TORY LEADERSHIP RACE ENTERS FINAL STAGE

Barring property, the big post-Brexit headline from this week was all about who will be the next prime minister. Following the second round of voting, Michael Gove was eliminated from the race, proving how to spectacularly destroy a political career in just a few weeks. This leaves two women standing. The task facing either home secretary Theresa May or energy minister Andrea Leadsom now is to reunite a polarised party, and to secure Britain the best deal in the wake of the vote to leave the European Union.

Away from politics, markets have remained cautious this week on the back of Brexit and the US labour report issued this afternoon. With investors likely to heed warning or optimism from just the smallest bit of news, it means that the FTSE 100 has been particularly volatile. Safe haven assets are rallying in the midst of it all; 10 Year US Treasury yields touched near record lows this week while Japanese yen strength is another clear indicator of this.

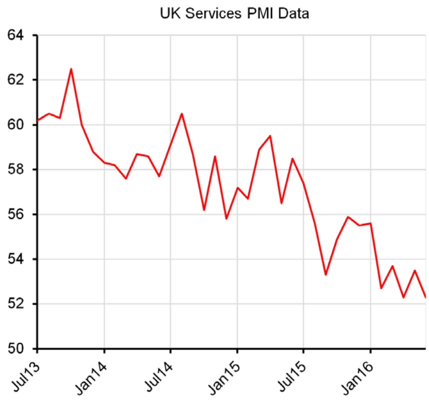
THE MARKETS THIS WEEK

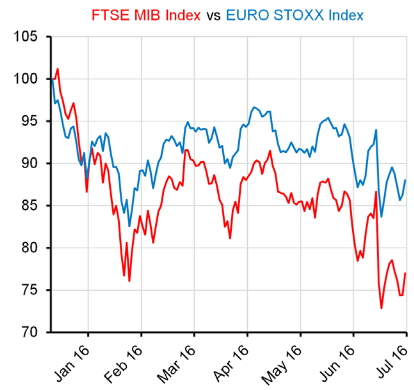
FTSE 100	S&P 500	Nikkei 225	Hang Seng	Dax 30	CAC 40	Ibex 35	Brent Crude	Natural Gas	Gold	Wheat
-0.67%	+1.40%	-2.59%	-0.42%	-3.66%	-3.65%	-3.15%	-8.91%	-5.12%	+2.24%	-3.20%

UK: SERVICES SECTOR WEAKENS

The latest data shows that Britain's dominant service sector slowed significantly in the months leading up to the EU referendum. What this now means for monetary policy is a lot different to what we encountered only six months ago. Ahead of the Bank of England's next policy meeting in July, the expectation is that a rate cut is now more likely than a rise, while a resumption of quantitative easing should not be out of the question. With many of the surveys being completed before the result, the Markit/CIPS purchasing managers index fell to 52.7 for the second quarter, its worst performance since the beginning of 2013. A reading above 50 still indicates economic expansion however.

In response to the services data and news of a nervy UK property market, sterling tumbled to a 31-year low against the dollar on Wednesday. The fall in sterling is not all bad however according to those at Capital Economics, who maintain that a "substantially lower exchange rate" could help to "limit the economic damage" of Brexit.





ITALY: BANKS ON THE BRINK

Despite being Europe's fourth largest economy, Italy is probably the weakest right now. On top of the macroeconomic readings which show public debt at 135 per cent of GDP and an unemployment rate second worst only to that of Greece, Italian banks are being strangled by $222bn of bad loans. On Friday, Bank of Italy Governor Ignazio Visco warned that state intervention may be necessary to halt the contagion spreading. Italian Prime Minister Matteo Renzi also wants to press ahead with this idea, however this would come at the expense of contravening the EU's latest rules against bank bailouts.

An estimated $45bn will be needed to shore up the country's banks, with two of the worst affected banks are Banca Monte dei Paschi di Siena SpA and Banco Popolare. On a year to date basis, the share prices of both have fallen by about 80 per cent. The problem with the debt securities held in these banks is that many of them are held by retail investors; any bail-in would see Italian households hit hard and exacerbate an already tender situation.

OIL: PRICES HIT TWO MONTH LOWS

Brent crude fell nearly 5 per cent on Thursday, after the US government reported that stockpiles had fallen by 2.2 million barrels in the week to 1 July. This shocked the markets, who had anticipated that the decrease would be larger. The American Petroleum Institute pencilled in a fall of 6.7m barrels earlier in the week, so the actual fall shows that there was little relief from the chronic oversupply of oil in global markets.

Oil has enjoyed a steady five-month rally since it recovered from more than decade lows of $28 per barrel in January, with unexpected supply outages in Canada and Nigeria helping to bump up the price. Oil output has been declining by an average of 3.8m barrels a day on a global level, however this trend may not continue for much longer. As OPEC giants Saudi Arabia and Iran potentially gear up for more production, the US could join in, but would only likely do so if they are incentivised to produce more at the right price.