while expectations for the end of the projection horizon remain stable at 3%. Despite May's lackluster activity print, the statement described activity momentum as consistent with the baseline scenario depicted in the 2Q17 Monetary Policy report.

In our view, the IMACEC disappointment in May, together with June's downside CPI surprise, is not consistent with the base case BCCh depicted in the 2Q Monetary Policy Report. Two months ago the monetary authority removed the dovish bias it had introduced in December last year, cutting the reference rate 100bp. On the domestic front, the Board underscored that inflationary pressures are contained and inflation expectations are well anchored, which now seems at risk given the soft tone of the latest activity and inflation data. Indeed, the latest survey published by BCCh shows the next 12-month median inflation expectation lower at 2.7%, from 2.9% previously (Figure 2).

Figure 2: Next 12 month Inflation expectations

Source: BCCh and JP. Morgan

We continue to see a 45% probability for another 25bp cut before year-end. Despite the policy decision, we expect a thorough discussion in the minutes (to be published on July 28) on how the Board members interpret these data and on whether the disappointments in activity and low inflation

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already merit reassessing the base scenario penciled in the 2Q Monetary Policy Report. In any case, it is likely that the Board will wait for more data before any policy action.

S&P downgrades Chile by one notch amid subdued economic growth

S&P downgraded Chile's long-term foreign currency rating to A+ from AA-, which should not come as a surprise. We believe the market had already priced in a one-notch downgrade. According to the rating agency, the downgrade reflects the increase in government debt in recent years, the result of extended below-potential economic growth, which, together with lower copper prices, has hurt fiscal revenues. Chile's rating by Moody's now stands at Aa3, one notch above the equivalent A+ by both Fitch and S&P.

Peru: BCRP eased 25bp amid activity underperformance and political hurdles

BCRP cut its policy rate 25bp to 3.75% this week. We expected the BCRP to ease to help beef up domestic demand as political hurdles have compromised the fiscal push encompassing both the reconstruction and infrastructure programs. Indeed, activity growth underperformed expectations in April and the output gap continued to widen, running at levels similar to 1Q14 and 3Q15.

Inflation behavior has aligned to the current phase of the business cycle. Inflation pressures continue to ease with Lima's headline inflation back inside the 2%±1% target range at 2.73%oya in April, down from 3.04% in May. With inflation inside the target range, BCRP took a more aggressive stance to support activity.

We believe BCRP will cut the policy rate another 25bp in September to a terminal level of 3.5%. This posture, together with the infrastructure and reconstruction plans in motion, should be enough to drive activity growth toward potential. As a risk scenario to our modal call, if execution risks delay the impact of countercyclical fiscal policies on domestic demand, we would not consider another 25bp policy rate cut.

Chile
Data releases and forecasts

Week of July 17 - 21

No data releases

Review of past week's data

Policy rate

	May	Jun	Jul	
%	2.5	2.5	~~2.5~~	2.5

Source: INE, and J.P. Morgan forecasts

Colombia
Data releases and forecasts

Week of July 10 - 14

Wed	Trade balance	Feb	Mar	Apr	May
Jul 19	$bn	-0.8	-0.7	-1.2	-0.2

Review of past week's data

Retail sales

	Mar	Apr	May	
%oya	3.0	-2.0	3.2	-0.5

Industrial production

	Mar	Apr	May	
%oya	4.6	-6.8	2.7	-0.6

Source: DANE and J.P. Morgan forecasts

Peru
Data releases and forecasts

Week of July 17 - 21

Mon	Economic activity	Feb	Mar	Apr	May
Jul 17	%m/m, sa	-0.9	-0.4	0.2	**0.6**

Review of past week's data

Policy rate

	May	Jun	Jul	
%	4.00	4.00	~~3.75~~	3.75

Source: BCRP, INEI, and J.P. Morgan

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United Kingdom

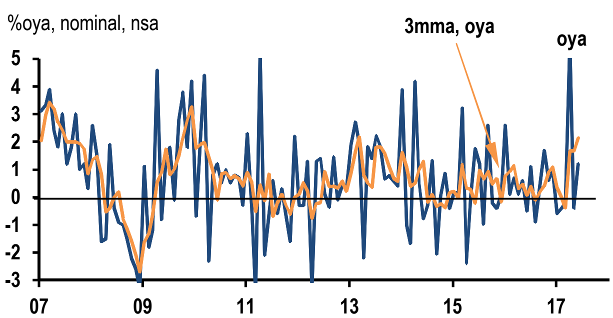
- **Rate rise before next year still unlikely**
- **Mixed signs on consumer spending in June**
- **Regular pay growth still low at 2%oya**
- **Inflation likely close to its peak in next week's June release**

MPC commentary remains in focus given the hawkish shift from a minority of members. BoE's Broadbent—a middle ground member who had offered little clarity on his views—made his position on a rate rise clear in an interview with the *Aberdeen Press and Journal* this week, stating: "I am not ready to do it yet." This places him broadly in line with Governor Carney and makes, in our view, an August rate rise unlikely. Ian McCafferty suggested in an interview with *The Times* that he is minded to vote for a rate rise again at the next MPC meeting. He also suggested in the interview that, with other central banks considering actions to reduce the size of their balance sheets, the BoE should consider whether it should do the same. The MPC has suggested its balance sheet will remain at the current size until rates rise toward 2%. Our sense is that MPC policy on the issue is unlikely to change at this point, although we could imagine it doing so later if rates were rising toward 2%, but only slowly.

While the possibility of a rate hike in November is still in play, we continue to think that soft growth will delay higher rates until next year. While the trend has between toward softer data of late, this week's releases were on the firmer side:

- The BRC retail sales monitor for June surprised to the upside (Figure 1). However, this likely in part was due to the second-warmest June on record and may prove to be only a temporary boost to sales.

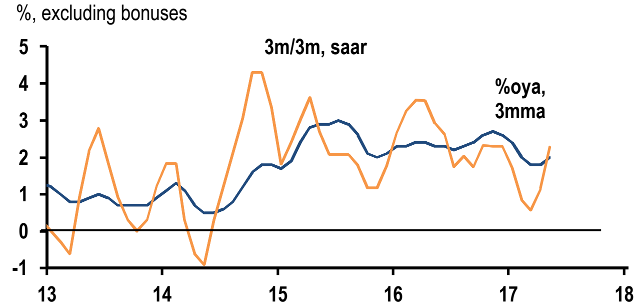
Figure 1: BRC like for like retail sales



Source: BRC

- The labor market data continue to report solid growth in employment, with the unemployment rate falling to 4.5%. Wage growth remains soft in oya terms, but the last couple of releases have pointed to a recovery in high frequency momentum (Figure 2).

Figure 2: Average weekly earnings



Source: ONS

- The 2Q BCC survey saw little movement in domestic sales readings in manufacturing and services sectors. The weighted average composite reading remains consistent with trend-like growth (Figure 3). The readings on employment and investment intentions also saw little movement and are not particularly weak.

Figure 3: BCC composite indicator of output growth

Source: BCC

The broader set of incoming output-side data covering manufacturing and construction point to a soft 2Q GDP gain of around 1.0%-1.5%q/q, saar (0.3%q/q non-annualized). The 2Q GDP report will be published on July 26, and will be one of the last data points the MPC sees ahead of its August 3 meeting. The MPC in May had a 1.6%q/q, saar forecast for 2Q GDP growth—i.e., a touch higher than we forecast—although this corresponds to the BoE's "post-revision" estimate of GDP, which is often assumed to be stronger than the initial GDP prints. The 2Q GDP report itself may therefore not be decisive—although we still view the latest drop in the PMI surveys as leaving the domestic activity data overall looking softer than a month or two ago.

Data releases and forecasts

Week of July 17 - 21

Tue
Jul 18
9:30am

Retail prices

%oya

	Mar	Apr	May	Jun
CPI	2.3	2.7	2.9	2.9
Core CPI[1]	1.8	2.5	2.6	2.7
RPI (1987=100)	269.3	270.6	271.7	272.7
RPI	3.1	3.5	3.7	3.6

1. CPI ex food, energy, alcohol, and tobacco.

We look for a further pickup in core inflation in June, with an ongoing currency-induced acceleration in goods inflation outweighing a slowing in service sector inflation (we assume airfares will not repeat last year's strong gain, while core services inflation gives back a little after a couple of firmer prints in Apr/May). The RPI/CPI wedge rose strongly last year and has since been falling back. We expect this moderation has further to run, and hence look for RPI inflation to slow to 3.6% despite a softening in energy inflation keeping headline CPI stable at 2.9%oya.

Tue
Jul 18
9:30am

House price index

%oya, nsa

	Feb	Mar	Apr	May
All dwellings	5.3	4.5	5.6	

Thu
Jul 20
9:30am

Retail sales

Volumes, sa

	Mar	Apr	May	Jun
Including auto fuel (%m/m)	-1.4	2.5	-1.1	0.7
Ex auto fuel				
(%m/m)	-1.0	2.1	-1.6	
(%oya)	2.8	4.6	0.6	
(%3m/3m saar)	-5.5	0.9	2.0	

Fri
Jul 21
9:30am

Public sector finance

£ bn, nsa

	Mar	Apr	May	Jun
PSNCR	-27.6	15.2	-13.4	
PSNB	1.5	8.7	6.0	
- ex. pub. banks	2.2	9.4	6.7	
Current budget (ex. pub. banks)	4.4	-5.7	-4.7	
Net debt to GDP (%)	101.5	100.9	101.4	
- ex. pub. banks	86.5	85.9	86.5	

Source: Rightmove, CBI, BBA, BCC, GFK, BRC Markit, SMMT, RICS, Land Registry, ONS, BoE, and J.P. Morgan forecasts

Review of past week's data

BRC retail sales monitor

%oya

	Apr	May	Jun	
Like for like sales	5.6	-0.4	~~1.0~~	*1.2*
Total	6.3	0.2	~~1.6~~	*2.0*

Labor market statistics

Sa

Average weekly earnings (3mma %oya sa)

	Mar		Apr		May	
Headline	2.3		2.1		1.8	
Ex bonuses	1.8		~~1.7~~	*1.8*	~~1.8~~	*2.0*
Private sector ex bonuses	2.0		2.0		~~2.0~~	*2.2*

Labor force survey (all percentage rates, sa)

Three months to:	Mar		Apr		Apr	
Activity rate	63.6		63.6		~~63.5~~	*63.6*
Employment rate	60.7		60.7		60.7	
Unemployment rate	4.6		4.6		~~4.5~~	*4.6*
- single month	~~4.3~~	*4.3*	~~4.6~~	*4.6*	~~4.7~~	*4.6*

Change over three months to:	Mar	Apr	May	
Employment (000s)	121	108	~~136~~	*175*

RICS housing market survey

% balance, sa

	Apr		May		Jun
Prices in last 3mnths	~~22.3~~	*22.0*	~~17.5~~	*16.6*	*7.2*
Stocks on books	43.8		43.1		*42.5*
Sales in last 3mnths	16.7		16.6		*16.7*
Sales:stocks ratio (%)	38.1		38.6		*39.3*
New buyer inquiries	~~-5~~	*-4*	~~-12~~	*-13*	*-8*

BCC quarterly economic survey

Index

	4Q16	1Q17	2Q17
Manufacturing			
Deliveries	15	20	*20*
Prices	52	47	*34*
Services			
Deliveries	15	22	*19*
Prices	30	32	*28*

BoE quarterly Credit Conditions survey

Net % balances

	4Q16	1Q17	2Q17
Availability of secured credit to Households:			
Past 3mnths	-3.9	3.6	*10.0*
Next 3mnths	8.7	13.4	*-7.5*
Availability of unsecured credit to Households:			
Past 3mnths	6.2	-6.6	*-10.3*
Next 3mnths	-7.9	-18.8	*-16.2*
Availability of overall corporate credit:			
Past 3mnths	-1.8	1.0	*0.9*
Next 3mnths	0.2	1.0	*0.9*

Source: Rightmove, CBI, BBA, BCC, GFK, BRC Markit, SMMT, RICS, Land Registry, ONS, BoE, and J.P. Morgan forecasts

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Emerging Europe

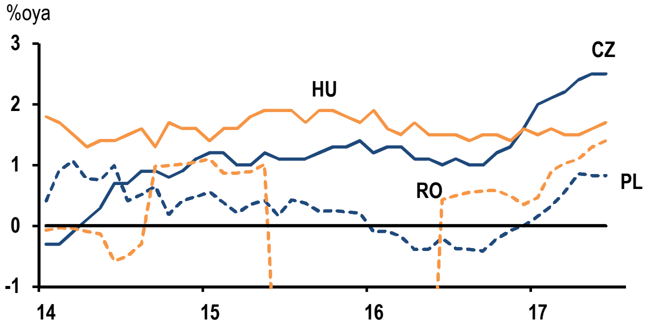
- **CEE: Core inflation firming slowly**
- **Turkey: Wider CAD comfortably financed by strong capital inflows in May**
- **Hungary: NBH likely to maintain dovish tone**
- **Russia: CA not as bad as it seems in 2Q**

CE-4: Core inflation firming slowly

June inflation prints added to evidence of gradual firming in core inflation across the region in the context of tightening labor markets, rapid wage growth, and solid domestic demand. CE-4 core inflation has risen 0.7%-pts on average over the past six months, and we expect the accelerating trend to continue over the coming year. In the Czech Republic, core CPI inflation was flat at 2.5%oya, but after eight consecutive increases it is already running above the 2% target and also slightly above the CNB forecast. We expect the CNB to be the first mover in the region, hiking rates to 0.25% this September. Romania's core inflation rose for a sixth consecutive month in June to 1.4% (from 1.3%), and with wages increasing at a 15% pace and consumption at 7.5%, we expect it will accelerate further. The NBR is likely to shift to a more hawkish stance as core continues to run above its forecast—we expect it to narrow the interest rate corridor in October and raise interest rates in 1Q18. In Hungary, like in Romania, wage growth is in double digits and core inflation has begun to show signs of life, with demand-sensitive inflation increasing to 1.6%oya in May and 1.7% in June after plateauing at 1.5% since early 2016. Polish core inflation has stabilized near 0.8%oya in the past few months as declines in core goods price offset upward pressure in services. Polish and Hungarian core inflation is still running significantly below the central banks' targets, and we don't expect them to hike rates before 4Q18 and 1Q19, respectively.

Figure 1: Core inflation in CE-4

%oya



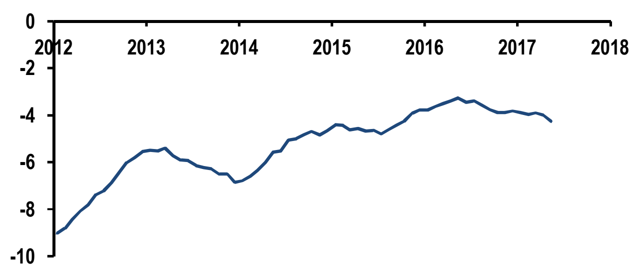
Source: J.P. Morgan, CNB, NBH, statistical offices

Turkey: Wider CAD, stronger capital inflows

Stronger gold and energy imports led to a widening in Turkey's current account deficit in May, but strong capital inflows comfortably financed the deficit. The US$5.2 billion deficit compared unfavorably with the US$3.1 billion shortfall in May 2016. Hence the 12-month trailing CAD widened to US$35.4 billion (4.3% of GDP) from US$33.2 billion (4.0%) in April (Figure 2). The widening was entirely due to higher gold and energy imports. In fact, excluding gold and energy, the current account deficit continued to narrow in May. Export strength reflecting strong EU demand and heightened price competitiveness has been the main factor behind this improvement. The recovery in tourism, which followed the lifting of the Russian ban on travel to Turkey, also started helping the external balances. However, strong domestic demand will likely prevent a significant improvement in external balances. Hence, we see the CAD stable around 4% of GDP until the end of the year. Barring a sharp worsening in global risk appetite, Turkey should face no difficulty in financing this deficit.

Figure 2: Turkey: 12-month trailing current account balance

% of GDP



Source: CBRT, J.P. Morgan

In fact, the May balance of payments data showed that such optimism was well grounded. Despite the widening in the CAD, Turkey's official reserves rose US$2.5 billion due to strong capital inflows. On top of the US$1.75 billion of eurobond issuance by the Treasury, May saw inflows of US$0.3 billion into the equity market, US$0.9 billion into the government bond market, and an all-time high US$2.7 billion into bank bonds. The long-term rollover ratio was 86% for banks and 156% for corporates. The low rollover ratio for the banks mainly reflects the desire to borrow from the bond market. FDI inflow of US$0.9 billion was in line with long-term averages. Finally, unexplained inflows (recorded as net errors and omissions) reached a six-month-high US$1.7 billion, reflecting stronger sentiment in May.

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Hungary: NBH likely to keep dovish tone

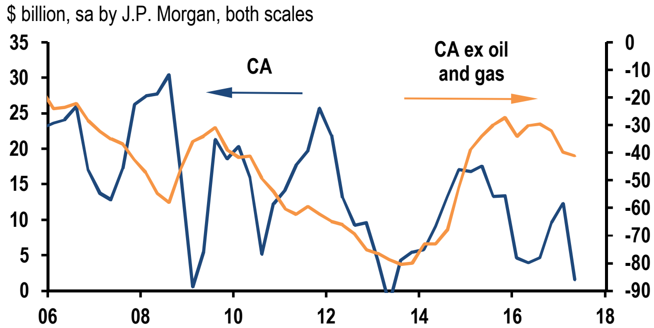
We expect the NBH to keep all of it its monetary policy parameters unchanged at next week's meeting and the statement to reiterate the guidance of an unchanged base rate and loose monetary conditions for an extended period. The bias to ease further using unconventional, targeted instruments is also likely to remain intact. The economic outlook has not changed much since the NBH published its updated forecasts four weeks ago. Wage growth and activity data remained strong and mostly surprised to the upside, but June inflation was in line with expectations, showing a slowdown in headline inflation alongside a modest pickup in core. A breach of the 3% CPI target looks unlikely over the NBH's policy horizon, barring any major food or energy prices shocks. Even assuming current loose monetary conditions are sustained, the NBH's forecast sees inflation approaching the 3% target only in early 2019. Moreover, the latest monetary council statement noted downside risks to the forecast due to external factors. Our CPI forecast is 0.5%-pt lower than NBH's, and we do not see a strong case for monetary tightening before 2019.

