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Weekly Macro & Markets View

Highlights and View

- **The Fed cuts its target 25bps to a 1.75%-2.00% range, though there were dissenters on both sides**

  We welcome the Fed's easing, but there is still the risk that it falls behind the curve as indicated by a flatter yield slope and a tick-down in inflation expectations following the decision.

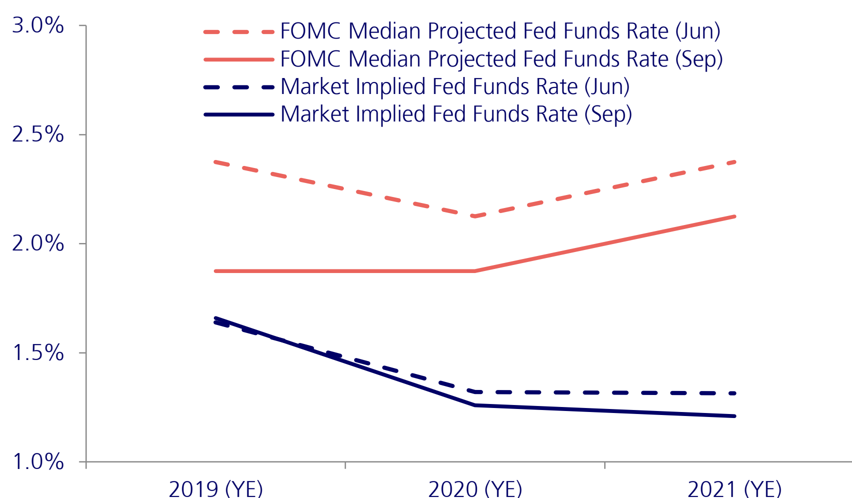
- **Volatile US repo rates resulted in Fed repo operations, but credit markets were resilient**

  Structural changes in the US financial system exacerbated the shortage of cash and need to be addressed longer term by the Fed, but US banks remain well capitalised, unlike a decade ago.

- **The Swiss National Bank leaves the policy rate unchanged at -0.75%, but creates space to cut further, if needed**

  A rate cut from here would help to stabilise the currency but the broader implications for the economy could well be negative.

The Fed cuts again but is split over the way forward



Source: Bloomberg

The S&P 500 came within a hair's breadth of a new all-time high, but failed to break through last week. As was widely expected, the Fed cut its target rate by another 25bps to a range of 1.75-2.00%, acknowledging weakening momentum and risks from a deteriorating trade environment. As in July, the decision was not unanimous, although this time in addition to the two dissenting votes on the hawkish side there was one voter who would have preferred a deeper cut. Looking beyond the median dots reveals that the FOMC is severely split over the way forward. While only two voters see rates staying at the current level until the end of next year, eight members expect further rate cuts but seven members see rates moving higher again next year. We welcome the Fed's moving ahead with further easing, particularly as it allows other central banks to follow its path. Nevertheless, given the slowdown in economic momentum, the Fed risks falling behind the curve, which is also reflected in a flatter Treasury yield curve and a tick-down in inflation expectations following the Fed's decision. On a more positive note, housing data revealed a solid rebound in August with building permits, housing starts and existing home sales picking up. Rising home builder confidence in September indicates that the housing market environment may have further improved this month.

Credit: Calm amid the turmoil in oil prices and repo rates

Credit markets were relatively calm last week, despite the spike in oil prices and the surge in US repo rates. Inflows into credit remained strong, while supply was robust, with the US market on track to set a monthly record. While the Fed rate cut had little impact on credit, the volatility in repo rates was talked about extensively. Repo rates briefly shot up to 10% last week and continued to remain volatile as tax payments and Treasury bond settlements caused a shortage of cash in the financial system. The Fed reacted aggressively by conducting several daily repo operations, which will now occur every day until October 10, in addition to three 14-day term repo operations. Although tax payments may have been a trigger, there are some structural problems that the Fed should fix in the long term. A decline in bank reserves, constraints from post-crisis regulatory frameworks, and the unwinding of quantitative easing and fiscal deficits may warrant revisiting the liquidity needs of the system. Encouragingly, however, unlike a decade ago, US banks remain well capitalised in the eyes of investors.

