

Weekly Update

CO | EXTERNAL PUBLICATION

Mid-term report card



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All data retrieved from Bloomberg (18/10/2018).

On Tuesday November 6, the United States will hold mid-term congressional elections. All 435 seats in the House of Representatives (the "House") will be contested, along with 35 out of the 100 seats in the Senate and 39 governorships. Will the balance of power shift away from the Republicans? And will it mean an easing of trade war tensions with China?

President Trump's Republicans currently hold both houses in Congress, with a majority of 235 seats in the House and 52 in the Senate. According to fivethirtyeight.com, a news site, there is an 84% chance they lose the House, a prediction priced at 79.8% on the University of Iowa's futures market. In the Senate race, 24 of the contested seats are held by Democrats and nine by Republicans (two are Independents), making a swing to the Democrats less likely – fivethirtyeight.com suggests an 80.8% chance the Republicans retain control, backed up by Iowa's 90.6% market price.

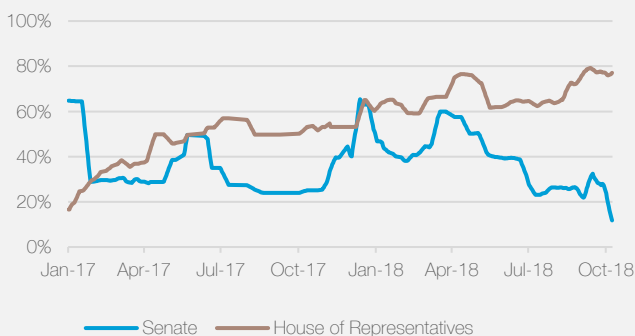
In the run-up, commentary has focused on whether a shift to the Democrats might trigger the President's impeachment (a process launched by the House Judiciary Committee). The powerful House or Senate committees are each chaired by an appointee from the majority party, meaning a likely Democrat lead on Judiciary. However, the final say on impeachment is the sole preserve of the Senate.

The probable split in Congress is also a recipe for legislative gridlock, unless President Trump is able to build bipartisan consensus, i.e. a remote prospect given many Democrats' animosity towards him. In this context, we would expect economic policy settings to remain broadly unchanged, meaning the US economy is likely to enter 2019 with continued strong momentum and high corporate confidence.

Congress has historically granted the President great autonomy in terms of trade policy. In our view, he is unlikely to change tack with China as: (a) a removal of his trade authority requires a two-thirds majority in both houses; (b) his protectionist convictions are long and deeply held; (c) his closest advisors view China as a strategic threat to US pre-eminence; and (d) his aggressive stance on tariffs has proved popular with Republicans (88% approval rate, according to a recent Gallup poll).

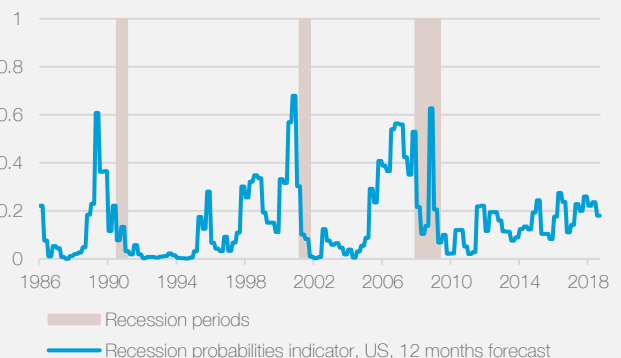
Putting it all together. Economic and trade policy is likely to remain unaffected by the mid-term results, and we expect growth to slow gradually in 2019 as the impact of this year's tax cuts fades. In this context, the Federal Reserve (the Fed) should continue to steadily tighten monetary policy, suggesting further outperformance of US equities over Treasuries.