Russia: CA deteriorated in 2Q

Russia's current account recorded a US$0.3bn, nsa, deficit in 2Q, surprising expectations to the downside. We estimate that seasonally adjusted the current account surplus narrowed from US$12.3bn in 1Q to US$1.6bn in 2Q (Figure 3). This sharp drop mainly was a consequence of lower commodity prices in 2Q, which pulled down oil and gas exports and slowed the expansion of non-energy exports. In addition, the OPEC agreement and increased oil supplies to Belarus (at lower prices) likely affected oil exports.

Figure 3: Russia's current account

$ billion, sa by J.P. Morgan, both scales

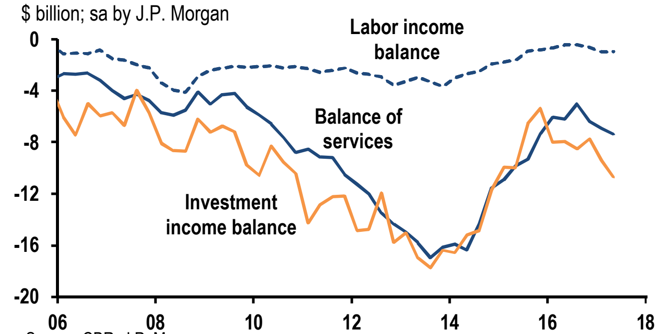


Source: CBR, J.P. Morgan

The deterioration in the underlying, non-energy, current account continued, but at slower pace in 2Q. Merchandise imports continued to rise, although sequential momentum slowed from a supercharged 13.7%q/q, sa in 1Q to 3.3% in 2Q. The pace of deterioration in the invisibles balance moderated, too (Figure 4). The deficit in services widened slightly amid increased foreign travel, and the investment income balance declined due to lower income inflows from overseas investments. We expect the non-oil CA to deteriorate further, given accelerating domestic demand growth in the current business cycle recovery. We note, however, that imports have expanded more strongly than implied by the historical relationship with the exchange rate and domestic demand, hence some moderation may be due (Figure 5).

Figure 4: Russia's CA components: "invisibles"

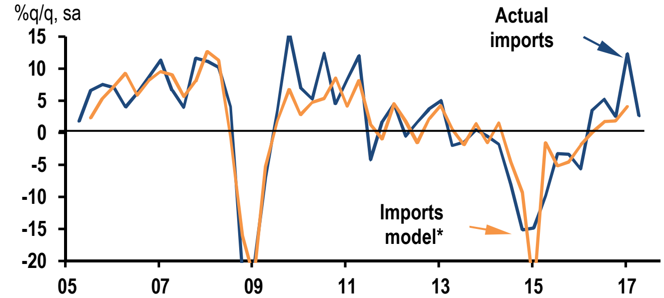
$ billion; sa by J.P. Morgan



Source: CBR, J.P. Morgan

Figure 5: Russia's imports of goods and services

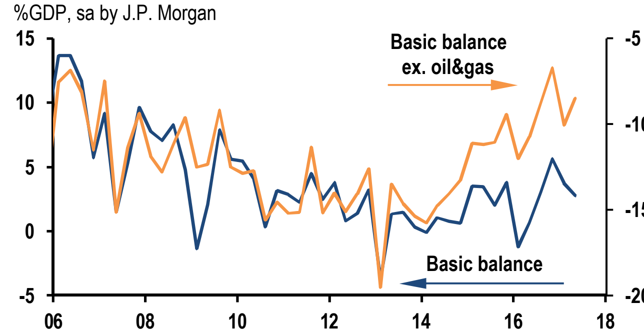
%q/q, sa



Source: CBR, Rosstat, J.P. Morgan estimates
* OLS regression of imports ($) vs. own lag, domestic demand, REER and EURUSD (all %q/q)

Figure 6: Russia's basic balance (CA + net FDI)

%GDP, sa by J.P. Morgan



Source: CBR, J.P. Morgan

Although Russia's CA has deteriorated, its basic balance—the sum of the CA and net FDI—looks more encouraging. The basic balance has fluctuated around 3% of GDP since 2015, while the non-energy basic balance (ex. volatile oil and gas revenues) has been on the uptrend in the past three years (Figure 6). The net FDI balance increased amid a level shift lower in outward FDI after 2014 and a recovery in inward FDI in the past several quarters—reinvested earnings, new capital injections, and debt financing (partly reflecting rising eurobond placements) all have been on the rise.

Portfolio inflows into government paper moderated in 2Q despite the new sovereign Eurobond placements. Grey capital flight popped up a bit—as reflected in higher errors and omissions—which seems normal given the rise in US$-value of exports and GDP. Debt inflows, however, continued to improve, with the rollover rate rising well above 100% in 2Q, driven by increased borrowing by the non-financial sector. Banks have struggled to refinance their foreign liabilities, perhaps because of sanctions, and, after a brief pause in 1Q, had to continue slashing their foreign assets in 2Q, which may ultimately lead to tighter dollar liquidity conditions on the local market.

As our expectations about EM flows remain constructive for 2H17, Russia's financial account will likely remain healthy as well, making space for lower CA surpluses. A slower pace of FX reserve accumulation by the CBR—due to both reduced spot FX intervention amid low oil prices and waning FX-repo maturities—should also reduce pressure in 2H17.

Data releases and forecasts

Week of July 17 – 21

Hungary:

Tue Jul 18 — **NBH rate decision**

See main essay.

Thu Jul 20 9:00am — **Average gross wages**

%oya

	Feb	Mar	Apr	May
Gross wages, nominal	10.4	12.8	14.6	__
Private sector	9.1	11.7	12.6	__
ex bonuses	9.9	12.4	12.5	__
Public sector	13.8	15.7	19.5	__

Source: NBH, National Statistics, Eurostat, J.P. Morgan forecasts

Poland:

Tue Jul 18 2:00pm — **Gross wages and employment**

%oya

	Mar	Apr	May	Jun
Gross wages, nominal	5.2	4.1	5.4	5.7
Real (CPI adj.)	3.1	2.0	3.4	3.5
Employment, 000s, nsa	5982	5991	5990	__
Employment, %oya	4.5	4.6	4.5	__

Wed Jul 19 2:00pm — **Industrial output**

%oya

	Mar	Apr	May	Jun
Industry	11.0	-0.6	9.1	4.0
%oya, swda by GUS	7.9	4.1	6.5	6.1
%m/m, swda by GUS	1.9	-1.1	1.2	0.2
Manufacturing	12.7	-0.8	9.5	__
Construction	17.2	4.4	8.5	__

A lackluster June PMI and drop in car production suggest IP gains moderated in June.

Wed Jul 19 2:00pm — **Retail sales**

%oya, unless otherwise stated

	Mar	Apr	May	Jun
Retail sales (nominal)	9.7	8.1	8.4	7.0
Real, CPI-adjusted	7.9	6.7	7.4	6.0
%m/m, sa	1.8	-0.1	0.6	0.3

Source: NBP, National Statistics, Eurostat, J.P. Morgan forecasts

Russia:

Wed Jul 19 5:00pm — **Industrial producer prices**

	Mar	Apr	May	Jun
%m/m, nsa	-0.3	-1.5	-0.5	0.4
%oya	11.3	7.6	5.9	3.5

Wed Jul 19 5:00pm — **Real economy indicators**

Real terms, %oya

	Mar	Apr	May	Jun
Construction	-5.0	-0.4	3.8	1.0
Agriculture	1.1	0.8	0.3	-0.5
Transportation	4.1	9.5	9.5	4.5
Retail sales	-0.2	0.1	0.7	0.9
Unemployment, %nsa	5.4	5.3	5.2	4.9
Industrial output	0.8	2.3	5.6	2.5

Jul 17-18 — **Industrial output**

%oya

Mar	Apr	May	Jun
0.8	2.3	5.6	2.5

Source: Rosstat, MinFin, AEB Russia, Markit, J.P. Morgan forecasts

Turkey:

Mon Jul 17 10:00am — **Labor market data**

	Jan	Feb	Mar	Apr
Unemployment (%)	13.0	12.6	11.7	10.9
Nonfarm payrolls (%oya)	1.5	1.6	2.3	2.1
Labor participation (%)	51.5	51.8	52.2	52.8

The seasonal increase in employment particularly in construction and agriculture was likely the main factor behind the expected fall in employment and the rise in labor participation in April. In seasonally adjusted terms, the improvement should be modest and reflect the government measures supporting new employment.

Source: Turkstat, CBRT, Ministry of Finance, J.P. Morgan forecasts

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Review of past week's data

Czech Republic:

Consumer prices
%oya

	Apr	May	Jun	
%oya	2.0	2.4	~~2.3~~	*2.3*
%m/m nsa	0.0	0.2		*0.0*
Food	3.6	4.5		*5.4*
Housing	0.9	1.7		*1.9*
Transport	5.5	4.1		*2.2*

Balance of payments
CZK bn

	Mar	Apr	May	
Current account	32.8	14.3		*-2.9*
YTD	94.5	108.9		*106.0*
YTD-a year ago	109.9	108.5		*110.0*
Trade balance	31.0	18.6		*24.7*
Service balance	9.6	6.8		*6.2*
Primary income	-5.1	-5.4		*-28.0*
Secondary income	-2.6	-5.7		*-5.8*
Financial account	-5.5	76.0		*-2.6*
FDI, net	-21.0	-3.4		*-8.8*
Portfolio investments	-385.6	229.0		*26.0*
Other investments	-74.6	-227.0		*-25.7*

Source: CNB, National Statistics, Eurostat, J.P. Morgan forecasts

Hungary:

Consumer prices
%oya

	Apr	May	Jun	
All items (KSH)	2.2	2.1	1.9	
%m/m nsa	0.4	0.2	~~0.2~~	*0.0*
Food	1.9	2.7		*3.1*
Consumer durables	-0.6	-0.3		*-0.4*
Fuel	10.8	4.8		*-0.3*
Services	1.7	1.5		1.4
Core inflation	1.9	2.1		2.4
%m/m, sa	0.3	0.3		0.3
Regulated g&s (NBH)	0.4	0.5		0.4
Market g&s (NBH)	2.6	2.4		2.2

Headline inflation slowed in June, as expected. The decline was entirely due to fuel prices, which fell for the third consecutive month (-1.7%m/m).Monthly fuel price declines coincided with substantial base effects resulting in a huge (-1.5%-pts) drag from fuel on annual inflation between March and June. The energy shock that had driven inflation sharply higher between November 2016 and February 2017 has now completely reversed.

Measures of underlying inflation are slowly moving higher, but the increase does not look broad based for now and is in line with official forecasts. The NBH's main underlying measure, the core CPI excluding indirect tax effects, accelerated to 2.2%oya from 2% in May—its highest rate since December 2012—and the quarterly data confirm a clear uptrend, with the 2Q17 average rising to 2%oya, from 1.8% in 1Q17, 1.5% in 4Q16, and 1.3% in 3Q16. We expect inflation to rebound, with a peak of 2.4%oya in August before falling to 2.1% at year-end.

Source: NBH, National Statistics, Eurostat, J.P. Morgan forecasts

Poland:

Consumer prices, final
%oya, unless otherwise stated

	Apr	May	Jun	
%oya	2.0	1.9	1.5	
%m/m, nsa	0.3	0.0	-0.2	
Food	2.8	3.7		*3.7*
Fuel	14.4	7.6		*0.4*

June inflation slowed, in line with the flash estimate but below the 1.7% expected before the flash. Similar to Hungary, fuel prices were responsible for the entire inflation slowdown, with the shock that drove inflation higher through February now fully reversed. However, food prices accounted for the bulk of the downside surprise. A choppy headline inflation trajectory over the next 12 months is likely to mask a gradual uptrend in core inflation. We think that June's 1.5%oya marks the low point for now, with inflation likely to hover in the 1.5%-2% range through November. The proposed new fuel charge, if approved by parliament, would add 0.3%-pts to inflation, helping to moderate the base effect driven year-end slowdown to 1.3%oya (from 1%) and raising the 1Q18 trough to 1%oya (from 0.8%)

Core inflation
%oya

	Mar	Apr	May	
CPI-ex food and energy	0.6	0.9	0.8	
CPI-ex administered prices	2.2	2.1		*2.0*
CPI-15% trimmed mean	1.4	1.4		*1.6*
Avg. of four NBP measures	1.3	1.4		*1.4*

Core inflation remained stable at 0.8%oya in June. A closer inspection shows price increases were concentrated in the service segments (e.g., healthcare, airfares, hotels and restaurants, hairdressing), while core good prices like cars and clothing that are generally imported mostly declined.

Balance of payments
EUR mn

	Mar	Apr	May	
CA balance	-529	-275		*-179*
YTD (bn)	1.2	0.9		*0.9*
YTD-a year ago (bn)	-2.8	-2.1		*1.9*
Trade balance	142	86		*-200*
Exports %oya	15	1		*14.5*
Imports %oya	17	3		*19.1*
Service balance	1257	1288		*1492*
Primary income	-1874	-1606		*-1398*
Secondary income	-54	-43		*-73*
Fin + cap balance	-589	-396		*261*
FDI, net	853	61		*-863*

Source: NBP, National Statistics, Eurostat, J.P. Morgan forecasts

Romania:

Consumer prices
%oya

	Apr	May	Jun	
%oya	0.6	0.6	~~1.0~~	*0.9*
%m/m nsa	0.3	0.3	~~0.2~~	*0.0*

Both headline and core inflation surprised the central bank to the upside in June. Acceleration in headline inflation was driven by food prices. Additionally, all measures of core inflation moved higher as well. CORE3 inflation, NBR's preferred, was

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exactly as we expected: 0.2%m/m and 1.4%oya from 1.3% in May; the NBR expected headline to be at 0.6%oya and CORE3 to be at 1%oya. In our opinion, the central bank is under increasing pressure to react to upside surprises in inflation, mainly driven by underlying inflation, and to rising medium-term inflationary risks stemming from large public-sector wage hikes already approved. We believe that core inflation will continue to move higher and the updated NBR staff forecast (in August) will likely show a higher core profile. Our current forecast sees CORE3 inflation at 2%oya in September and 2.3%oya in December 2017, above the current NBR forecast (1.4% and 2.1%, respectively).

Industrial output
%oya

	Mar	Apr	May	
Industrial output, nsa	10.9	-0.6		*17.2*
Industrial output, sa	8.4	5.5		*15.3*
%m/m sa	2.7	-0.6		*3.5*

IP growth was stronger than we expected and, together with very strong print in retail sales last week, signal substantial upside risks to our 2Q forecast. Data would indicate acceleration on a sequential basis, but we await June activity to see how large the payback might be.

Current account balance
EUR bn

	Mar	Apr	May	
Current account	-0.7	-0.6	-0.6	
Ytd	-0.8	-1.4	-2.0	
Ytd a year ago	-0.3	-0.9		*-1.7*

Source: NBR, National Statistics, Eurostat, J.P. Morgan forecasts

Russia:

Balance of payments
US$ bn

	4Q16	1Q17	2Q17	
Current account balance	10.3	23.3	~~5.0~~	*-0.3*
Goods balance	27.3	34.4		*24.8*
Exports %oya	1.9	36.2		*22.9*
Imports %oya	8.7	26.1		*28.5*
Service balance	-6.0	-5.1		*-7.1*

Merchandise trade
US$ bn, nsa

	Mar	Apr	May	
Trade balance	12.5	8.0		*8.5*
Exports	31.2	26.1		*28.2*
Imports	18.7	18.1		*19.7*

Source: Rosstat, MinFin, AEB Russia, Markit, J.P. Morgan forecasts

Turkey:

Industrial production
%oya

	Mar		Apr		May	
Total	~~2.5~~	*2.6*	~~5.9~~	*6.0*	~~4.5~~	*4.1*
Manufacturing	2.2		6.4		~~4.2~~	*3.8*
Mining	-3.5		1.4		~~3.7~~	*3.5*
Energy and utilities	~~-3.5~~	*7.7*	4.8		~~5.5~~	*6.0*

Balance of payments
US$ bn

	Mar	Apr	May	
Current account	-3.0	-3.6	~~-4.7~~	*5.2*
Trade balance	-2.9	-3.5	~~-5.8~~	*-5.7*
Exports	15.3	13.6	~~14.1~~	*14.5*
Imports	18.2	17.1	~~19.9~~	*20.2*
Net invisibles/transfers	-1.1	-3.9	~~1.1~~	*0.5*
Capital account	-1.6	-3.7	~~3.5~~	*6.0*
Overall balance	2.5	3.8	~~1.5~~	*2.4*

See main text.

Source: Turkstat, CBRT, Ministry of Finance, J.P. Morgan forecasts

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South Africa & SSA

- **South Africa: Finance minister presents outline of inclusive growth action plan**
- **SARB likely to hold rates steady at 7% next week, even as inflation report should reflect further drop**
- **Ghana: Primary surplus intact**

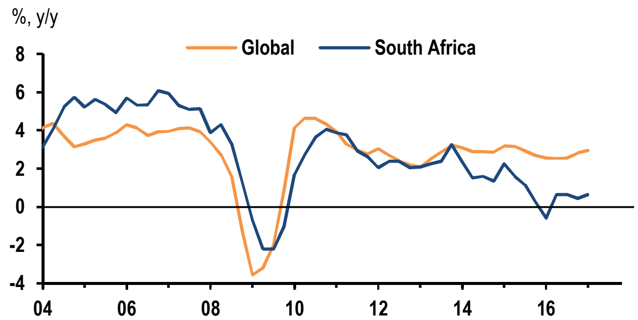
South Africa: Inclusive growth action plan details welcome, but impact uncertain

Finance Minister Gigaba this week presented the government's inclusive growth action plan as a response to weak economic data indicating a technical recession in 1Q17. The measures include efforts to improve the balance sheets of state-owned entities (via considering a framework for the disposal of non-core assets), proposing a board appointment framework for SOEs, and considering soft support for a parastatal until electricity tariff adjustments in 2018. The plan also calls for a sustainable multi-year public sector wage agreement and private sector participation framework engagements. The minister also reflected on his commitment to the fiscal framework with indications that any economic support package would not breach the fiscal expenditure ceiling. The intention of the plan is to support a recovery in business and consumer confidence and thereby underpin an economic recovery.

While the details and firm timelines of the inclusive growth action plan are welcome, it is less clear how relevant these measures will be to the near-term and medium-term economic outlook. Political and policy uncertainties frequently are cited as investment constraints, and this sense of uncertainty is unlikely to be reduced before the year-end ANC elective conference at the earliest. Moreover, the rhetoric from policy makers and politicians and unexpected news flow continues to surprise investors, even if these are later partly neutralized (e.g., the Public Protector's remedial action at changing the SARB mandate, or the mining charter).

