WEEKLY UPDATE

Budget rules review may be controversial but will be decisive for the euro zone

An essential review of the Stability and Growth Pact. The so-called Maastricht rules sought to restrict the debt European states could run up, a key structural issue for countries embarking on monetary union. They capped government debt and public sector deficits at 60% and 3% of GDP, respectively. These lines, often seen as pulled out of a hat, proved hard to hold in the wake of the 2008 financial crisis and were a key factor in the euro zone debt crisis that followed. The reaction to the Covid crisis was markedly different. European states quickly agreed to dump the rules and inject massive coordinated aid to their economies. Now, with the health crisis fading, a measure of fiscal discipline looks essential again, but under a revised framework that avoids past problems. The European Commission has launched a public consultation on what these rules should be and hopes to have the new framework in place by 2023.

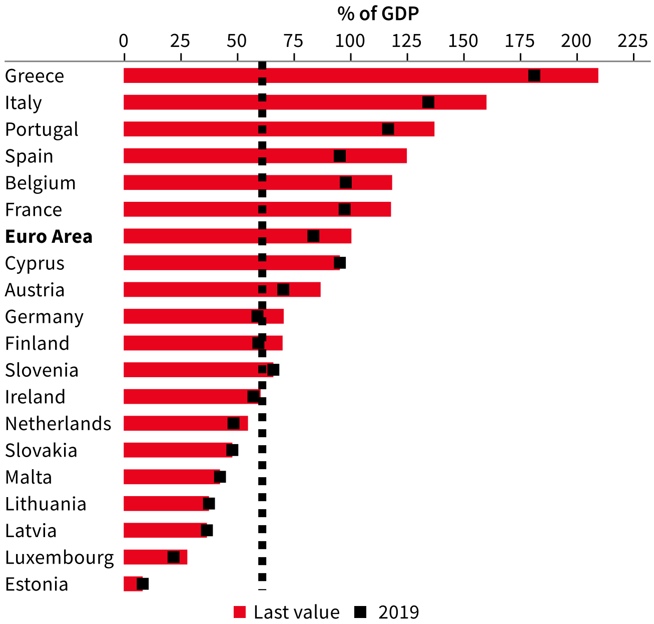
Country-specific debt targets and free passes for some investments? The consultation document includes a broad spectrum of proposals at this stage. Reforms likely to make it through include tailoring sovereign debt targets to each country, taking account of the existing scale and viability of their debt, and backing this up with budget surveillance, at least for countries with debt running above 60% of GDP. The Commission is also considering not counting some types of public investment (e.g. green investment) toward the budget target, a proposal that has perked interest across the EU.

The debate will be lively but decisive for euro zone stability. One group of countries has already registered its objection to any rule review and wants a straight return to the 60%/3% ceilings by 2023. This could mean a fiscal clampdown that would be bad for the euro zone economy and potentially counter-productive in reducing state debt; if debt fell slower than GDP the ratio would deteriorate. That said, letting public debt keep growing on its current path is clearly unsustainable and would quickly imperil financial stability once again. Shifting political balances, with a new coalition in Germany, and looming elections in Italy and France, will be crucial to how the review pans out. The new coalition has yet to pronounce on the European framework but when it comes to Germany looks to be moderate at best, arguing for holding budget discipline and limited public investment.

Bottom line. Since the euro zone sovereign debt crisis, the ECB's asset purchase and refinancing programmes have damped down the yield gaps between zone countries and hence how much states have to pay for their finance. The debate about new budget rules will be decisive for the future of this policy and the future credibility of the single currency.

Nonhomogeneous debt to GDP ratio in Eurozone

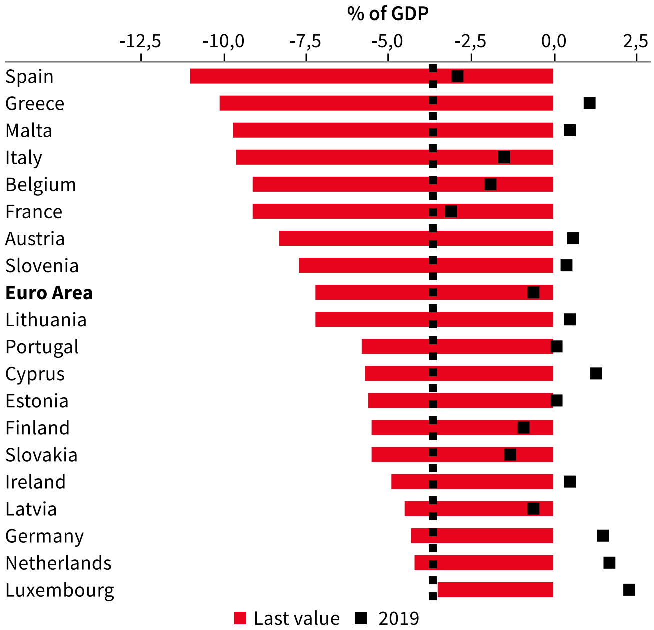
Government debt to GDP ratio



Sources : SGPB, Macrobond, BIS, IMF, Q1 2021

Deficits have surged due to Covid crisis

Public sector deficits to GDP ratio



Sources : SGPB, Macrobond, BIS, IMF, 2020

OUR MACRO COMMENTS

Events of the week

Jens Weidmann, one of the most conservative members of the ECB's Governing Council, will step down as President of the Bundesbank on December 31. This resignation sounds like an admission of failure for this leader of the "hawks" who advocate monetary orthodoxy, in the face of the "doves" who are considered laxer within the ECB.