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Eurozone: German government announces Green spending plan, but more needed

The German government has agreed on a Green spending plan of around EUR 50bn spread over four years. Various measures will be introduced to shift households and companies towards less environmentally impactful activities (e.g. subsidies and taxes to favour train travel over plane travel). One million charging stations for electric vehicles are to be installed by 2030 and a carbon-dioxide emissions pricing charge introduced for traffic and buildings. Overall, the extra spending could represent fiscal boost to growth of a few tenths of a percentage point each year to German GDP, which is non-negligible. However, at the Eurozone level this would amount only to around a one tenth of a percentage point boost to GDP per year, not changing the overall macro outlook dramatically. The ZEW investor expectations indicator for Germany rebounded in September from a multi-year low in August; perhaps just a short-term reversal from overly negative sentiment. Indeed, this morning's flash PMI data point to a further slowdown in growth in the Eurozone, with Germany likely already in recession.

Switzerland: The SNB opens up for further rate cuts

The SNB left the policy rate unchanged last week. This was in line with our expectation but contrary to consensus expectations that the SNB would follow the ECB with a rate cut. However, the SNB prepared the ground to reduce rates further if needed, with a very dovish policy statement and adjustments to the basis for how negative interest on sight deposits at the SNB is calculated. The inflation forecast was slashed and inflation is now projected to only reach 0.6% in 2021 compared to 1.1% before. The forecast is, however, conditional on the policy rate remaining at -0.75%, so this sent a strong signal that the SNB may cut rates further. The exemption threshold for the tiering system for excess reserves was also raised – from 20 to 25 times minimum reserves – which effectively reduces the lower bound on the policy rate. This was a pragmatic move by the SNB that allowed it to postpone a further rate cut, which is damaging to the economy, but create space to follow the ECB if pressure on the franc and the economy intensify.

Asia: Monetary and fiscal policy in focus

Bank Indonesia cut its policy rate by 25bps to 5.25%, the third cut in a row. It also eased the loan-to-value ratio by 5bps for property and by 5-10bps for motor vehicle loans, aiming to encourage credit growth. This move sends a clear signal that supporting growth is currently BI's priority. We expect a further cut to be delivered in the next quarter amid external headwinds. The Bank of Japan left monetary policy unchanged, as we had expected, but will re-examine economic and price developments in its October 31 MPC meeting. Taiwan's CBC kept its policy rate at 1.375% as there are signs of an improvement in economic activity. China's PBoC cut its new benchmark rate, the Loan Prime Rate (LPR) by 5bps to 4.2%, while keeping its 5yr LPR unchanged at 4.85%. India announced large corporate tax cuts from 30% to 22%, with the effective tax rate falling by nearly ten percentage points to 25.2%, in an effort to lift corporate profitability and boost business sentiment. Following the announcement, the Sensex and Nifty equity indices rallied nearly 10% while the bond yield rose by 15bps amid concerns over the budget deficit.

Australia: Will there be a housing boom?

After two years of a 10% peak-to-trough price fall, Australia housing market is finally seeing some positive movement. August prices edged up by 1% MoM, led by Sydney and Melbourne. The September auction clearing rate was above 75%, compared to a June low of 52%. The ratio of sales to new listings improved from about 0.8 to 1.0 in recent months. With the RBA's rate cuts and easing of lending conditions, July housing credit increased by 4.2% MoM. These measures are good guides as to the robustness of demand. Nevertheless, the supply side does not show the same level of excitement. July building approvals collapsed by 28.5% YoY, while construction work was down by 3.8% MoM. Indeed, supply falling short of demand will support prices further, but there are reasons not to get carried away. Although falling prices have made it more affordable for home buyers, properties remain expensive while household debt is already at a record high. As the unemployment rate and wage growth remain subdued, we do not see a forthcoming significant impulse from the demand side for another boom.

What to Watch

- The G3 flash manufacturing PMIs are expected to show continued weakness in the global economy.
- The central banks of Thailand and the Philippines will convene next week. We do not expect further cuts but dovish rhetoric is expected to remain. We see weakness persisting in Singapore's August industrial production, while Thailand's production will probably have weakened a bit less than in July. In Japan, Tokyo's CPI statistics are likely to reflect weaker price pressures in September.
- Various Eurozone business confidence data are likely to confirm the Eurozone economy is slowing, putting pressure on governments to spend more.

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