Global Capital Markets & Thematic Research

FridayMail

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"QE – QT – Quo vadis, Fed?

After the sell-off at the end of the past week, both European stock markets and the Wall Street experienced a recovery towards the middle of this week. The **"emerging markets / commodities / disinflation" trio** continues to be one of the main influences on the markets(*see our* *Capital Markets Monthly*). New economic data from **China**, announcements of economic policy measures and stock market interventions worth roughly RMB 1.5 trn (about EUR 210 bn) are keeping the international markets on their toes:

- Disappointing Chinese import data for August were interpreted as a sign of a domestic slowdown and weighed not only on the Shanghai stock exchange at the beginning of the week.
- One trigger for the subsequent upswing was that the Chinese ministry of finance announced additional fiscal impulses, such as infrastructure investments and tax relief for small and medium-sized enterprises.

> ***"US bond yields and the US dollar will be particularly sensitive to Fed rate policy speculations in the next few days."***

Declining **commodity prices** suggest that inflation rates in the industrial countries will remain low in the coming months. While the **Bank of England** took a wait-and-see stance at its meeting on Thursday, attention is focusing on another issue: **Will the Fed lift off or not?**

Right up until now, the Federal Open Market Committee (FOMC) is split about a rate hike on **17 September** (next Thursday), which will just be the first step in a slow and gradual monetary normalisation procedure. The Federal Reserve's (Fed's) **dual mandate** traditionally puts the US central bank in a position where it has to decide between preserving price stability and supporting employment.

- **Inflation** is not forcing the Fed to take action. Headline inflation came in at only 0.2% yoy in August, driven by lower commodity prices and the strong US dollar, which makes imports cheaper. The July **PCE** price index, excluding food and energy, which is regarded as the Fed's main inflation indicator, slowed from 1.3% to 1.2% yoy.
- In contrast, the steady improvement on the **labour market** and the continued economic upswing are arguments in favour of

Publications


"At present, the trio 'emerging markets/commodities/disinflation' appears to be thwarting some of the ECB's achievements since the launch of its QE programme. But even if the market impact of QE seems to be fading, the ECB will likely retain a 'policy of the steady hand'."

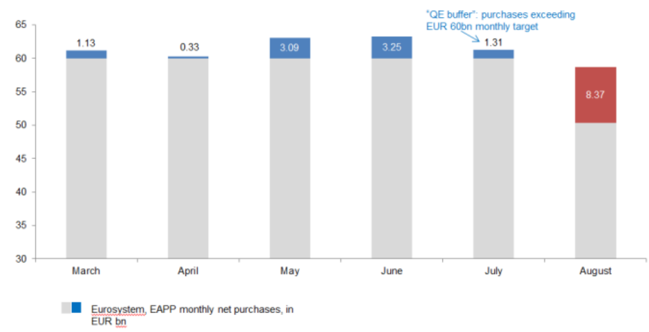
"QE Monitor"

A new government bond buyer has entered the stage in March 2015, in the shape of the ECB. At present, the nexus "emerging markets / commodities / disinflation" appears to be thwarting some of the ECB's achievements since the launch of its QE programme. Are Eurozone deflation fears again "ante portas"?

"Under the Macroscope: Protecting against inflation in a deflationary world"

Eventual rising price levels will force individual and institutional investors to reconsider how best to hedge inflation risk. Read more in Steve Malin's latest white paper.

Chart of the Week: ECB is unwinding its "QE buffer": Monthly net purchases, in EUR bn



Sources: ECB, AllianzGI Global Capital Markets & Thematic Research, as of September 7th, 2015.

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the first rate hike since June 2006. The unemployment rate amounted to 5.1% in August – a sign that the US economy is heading **towards full employment**. In addition, the Labor Market Conditions Index (LMCI), which is calculated by the Fed on the basis of 19 individual labour market indicators, rose again in August (+2.1 points). This suggests that **domestic price pressures will rise**.

Investors will closely watch several indicators in the run-up to the FOMC meeting, for example industrial output, capacity utilisation, the Empire State Manufacturing Index and retail sales (all on Tuesday). **US bond yields** and the **USD exchange rate** will be particularly sensitive to Fed rate policy speculations in the next few days.

Meanwhile, "**quantitative tightening**" (QT) has become a new buzzword in discussions about the question whether the global decline in central banks' **foreign exchange (FX) reserves** will reduce the Fed's ability to tighten the monetary reins. Central banks in the emerging markets have recently used their FX reserves in order to offset capital outflows and/or support their domestic currencies. For this purpose, the central banks sell their US Treasuries inter alia. Some analysts argue that lower central bank reserves will therefore tend to result in higher US Treasury returns – **without any action by the Fed**!

Market discussions in the **euro area** have shifted from a tapering of the ECB's **quantitative easing** (QE) measures towards a potential extension of the asset purchase programme. Quite the opposite, the QE purchases were **significantly below the monthly target** of EUR 60bn in August, a month in which trading is slower. Thus, the Eurosystem almost completely used up its **"QE buffer"** worth EUR 9.1 bn (see our *Chart of the Week*). However, the ECB is still on target across the six months of the programme. Moreover, at the most recent meeting, ECB President Mario Draghi raised the **issue limit** and thus underlined the ECB's willingness to adjust QE while keeping a steady hand on the tiller (*see also our latest QE Monitor*).