Chinese real estate giant Evergrande avoids default in extremis by paying $80 million in interest, one day before the deadline.

Figures of the week

		Actual		Forecast	Previous
US	Composite PMI (October)	57.3	↑	54.7	55
US	Philadelphia Fed Manufacturing Survey (October)	23.8	↓	25	30.7
Eurozone	Consumer confidence (October)	-4.8	↑	-5	-4
Eurozone	Composite PMI (October)	54.3	↓	55.2	56.2
UK	Inflation (YoY, September)	3.1%	↓	3.2%	3.2%
UK	Composite PMI (October)	56.8	↑	54	54.9
China	GDP (YoY, Q3)	4.9%	↓	5.2%	7.9%
China	Retail sales (YoY, September)	4.4%	↑	3.3%	2.5%
Japan	Inflation (YoY, September)	0.2%	↑	-0.3%	-0.4%

The week ahead

Monday	Tuesday	Wednesday	Thursday	Friday
IFO – Business climate (Germany)	Consumer confidence (US)	GfK consumer confidence (Germany)	ECB interest rate decision (Eurozone)	Core inflation (PCE) (US)
Chicago Fed national activity index (US)	ECB bank lending survey (Eurozone)	Durable goods orders (US)	Inflation (Germany)	GDP (Germany)
			GDP annualized (US)	GDP (Eurozone)

Sources: Refinitiv Eikon, 22 October 2021.
Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Managers' Index, CPI = Consumer Price Inflation.

MARKET PERFORMANCE

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0.49 %	0 bp	→	-1 bp	1 bp	-2 bp
3mth Euribor (EUR)	-0.55 %	0 bp	→	0 bp	0 bp	-4 bp
3mth Libor (USD)	0.12 %	0 bp	→	-1 bp	-11 bp	-9 bp
3mth Libor (GBP)	0.21 %	8 bp	↑	14 bp	19 bp	17 bp
10-year US Treasury bond	1.68 %	16 bp	↑	39 bp	76 bp	86 bp
10-year German bond	-0.10 %	9 bp	↑	30 bp	48 bp	49 bp
10-year French bond	0.24 %	10 bp	↑	28 bp	58 bp	55 bp
10-year UK bond	1.20 %	16 bp	↑	60 bp	101 bp	96 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	-0.4%	↓	-1.3 %	-1.0 %	0.1 %
BAML EURO Corp HY	-0.1%	→	-0.1 %	3.0 %	7.3 %
BAML GBP Corp IG	-1.1%	↓	-3.4 %	-4.9 %	-1.7 %
BAML US IG	-0.9%	↓	-1.5 %	-1.8 %	1.0 %
BAML US HY	0.1%	→	0.7 %	4.5 %	9.7 %
BAML Global EM Sov. External Plus	-0.3%	↓	-2.2 %	-3.5 %	2.2 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.16	0.2 %	↑	-1.4 %	-4.8 %	-2.0%
EUR/CHF	1.07	-0.3 %	↓	-1.4 %	-1.3 %	-0.6%
GBP/USD	1.38	0.9 %	↑	0.6 %	0.9 %	4.9%
USD/JPY	114.0	0.3 %	↑	3.3 %	10.4 %	9.0%
USD/BRL	5.66	2.6 %	↑	9.1 %	8.9 %	0.9%
USD/CNY	6.39	-0.7 %	↓	-1.2 %	-2.0 %	-3.9%
USD/RUB	71.2	-0.4 %	↓	-3.7 %	-3.8 %	-7.2%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	-0.7 %	↓	-1.8 %	-2.4 %	-2.3 %
United Kingdom (3-7yr)	-0.7 %	↓	-2.1 %	-3.3 %	-3.2 %
Germany (3-7yr)	-0.5 %	↓	-1.4 %	-1.8 %	-2.2 %
Japan (3-7yr)	0.0 %	→	-0.3 %	-0.2 %	-0.2 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	742	2.2 %	↑	3.7 %	16.7 %	30.6 %
Eurostoxx 50	4 156	0.2 %	↑	3.6 %	19.8 %	33.9 %
DAX	15 473	0.1 %	→	0.3 %	12.8 %	23.2 %
CAC 40	6 686	0.0 %	→	3.7 %	23.1 %	41.0 %
S&P 500	4 550	2.5 %	↑	4.8 %	22.5 %	34.4 %
FTSE 100	7 190	-0.2 %	↓	4.0 %	14.8 %	29.1 %
SMI	12 039	1.2 %	↑	0.3 %	15.7 %	24.2 %
Topix	2 001	0.7 %	↑	5.9 %	13.0 %	24.8 %
IBOV Brazil	107 735	-4.8 %	↓	-14.5 %	-9.5 %	7.1 %
MICEX Russia *	4 219	-1.0 %	↓	13.3 %	28.3 %	51.4 %
MSCI EM	1 293	2.1 %	↑	-0.8 %	2.2 %	16.3 %
SENSEX 30 India	60 924	-0.6 %	↓	16.9 %	28.7 %	51.2 %
Hang Seng (H-K)	26 018	4.2 %	↑	-3.8 %	-2.1 %	7.9 %
Shanghaï Composite	3 595	1.0 %	↑	0.9 %	3.5 %	8.1 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$84.7	0.7 %	↑	17.1 %	63.3 %	102.7 %
Gold	$1 781	-0.9 %	↓	-1.2 %	-6.2 %	-7.4 %
Copper	$10 079	-0.5 %	↓	8.2 %	30.1 %	44.4 %

Source: DataStream, on 21 October 2021.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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