

Weekly Macro & Markets View

Highlights and View

- **PM Kishida's ruling LDP achieved an absolute stable majority in Japan's Lower House elections**

The government will now be able to focus on formulating the FY2021 supplementary budget, the FY2022 initial budget plan and new climate initiatives.

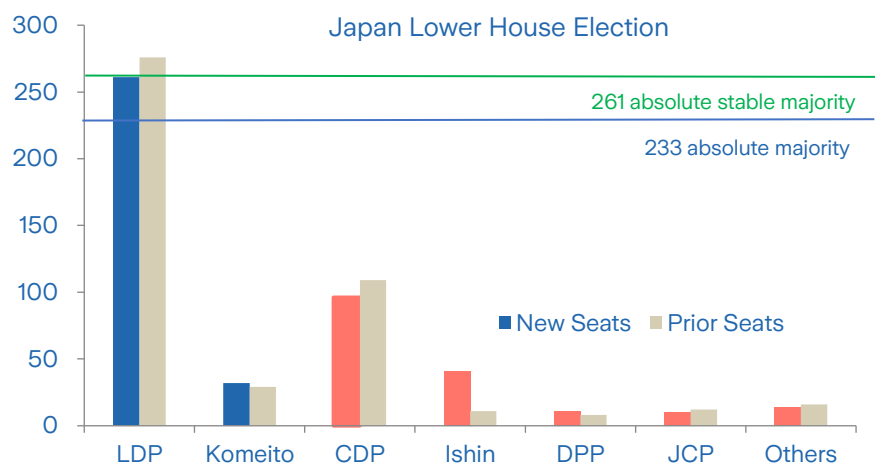
- **The ECB confirms PEPP will end in March and attempts to push back on rate hike expectations**

The ECB's communication challenge is being made more difficult by surging inflation, but we do not share the market's view that the ECB will raise rates in 2022.

- **Rates surge as the outlook for developed market central bank actions is reassessed**

A hawkish shift among central banks is justified given strong growth and inflation, but the degree of tightening that is now priced in appears rather steep in many regions.

Investors applaud Japan's Lower House election results



Source: NHK

Japan's ruling LDP/Komeito coalition (blue bars in chart) lost 13 seats in Sunday's Lower House election but fared far better than expected. The LDP alone was not only able to secure an absolute majority, but even a so called 'absolute stable majority', which allows it to chair and hold a majority in all Lower House standing committees. The election result strengthens PM Kishida's standing, which had recently been challenged by political observers. Investors applauded the outcome, with the Topix index rallying by 2.2%, while 214 stocks in the Nikkei 225 index rose versus just 11 stocks falling. LDP general secretary Akira Amira, the driving force within the LDP, lost his single constituency and offered his resignation. PM Kishida will now attend the COP26 climate talks in Glasgow, then form his new cabinet, which is likely to see few changes, and thereafter focus on the FY2021 supplementary budget, which is expected to be huge. However, we need to wait for the 'clear water' (真水) impact, which tends to be far smaller than the headline number suggests. Economic indicators released last week for September and October suggest that the economy is continuing to struggle in the aftermath of the latest Delta infection wave and severe supply chain disruptions, which particularly hit the auto sector, with output falling nearly 41% YoY in September. However, leading indicators and corporate surveys suggest that the recovery is now in full swing.

US: GDP growth slows down markedly in Q3

The S&P 500 index ended its best month so far this year on a positive note, enjoying a gain of 6.9% in October. With slightly more than half of the S&P 500 index companies having reported so far, the average earnings surprise stands at 9.7%. Although this is the weakest quarter since Q1 2020 in terms of positive surprises the reports help to support the stock market, particularly given the cautious mood of investors ahead of the earnings season. Economic data have further helped to lift sentiment. The Conference Board's survey shows that consumer

confidence rose in October driven both by current perception and expectations. Meanwhile, the first estimate for Q3 GDP data confirm the marked slowdown in the pace of the expansion with the annualised growth rate falling to 2% from 6.7% in Q2. Though peak growth is behind us we still expect solid growth in the quarters ahead helped by healthy consumer spending. Finally, the PCE Core inflation measure stood at 3.6% YoY in September, the same as the month before.