With inflation in Japan slowing, there has been some speculation about the **Bank of Japan** (meeting on Tuesday) expanding its QE programme again. The current programme has been in place since 2013. Inflation in Japan is still just above zero and thus considerably below the target of 2%. Credit growth in Japan is slow to pick up, commodity prices are declining and the yen has recently appreciated. That means that there is neither domestic nor external price pressure.

The **Greek elections on Sunday** will attract considerable attention at the end of the week. Alexis Tsipras is hoping to improve his position after only eight months in office. **Political stability** is a precondition for a success of Greece's ambitious reform programme. However, recent surveys suggest that Tsipras' Syriza party has only a small lead over Nea Dimokratia. In this case, a new coalition, possibly consisting of several parties, is the most likely outcome.

The upcoming **regional elections in Catalonia on 27 September** are another source of uncertainty. The spread between ten-year Spanish and Italian government bonds has recently reached its highest level since mid-2013.

Volatility is therefore likely to remain elevated, even if the bulls are gaining ground on both sides of the pond.

Ann-Katrin Petersen
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Wishing you a clear view, no matter where the Fed is heading,

Ann-Katrin Petersen

Ann-Katrin Petersen

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Upcoming political Events 2015

September:

11./12. Sep	Eurogroup and ECOFIN Meetings in Milan
14. Sep	EU Special Summit on Refugee Crisis
16.-17. Sep	FOMC Meeting
20. Sep	Snap Elections in Greece

→ Overview political events 2015

Further Publications:

Project M: "Monetary policy: off to new shores"

Stefan Scheurer on what the renminbi devaluation means for institutional investors and the global economy.

Calendar Week 38:

Monday

- Eurozone:
  - Industrial Production (Jul) (prior: -0.4% m/m)
  - ECB, weekly change of Eurosystem holdings under the expanded asset purchase programme (PSSP, CBPP3, ABSSP)
- Italy:
  - Harmonized CPI (Aug final) (+0.5% y/y)
- China:
  - Industrial Production (Aug) expt : +6.3% y/y (+6.0% y/y)
  - Money Supply M2 (Aug) +13.3% y/y (+13.3% y/y)
  - Retail Sales (Aug) +10.6% y/y (+10.5% y/y)

Payment Redemptions: Italy (9.08bn EUR)

Tuesday

- Germany:
  - ZEW Expectations (Sep) (25.0)
- Eurozone:
  - Trade Balance (Jul) (21.9bn EUR)
  - Employment (2Q) (+0.8% y/y)
  - Chief of ECB banking supervision Nouy gives speech at Financial Market Authority Conference in Vienna
- France:
  - Harmonized CPI (Aug) (+0.2% y/y)
- UK:
  - CPI core (Aug) (+1.2% y/y)
- US:
  - Empire Manufacturing (Sep) 0.0 (-14.92)
  - Industrial Production (Aug) -0.2% m/m (+0.6% m/m)
  - Capacity Utilization (Aug) 77.7% (78.0%)
  - Business Inventories (Jul) +0.2% m/m (+0.8% m/m)
- Japan:
  - Results from monetary policy meeting

Wednesday

- Eurozone:
  - ECB Council, non-monetary Policy Meeting
  - CPI (Aug final) (+0.2% y/y)
  - CPI core (Aug final) (+1.0% y/y)
- US:
  - MBA Mortgage Applications (CW 37)
  - CPI (Aug) (+0.2% y/y)
  - Real Avg. weekly earnings (Aug) (+2.0% y/y)
- UK:
  - ILO Unemployment Rate (Jul) (5.6%)

Payment redemptions: Spain (7.2bn EUR)

Thursday

- Eurozone:
  - ECB General Council Meeting
  - ECB Economic report
- US:
  - Current Account Balance (2Q) -109.7bn USD (-113.3bn USD)
  - Housing Starts (Aug) -4.6% m/m (+0.2% m/m)
  - Building Permits (Aug) +0.0% (-15.5% m/m)
  - Initial Jobless Claims (CW37)
  - Continuing Claims (CW36)
  - Philadelphia Fed Business Outlook (Sep) 5.0 (8.3)
  - Fed, Results from FOMC Meeting incl. Economic Projections, Press Conference with Fed Chair Janet Yellen in Washington
- Italy:
  - Trade Balance (Jul) (2809mn EUR)
- Switzerland:
  - SNB, Results from monetary policy meeting
- Japan:
  - Trade Balance (Aug) (-268.4bn JPY)

Friday

- Eurozone:
  - Current Account (Jul) (25.4bn EUR)
  - Moody´s results from rating review of France and UK
  - S&P´s results from rating review of Portugal
- Germany:
  - Eurex large expiry ("Hexensabbat")
- Italy:
  - Current Account Balance (Jul) (3528mn EUR)
- Japan:
  - Protocol of monetary policy meeting

Payment Redemptions: Portugal (1.4bn EUR), Spain (7.4bn EUR), Greece (1.6bn EUR)