The South African economy, which historically has closely tracked global growth, has substantially underperformed since 2015 (Figure 1). To be sure, a trend decline in the terms of trade and a prolonged drought have contributed to growth headwinds, as has fiscal consolidation, yet the softness in economic data is considerably more broad based and pervasive. In particular, a negative credit impulse, low consumer confidence, and a freeze in financial sector activity contributed to the 1Q17 GDP drop. That said, more recent economic data from the primary and secondary sectors are somewhat more upbeat, and the squeeze on consumer purchasing power likely eased substantially in 2Q17. For now, the activity data remain very mixed, but overall they signal stronger 1.8%, saar GDP growth in 2Q17. The main caveat remains the depth of the 1Q17 service sector weakness, which was not reflected in timely indicators. Therefore the risk remains that the services sector could potentially contract even more sharply in 2Q17 as the impact of the ratings downgrades and cabinet reshuffle work through decision making.

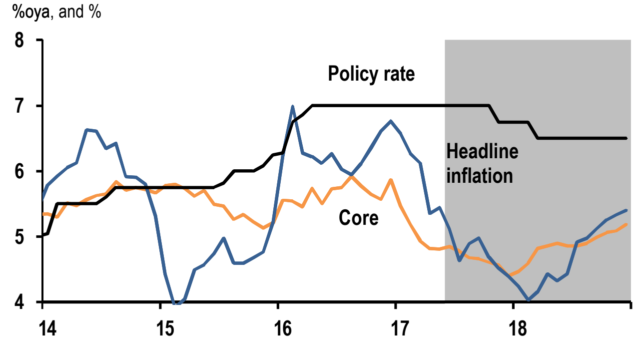
Figure 1: South Africa and Global growth



Source: SARB, J.P. Morgan

Separately, the SARB will meet next week to update its economic and inflation outlook, yet it will likely keep the policy rate unchanged at 7%, in our view. The June inflation report, released just prior to the MPC meeting, should reflect a further decline in inflation to 5.1%, from 5.4%, helped by a drop in transportation inflation on the back of a 25c/l gasoline price cut at the pump. Moreover, there is scope for a deceleration in restaurant price inflation, largely on the back of base effects. Meanwhile, food inflation probably moved sideways at 6.9%. We continue to expect a slide in inflation to 4.2% in 1Q18, notwithstanding the recent ZAR depreciation (Figure 2). In our view, given the considerable domestic and global uncertainties, the SARB will remain relatively conservative, keeping interest rates unchanged for now but keeping the door open to consider lowering rates in subsequent meetings. We continue to look for a 25bp cut in November with scope for a further 25bp easing in March, should chances of a further ratings downgrade in 1Q18 subside.

Figure 2: South Africa inflation outlook



Source: StatsSA, SARB, J.P.Morgan forecast

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Ghana: Primary surplus intact

The Minister of Finance is likely to present the midyear fiscal review before the end of July. The review should introduce adjustments to the projections and assumptions (including the benchmark oil price, which is currently set at US$56/b). We also think the government will consider new tax measures. Critically, in the same period, the IMF is likely to consider the authorities' request to keep the Extended Credit Facility in place until the end of 2018. These are, in our view, likely to provide further support to the fiscal consolidation already underway. As argued before, we feel the current administration is highly committed to fiscal consolidation, which we believe will result in improved public financial management.

Fiscal performance data thus far seems to have been constructive. Data for the first four months of this year show that the fiscal deficit on a cash basis reached 1.5% of GDP as disappointing revenue collections were more than offset by below-targeted expenditure. Tax revenues and grants reached 5.4% of GDP compared to a 6.5% programmed target for the period (January to April 2017). Expenditures reached 6.6% of GDP against a targeted 8.3%, largely driven by under-execution of foreign-financed capital expenditures. Interest payments, which contributed 31% to total expenditures, were 9% below that programmed for this period. While we expect budget execution to pick up as the year progresses, we project the government to reach its 6.5% of GDP fiscal deficit target for 2017. Furthermore, the primary balance is likely to remain in surplus after reaching 0.6% of GDP in the first four months of this year.

South Africa

Data releases and forecasts

Week of July 17 – 21

Wed
Jul 19
10:00am

Consumer prices
%oya, except as noted

	Mar	Apr	May	Jun
CPI	6.1	5.3	5.4	5.1
%m/m, sa	0.6	0.1	0.3	0.2
Core	4.9	4.8	4.8	4.8

Wed
Jul 19
1:00pm

Retail sales
%oya

	Feb	Mar	Apr	May
Real	-1.6	0.9	1.5	__
Nominal	4.9	6.6	6.6	__

Thu
Jul 20

SARB rate decision

We expect the SARB to leave its policy rate unchanged at 7%.

Review of past week's data

RMB/BER business confidence
Index

	4Q16	1Q17	2Q17
Composite total	38.0	40.0	*29.0*
Manufacturing	30.0	28.0	*16.0*
Retail	34.0	45.0	*35.0*
Wholesale	53.0	56.0	*49.0*

Manufacturing production
Volume output

	Mar	Apr	May
Manufacturing (%oya)	0.4	-4.1	*-0.8*
%m/m, sa	-0.4	2.3	*-0.3*

Source: Stats SA

SSA

Data releases and forecasts

Week of July 17 - 21

Nigeria Jul 17

CPI
%oya

Mar	Apr	May	Jun
17.3	17.2	16.3	__

Kenya Jul 17

Policy rate announcement

We expect the CBK to leave its policy rate unchanged at 10.0%

Source: CBK, BOG, CBN, GSS, NBS, KNBS, J.P. Morgan forecasts

Review of past week's data

Ghana: CPI

%oya	Apr	May	Jun
	13.0	12.6	*12.1*

Source: CBK, BOG, CBN, GSS, NBS, KNBS, J.P. Morgan forecasts

MENA

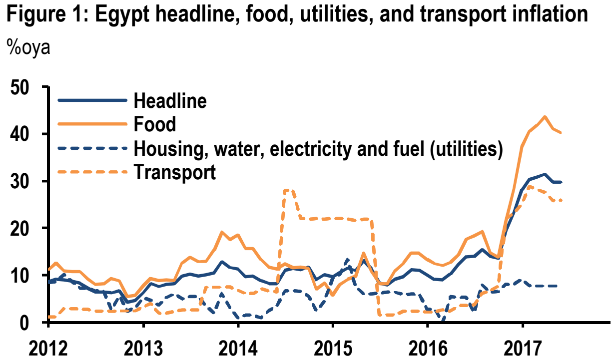
- **Egypt: CBE responds to administered price increases by hiking rates by 200bp**
- **Saudi Arabia: Economy contracts in 1Q17**
- **Saudi Arabia: C/A balance continues to improve**

Egypt: Minimal change in inflation

Headline inflation has stabilized around the 30% mark in recent months. But this stability is likely to be short-lived as sharp rises in gasoline and electricity prices should drive a steep increase in inflation in coming months. Concerned by the possible second-round effects of these administered price hikes the Central Bank of Egypt (CBE) raised its policy rate another 200bp last week. We expect this hike to be the last of this tightening cycle but the CBE remains ready to deliver more in case inflation expectations rise and inflation inertia strengthens.

Headline inflation reached 29.8%oya in June, rising only 10bps from May (Figure 1). Food inflation edged down to 40.3%oya in June, from 41.1%oya in May (Figure 1). In June, the government announced a round of gas and fuel price hikes, fuel prices by an average of 50%, gas cylinder (used in households) prices 100% and electricity prices 40%. These price hikes were not reflected in this month's inflation reading, but we estimate they will to add roughly 4%-pts to July's headline inflation reading and to gradually lift food inflation in the coming months.

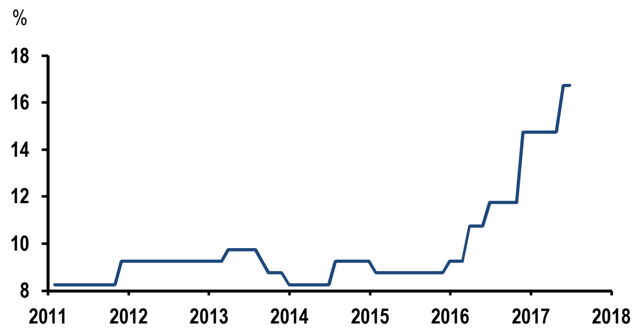
Figure 1: Egypt headline, food, utilities, and transport inflation



Source: SAMA, J.P. Morgan

The CBE responded to the administrative price increases by raising its policy rate to 18.75% from 16.75% (Figure 2). Importantly, the CBE stressed that the objective of its tighter stance was not to offset the first-round effects of supply shocks, but to contain second-round effects and ensure that it achieved the targeted disinflation path. The Bank underlined that measured easing would be on the table as soon as underlying inflation starts to moderate. This supports our view that last week's move was the last hike of this cycle.

Figure 2: Egypt overnight deposit rate (policy rate)

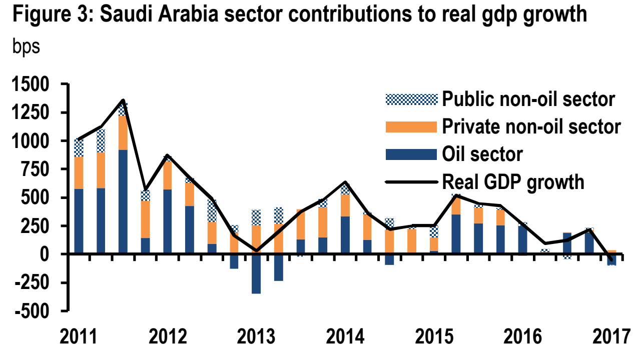


Source: CBEm J.P. Morgan

Saudi Arabia: Economy contracted in 1Q17

Real GDP contracted 0.5%oya in 1Q17 (Figure 3), well below the 2.6% growth recorded in 1Q16. The oil and gas sector was the main cause for the drop in growth, contracting 2.3%oya. Saudi Arabia produced an average of 9.9mbdp in 1Q17, down 3.3% from the 10.2mbdp average in 1Q16. The oil and gas sector will continue to face growth pressure as production is limited by the OPEC curtailment agreement.

Figure 3: Saudi Arabia sector contributions to real gdp growth



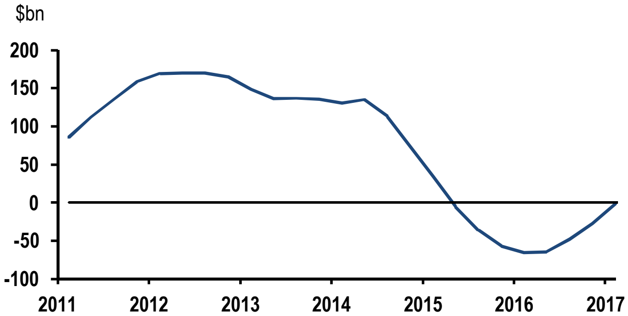
Source: SAMA, J.P. Morgan

Away from oil and gas, the economy proved resilient in 1Q17, expanding 0.6%oya. In June, the authorities reversed their September 2016 decision to reduce civil servant salaries and bonuses and announced that all civil servants will receive all salaries and bonuses cancelled for the last 6 months. This should bolster consumer confidence and continue to support non-oil sector growth, as should favorable liquidity conditions, with the SAIBOR rate remaining below the December 2016 highs. In early July the Saudi Finance Minister stated that the government may issue external bonds later this year, which should support funding conditions.

C/A balance continues to improve

Saudi Arabia posted a $6.2bn current account surplus in 1Q17 after a $20.3bn deficit in 1Q16. The four-quarter rolling CAD narrowed to $1bn in 1Q17, from $65bn in 1Q16, driven by recovering goods exports and a continuous decline in imports.

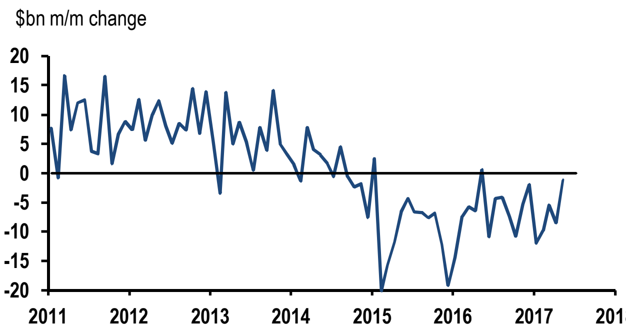
Figure 4: Saudi Arabia 4-quarter rolling C/A balance



Source: SAMA, J.P. Morgan

Saudi Arabia's goods exports are mainly composed of hydrocarbon products. Merchandise goods exports surged 47%oya to $60bn in 1Q17, reflecting higher prices of crude oil products. Brent crude oil prices rose significantly, averaging $54.1 per barrel in 1Q17, vs. $34.3 in 1Q16.

Figure 5: SAMA foreign reserves



Source: SAMA, J.P. Morgan

The Saudi Arabian Monetary Agency's foreign reserves have declined at a slower pace over the past few quarters (Figure 5); as a result of the improvement in the current account. Previously the Saudi authorities covered the budget deficit by using foreign reserves. As oil prices stabilized and exports increased, there has been less pressure on the Saudi authorities to draw on SAMA's foreign reserves. The current account may continue to improve slowly if crude oil prices remain above $50 per barrel (JPM forecasts a US$52 average oil price n 2017 and US$45 in 2018).

The next MENA data watch will be published July 28.

Data releases and forecasts

Weeks of July 17 – 28

Egypt

Mon-Sat Jul 17-22

Trade balance

US$bn, unless indicated otherwise

	Feb	Mar	Apr	May
Trade balance	-2.1	-2.5	-1.9	-
Exports	2.0	2.2	2.0	-
Imports	4.1	4.7	4.0	

Source: CBE, J.P. Morgan

Saudi Arabia

Wed-Tue Jul 19-25

CPI

%oya

	Mar	Apr	May	Jun
Headline	-0.4	-0.6	-0.7	-
Food	-2.7	-2.6	-2.3	-

Source: SAMA, J.P. Morgan

Review of past week's data

Weeks of July 13 – 14

Egypt

Gross international reserves

US$bn, unless indicated otherwise

	Mar	Apr	May	Jun
Reserves	28.5	28.6	31.1	31.3
%oya	72.1	68.2	77.4	78.2

Source: CBE, J.P. Morgan

CPI

%oya

	Mar	Apr	May	Jun
Headline	30.9	31.5	29.7	29.8
Core	32.3	32.1	30.6	32.0
Food	41.8	43.6	41.1	40.3

Source: CBE, J.P. Morgan

Overnight deposit rate (Policy rate)

%

	Apr	May	Jun	Jul
O/N deposit rate	14.75	14.75	16.75	18.75

Source: CBE, J.P. Morgan

Saudi Arabia

Current account balance

US$bn, unless indicated otherwise

	2Q16	3Q16	4Q16	1Q17
C/A balance	-7.0	2.2	-2.3	6.2
Goods balance	13.0	18.3	22.0	25.0
Services balance	-13.9	-11.2	-16.7	-12.3

Source: SAMA, J.P. Morgan

Gross domestic product

%oya

	2Q16	3Q16	4Q16	1Q17
Real GDP	0.9	1.2	-2.2	-0.5

Source: SAMA, J.P. Morgan

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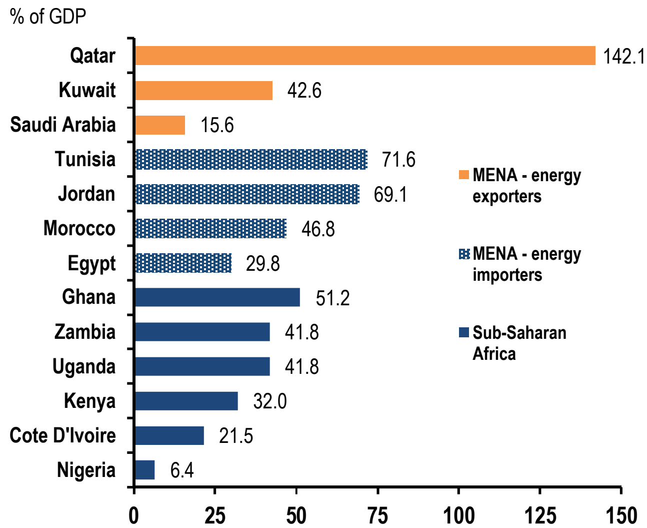
EMEA EM focus: External debt in the MENA and SSA

This week we return to the topic of external debt in the EMEA EM, shifting the focus to the sub-regions of MENA and SSA. Only a few countries in these regions publish external debt statistics, so we build estimates for the remainder using national and international sources, but necessarily this implies a likely higher margin for error. The picture is quite diverse, with end-2016 external debt ranging from a negligible 6.4% of GDP in Nigeria to Qatar's 142% (Figure 1).

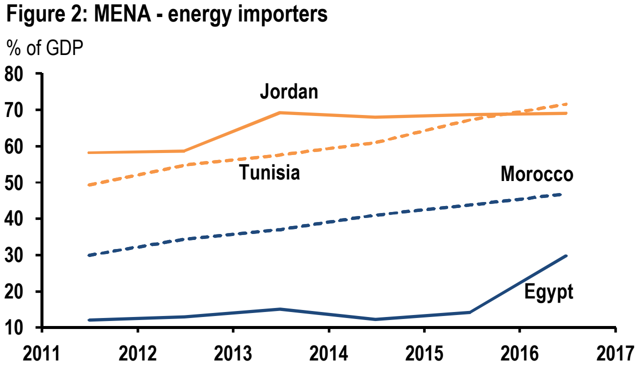
Figure 1: External debt in MENA and SSA- end 2016



Source: BIS, IMF, National statistical offices, National Central Banks
For Cote D'Ivoire, Egypt, Jordan, Kenya, Morocco, Tunisia and Uganda external debt statistics. On the remainder we compile government foreign debt data and complement it with private international bonds outstanding, cross-border bank lending from the BIS database as well as data on local banking system foreign debt.

The energy-importing MENA countries (Figure 2) tend to be the most externally indebted, at an average 54% of GDP.