Eurozone: The ECB pushes back on rate hike speculation as inflation surges

At the ECB's regular monetary policy meeting President Christine Lagarde confirmed that PEPP would end in March. Lagarde also attempted to push back on market expectations that the ECB might raise rates in 2022, saying 'our analysis does not support that the conditions of our forward guidance are satisfied, neither at the time expected by markets of lift-off or any time thereafter soon.' However, the strength of this statement was weakened when Lagarde later said that it was not for her to say if markets 'were ahead of themselves'. The ECB's

communication challenge is being made more difficult by surging inflation. Eurozone headline inflation rose to 4.1% in October from 3.4% in September, mainly because of record energy inflation. Headline inflation should moderate in 2022 as various base effects diminish, and we still do not expect the ECB to raise rates any time soon. Finally, Eurozone GDP grew 2.2% QoQ in Q3, around the same pace as in Q2. Growth will moderate in Q4, as the rebound from Covid diminishes in intensity, but the recovery remains intact.

China: PMIs continue to disappoint

China's Manufacturing PMI surveys for October once again revealed a mixed picture. While the official NBS PMI fell further below the 50 mark to 49.2, the weakest reading in 2½ years apart from the Covid shock last year, the Caixin PMI rose to 50.6, a four-month high, amid stronger new domestic orders. Apart from different survey dates in October, the Caixin PMI is more tilted towards export-oriented SMEs, while the NBS version focuses more on SOEs. However, digging a bit deeper, and looking at sub-components like delivery times and stock of purchases, reveals that

manufacturing firms are still struggling. As for the Non-manufacturing PMIs, we have to wait until Wednesday to see the Caixin version, but the NBS version clearly shows that both the Services and Construction PMIs faltered. The latter fell to an eight-month low, reflecting weaker property investments in the aftermath of the Evergrande collapse, while the former is suffering from lockdown measures following another Delta virus outbreak across 13 provinces. Despite some targeted stimulus, we expect economic activity to remain patchy into early next year.

Australia: 3yr bond yields rise sharply, challenging the RBA's rate target

Headline CPI was largely in line with consensus expectations in Q3. However, trimmed mean CPI increased to 2.1% YoY and crossed above the lower band of the RBA's target for the first time since 2015. Inflation was mostly related to a surge in energy prices and higher demand for goods during lockdowns. We expect buoyant domestic demand amid the reopening is likely to keep inflation afloat, but a shift towards more services consumption will help ease pressure on goods inflation. The latest CPIs have stirred the rate market, with 3yr bond

yields rising sharply to above 1%, challenging the RBA's 0.1% yield target under its yield curve control (YCC). What worried investors was the RBA's lack of rate defence, raising concerns about a sudden hawkish shift in November leading to the immediate removal of YCC. While inflation is higher than we initially expected, the latest CPI prints did not alarm us to the extent that we now anticipate a complete U-turn in the RBA's forward guidance. This week's RBA MPC meeting will reveal the central bank's thoughts behind its lack of action in the rate markets.

Bonds: Rates market tantrum

Last week saw remarkable volatility in rates markets as hawkish central banks triggered a sharp repricing of the near-term policy outlook. The tantrum was initially triggered by the Bank of Canada, which surprised markets by ending QE and projecting a steeper path for the policy rate. This was followed by the RBA, which did not step in to defend its yield curve control target for the 3yr bond yield. The ECB maintained a dovish tone but did not push back strongly against the repricing of the rates outlook. This led to a surge in yields at the front end, with outsized moves for

Australia and Canada. The longer end of the yield curve was relatively stable, helped by declining inflation expectations and resulting in flatter curves. While the direction for rates is up given a more mature economic cycle and inflationary pressures, a rather steep path is now priced in many regions. Risk assets have so far been relatively immune to these moves, helped by a positive earnings backdrop, but this week's central bank decisions will be critical to assessing the path going forward.

What to Watch

- In the US, the Fed is expected to announce the tapering of its asset purchases while the ISM surveys and the latest batch of labour market data will give insights into the current state of the economy.
- In the Eurozone, the final PMIs and German factory orders and industrial production will be the main data to watch.
- In APAC, our focus will be on Australia's RBA MPC meeting, while Malaysia's BNM is likely to keep policy rates unchanged. Indonesia's GDP Q3 should reveal economic damages caused by lockdowns due to the Delta outbreak. Hong Kong will release Q3 GDP and September retail sales data, while export data will be published in China and the Philippines. Japan will release the September Household Survey. Various countries will publish October Manufacturing PMIs and CPI data. In Australia, we will watch Q3 house price data, October retail sales and the September trade balance. Markets will be closed on Wednesday in Japan due to Culture Day and on Thursday in India and Singapore due to Diwali/Deepavali.

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