

# Weekly Macro & Markets View

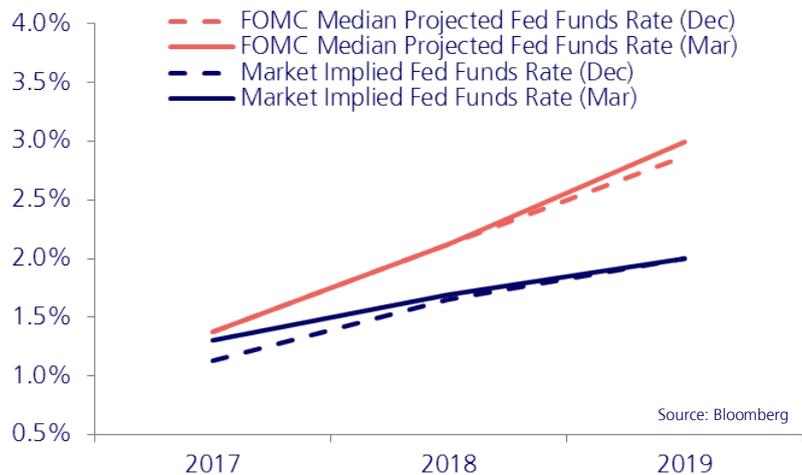
## Highlights

- The BoJ stood pat and reaffirmed its commitment to yield curve control
- The House of Commons votes down the Brexit bill amendments included by the House of Lords
- The Swiss National Bank leaves policy unchanged, stating that it will remain active in forex markets

## Our view

- The BoJ is likely to remain on hold, its policy diverging with the policy and tone of the other G3 central banks
- Having cleared all obstacles, Theresa May is expected to trigger Art. 50 before the end of March
- This is not the right time for the SNB to abandon its policy, given high political risk in Europe

## The Fed hikes, but does not alter its rate trajectory



As was widely expected, the Fed increased its target rate by 0.25% for the second time in three months to a range of 0.75% to 1.0%, acknowledging the continued improvement in economic activity. The FOMC feels comfortable with inflation developments and has slightly increased its expectation for the level of Core PCE inflation this year to 1.9% from 1.8%. Interestingly, the statement included a new reference to a symmetric inflation goal. This could be interpreted as a willingness to tolerate the inflation rate overshooting its target for a certain time. All in all, the statement and the basically unchanged rate trajectory were more dovish than market participants had expected. Accordingly, Treasury yields fell significantly after the announcement.

With the Fed taking the opportunity to hike in March, the probability of having three rate hikes this year has obviously increased. Nevertheless, this is not yet set in stone as the Fed wants to see a sustainable return to 2% inflation. Considering this, the University of Michigan's inflation expectations falling to the lowest on record in March will certainly not help to reassure the more dovish Fed members. Meanwhile, economic data remain firm with the small business optimism index sticking close to its post-recession high and the NAHB Home Builder Index reaching the highest level since 2005. CPI headline inflation has accelerated to 2.7% YoY, but is expected to fall again as the energy base effect is fading.

## Currencies: Collapsing FX volatility rejuvenates carry trades

The USD suffered its worst weekly decline since July of last year and is on the way to its biggest quarterly decline since 2009. Amid heavy technical resistance, long positions have been curtailed since the beginning of the year and, despite all the talks, we now have 80% of currencies appreciating against the greenback YTD. With the Fed being gracefully late in hiking rates and the rest of the world seemingly reflating, carry trades are back in vogue with the more risky high-yielding currencies performing very well last week. Worth noticing is the collapse of FX implied

volatility, which reached its lowest level since November 2014. Emerging market currencies broke out and reached their best level since May 2015. With global growth on an upswing and US real rates contained, carry trades seem likely to be refilled.

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## Eurozone: Dutch election result reduces investor fears over spread of populism

The Dutch parliamentary elections saw the ruling People's Party for Freedom and Democracy (VVD) retain its status as the largest single party. The far-right Party for Freedom (PVV), led by Geert Wilders, is now the second-largest group in parliament, but it received less votes than polls were suggesting just a few months ago. The results of the Dutch elections allayed investor fears of a spread of populism across Europe, and Eurozone government bonds spreads narrowed on the result. However, we would caution against implying that the outcome in

anyway mitigates political risks in other countries.

In terms of economic data, Eurozone industrial production rose by 0.9% MoM in January, partly reversing the 1.2% drop the previous month. However, the hard data, such as industrial production and retail sales, have not improved in recent months as much as the buoyancy of business surveys like the PMIs suggest they should have.

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## China: Delivering on "more neutral" policy, as economy recovers

Soon after signalling a "more neutral" monetary policy at the NPC, and hours after the Fed's rate hike, the PBoC raised its open market operations and mid-term lending facilities rates by 10bps. This led to a spike in the 7-day interbank rate. The move helped to pare potential pressure on the USDCNY and to tighten funding costs for non-bank financial players, which have been excessively engaged in shadow banking operations. Banks, as net lenders on the interbank market, should benefit from the hike, as confirmed by the jump in the bank-heavy HSCEI 'H'-share index. On the economic

front, the recovery continues, fuelled by public and private investment in infrastructure and property, which is positive for base metals. Mobile phone production ticked down, though, which might signal slower tech momentum. We would not read too much into the softer retail sales print, which likely reflects lower tax incentives for car purchases. In contrast, we are focussing on improving consumer confidence and labour market conditions. Finally, we are encouraged by a more conciliatory tone between the US and China.

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## Latin America: Central banks remain accommodative

The Chilean central bank cut its reference rate for the second time this year by 25bps to the 3% mark and kept a dovish bias. The cut is in line with expectations and confirms the regional theme of monetary easing in 2017. Lacklustre economic data, which will also suffer a temporary drag from the strike at the BHP Escondida mine, combined with a receding inflation rate allowed the monetary authority to ease again.

The Peruvian central bank is the only one left to join the easing movement, and it has

started to send dovish signals amid a strong and punishing El Nino as well as political bribery scandals that are taking their toll on confidence. Monetary policy is likely to turn accommodative via lower reserve requirements on bank deposits and then an eventual policy rate cut.

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## Credit: US high yield suffers significant outflows

US credit markets have been underperforming recently, driven by weakness in the oil price, although short dated paper also sold off ahead of the Fed rate hike. US high yield funds suffered significant outflows in March. Notably, spreads in the energy sector seemed to have transitioned from being very cheap in late 2015, to levels that now don't seem to discount the risk of any significant oil price decline. Furthermore, the ratio of High Yield spreads to those of Investment Grade is also quite low by historical standards. Even in

Investment Grade credit, newly issued bonds have not been rallying as much in the secondary markets as they used to, despite the search for yield and substantial new issue oversubscription. All of this said, some stability has tentatively returned and it may be too soon to extrapolate the recent weakness, as some market participants are doing.

## What to Watch

- Reaction to the first French presidential election TV debate will be important to watch. Data-wise, the Eurozone flash PMIs will give an early indication of the state of economic activity at the end of the quarter.
- We will watch Japanese PMI and trade data to assess whether the recovery in manufacturing and exports continues.
- US Markit PMI will also be released.

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