Figure 2: MENA - energy importers

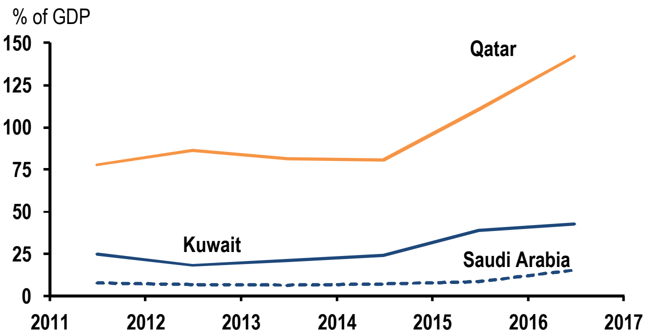


Source: National statistical offices, central banks, J.P. Morgan

In 2016 Tunisia overtook Jordan as the most externally indebted in this region, mostly due to depreciation of the Tunisian dinar while Jordan's peg held firm, but in US dollar terms Jordan's debt actually increased more. Morocco's debt has been on a gradual upward trend, driven by both the public and private sectors, as the current account deficit averaged a wide 6% of GDP in 2011-16. Egypt has the least external debt, which had remained stable at 10%-15% of GDP during 2011-15 but jumped to 30% of GDP in 2016 due to new loans from the IMF and GCC together with sharp FX devaluation.

Turning to the energy-exporting Gulf region (Figure 3), Saudi Arabia's previously stable (5%-10% of GDP) external debt jumped to US$45 billion or 16% of GDP in 2016, in large part to finance a ballooning budget deficit after Brent's collapse.

Figure 3: MENA - energy exporters

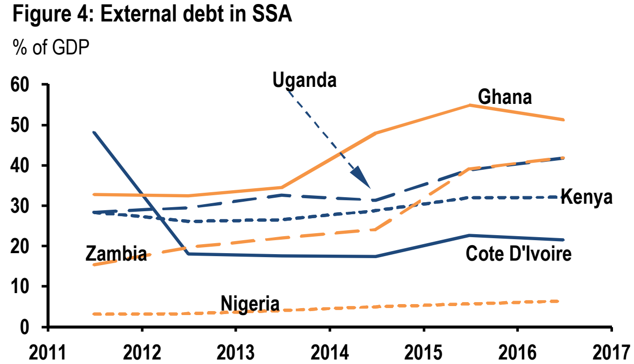


Source: National statistical offices, central banks, BIS, IMF, J.P. Morgan

Qatar stands out for both the level (142% of GDP in 2016) and growth of its external debt, which exploded from 80% of GDP in 2014, exacerbated by the 25% collapse in GDP in the same period. Kuwait's external debt, although roughly doubling from 2013 as a share of GDP (from 21% to 43%), grew by less than US$10 billion as GDP fell 35%.

In Sub-Saharan Africa, external debt generally increased after 2012, driven by a boost to international bond issuance amid favorable international market conditions: Ghana issued US$3.75 billion, Zambia US$2 billion, Kenya US$2.75 billion, and Cote D'Ivoire US$3.625 billion. Nigeria's external debt doubled to US$101 billion in 2015, but as a share of the economy it remains the lowest in the region. Ghana's and Zambia's indebtedness were exacerbated by sharp FX depreciation.

Figure 4: External debt in SSA



Source: National statistical offices, central banks, BIS, IMF, J.P. Morgan

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Australia and New Zealand

- **Australian business confidence rallied to lofty terrain in June, though capacity utilization normalized somewhat**
- **Investment mortgages slowing due to macroprudential tightening**
- **We expect the unemployment rate to hold steady at 5.5% in next week's survey**
- **In NZ, looking for 0.2%q/q CPI rise in 2Q next week; housing and retail underperform**

This week's Australian data leave open questions on the domestic demand outlook. Regulators should be heartened by the ongoing slide in new mortgage loans to investors. Another dip was recorded in May, and such loan flows have generally been shrinking over the last six months. The NAB business confidence survey by contrast was strong, with confidence and conditions indices rising. Trading conditions in particular moved back to the early-2017 highs. The sectoral narrative driving the NAB survey gains is unclear, so we place more faith in the hard data for now (such as weakening real consumption, rising mortgage rates/energy costs), though next week's industry breakdown of the NAB survey will be of interest.

For the June labor force survey, also out next week, we project that the unemployment rate held steady at 5.5%, with reasonably firm jobs growth (+18,000). We view the current level of unemployment as a fair representation of reality, and do not read anything into the recent downward momentum in the jobless rate, as this seems technically driven (see below).

The economic news was generally downbeat in New Zealand this week. Retail card spending stalled in June, despite the significant tailwind to the hospitality sector from British and Irish Lions Rugby Tour visitors. Also the housing market slowdown extended, with home sales down 25%oya and price inflation in Auckland dropping to near 0 after running at double digits last year. The June food price data came in close to flat, and we maintain our forecast for a benign 0.2%q/q result in 2Q CPI next week.

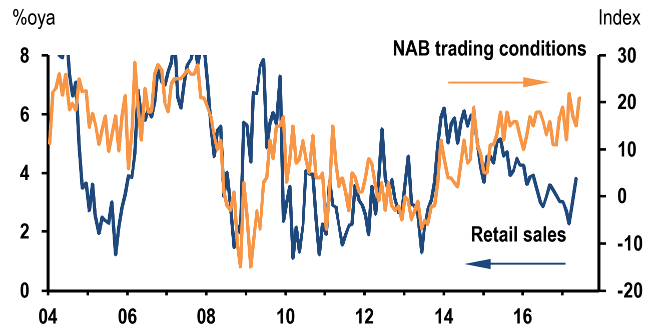
NAB survey goes from strength to strength

Australia's NAB business survey reading for June was robust, with confidence up a point to 9 and current conditions up 4pts to 15. Trading conditions moved back up to 21, where they started 2017 (from 15), and the profitability index posted a similar gain. The employment index was steady at 7, and hasn't moved much after starting the year with a jump to cycle highs.

Exporters' sales gained strongly over the month, jumping 10pts to 10. Resumption of output growth after supply disruptions in April/May likely was a tailwind here. The minor blemish on the report was capacity utilization, which declined from an extremely elevated 82.5% to 81.9%.

The sectoral story underpinning the improvement in the NAB survey this year still is somewhat unclear. More complete sectoral details are due out in the NAB's quarterly report next week, though we need to see broad-based improvement in sectors with a significant domestic demand and labor utilization footprint to be convinced that the growth outlook is improving. We are also treating the prevailing strong tone of the NAB survey with some caution given that rising mortgage costs, limits to further declines in the saving rate, and rising household energy bills are challenging the consumption outlook (Figure 1).

Figure 1: Retail sales and NAB survey trading conditions



Source: ABS, NAB, J.P. Morgan

No underlying change in the labor market

From our reading of domestic demand performance, the surveys and leading indicators (such as advertisements, vacancies and welfare data), the current level of the unemployment rate, at 5.5%, looks fair. The question is whether we should expect the steep trend improvement in recent surveys to persist. Unemployment has dropped four-tenths in the last two surveys, and employment growth has accelerated noticeably this year. However, we see recent swings as mostly reflecting technical factors, and so expect unemployment to hold at 5.5% in next week's June survey.

First, the acceleration in working age population growth in the last six months is among the sharpest recorded in the last 30 years, bettered only in 2008. This migration-driven pickup directly boosts the ABS' estimate of employment growth, even at steady unemployment and participation rates, but clearly doesn't imply any fundamental change in hiring conditions or capacity use.

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Second, the ABS reports that sample rotation effects have been influential for the swift decline in the unemployment rate in the last two months. While there is always sampling noise, and so we believe the reported level of the unemployment rate is the "true" one, month-to-month changes driven by sample rotation clearly do not attribute any underlying momentum to unemployment, as the bias could just as easily swing in the other direction in the next reading.

Inflation to normalize after a 1Q pop

This week's data in New Zealand confirm that there should be little imperative for the RBNZ to join the hawkish central bank chorus at the August MPS. The food price index was up 0.2%m/m in June, close to our call for a flat reading, after rising 2.4%m/m in May. This means that while food price inflation will again have been strong in 2Q, it won't generate the same lift to CPI as in 1Q, while other previous supports like 1Q's tobacco excise tax rise and fuel price increases either drop out or reverse. Along with slowing growth and a rising TWI, this should see the CPI rise much less than 1Q's 1%q/q print. We look for 0.2%q/q and the RBNZ MPS forecast for 0.3%.

NZ retail falls short in June

Retail card spending in New Zealand was flat in June, and has had a soft six months. While there had been reports from payment system vendors of strong sales in the hospitality sector due to British and Irish Lions' rugby tour visitors—which the card spending data verified—weakness elsewhere held total sales growth well below lofty expectations (consensus 0.8%m/m, JPM 0.9%).

While the growth in hospitality spending was the strongest in nine months, fuel was a significant drag (-3.2%m/m) due to falling prices. More significantly, durables spending stayed near flat (+0.1%m/m) for a second consecutive month, and apparel purchases declined 0.9%m/m.

The smoothed run-rates in retail spending remain pretty uninspiring, with total sales up 3.8%oya in June, compared to 5.4% average growth over the prior two years. Similarly core sales (ex. fuel and autos) grew 4.3%, compared to a 6.2% two-year average. With the exception of consumables (such as food, liquor) annual growth in all major categories has dropped significantly, with the bellwether durables spending one of the more striking slumps. GDP growth has slowed in recent quarters and the weaker trend in retail is another reminder of the degree to which rising mortgage rates and more stringent credit criteria are tightening financial conditions.

Housing strains under financial conditions

REINZ June housing market data released this week confirmed that the rapid slowdown in housing is extending through winter. Home sales continue to track steep declines (-25%oya) while price inflation eased again. The RBNZ's preferred measure of price inflation (%3m/3m year ago) has fallen from 16% nationwide at this time last year, to 5% this June, while Auckland price gains have slowed to 2%. Prices have been falling in recent months, so the annual rates should keep coming down in the near term. The housing market slowdown removes much of the earlier pressure for higher rates, and also introduces some weakness into the consumption profile, as reflected in the retail card spending data.

Australia

Data releases and forecasts

Week of July 17 – 22

Thu
Jul 20
11:30am

Labor force survey

	Mar	Apr	May	Jun
Unemployment rate (%)	5.9	5.7	5.5	5.5
Employment (ch. 000s)	53	46	42	18
Participation rate (%)	64.8	64.8	64.9	64.9

Review of prior week's data

Housing finance (11 Jul)

	Mar	Apr	May	
%m/m	-0.9	-1.9	~~2.0~~	*1.5*

NAB business confidence (11 Jul)

	Apr	May	Jun	
Index	7	13	~~7~~	*9*

New Zealand

Data releases and forecasts

Week of July 17 – 22

Tue
Jul 18
8:45am

Headline CPI

	15Q1	15Q2	15Q3	15Q4
%q/q	0.3	0.4	1.0	0.2

Review of prior week's data

Electronic card transactions (retail) (11 Jul)

	Oct	Nov	Dec	
%m/m	0.9	-0.4	~~0.9~~	*0.0*

Source: ABS, RBA, StatsNZ, NAB, J.P. Morgan forecasts

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Greater China

- **China: A preview of the National Financial Work Conference**
- **CPI and PPI inflation steady in June**
- **June bank loans and TSF beat expectations**
- **Solid pickup in June exports, with further gains in commodity imports**

China's quinquennial National Financial Work Conference (NFWC) began on July 14. It is widely expected that financial regulatory reform and financial stability will be the main focus of the meeting. The conference could have a long-lasting impact in the next three to five years as China's financial risk has built up and requires coordinative efforts in deleveraging (see "China's debt: The sum of all fears," June 23); the conference may signal the next phase in those efforts ("Impact of China's financial stability tightening on markets," May 22).

The National Financial Work Conference has been held every five years since 1997, with the last one in 2012. The premier usually chairs the conference, which covers primary issues in financial reform and maintaining financial stability. The NFWC has been the source of almost all of China's major financial reform achievements in the past 20 years, including disposal of non-performing loans at the big four banks (1997 NFWC), establishment of a sector-specific regulatory scheme and three regulatory commissions (1997 and 2002), shareholding reform and IPOs of big four banks (2002 and 2007), establishment of Central Huijin (2002) and CIC (2007), and promoting the corporate bond market and more broadly the capital market (2007 and 2012). The NFWC is usually held at the beginning of the conference year. This year's conference has been delayed, possibly reflecting internal debate regarding the most pressing topics and solutions in financial regulatory reform.

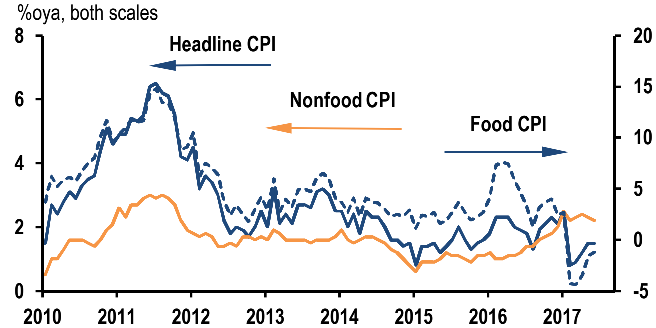
The outcome could be similar to the 2012 conference, i.e., relatively broad coverage on various financial topics, rather than narrow focus on specific issues resulting in major institutional changes. We base this view on our judgment that China's policymakers are more likely to adopt a gradual, managed, and controllable approach to deleveraging , rather than an aggressive forced strategy.

Whether coordinated regulation will lead to changes to regulatory institutions is one major focus of the conference. In the past couple of years, various regulatory reform proposals have included i) a super central bank; (ii) one central bank one regulator; (iii) a central bank and a prudential regulation agency; and iv) replacing the existing financial coordinating joint conference by one committee and the existing central bank's three regulators, creating a more powerful institution in major policy decisions as well as daily operations. If this proposal is adopted, it would imply that senior leaders have accepted that unifying regulatory standards and improving regulatory functions are more important than the regulatory institutional setup. Under this scheme, the deputy premier in charge of monetary and financial work and the PBOC governor will be have most important roles in advancing financial regulatory reform.

CPI and PPI inflation rates steady in June

China's June CPI inflation came in at 1.5%oya, unchanged from May. Seasonally adjusted, the headline CPI rose 0.1%m/m, sa in June, following a 0.3% increase in May. Excluding food and energy prices, core CPI rose 2.2%oya in June, up from 2.1% in May. Non-food CPI inflation eased to 2.2%oya in June from 2.3% in May (Figure 1).

Figure 1: China headline CPI, food and non-food CPI
%oya, both scales



Source: NBS

Meanwhile, PPI inflation remained steady at 5.5%oya June. Seasonally adjusted, the PPI slipped 0.1%m/m, sa in June, slowing from the 0.5% drop in May.

CPI inflation has been modest so far this year, averaging 1.4%oya in the first six months. Following the notable decline in 1Q, food prices stabilized somewhat through 2Q, though the sequential momentum remained rather sluggish. Meanwhile, the passthrough of upstream industrial price pressures to downstream sectors has been limited, highlighted by the modest 0.5%oya rise in the PPI for consumer goods in June. We expect annual headline CPI inflation to stay slightly below 2%oya during 2H17. Thus, our full-year 2017 CPI inflation forecast stays at 1.6%oya, down from 2.0% in 2016, and still comfortably below the 3% official inflation target for 2017, suggesting that CPI inflation should not be a major policy concern for the rest of the year.

Annual PPI inflation likely will ease further in coming months, aided by base effects. Global commodity price trend, domestic demand conditions, domestic overcapacity reduction efforts, and exchange rate swings have been crucial in driving

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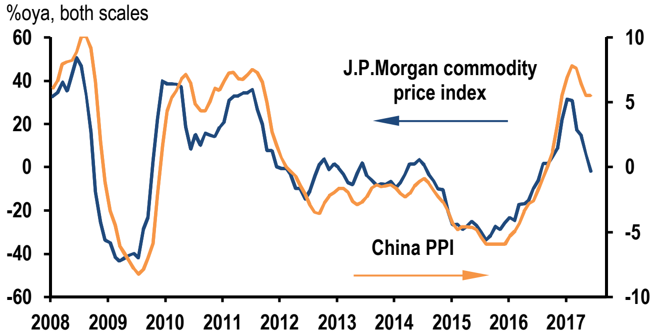
the overall PPI. Not surprisingly, China's PPI inflation appears to have peaked along with the general trend in global commodity prices (Figure 2).

Figure 2: China PPI vs. global commodity price index



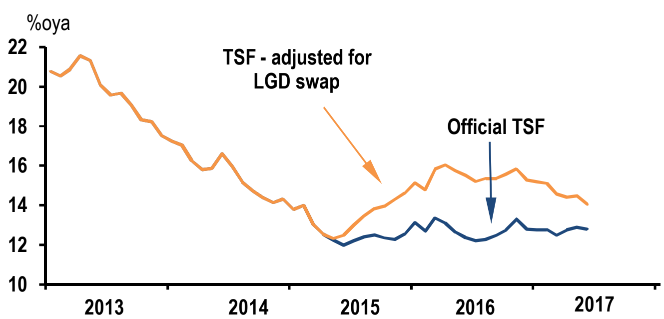
Source: NBS, J.P. Morgan

We expect economic growth to slow moderately in 2H, as macroeconomic policy support is scaled back. Overall, full-year 2017 PPI inflation will likely average about 5.1%, up sharply from -1.3%oya in 2016.

June bank loans and TSF beat expectations

The June credit report shows solid bank loan growth, along with stronger non-bank financing (led by trust loans). Meanwhile, our measure of aggregate credit growth, in the form of TSF growth adjusted for the local government debt swap program, eased moderately to 14.1%oya in June from 14.5% in May (Figure 3).

Figure 3: China TSF growth



Source: PBOC, J.P. Morgan

The difference is mainly due to the scale of the local government debt swap program, which was 350 billion yuan this June, compared to 374 billion yuan in May but much smaller than the 832 billion yuan in June 2016 (the second highest monthly figure).

The assessment of credit conditions could be tricky depending on which TSF growth measure is used. Official TSF growth has been very stable between 12.5% and 12.9% this year, and we think it will remain stable for the rest of the year. But actual credit growth dynamics could be different reflecting to the local government debt swap program and unrecorded shadow credit (see "China: Macro & Financials: Impact of shadow bank tightening on credit growth," May 25). In our baseline scenario, we expect actual TSF growth to be about 2%-pt lower in 2017 vs. 2016—due in part to the smaller size of local government debt swap this year (our forecast of 3.5 trillion yuan this year vs. 5 trillion in 2016), and in part to the slowdown in unrecorded shadow credit as a result of financial deleveraging. One piece of evidence is that interbank business, especially interbank bank claims on non-bank financial institutions, has decelerated sharply, which could reflect the collapse in speculative financial transactions or the slowdown and shift from shadow credit (outside the TSF statistics) to bank balance sheets or other TSF components.

