

Weekly Macro & Markets View

Highlights and View

- **The ECB restarts QE and cuts interest rates further into negative territory**

While the ECB action is broadly welcome, it is approaching the point of diminishing returns in terms of impact on the economy, putting pressure on fiscal policy to do more.

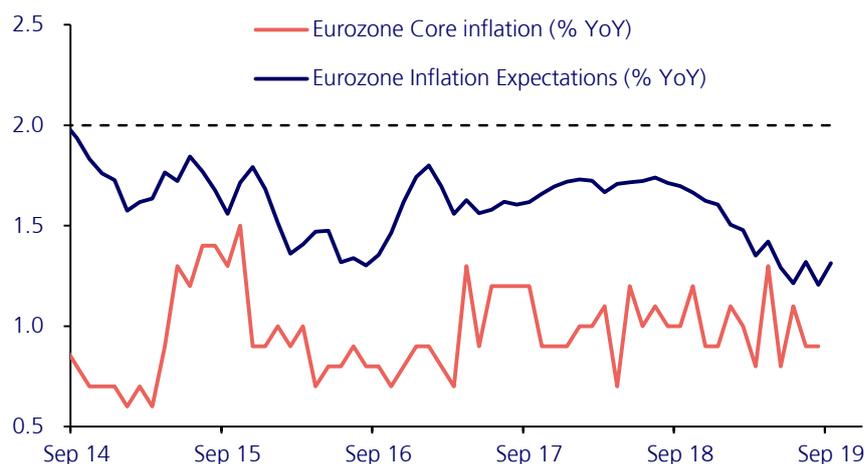
- **Strong demand in primary and secondary credit markets as the ECB boosts investor sentiment**

While short-term investor sentiment remains positive and ECB QE will support demand, credit is likely to continue lagging equities in the medium term as tight spreads limit further upside.

- **China's growth continues to deteriorate**

We expect a bounce back in production and stronger infrastructure investment to support growth in Q4.

ECB announces easing measures, but hands the baton to fiscal policy



Source: Bloomberg

The ECB announced a range of easing measures last week, including, as we expected, re-starting QE and cutting the deposit rate by 10bps to -50bps. The size of monthly asset purchases was at the low end of the potential range, at 20 billion euros a month, but the commitment to QE was open-ended. ECB President Mario Draghi confirmed in the Q&A session that the composition of asset purchases would be similar to the previous programme, i.e. consisting mainly of government and corporate bonds. The ECB also announced more support for banks, including tiering interest rates on excess reserves held with the ECB and more favourable TLTRO 3 terms. Forward guidance on interest rates was changed from calendar based to a commitment to keep interest rates at present or lower levels until '... we have seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% ...'

While many easing measures were announced we doubt they will bring inflation back to the ECB's target any time soon, or do much to stimulate growth. At best they may help stabilise inflation expectations at around current low levels, and boost financial market risk appetite in the near term. Indeed, Draghi himself seemed to acknowledge as much when he said, '...fiscal policy should become the main instrument' to stimulate demand, suggesting that monetary easing in the Eurozone appears to be reaching the point of diminishing effectiveness.

Credit: The ECB gives a fillip to European credit

The ECB's meeting was the highlight of the week capping a firm week for credit, although US credit continues to lag equity in the recent rally. Notably, previously unloved parts of the market have recovered some lost ground. High yield energy has seen a dramatic reversal of some of the widening from August, even before the escalation of geopolitical tensions over the weekend, which are causing oil prices to rise sharply this morning. Banks gained strongly in equities and credit due to higher yields. Inflows were also strong, with the US IG market seeing the

third highest inflow on record. Supply was running at a frenetic pace, with September looking likely to set a record, especially in the US. The ECB announcement was a shot in the arm for European credit, as spreads rallied by 4-6bps on Thursday. The ECB's QE announcement is positive in structure and open-endedness, but underwhelming in size, although the tweaks to TLTROs and tiered interest rates are a step in the right direction in our view, alleviating some of the impact of negative rates on banks and monetary policy transmission.