Overall, we expect the moderate slowdown in actual TSF growth will weigh on GDP growth in 2H. But in the very near term, the negative impact remains limited, as reflected in latest PMI readings.

Solid pickup in June exports, with further gains in commodity imports

China's June merchandise trade report showed solid sequential gains in exports along with steady imports. Exports (in US$ terms) expanded 11.3%oya after an 8.7%oya rise in May. Seasonally adjusted exports increased 2.7%m/m, sa in June, following a 0.5% rise in May.

Meanwhile, imports grew 17.2%oya accelerating from 14.8% in May (Figure 4). Seasonally-adjusted, imports declined 0.7%m/m, sa in June, although that followed an 8.4% surge in May. The trade surplus widened to US$42.8 billion in June from US$40.8 billion in May.

Figure 4: China merchandise trade growth

Source: NBS

China's trade activity has grown solidly so far this year, with exports rising at an average 1.2%m/m, sa pace in the first five months, while imports expanded at an average 1.3% rate. Thus, the 2.7%m/m, sa exports gain in June exports highlights

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a further uptick in exports momentum, with details suggesting tech exports outperformed (up 6.7% m/m sa), consistent with the strength in Taiwan's June tech exports.

On the import front, adjusting for price changes, import volumes of a number of major commodities, including crude oil, iron ore, and copper, continued to rise in June, adding to the notable rebound in May. The continued gains in commodity imports are consistent with the positive signals from the PMI.

Given J.P. Morgan's expectation that the global economy will maintain modestly above-trend growth (at around 3%) in 2H17, with recent data pointing to encouraging strength in global final goods demand, across consumer goods as well as capital goods spending (see "Global Data Watch: Reflation: Reports of my death are greatly exaggerated," July 7), the fundamentals appear to support further moderate growth in China's export sector this year. Meanwhile, import growth may moderate somewhat down the road, as our baseline scenario looks for gradual growth moderation, with GDP growth easing to a 6.4%q/q, saar average pace in 2H17 from 6.9% in 1Q and our estimate of 6.6% in 2Q.

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China:
Data releases and forecasts

Week of July 17 – 21

Mon Jul 17 10:00am — **Real GDP**
% change

	16Q3	16Q4	17Q1	17Q2
%oya	6.7	6.8	6.9	6.8
%q/q, saar	6.8	6.7	6.9	6.6

Mon Jul 17 1:30am — **Industrial production**
%

	Mar	Apr	May	Jun
%oya	7.6	6.5	6.5	6.3
%m/m, sa	1.7	-0.4	0.6	0.5

Mon Jul 17 1:30am — **Fixed investment**
% change

	Mar	Apr	May	Jun
%oya	9.4	8.3	7.9	8.1
%oya, ytd	9.2	8.9	8.6	8.5

Mon Jul 17 1:30am — **Retail sales**
% change

	Mar	Apr	May	Jun
%oya	10.9	10.7	10.7	10.2
%m/m, sa	2.1	0.7	0.9	0.9

Review of past week's data

Merchandise trade (Jul 13)
US$ bn

	Apr	May	Jun	
Balance	38.0	40.8	~~35.1~~	*42.8*
Exports	180.0	191.0	~~189.4~~	*196.6*
%oya	8.0	8.7	~~7.3~~	*11.3*
Imports	142.0	150.2	~~154.4~~	*160.9*
%oya	11.9	14.8	~~17.6~~	*17.2*

Producer prices (NBS) (Jul 10)
% change

	Apr	May	Jun	
%oya	6.4	5.5	~~5.3~~	*5.5*
%m/m sa	-0.6	-0.5	~~-0.2~~	*-0.1*

Consumer prices (Jul 10)
% change

	Apr	May	Jun	
%oya	1.2	1.5	~~1.6~~	*1.5*
%m/m sa	0.3	0.2	~~0.3~~	*0.1*

Monetary aggregates (Jul 12)
%oya, bn yuan

	Apr	May	Jun	
M2	10.5	9.6	~~9.3~~	*9.4*
New loan creation	1100	1110	~~1456~~	*1540*

Source: NBS, Markit, J.P. Morgan forecasts

Hong Kong:
Data releases and forecasts

Week of July 17 – 21

Tue Jul 18 4:30pm — **Labor market survey**
Sa, 3mma

	Mar	Apr	May	Jun
Unemployment rate	3.2	3.2	3.2	3.2

Thu Jul 20 4:30pm — **Consumer prices**
% change

	Mar	Apr	May	Jun
%oya	0.5	2.0	2.0	2.1
%m/m, sa	0.6	1.1	0.2	0.2

Review of past week's data

No data released.

Source: Hong Kong Census and Statistics Department, J.P. Morgan forecast

Taiwan:
Data releases and forecasts

Week of July 17 – 21

Thu Jul 20 4:00pm — **Export orders**
% change

	Mar	Apr	May	Jun
%oya	12.3	7.4	9.1	9.1
%m/m, sa	-5.9	-8.7	6.2	1.5

Review of past week's data

No data released.

Source: Taiwan Ministry of Economic Affairs, DGBAS, MoF, J.P. Morgan forecasts

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Korea

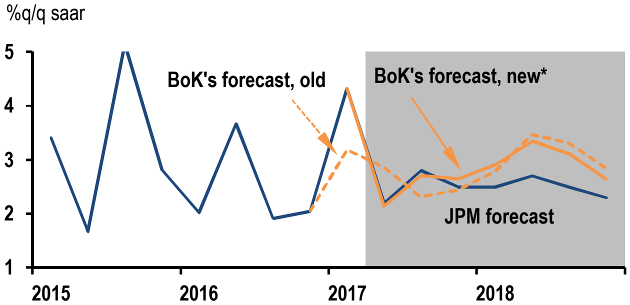
- **BoK revised up its 2017 growth forecast, with no hint of near-term rate action**
- **Jobless rate bounced in June with relatively firm details**

At this week's meeting, the Bank of Korea unanimously voted to leave the base rate unchanged at 1.25%. The governor's slightly more hawkish tone in the press conference (see "BoK: Initial thoughts on the governor's cautious step to invite hawkish bias," June 12) was not echoed forcefully by the MPC official statement, which tracks other members' views. With no surprising comments from the MPC, we maintain our view that the BoK will stand pat for the rest of the year, but with risk of hawkish dissenting votes before year-end.

BoK revised up 2017 growth outlook yet barely strengthened its hawkish bias

As we had expected, the BoK revised up its full-year 2017 growth forecast by 0.2%-pt to 2.8%y/y, mainly as a backward-looking adjustment for the upgrade to the 1Q17 GDP growth estimate from 3.6%q/q, saar to 4.3%, rather than a meaningful change to the outlook. However, the governor said that the risk to this forecast is to the upside as the revised outlook does not yet take into account the potential impact of the supplementary budget, as it remains uncertain whether the National Assembly will approve the plan, and what details might change in the process. Even so, the governor did not mention the BoK's assumption on tax revenue, which has so far outperformed the government's projection by a large margin and is the key factor in assessing fiscal thrust. We also note that the MPC statement was somewhat less upbeat than the governor himself, with its rhetoric changing little from May's MPC in detailing the growth outlook and monetary policy path.

Figure 1: Korea's real GDP



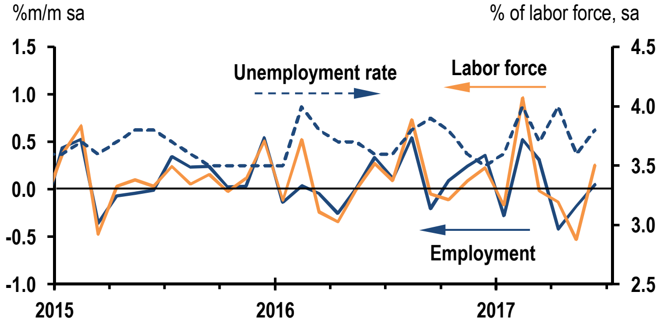
Source: BoK, and J.P. Morgan
* BoK's bi-annual forecast, available in OYA basis, is interpolated and converted to QoQ

We expect the main focus of future MPC debates will be the timing of the first rate hike, not the direction of the next policy rate adjustment itself. Based on the BoK's own forecast that growth will accelerate slightly further from midyear to reach 2.9%y/y in 2018 (Figure 1), the BoK should start raising rates as soon as 1H18. However, the key question is how strong Korea's growth will be in the medium term, with China's growth expected to slow in 2018 and Korea's own construction cycle likely to turn down by then. In our view, therefore, strong growth in 2018 would still require more support from government policy, such as fiscal expansion to boost medium-term domestic demand, and well-coordinated micro-level measures to guide a soft landing of the nexus of household debt, the housing market, and construction activity. Thus, the detailed agenda for new government policy will be important to watch; we will review our BoK call once the government discloses key economic policy measures scheduled to be made public by August at the latest.

Employment rose modestly in June

The seasonally adjusted jobless rate rose 0.2%-pt to 3.8% in June after falling 0.4%-pt in May. The monthly swings in the jobless rate since February mostly stem from a surge that month in the labor force (reflecting under-controlled seasonality from a surge in applications in response to public sector recruitment) and the subsequent volatile corrections in both the labor force and employment (Figure 2). The labor force increased 0.3%m/m, sa after falling 0.5% in May, partly on technical payback from the recent declines. Meanwhile, employment increased 0.1% after declining 0.2% in May as manufacturing employment continued to recover from last year's contraction. Service-sector employment remained soft, staying flat after falling in April (Figure 3), likely dragged down by depressed services activity reflecting the decrease in Chinese tourist inflows. Looking forward, we expect employment to advance slightly further, but the monthly swings in the unemployment rate should continue as labor participation likely will rise further with job applicants expecting that the government will ramp up public sector employment further.

Figure 2: Labor force and employment



Source: NSO, and J.P. Morgan

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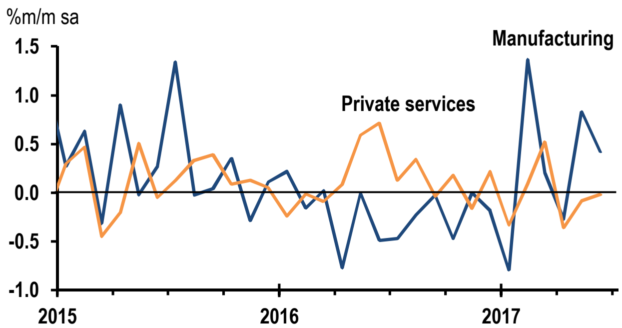
Figure 3: Employment



Source: NSO, and J.P.Morgan

Data releases and forecasts

Week of July 17 – 21

Wed
Jul 19
6:00am

Producer prices

% change

	Mar	Apr	May	Jun
%oya	4.3	3.8	3.5	3.1

We expect producer prices to fall further in June with continued weakness in global oil prices.

Wed
Jul 19
6:00am

Stage of processing price index

% change

	Mar	Apr	May	Jun
%oya	5.5	5.1	4.1	4.1

If combining imported goods prices, we expect the stage of processing price index to fall less than producer prices as KRW depreciated modestly in trade-weighted terms.

Review of past week's data

Monetary aggregates (Jul 12)

%oya, monthly average

	Mar	Apr	May	
M2	6.2	6.6	~~6.4~~	*6.1*
Lf	7.3	7.4	~~7.3~~	*7.1*

Unemployment rate (Jul 12)

% of labor force

	Apr	May	Jun	
Seasonally adjusted	4.0	3.6	~~3.7~~	*3.8*
Not seasonally adjusted	4.2	3.6	~~3.7~~	*3.8*

Seasonally adjusted unemployment rose slightly more than expected, but the details were in line with expectations as a rebound in the labor force led the rise in the jobless rate. Meanwhile, employment increased 0.1%m/m, sa after falling 0.4% in April and 0.2% in May. Manufacturing sector employment rose for a second month by 0.4% following a 0.8% gain in May, while service sector employment stayed broadly flat after falling in April. Retail sales, restaurant, and accommodation service employment fell in particular.

Import and export prices (Jul 14)

%oya, in local currency terms

	Apr	May		Jun	
Export prices	8.9	~~5.3~~	*5.1*	~~4.7~~	*4.9*
Import prices	9.2	4.1		2.3	

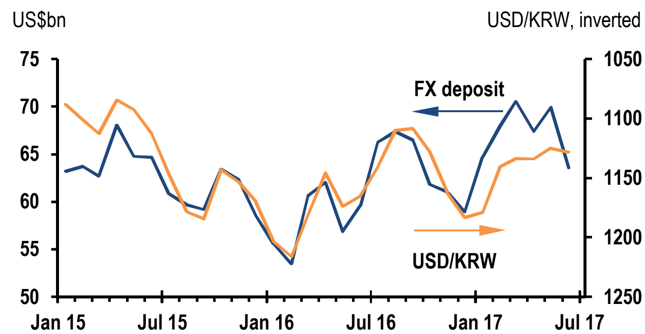
If seasonally adjusted by J.P. Morgan, import prices fell 1.4%m/m, sa in June, led by energy prices, which fell 5.7% in June for the fourth consecutive monthly drop. Meanwhile, non-oil manufacturing product prices held up, including general machinery, metal products, and precision equipment prices. Export prices fell 0.7%, also with a 6.4% fall in energy prices. IT export prices edged up 0.2% after staying flat in May.

Source: BoK, NSO, and J.P. Morgan forecasts

BoK Watch

The Bank of Korea reported that residents' FX deposits in domestic banks and local branches of foreign banks decreased US$6.3bn to US$63.6bn in June after increasing US$2.6bn in May (Figure 4). The BoK attributed the fall to USD selling by exports firms as KRW depreciated modestly through June.

Figure 4: Residents' FX deposits



Source: BoK, and J.P. Morgan

ASEAN

- **Data point to solid Malaysia growth, 2Q17 GDP revised up raising 2017 full-year growth to 5.4%y/y from 5.2%**
- **Capital goods imports remained strong in May, suggesting solid 2Q17 fixed investment outlays**
- **Inflation should soften further, keeping Bank Negara on hold through 2H17 but watchful of core trends**
- **Foreign participation in local bonds rose in 2Q17, prompting some FX reserves accumulation**

Our narrative for Malaysia penciled in cyclical stabilization for this year, coupled with an improvement in the external position following the BNM's December amendments to FEA (Foreign Exchange Administration) regulations, reflected in our forecast for a rise in FX reserves this year (see "Malaysia Data Watch 0120: Cyclical turn, watching FX reserves and M2," January 20). However, incoming trade data suggest that capital goods imports, a useful proxy of domestic fixed investment, remain on an uptrend. These data run against our forecast of an easing in capex growth in 2Q17 and beyond. Recently, private consumption proxies have turned up as well and suggest a shallower-than-forecast slowing in 2Q17. Thus, given the strength of the data, we have revised 2Q17 GDP growth to 4.5%q/q, saar from 3.4%, which would raise full-year 2017 growth to 5.4%y/y from 5.2% in the prior forecast.

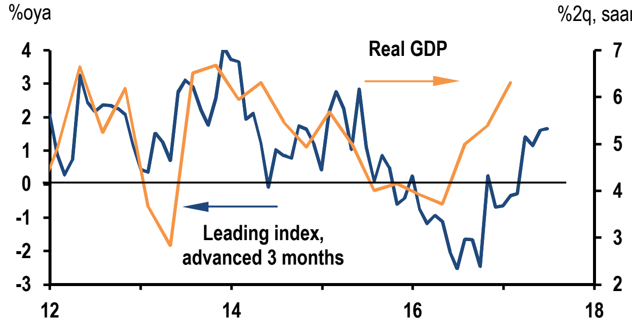
Nonetheless, we expect that a gradual pickup in domestic demand will limit pricing power at the household level, keeping underlying inflation modest. For this reason, we maintain the view that price pressures remain quiescent and we expect Bank Negara to remain on hold through this year. However, should the data continue to firm, boosting household confidence, this could add to inflationary pressures. That said, we expect headline inflation to turn lower in 2H17 due in part to the retrenchment in global energy prices. Thus, in our view, the growth threshold for Bank Negara to move toward a more hawkish stance remains high.

Separately, the May data suggest that net FX reserves have risen, suggesting the December amendments to the FEA regulations to reduce outflows are working (see "Malaysia: Looking for stabilization after 1Q17 outflows," May 5).

2Q17 GDP revised up

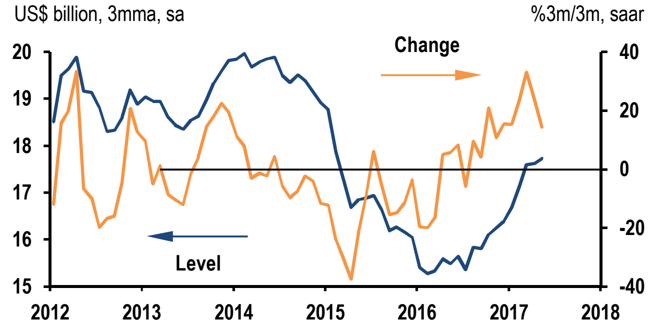
The J.P. Morgan growth forecast had penciled in a slowing to 3.4%q/q, saar in 2Q17 and an average 4.5% in 2H17 growth for the rest of the year after the 7.5% spurt in 1Q17. However, the composite leading index, a useful marker of cyclical inflection points, suggests that the momentum in 1Q17 has carried through to 2Q17 (Figure 1).

Figure 1: Malaysia composite leading index and real GDP



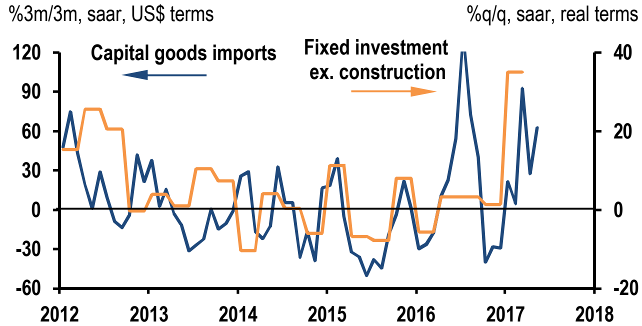
Source: DOS

Figure 2: Malaysia exports



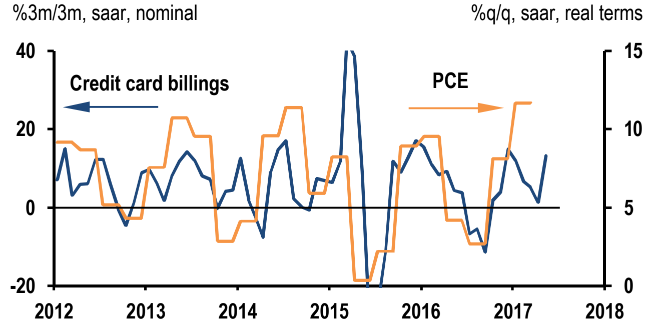
Source: DOS

Figure 3: Malaysia capital goods imports and fixed investment



Source: DOS

Figure 4: Malaysia PCE and credit card billings

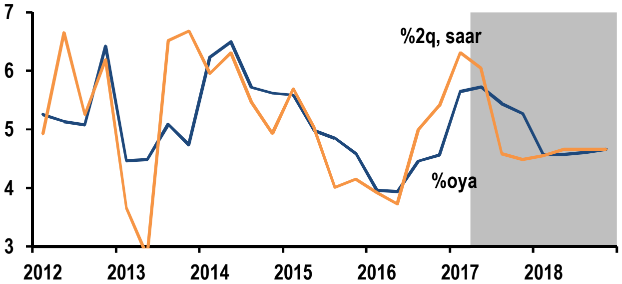


Source: BNM and DOS

Moreover, the data through May have been upbeat, with exports, capital goods imports and credit card billings continuing to firm (Figures 2, 3, and 4). We have thus raised our 2Q17 GDP growth forecast to 4.5%q/q, saar from 3.4% which would lift full year growth to 5.4%y/y from 5.2% previously (Figure 5).

Figure 5: Malaysia real GDP

% change

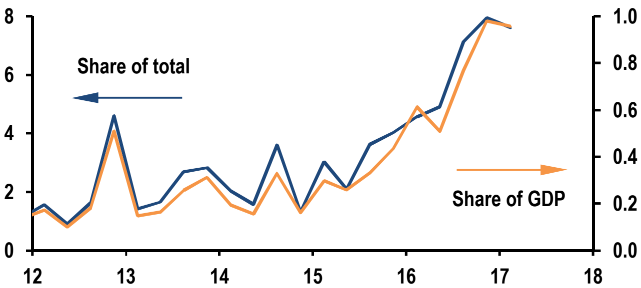


Source: DOS and J.P. Morgan forecasts in shaded area

Aside from the high-frequency data, China's direct investment in Malaysia has risen noticeably in the past year (Figure 6). To the extent that related infrastructure projects continue, this would continue to support growth and could be a source of upside surprise as was the case in 1Q17. The most prominent of these is the ECRL (East Coast Rail Link), which is a key Chinese/Malaysian project, worth around 4.5% of GDP (US$13 billion) and will be an important barometer to watch.

Figure 6: Malaysia FDI inflows from China

% of total FDI % GDP



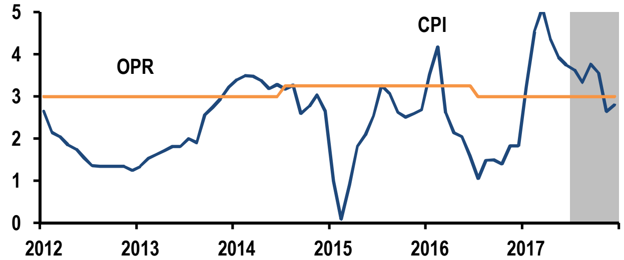
Source: BNM and DOS

Watching underlying inflation

Given the stronger-than-expected data prints in 2Q17, the focus turns also to the central bank's response. Although private domestic demand looks to be strengthening, we expect inflation to remain modest, easing to below 3%oya by 4Q17. With inflation generally well behaved and domestic demand conditions on a gradual uptrend, the risk of a more hawkish tilts remains limited. In the interim, we expect the central bank to remain watchful, of both aggregate demand conditions and its impact on inflation (Figure 7).

Figure 7: Malaysia CPI and OPR

%oya and %p.a., eop



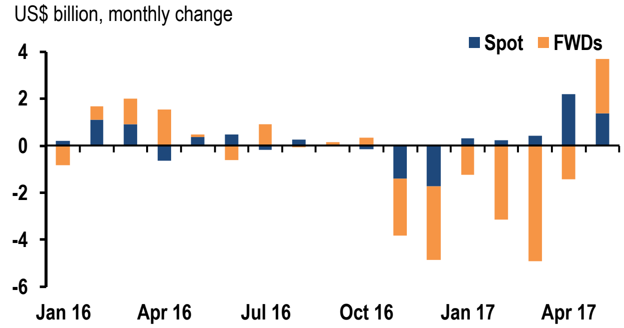
Source: BNM, DOS and J.P. Morgan forecasts in shaded area

Net FX reserves rose in May

Following a rise in spot FX reserves in April, May marks the first month since 1Q16 when both BNM's spot and forward FX positions have risen in tandem (Figure 8).

Figure 8: Malaysia net FX reserves

US$ billion, monthly change

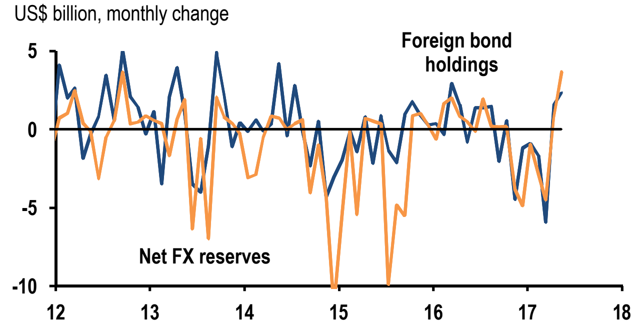


Source: BNM

The bulk of the increase appears to reflect fixed income-related portfolio inflows, correlating closely with changes in the net FX reserves position (Figures 9 and 10).

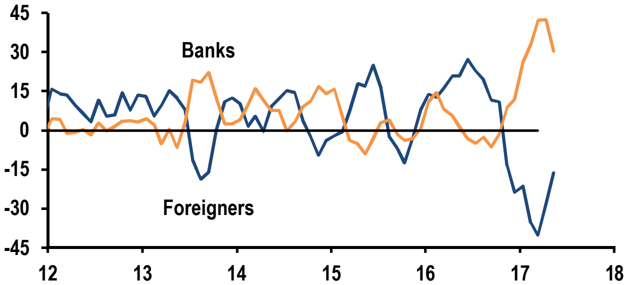
Figure 9: Net FX reserves and foreign holdings of Malaysian bonds

US$ billion, monthly change



Source: BNM

Figure 10: Malaysia holdings of Malaysian government bonds
MYR billion, 3-mo. rolling sum of monthly changes



Source: BNM

The main message here is that administrative oversight over FX markets likely has reduced outflows; to the extent that core market rates trend higher, prompting some USD strength, the impact on domestic outflows should be more muted than in the past.

ASEAN

Indonesia

Data releases and forecasts

Week of July 17 - 21

Mon Jul 17 — **Merchandise trade**
US$ bn, nsa

	Mar	Apr	May	Jun
Trade balance	1.4	1.3	0.5	0.4
Exports, %oya	24.3	12.6	24.1	12.0
Imports, %oya	17.5	10.3	24.0	16.9

Thu Jul 20 — **BI monetary policy meeting**
% pa

	Apr	May	Jun	Jul
BI rate	4.75	4.75	4.75	4.75

Review of past week's data

No data released.

Malaysia

Data releases and forecasts

Week of July 17 - 21

Wed Jul 19 12.00pm — **Consumer prices**
% change

	Mar	Apr	May	Jun
%oya	5.1	4.4	3.9	3.7
%m/m, sa	-0.1	-0.3	-0.2	0.0

Review of past week's data

Industrial production (Jul 12)
% change

	Mar	Apr	May	
Total, %oya	4.6	4.1	~~4.2~~	4.6
%m/m, sa	-0.6	-0.1	~~0.3~~	0.6

Details point to a broad-based turn-up in output, driven by a strong rise in electricity output. The manufacturing production sub-index expanded 0.2%m/m, sa, led by continued strength in electronics output, rising 1.5%m/m, sa and marking the fifth consecutive month of tech production gains.

BNM monetary policy meeting (Jul 13)
% pa

	May	Jun	Jul
O/N policy rate	3.00	3.00	*3.00*

The statement resonates broadly with our view that a positive cyclical narrative remains in place. The BNM noted that external conditions have improved and could add to the cyclical lift this year. We concur and note that growth looks to be turning a corner as recent cyclical indicators lay the groundwork for stabilization if not a pickup this year given the stronger external conditions.

While recovery is still in its nascent stages, J.P. Morgan expects monetary policy to remain broadly supportive, which underscores our view that BNM will likely remain on extended hold, consistent with the tone of the monetary policy statement.

Philippines:

Data releases and forecasts

Week of July 17 - 21

Mon Jul 17 — **OFW remittances**
% change

	Feb	Mar	Apr	May
%oya	3.4	10.7	-5.9	6.6
%m/m, sa	1.1	1.5	1.5	-6.5

Review of past week's data

Merchandise trade (Jul 11)
US$ bn, nsa

	Mar	Apr	May	
Trade balance	-2.3	-1.8	~~-1.6~~	*-2.8*
Exports, %oya	18.1	19.1	~~14.8~~	*13.7*
Imports, %oya	18.0	-0.1	~~0.8~~	*16.6*

The Philippines trade deficit widened in May to US$2.75 billion, the largest deficit on record. The broad-based strength in imports, up 11.2%m/m, sa, drove the bulk of the widening trade deficit, following the strong pull-back in imports in April.

J.P. Morgan has held a view that the fixed investment cycle will ease owing to a gradual slowdown in capex growth over the next few quarters, which should turn the current account outlook more favorable. While the May trade report challenges this view, we attribute the strength in capital goods imports to two factors: (1) a technical payback to the weakness in April and (2) a notable gain in aircraft, ships and boats imports, up 95.9%m/m, sa. Therefore, the May trade report does little to change our broad economic narrative in the Philippines, which pencils in some easing in the domestic investment growth in 2H17.

Source: Central Bureau of Statistics, Indonesia; Department of Statistics, Malaysia; Coordination Board and National Statistics Office, Philippines; J.P. Morgan forecasts

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Singapore:
Data releases and forecasts

Week of July 17 - 21

Mon
Jul 17

Merchandise trade

US$ bn, nsa

	Mar	Apr	May	Jun
Trade balance	4.3	4.1	3.3	4.8
Exports	32.8	28.9	31.1	33.2
…Non-oil domestic (NODX)	11.4	9.8	10.5	11.2
…%m/m, sa, US$ terms	-0.7	-8.4	6.7	0.7
…%oya, US$ terms	13.8	-4.2	-3.0	11.0

Review of past week's data

Real GDP (Jul 14)

% change

	4Q16	1Q17		2Q17	
%oya	2.9	~~2.7~~	*2.5*	~~3.2~~	*2.5*
%q/q, saar	12.3	~~-1.3~~	*-1.9*	~~2.6~~	*0.4*

The weaker-than-expected outcome reflects the limited pickup in the services sector, which in the past was highly correlated with manufacturing. However, in recent quarters, the uplift in manufacturing has not percolated into the services sector. Another puzzle has been the decline in paid hours worked in the overall economy despite the ostensible pickup in growth. The main message is that cyclical lift has not had the same impact on the labor markets as in the past, though for reasons that are not entirely clear to us.

The 2Q17 GDP release will be the week of August 18-25, and should provide more detail on the sectoral breakdowns. In terms of the cyclical profile, we expect growth to expand an average of 1.4%q/q, saar, which would be higher than the 1H17 outcome, but still lower than the average 3%q/q, saar from 2013 to 1Q17.

Thailand:
Data releases and forecasts

Week of July 17 - 21

No data releases.

Review of past week's data

No data released.

Vietnam:
Data releases and forecasts

Week of July 17 - 21

No data releases.

Review of past week's data

No data released.

Source: Singapore Department of Statistics; Office for Industrial Economics, Thailand; Bank of Thailand; General Statistics Office of Vietnam; J.P. Morgan forecasts

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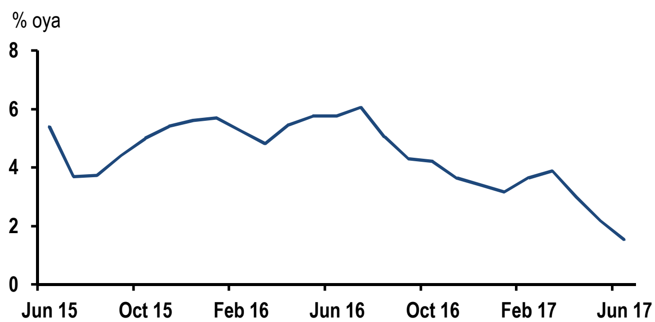
India

- **June CPI inflation prints at series low 1.5%, largely on food deflation; core-core price momentum remains soft**
- **June CPI reinforces our call of 25bp cut at August review**
- **May IP reveals incomplete post-demonetization recovery**

June CPI inflation expectedly dips below 2%...

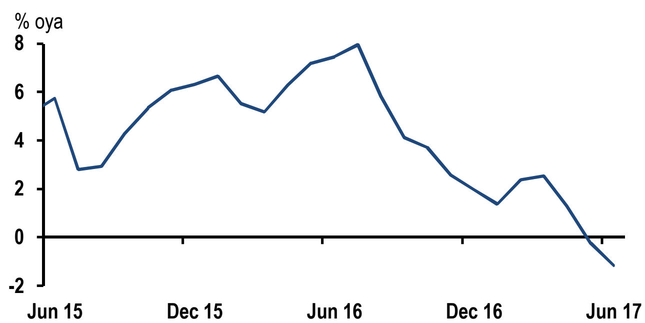
The CPI declined sequentially for a third consecutive month in June, pulling down CPI inflation to a series-low 1.5% from 2.2% in May (Figure 1). Price pressures were muted across the board. Food prices declined for a third straight month (-0.6%m/m, sa) dragging down food inflation to 1.2%oya, also a series low (Figure 2). More importantly, core-core price momentum remained soft at 0.2%m/m, sa in June, holding annual core-core inflation at 4%—the RBI's medium-term inflation target—for a third consecutive month (Figure 3).

Figure 1: CPI inflation



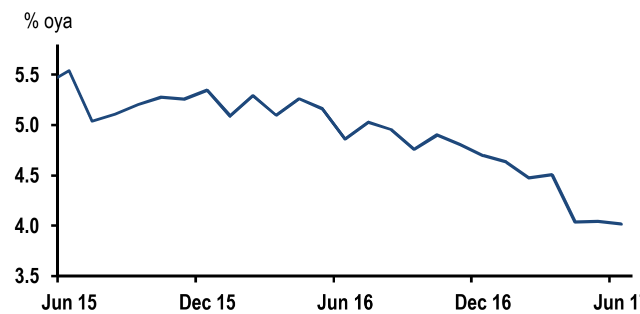
Source: MOSPI

Figure 2: Food inflation



Source: MoSPI

Figure 3: Core-core inflation



Source: MoSPI

Recall, the increase in core-core momentum to 0.5% in May had raised concerns amongst analysts. However, we were of the view that the atypical increase in May was simply payback after prices remained virtually flat in April. Supporting our view, June sequential gain is consistent with recent months' softening core-core momentum. Even the standard measure of core inflation that several MPC members cite (headline ex. food and fuel), but which we believe is contaminated by the inclusion of diesel and gasoline prices, slowed to a series-low 4% in June, again in line with the RBI's medium-term inflation target.

We think June marked the trough of the inflation cycle. We forecast inflation to accelerate to nearer 2% in July. Tomato prices have soared over the last few weeks, but largely due to idiosyncratic factors, with heavy rainfall hurting the crop. We expect these factors to reverse ahead. Meanwhile pulse prices, which declined further in June and month-to-date in July—and are now 20% lower than a year ago, should stabilize eventually, then possibly accelerate. More broadly, however, food price increases have remained relatively muted, less than the typical seasonal increase. Finally, we don't project any meaningful growth acceleration this year, which should contain pricing power and core-core inflation in the coming months. With the inflation impact of the goods and services tax (GST) expected to be modest, we forecast headline CPI inflation to average close to 4% in 1Q18, in line with the RBI's target. This includes the roughly 40bp direct impact of the House Rent Allowances (HRA) on public-sector wages—which kicked in this month and accumulate over six months. To be sure, this is a statistical artifact, akin to a one-time tax increase, and would begin fading out of annual inflation in July 2018. That said, at some point states, too, would implement their Pay Commissions and their HRA allowances, so this statistical artifact could endure for longer. However, the RBI is likely to focus more on whether this one-time increase spills over into more generalized inflation, which appears unlikely given the amount of slack in the economy.

…likely paving way for an August cut

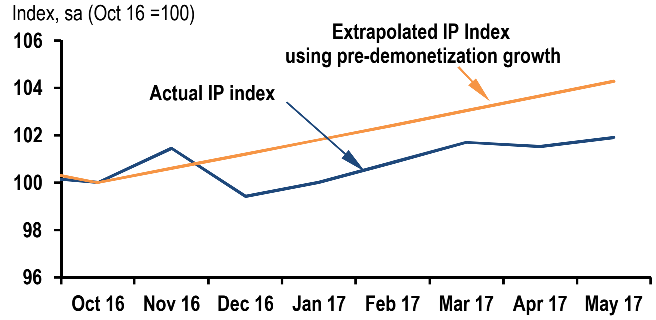
What does all this mean for policy? We read the June review and minutes as revealing a Committee that—surprised by the sharp downside surprises to the inflation trajectory—had become more agnostic about inflation prospects, and therefore was prepared to be data-dependent (reflected in the "wait and watch" theme espoused in the MPC minutes). Since the June meeting, there have been two CPI prints, with CPI inflation sliding from 3% in April to 2.2% in May and 1.5% in June—with the latest print below the 2%-3.5% range that the RBI had forecast for the first half of the fiscal year. We think the latest two prints will reassure the MPC that (i) some of the food disinflation is structural and not just demonetization-induced, (ii) continued soft core inflation indicates that the negative output gap will be sustained, (iii) any impact from the GST on consumer prices should be modest, and (iv) the monsoon is off to a reasonably good start, with cumulative rainfall just 1% below normal thus far, and fears of an El Niño in the second half fading somewhat. All this reinforces our call for further easing, and adds some conviction that the cut will occur at the next review in August. That said, the timing of the cut is still a close call with the MPC maybe wanting to see more data before pulling the trigger. Our baseline call, however, remains for a 25bp cut at the August review, a view the June CPI report reinforces.