US: Core inflation reaches a post-recession high

The S&P 500 ended its third week in a row in positive territory, rising 0.96%, and now stands less than 1% from its all-time high. Some positive economic data helped to lift investors' mood though the picture looks a bit more mixed beneath the surface. Retail sales are holding up reasonably well, but slowed in August from their solid levels the month before, and although the University of Michigan's consumer sentiment survey ticked up in September, it remains close to its lowest level since 2016. Small business optimism receded in August and employment-related

components have weakened in particular, though initial jobless claims falling back to very low levels indicate no immediate weakness in the labour market. The ongoing tightness in the labour market and the fact that inflation accelerated further in August will make it difficult for the Fed to send a very dovish message at its meeting this week. While headline CPI inflation slowed to 1.7% YoY, core CPI has picked up to 2.4%, a post-recession high.

Japan: Various surveys convey the same message: Weak manufacturing, resilient services

The MoF Business Survey for Q3, the Eco Watchers Survey for August and the Reuters Tankan for September were all published last week. The message of each survey is clear: Corporate sentiment keeps deteriorating in the manufacturing sector, while holding up well in the non-manufacturing industries. We believe that this observation will be reconfirmed by the headline grabbing Tankan Survey for Q3 to be published on October 1. Interestingly, investment plans continue to be upbeat, with plans to increase capex by 8.3% YoY this fiscal year. While not as strong as last

year, this number confirms resilience in the investment outlook, as structural, not cyclical investment remains a strong pillar. Even the machinery orders for July were not as weak as the headline number suggests when accounting for special factors. Meanwhile, there is speculation that the Bank of Japan will expand its monetary policy further when its MPC convenes this Thursday, leading to a yen depreciation from below 105 to above 108 against the USD. We believe these expectations are overdone and we expect the BoJ to keep its policy roughly unchanged.

China: Growth continues to deteriorate, urging public stimulus to gain steam

China's activity data for August published today confirm that the slump that became evident in July continues. Industrial production growth fell to a 17-year low of only 4.4% YoY in August. The negative impact of the trade war has certainly contributed, but we believe that production cutbacks to improve the air quality before the October 1st celebrations for the 70th National Day may have started to have a negative impact as well. We expect a bounce back in Q4. Fixed asset investment growth decelerated from 5.2% to 4.3% YoY, with the slowdown of

private manufacturing investment being the main drag, while infrastructure investment held up rather well and property investment remained resilient. Frontloading of special local government bond issuance should help to underpin infrastructure investment in Q4. Retail sales growth inched lower again to 7.5% YoY, mainly impacted by a slump in auto sales of 8.1% YoY. Other segments of consumption improved. Aggregate financing surged in August, but this was mainly due to seasonal reasons. On a YoY comparison credit growth remained unchanged from July.

Bonds: Yields rise on better sentiment and a stabilisation in macro data

Bond yields spiked higher last week from stretched levels. This was part of a broader risk-on move that appears to have been triggered by better news flow on the US-China trade war, with investors turning more optimistic that a new deal could be agreed. Bond market pricing was also consistent with a significant amount of central bank stimulus. While the ECB delivered a comprehensive package, the 10bps deposit rate cut was at the lower end of market expectations. Fed pricing has also turned less dovish ahead of this week's FOMC meeting, helped by a firm

CPI inflation print. Data releases more broadly have tended to surprise on the positive side, helping to contain fears of recession. Looking forward, however, geopolitical risk remains high and will be a headwind to global growth, and the global manufacturing recession remains in place. Further upside to yields looks limited.

What to Watch

- The Fed is expected to cut its target rate by 25bps this week. Given the strong labour market and the recent acceleration of core inflation it is unlikely to send a very dovish message but it will keep its options open for further rate cuts later this year.
- This week's SNB's meeting will be closely watched given the ECB's rate cut last week. The BOE will also meet, but no action is expected.
- In Asia, the MPCs of the central banks of Japan, Taiwan, Indonesia and Pakistan will convene this week. Following the somewhat surprising cut of its policy rate by Vietnam's SBV last week, we expect the Bank Indonesia to follow with a 25 bps cut.
- We will watch August export data for Japan, Taiwan, Singapore, Indonesia and Thailand. In Australia, house price data for Q2 and labour market data for August will be released. Mid-level trade talks between the US and China will be in focus.

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