May IP print suggests post-demonetization recovery still incomplete

IP grew 0.4%m/m, sa in May taking the annual growth rate to 1.7%oya. There was a hope amongst analysts that the lost output due demonetization would be made up in the subsequent months. However, the recovery is still very incomplete. Average monthly IP momentum from January to May was 0.5%m/m, sa, below the 0.6% pre-demonetization run rate (August to October). Slower momentum, in conjunction with the large decline in output in December, means that the seasonally adjusted output level in May was far below what it would have been had the pre-demonetization run-rate continued from November (Figure 4). For example, while consumer durables production grew for the third successive month in May, increasing 0.7% m/m, sa after 2.3% growth in April, is was still lower than the pre-demonetization level in October.

Figure 4: Industrial Production

Index, sa (Oct 16 =100)



Source: MOSPI, JPM research

Production of consumer non-durables, a proxy for rural-economy output, had another strong month in May, surging 6.8%m/m, sa after a 4.2% increase in April. The solid growth is surprising given the distress in the rural economy. We will wait for more data to ascertain whether the last two months are an aberration or an inflexion point.

Data releases and forecasts

Week of July 17-21

No data releases.

Review of past week's data

Consumer prices (July 12)

% oya

	Mar	April	May	July
Overall	3.9	3.0	2.2	1.5
Core-Core	4.5	4.0	4.0	4.0

Industrial production (July 12)

% oya

	Feb	Mar	Apr	May
Overall	0.8	3.8	2.8	1.7
% m/m, sa	0.8	0.9	-0.2	0.4

Wholesale prices (July 14)

% oya

	Mar	April	May	July
Overall	5.1	3.9	2.2	0.9
Core	2.2	2.6	2.1	2.1

Source: Central Statistical Organization and Ministry of Commerce, Government of India; Markit; Reserve Bank of India; and J.P. Morgan forecasts

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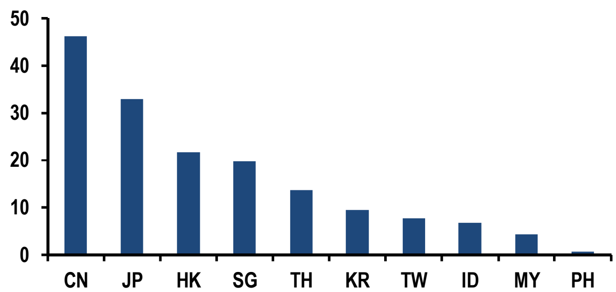
Asia focus: FX reserve trends

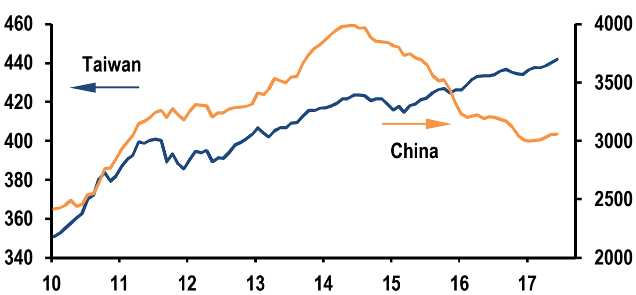
EM Asia's gross FX reserves rose US$130.5 billion in the first half of 2017, recovering from the US$282 billion decline last year. Broad EM inflows and a weaker-than-expected USD have raised gross FX reserves across all countries in the region (Figure 1 and Table 1). In China, capital outflows have eased this year, with reserves rising for five consecutive months since January (Figure 2). In India and Indonesia, two countries with current account deficits, reserves also have continued to rise, with India's reserves reaching historical highs (Figure 3). Malaysia is the only country in the region where net reserves declined this year, due to increased short FX forward positioning (Figure 4).

Figure 1: Asia gross FX reserves
US$bn, change, ytd



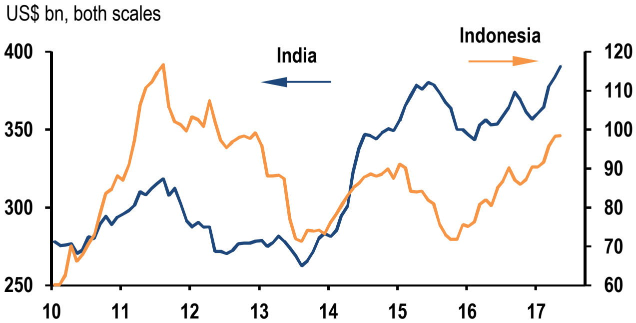
Source: National central banks

Figure 2: China and Taiwan gross FX reserves
US$ bn, both scales



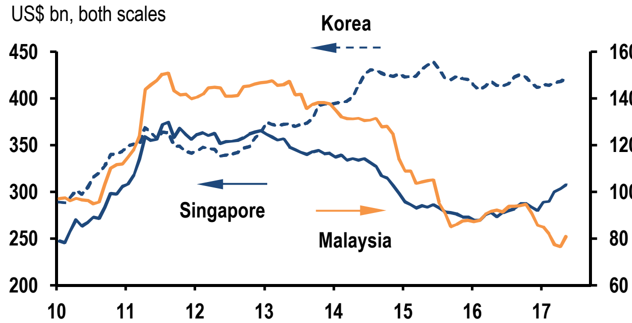
Source: PBOC and CBC

Figure 3: India and Indonesia net FX reserves
US$ bn, both scales



Source: RBI and BI

Figure 4: Korea, Malaysia, and Singapore net FX reserves
US$ bn, both scales



Source: BOK, BNM and MAS

Table 1: Asia international reserves and FX liquidity position[1]
US$ bn, eop

	2015	1Q16	2Q16	3Q16	4Q16	1Q17	Jun	YTD
China: Gross	3330	3213	3205	3166	3011	3009	3057	46
Taiwan: Gross	426	432	434	437	434	438	442	8
Japan	1263	1291	1293	1292	1251	1255	1270	19
1. Gross	1233	1262	1265	1260	1217	1230	1250	33
2. Net FX flows	0	0	0	0	0	0	0	0
3. Net FX FWDs	29	29	28	32	34	24	20	-14
Korea	420	413	413	426	411	415		8
1. Gross	368	370	370	378	371	375	381	9
2. Net FX flows	0	0	0	0	0	0	..	0
3. Net FX FWDs	52	44	44	48	40	39	..	1
India	350	353	354	374	357	378		34
1. Gross	350	360	364	372	359	370	..	21
2. Net FX flows	-5	-5	-5	-5	-5	-5	..	0
3. Net FX FWDs	4	-2	-5	7	3	13	..	13
Singapore	273	275	278	287	280	300	..	28
1. Gross	248	246	249	253	247	260	266	20
2. Net FX flows	0	0	0	0	0	0	..	0
3. Net FX FWDs	26	29	29	34	33	41	..	10
Hong Kong	359	362	361	362	378	387		17
1. Gross	359	362	361	362	386	396	408	22
2. Net FX flows	0	0	0	0	0	0	..	0
3. Net FX FWDs	0	0	0	0	-8	-9	..	0
Thailand	168	184	194	200	197	207	217	20
1. Gross	157	173	179	180	172	181	186	14
2. Net FX flows	0	0	0	0	0	0	0	0
3. Net FX FWDs	12	11	15	20	26	27	31	6
Malaysia	88	90	92	94	86	77		-5
1. Gross	95	97	97	98	95	95	99	4
2. Net FX flows	-1	-1	-1	0	0	0	..	0
3. Net FX FWDs	-6	-5	-4	-3	-8	-18	..	-8
Indonesia	76	81	85	87	90	96	..	8
1. Gross	106	108	110	116	116	122	123	7
2. Net FX flows	-23	-23	-20	-27	-20	-23	..	-5
3. Net FX FWDs	-7	-4	-5	-2	-6	-3	..	4
Philippines	76	81	83	83	77	77		2
1. Gross	81	83	85	86	81	81	81	1
2. Net FX flows	-5	-5	-5	-5	-4	-3	..	0
3. Net FX FWDs	1	3	3	2	0	0	..	0

1. Shaded area is net reserves (IRFCL) defined as sum of gross reserves, pre-determined net FX flows and FWDs. Source: Central banks, except Japan; MoF

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US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **Empire State manufacturing** (8:30am) Jul 14.0	**18 Jul** **Import prices** (8:30am) Jun -0.2% **Business leaders survey** (8:30am) Jul **NAHB survey** (10:00am) Jul 67 **TIC data** (4:00pm) May	**19 Jul** **Housing starts** (8:30am) Jun 1,140,000 Permits 1,215,000	**20 Jul** **Initial claims** (8:30am) w/e Jul 15 240,000 **Philadelphia Fed manufacturing** (8:30am) Jul 22.0 **Leading indicators** (10:00am) Jun Announce 2-year FRN $15bn Announce 2-year note $26bn Announce 5-year note $34bn Announce 7-year note $28bn Auction 10-year TIPS $13bn	**21 Jul**
24 Jul **Manufacturing PMI** (9:45am) Jul flash **Services PMI** (9:45am) Jul flash **Existing home sales** (10:00am) Jun	**25 Jul** **Philadelphia Fed nonmanufacturing** (8:30am) Jul **S&P/Case-Shiller HPI** (9:00am) May **FHFA HPI** (9:00am) May **Consumer confidence** (10:00am) Jul **Richmond Fed survey** (10:00am) Jul Auction 2-year note $26bn **FOMC meeting**	**26 Jul** **New home sales** (10:00am) Jun Auction 2-year FRN $15bn Auction 5-year note $34bn **FOMC statement (2:00pm)**	**27 Jul** **Initial claims** (8:30am) w/e Jul 22 **Durable goods** (8:30am) Jun **Advance economic indicators** (8:30am) Jun **Housing vacancies** (10:00am) 2Q **KC Fed survey** (11:00am) Jul Auction 7-year note $28bn	**28 Jul** **Real GDP** (8:30am) 2Q advance **Employment cost index** (8:30am) 2Q **Consumer sentiment** (10:00am) Jul final Minneapolis Fed President Kashkari speaks at townhall event (1:20pm)
31 Jul **Chicago PMI** (9:45am) Jul **Pending home sales** (10:00am) Jun **Dallas Fed manufacturing** (10:30am) Jul	**1 Aug** **Personal income** (8:30am) Jul **Manufacturing PMI** (9:45am) Jul final **ISM manufacturing** (10:00am) Jul **Construction spending** (10:00am) Jun **Dallas Fed services** (10:30am) Jul **Light vehicle sales** Jul	**2 Aug** **ADP employment** (8:15am) Jul Announce 10-year note $23bn Announce 30-year bond $15bn Announce 3-year note $24bn Cleveland Fed President Mester speaks to community banking conference (12:00pm) San Francisco Fed President Williams speaks in Las Vegas on Monetary policy (3:30pm)	**3 Aug** **Initial claims** (8:30am) w/e Jul 29 **Services PMI** (9:45am) Jul final **ISM nonmanufacturing** (10:00am) Jul **Factory orders** (10:00am) Jul	**4 Aug** **Employment** (8:30am) Jul **International trade** (8:30am) Jun
7 Aug **Senior loan officer survey** (2:00pm) 3Q **Consumer credit** (3:00pm) Jun	**8 Aug** **NFIB survey** (6:00am) Jul **JOLTS** (10:00am) Jun Auction 3-year note $24bn	**9 Aug** **Productivity and costs** (8:30am) 2Q prelim **Wholesale trade** (10:00am) Jun Auction 10-year note $23bn	**10 Aug** **Initial claims** (8:30am) w/e Aug 5 **PPI** (8:30am) Jul **Federal budget** (2:00pm) Jul Announce 5-year TIPS (r) $14bn Auction 30-year bond $15bn	**11 Aug** **CPI** (8:30am) Jul

Times shown are EDT.

Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **Euro area:** HICP final (11:00am) Jun 1.3%oya	**18 Jul** **Euro area:** ECB bank lending survey (10:00am) 2Q **Germany:** ZEW bus. survey (11:00am) Jul	**19 Jul** **Euro area:** Construction output (10:00am) May **Belgium:** BNB cons. conf. (3:00pm) Jul	**20 Jul** **Euro area:** Balance of Payments (10:00am) May ECB rate announcement (1:45pm) Jul EC cons. conf. (4:00pm) Jul -1.5%bal **Germany:** PPI (8:00am) Jun	**21 Jul**
24 Jul **Euro area:** PMI mfg (10:00am) Jul PMI serv. & comp (10:00am) Jul **Germany:** PMI mfg (9:30am) Jul PMI serv. & comp (9:30am) Jul **France:** PMI mfg (9:00am) Jul PMI serv. & comp (9:00am) Jul	**25 Jul** **Germany:** IFO bus. survey (10:00am) Jul **France:** INSEE bus. conf. (8:45am) Jul PPI (8:45am) Jun **Belgium:** BNB bus. conf. (3:00pm) Jul	**26 Jul** **France:** INSEE cons. conf. (8:45am) Jul **Italy:** ISAE bus. conf. (10:00am) Jul ISAE cons. conf. (10:00am) Jul	**27 Jul** **Euro area:** M3 (10:00am) Jun **Germany:** GfK cons. conf. (8:00am) Aug	**28 Jul** **Euro area:** EC cons. conf. (11:00am) Jul EC econ. sent. (11:00am) Jul EC capacity utilization (11:00am) 3Q **Germany:** CPI 6 states and prelim (2:00pm) Jul **France:** GDP flash (7:30am) 2Q Cons. of mfg goods (8:45am) Jun CPI prelim (8:45am) Jul **Spain:** CPI prelim (9:00am) Jul GDP prelim (9:00am) 2Q **Belgium:** CPI (8:00am) Jul **Netherlands:** CBS bus. conf. (6:30am) Jul
31 Jul **Euro area:** HICP flash (11:00am) Jul Unemployment rate (11:00am) Jun **Germany:** Employment (9:55am) Jun Unemployment (9:55am) Jul Retail sales (10:00am) Jun **Italy:** CPI prelim (11:00am) Jul PPI (12:00pm) Jun **Belgium:** GDP prelim (3:00pm) 2Q	**1 Aug** **Euro area:** PMI mfg (10:00am) Jul GDP flash (11:00am) 2Q **Germany:** PMI mfg (9:55am) Jul **France:** PMI mfg (9:50am) Jul **Italy:** PMI mfg (9:45am) Jul **Spain:** PMI mfg (9:15am) Jul	**2 Aug** **Euro area:** MFI interest rates (10:00am) Jun PPI (11:00am) Jun	**3 Aug** **Euro area:** PMI serv. & comp (10:00am) Jul ECB economic bulletin (10:00am) Retail sales (11:00am) Jun **Germany:** PMI serv. & comp (9:55am) Jul **France:** PMI serv. & comp (9:50am) Jul **Italy:** PMI serv. & comp (9:45am) Jul **Spain:** PMI serv. & comp (9:15am) Jul	**4 Aug** **Germany:** Mfg orders (8:00am) Jun
7 Aug **Germany:** Industrial production (8:00am) Jun	**8 Aug** **Germany:** Foreign trade (8:00am) Jun **France:** Foreign trade (8:45am) Jun Monthly budget situation (8:45am) Jun **Netherlands:** CPI (6:30am) Jul	**9 Aug** **Italy:** Industrial production (10:00am) Jun	**10 Aug** **France:** Industrial production (8:45am) Jun **Italy:** Foreign trade (10:00am) Jun	**11 Aug** **Germany:** CPI final (8:00am) Jul **France:** CPI final (8:45am) Jul **Italy:** CPI final (10:00am) Jul **Spain:** CPI final (9:00am) Jul

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul *Holiday: Japan*	**18 Jul** **Construction spending** (2:00pm) May Auction 1-year bill	**19 Jul** **Reuters Tankan** (8:30am) Jul 28 BoJ Monetary Policy Meeting Auction 3-month bill	**20 Jul** **Trade balance** (8:50am) Jun 175 billion yen, sa BoJ Monetary Policy Meeting BoJ outlook report BoJ governor Kuroda's press conference	**21 Jul** **Employers' survey final** (9:00pm) May
24 Jul **PMI manufacturing prelim** (9:30am) Jul	**25 Jul** Minutes of the Jun 15-16 BoJ Monetary Policy Meeting (8:50am) Auction 40-year bond	**26 Jul** **Corporate service prices** (8:50am) Jun **Shoko Chukin small firm survey** (2:00pm) Jul BoJ deputy governor Nakaso's speech at a meeting with business leaders in Hiroshima (10:30am) Auction 3-month bill Auction 2-year note	**27 Jul**	**28 Jul** **All household spending** (8:30am) Jun **Job offers to applicants ratio** (8:30am) Jun **Nationwide core CPI** (8:30am) Jun **Unemployment rate** (8:30am) Jun **Total retail sales** (8:50am) Jun Summary of Opinions at July 19-20 BoJ Monetary Policy Meeting (8:50am)
31 Jul **IP** (8:50am) **Housing starts** (2:00pm) Jun	**1 Aug** **PMI manufacturing** (9:30am) **Auto registrations** (2:00pm) Jul Auction 10-year bond	**2 Aug** **Consumer sentiment** (2:00pm) Jul	**3 Aug** **PMI services** (9:30am) Jul Auction 3-month bill Auction 10-year inflation-indexed bond	**4 Aug** **Employers' survey** (9:00pm) Jun
7 Aug	**8 Aug** **Bank lending** (8:50am) Jul **Current account** (8:50am) Jun Auction 6-month bill Auction 30-year note	**9 Aug** Auction 3-month bill	**10 Aug** **Corporate goods prices** (8:50am) Jul **Private machinery orders** (8:50am) Jun **Tertiary sector activity index** (1:30pm) Jun	**11 Aug** *Holiday: Japan*
During the week: CAO private consumption index Jun (7-11 Aug)				

Times shown are local.

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **Nonresidential construction** (8:30am) 2Q **International transactions in securities** (8:30am) May **Existing home sales** (9:00am) Jun	**18 Jul**	**19 Jul** **Manufacturing sales** (8:30am) May 0.8%	**20 Jul**	**21 Jul** **CPI** (8:30am) Jun -0.1%(1.0%oya) **Retail sales** (8:30am) May 0.0% Ex auto -0.3%
24 Jul **Wholesale sales** (8:30am) May	**25 Jul**	**26 Jul**	**27 Jul** **CFIB Business Barometer Index** (6:00am) Jul **Payroll employment** (8:30am) May	**28 Jul** **Monthly GDP** (8:30am) May
31 Jul **IPPI** (8:30am) Jun	**1 Aug**	**2 Aug**	**3 Aug**	**4 Aug** **Labor Force Survey** (8:30am) Jul **International trade** (8:30am) Jun **Ivey PMI** (10:00am) Jul
7 Aug *Civic Day Markets closed*	**8 Aug** **Housing starts** (8:15am) Jul	**9 Aug** **Building permits** (8:30am) Jun	**10 Aug** **New housing price index** (8:30am) Jun	**11 Aug**

All existing home sales are tentative. Times shown are local.

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Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **Brazil:** IGP-10 Jul -0.91%m/m, -1.87%oya **Colombia:** IP May Retail sales May **Peru:** Unemployment rate Jun Economic activity index May 0.6%m/m, sa	**18 Jul** **Mexico:** Central bank reserves (prior week) *Holiday: Uruguay*	**19 Jul** **Colombia:** Trade balance May US$-0.2bn **Argentina:** PS budget balance Jun	**20 Jul** **Brazil:** IPCA-15 Jul -0.12%m/m, 2.84%oya *Holiday: Colombia*	**21 Jul** **Colombia:** Economic activity index May BanRep meeting **Brazil:** Current account Jun US$1.4bn FDI Jun US$2.5bn **Mexico:** Unemployment rate Jun 3.5% sa **Uruguay:** Unemployment rate Jun
During the week: Brazil: Tax collections Jun (17-21 Jul), Formal job creation Jun (17-21 Jul);				
24 Jul **Mexico:** CPI 1H Jul Economic activity index May	**25 Jul** **Argentina:** Trade balance Jun Economic activity index May BCRA meeting **Brazil:** FGV consumer confidence Jul **Mexico:** Retail sales May Central bank reserves (prior week)	**26 Jul** **Brazil:** BCB meeting	**27 Jul** **Brazil:** BCB credit report Jun Central government budget Jun **Mexico:** Trade balance Jun **Colombia** BanRep meeting	**28 Jul** **Brazil:** IGP-M Jul Unemployment rate Jun Primary budget balance Jun Net debt as % of GDP Jun **Chile:** IP Jun **Mexico:** PS budget balance Jun *Holiday: Peru*
31 Jul **Argentina:** IP Jun **Chile:** Unemployment rate Jun **Colombia:** Unemployment rate Jun **Mexico:** GDP 2Q Preview **Uruguay:** PS Budget balance Jun	**1 Aug** **Peru:** CPI Jul **Brazil:** Trade balance Jul IP Jun PMI Manufacturing Jul **Mexico:** Remittances Jun IMEF manufacturing index Jul IMEF nonmanufacturing index Jul Central bank reserves (prior week)	**2 Aug** **Brazil:** FIPE CPI Jul **Chile:** Retail sales Jun **Colombia:** Exports Jun	**3 Aug** **Argentina:** Auto report Jul **Brazil:** PMI Services Jul **Mexico:** Consumer confidence Jul **Uruguay:** CPI Jul	**4 Aug** **Mexico:** GFI May **Colombia:** BanRep meeting minutes WPI Jul
During the week: Argentina: Tax collections Jul (1-5 Aug); **Brazil:** Vehicle sales Jul (1-3 Aug), BCB Commodity price index Jul (2-9 Aug), Auto production Jul (4-7 Aug); **Colombia:** CPI Jul (5 Aug); **Mexico:** Vehicle sales Jul (1-4 Aug);				
7 Aug **Chile:** Economic activity index Jun Trade balance Jul Nominal wages Jun *Holiday: Colombia*	**8 Aug** **Argentina:** New CPI Jul BCRA meeting **Brazil:** IGP-DI Jul **Chile:** CPI Jul **Mexico:** Central bank reserves (prior week)	**9 Aug** **Mexico:** ANTAD same-store sales CPI Jul **Brazil:** IPCA Jul	**10 Aug** **Mexico:** Banxico meeting **Peru:** BCRP meeting	**11 Aug** **Mexico:** IP Jun **Uruguay:** IP Jun
During the week: Chile: Vehicle Sales Jul (7-8 Aug); **Mexico:** Auto production (7-11 Aug), Formal job creation Jul (7-11 Aug), Nominal wage Jul (10-13 Aug); **Peru:** Trade balance Jun (9-11 Aug);				

Times shown are local.

UK and Scandinavia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **United Kingdom:** Rightmove HPI (12:01am) Jul	**18 Jul** **United Kingdom:** CPI (9:30am) Jun 2.9%oya ONS HPI (9:30am) May PPI (9:30am) Jun **Sweden:** Riksbank MPM minutes (9:30am) BoE's Carney speaks in Winchester	**19 Jul**	**20 Jul** **United Kingdom:** Retail sales (9:30am) Jun 0.7%m/m	**21 Jul** **United Kingdom:** Public sector finances (9:30am) Jun **Norway:** Building stats (10:00am) Jun
24 Jul	**25 Jul** **United Kingdom:** CBI industrial trends (11:00am) Jul **Sweden:** PPI (9:30am) Jun **Norway:** Business tendency survey (8:00am) 2Q	**26 Jul** **United Kingdom:** BBA Mortgage lending (9:30am) Jun Index of services (9:30am) May Real GDP (9:30am) 2Q **Sweden:** Trade balance (9:30am) Jun	**27 Jul** **United Kingdom:** CBI distributive trades (11:00am) Jul **Sweden:** Consumer confidence (9:00am) Jul Economic Tendency survey (9:00am) Jul Household lending (9:30am) Jun Labor force survey (9:30am) Jun **Norway:** AKU unemployment (8:00am) May	**28 Jul** **United Kingdom:** Gfk cons. conf. (12:01am) Jul EC consumer confidence (10:00am) Jul **Sweden:** GDP prelim (9:30am) 2Q Retail sales (9:30am) Jun **Norway:** Retail sales (8:00am) Jun Labor directorate unemployment (10:00am) Jul
During the week: United Kingdom: Nationwide HPI Jul (28-3 Aug)				
31 Jul **United Kingdom:** Lloyds business barometer (12:01am) Jul M4 & M4 lending final (9:30am) Jun Net lending to individuals (9:30am) Jun **Sweden:** Wage stats (9:30am) May	**1 Aug** **United Kingdom:** PMI Mfg (9:30am) Jul **Sweden:** PMI Mfg (8:30am) Jul **Norway:** PMI Mfg (9:00am) Jul	**2 Aug** **United Kingdom:** PMI Construction (9:30am) Jul	**3 Aug** **United Kingdom:** PMI Services (9:30am) Jul MPC rate announcement, asset purchase target and inflation report (12:00pm) Aug **Sweden:** PMI Services (8:30am) Jul	**4 Aug** **United Kingdom:** New car regs (9:00am) Jul
7 Aug **United Kingdom:** Halifax HPI (8:30am) Jul Quoted mortgage interest rates (9:30am) Jul Visa consumer spending index (9:30am) Jul **Sweden:** Budget Balance (9:30am) Jul **Norway:** IP Mfg (8:00am) Jun	**8 Aug** **United Kingdom:** BRC retail sales monitor (12:01am) Jul **Norway:** Credit indicator growth (8:00am) Jun	**9 Aug**	**10 Aug** **United Kingdom:** RICS HPI (12:01am) Jul Construction output (9:30am) Jun Industrial production (9:30am) Jun Trade balance (9:30am) Jun **Sweden:** House price data (9:30am) Jul IP & orders (9:30am) Jun Services production (9:30am) Jun **Norway:** CPI (8:00am) Jul PPI (8:00am) Jul	**11 Aug** **Norway:** Building stats (10:00am) 2Q

Times shown are local.

Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **Turkey:** Unemployment (10:00am) Apr 10.9 %	**18 Jul** **Hungary:** NBH rate decision (2:00pm) Jul On hold, 0.90% **Poland:** Average gross wages 5.7 %oya and Employment (2:00pm) Jun	**19 Jul** **Poland:** Industrial output (2:00pm) Jun 4.0 %oya PPI (2:00pm) Jun Retail sales (2:00pm) Jun 7.0 %oya **Russia:** PPI (5:00pm) Jun 3.5 %oya Retail sales 0.9 %oya, Unemployment 4.9% & Investment (5:00pm) Jun **South Africa:** CPI (10:00am) Jun 5.1 %oya Retail sales (1:00pm) May	**20 Jul** **Czech Republic:** PPI (9:00am) Jun **Hungary:** Average gross wages (9:00am) May **South Africa:** SARB rate decision Jul On hold, 7.0%	**21 Jul**
During the week: **Poland:** Budget balance Jun (17-31 Jul) **Russia:** Industrial output Jun (17-18 Jul) 2.5 %oya				
24 Jul	**25 Jul** **Poland:** Unemployment (10:00am) Jun **Turkey:** Capacity utilization (2:30pm) Jul **South Africa:** Quarterly Labour Force Survey (11:30am) 2Q	**26 Jul**	**27 Jul** **Hungary:** Unemployment (9:00am) May **Turkey:** CBRT rate decision (2:00pm) Jul	**28 Jul** **Russia:** CBR rate decision (2:30pm) Jul **South Africa:** Budget (2:00pm) Jun
31 Jul **Hungary:** PPI (9:00am) May **Poland:** CPI prelim (2:00pm) Jun **Turkey:** Foreign trade (10:00am) Jun **South Africa:** Private sector credit (8:00am) Jun Trade balance (2:00pm) Jun	**1 Aug** **Czech Republic:** PMI (9:30am) Jul **Hungary:** PMI (9:00am) Jul Trade balance final (9:00am) Jun **Poland:** PMI (9:00am) Jul **Russia:** Manufacturing PMI (10:00am) Jul **Turkey:** PMI (10:00am) Jul	**2 Aug**	**3 Aug** **Czech Republic:** CNB rate decision (1:00pm) Aug **Hungary:** Retail sales (9:00am) Jun **Romania:** Retail sales (9:00am) Jun **Turkey:** CPI (10:00am) Jul	**4 Aug** **Czech Republic:** Retail sales (9:00am) Jun **Hungary:** Industrial output (9:00am) Jun **Romania:** NBR rate decision Aug
During the week: **Russia:** CPI Jul (4-7 Aug)				
7 Aug **Czech Republic:** Industrial output (9:00am) Jun Trade balance (9:00am) Jun **South Africa:** Gross reserves (8:00am) Jul	**8 Aug** **Hungary:** CPI (9:00am) Jul Trade balance (9:00am) Jun **Turkey:** Industrial output (10:00am) Jun	**9 Aug** **Czech Republic:** CPI (9:00am) Jul **Romania:** Trade balance (9:00am) Jun	**10 Aug** **South Africa:** Manufacturing output (1:00pm) Jun	**11 Aug** **Poland:** CPI (2:00pm) Jul **Romania:** CPI (9:00am) Jul Industrial output (9:00am) Jun **Russia:** Foreign trade (5:00pm) Jun GDP flash (5:00pm) 2Q **Turkey:** Current account (10:00am) Jun
During the week: **Poland:** Current account Jun (11-16 Aug) **South Africa:** BER business confidence 2Q (11-28 Aug)				

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Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 Jul **China:** FAI (10:00am) Jun 8.5%oya, ytd GDP (10:00am) 2Q 6.8%oya IP (10:00am) Jun 6.3%oya Retail sales (10:00am) Jun 10.2%oya **Indonesia:** Trade balance Jun US$0.4bn **Philippines:** OFW remittances May 6.6%oya **Singapore:** NODX (8:30am) Jun US$11.2bn	**18 Jul** **Australia:** New motor vehicle sales (11:30am) Jun **Hong Kong:** Unemployment rate (4:30pm) Jun 3.2% sa, 3mma	**19 Jul** **Korea:** PPI (6:00am) Jun 3.1%oya **Malaysia:** CPI (12:00pm) Jun 3.7%oya	**20 Jul** **Australia:** Unemployment rate (11:30am) Jun 5.5% **Hong Kong:** CPI (4:30pm) Jun 2.1%oya **Indonesia:** BI monetary policy meeting no change **Taiwan:** Export orders (4:00pm) Jun 9.1%oya	**21 Jul**
During the week: **Philippines:** Budget balance Jun (19-31 Jul)				
24 Jul **Singapore:** CPI (1:00pm) Jun **Taiwan:** IP (4:00pm) Jun Unemployment rate (4:00pm) Jun **Vietnam:** CPI Jul	**25 Jul** **Korea:** Consumer survey (6:00am) Jul	**26 Jul** **Australia:** CPI (11:30am) 2Q **New Zealand:** Trade balance (10:45am) Jun **Singapore:** IP (1:00pm) Jun	**27 Jul** **Hong Kong:** Trade balance (4:30pm) Jun **Korea:** GDP prelim (8:00am) 2Q	**28 Jul** **Australia:** PPI (11:30am) 1Q **Korea:** FKI Business Survey (6:00am) Jun IP (8:00am) Jun **Taiwan:** GDP prelim (4:00pm) 2Q *Holiday: Thailand*
During the week: **Thailand:** Mfg. Production Jun (28-31 Jul) **Vietnam:** Trade balance Jul (25-31 Jul)				
31 Jul **Australia:** Pvt. sector credit (11:30am) Jun **New Zealand:** Building permits (10:45am) Jun NBNZ business confidence (1:00pm) Jul **China:** PMI mfg. (NBS) (9:00am) Jun **Thailand:** PCI (2:30pm) Jun PII (2:30pm) Jun Trade balance (2:30pm) Jun	**1 Aug** **Australia:** RBA official rate announcement **China:** PMI Mfg. (9:45am) Aug **India:** PMI mfg. (10:30am) Aug **Indonesia:** CPI (11:00am) Jul **Korea:** CPI (8:00am) Jul Trade balance (9:00am) Jul PMI mfg. (9:30am) Jul **Taiwan:** PMI mfg. (8:30am) Jul	**2 Aug** **Australia:** Building approvals (11:30am) Jun **Hong Kong:** Retail sales (4:30pm) Jun **India:** RBI monetary policy meeting **Singapore:** PMI (9:00pm) Jul	**3 Aug** **Australia:** Trade balance (11:30am) Jun **New Zealand:** ANZ commodity price (1:00pm) Jul **Korea:** Current account balance (8:00am) Jul	**4 Aug** **Australia:** Retail sales (11:30am) Jun **Malaysia:** Trade balance (12:00pm) Jun **Philippines:** CPI (9:00am) Jul
During the week: **Indonesia:** GDP 2Q (4-7 Aug)				
7 Aug **Australia:** ANZ job advertisements (11:30am) Jul **China:** Foreign Exchange Reserves Jul **Taiwan:** Trade balance (4:00pm) Jul	**8 Aug** **Australia:** NAB business confidence Jul **China:** Trade balance Jul **Taiwan:** CPI (4:00pm) Jul	**9 Aug** **China:** CPI (9:30am) Jul PPI (9:30am) Jul **Korea:** Unemployment rate (8:00am) Jul Money supply (12:00pm) Jun *Holiday: Singapore*	**10 Aug** **New Zealand:** RBNZ official rate announcement **Malaysia:** IP (12:00pm) Jun **Philippines:** Trade balance (9:00am) Jun BSP monetary policy meeting	**11 Aug** **Hong Kong:** GDP (4:30pm) 2Q **India:** IP (5:30pm) Jun **Singapore:** Retail sales (1:00pm) Jun
During the week: **China:** Money supply/TSF Jul (10-15 Aug) **India:** Trade balance Jun (10-16 Aug)				

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
15 - 21 July	**17 July**	**18 July**	**19 July**	**20 July**	**21 July**
Russia • IP (Jun)	**China** • FAI (Jun) • GDP (2Q) • IP (Jun) • Retail sales (Jun) **Singapore** • NODX (Jun) **United States** • Empire St srvy (Jul)	**Euro area** • ECB bnk lnding srvy (2Q) **Hungary** • NBH mgt: no chg **United Kingdom** • CPI (Jun) **United States** • Import prices (Jun) • NAHB srvy (Jul)	**Japan** • Reuters Tankan (Jul) **Poland** • IP (Jun) **Russia** • Retail sales (Jun) • Labor mrkt report (Jun) **South Africa** • CPI (Jun) **United States** • Housing starts (Jun)	**Australia** • Labor mrkt report (Jun) **Euro area** • ECB mtg: no chg • EC cons conf (Jul) **Indonesia** • BI mtg: no chg **Japan** • BoJ mtg: no chg **South Africa** • SARB mtg: no chg **Taiwan** • Export orders (Jun) **United Kingdom** • Retail sales (Jun) **United States** • Philly Fed srvy (Jul) • Leading indicators (Jun)	
22 - 28 July	**24 July**	**25 July**	**26 July**	**27 July**	**28 July**
	Euro area • Flash mfg & srv PMI (Jul) **Japan** • Flash mfg PMI (Jul) **Taiwan** • IP (Jun) **United States** • Flash mfg & srv PMI (Jul) • Existing hm sls (Jun)	**Germany** • IFO bus srvy (Jul) **United States** • Case-Shiller HPI (May) • CB cons conf (Jul)	**Australia** • CPI (2Q) **Brazil** • BCB mtg: -75bp **Japan** • Shoko Chukin srvy (Jul) **United Kingdom** • GDP (2Q) **United States** • FOMC mtg: no chg	**Brazil** • BCB credit report (Jun) **Colombia** • BanRep mtg: -25bp **Korea** • GDP (2Q) **Mexico** • Trade balance (Jun) **Turkey** • CBRT mtg: no chg **United States** • Durable goods (Jun) • Adv econ indicators (Jun)	**Brazil** • Labor market report (Jun) **Euro area** • EC econ snt (Jul) **France:** GDP (2Q, flsh) **Germany:** CPI (Jul) **Japan:** Core CPI (Jun) • Labor mrkt report (Jun) • All hhold spending (Jun) **Korea:** IP (Jun) **Russia** • CBR mtg: -25bp **Spain** • GDP (2Q, flsh) **Sweden:** GDP (2Q) **Taiwan:** GDP (2Q) **United States** • GDP (2Q, adv) • ECI (2Q) • UMich cons snt (Jul, fnl)