University of Iowa's futures market on the US mid-terms elections
 Percentage chance the Republicans lose the Senate and House



Sources: SGPB, Iowa Electronic Markets, data have been smoothed, 17/10/18

Probability of a US recession
 Overview 1986-2018



Sources: SGPB, Macrobond, 18/10/18

This week and next

EUROZONE

- Headline inflation rose from 2.0% YoY to 2.1% in September, according to final data. However, excluding volatile items such as food and energy, price growth slid from 1.2% YoY to 1.1%.
- On first estimates, the trade balance surplus narrowed in August for the second month in a row from €17.6bn to €11.7bn as imports (+8.4% YoY) rose more than exports (+5.6% YoY). Interestingly, intra-euro area trade worth at €140.7bn was 5.1% higher YoY.
- The German ZEW business survey revealed that the German economy was at its lowest level since the start of the year, down from 76.0 to 70.1 in October after a rebound in September.
- In Italy, both industrial orders (+4.9% MoM) and sales (+1.2% MoM) rebounded in August after a weak momentum in June and July.

UNITED KINGDOM

- Headline inflation decelerated to 2.4% YoY in September, after 2.7% a month earlier, whereas expectations were for 2.6%.
- The unemployment rate remained unchanged at 4.0% in the three months to August – a level last reached in 1975.
- Average weekly earnings rose from 2.6% YoY to 2.7% on average in the three months to August. Excluding bonuses, wages were up 3.1% YoY, the highest rate since 2009 while lower inflation helped to lift real wages.



Next week's key events

	Per.	Prev.	Cons.
23 Oct Consumer confidence (P)	Oct	-2.9	--
24 Oct Composite PMI (P)	Oct	54.1	--



Next week's key events

	Per.	Prev.	Cons.
23 Oct CBI industrial trends survey (orders)	Oct	-1	--
24 Oct Mortgage approvals	Sep	39.4k	--

UNITED STATES

- Despite hurricane Florence, industrial production rose from 4.9% YoY to 5.1% in September, its highest rate since January 2011. The capacity utilisation rate for the sector was unchanged at 78.1% in September, still below its long-run (1972–2017) average.
- Business sentiment improved slightly in October (NY Fed General Business Conditions index), from 19 to 21.1 due to new orders and shipments. Companies remain optimistic on a six-month horizon.
- The Philly Fed index report showed that manufacturing remained buoyant in the region of Philadelphia according to the Diffusion index for current general activity. Although the October reading was down from 22.9 to 22.2, nearly 36% of all manufacturers reported increases in overall activity, while 14% reported decreases.

ASIA & EMERGING COUNTRIES

- In Japan, the trade balance deficit widened for the third consecutive month to ¥-239bn in September with imports rising 7% YoY and exports shedding 1.2% YoY.
- Inflation ex volatile items is gaining traction in Japan inching up to 1% YoY in September, though this is still only halfway from the Bank of Japan's target.
- China's economy grew at its weakest pace in Q3 since 2009, at 6.5% YoY, down from 6.7% in Q2 and missed expectations of 6.6% growth. Retail sales grew from 9% to 9.2% in September YoY, while industrial production growth slowed from 6.1% to 5.8%.



Next week's key events

	Per.	Prev.	Cons.
26 Oct GDP growth rate (A)	Q3	4.2%	3.3%
26 Oct U. of Michigan consumer sentiment (F)	Oct	100.1	99.5



Next week's key events

	Per.	Prev.	Cons.
24 Oct Japan: Manufacturing PMI (P)	Oct	52.5	--
26 Oct Russia: Central bank rate	Oct	7.5%	7.5%

Sources: Datastream, Bloomberg, 22 October 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.15	1.15
GBP/USD	1.30	1.32
EUR/CHF	1.14	1.09
USD/JPY	112	110
Brent	\$79.7	\$80
Gold	\$1227	\$1220

Our 3-month targets are unchanged this week.

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not be seen as a guarantee of future returns.

No Q&A this week.

Market performance

Past performance should not be seen as a guarantee of future returns.

Interest rates

	Last	1wk	3mth	YTD	12mth
EONIA (EUR)	-37 bp	0 bp →	0 bp	-2 bp	-1 bp
3mth Euribor (EUR)	-32 bp	0 bp →	0 bp	1 bp	1 bp
3mth Libor (USD)	247 bp	3 bp ↑	12 bp	77 bp	111 bp
3mth Libor (GBP)	80 bp	0 bp →	5 bp	28 bp	42 bp
10-year US Treasury bond	318 bp	4 bp ↑	rke	76 bp	84 bp
10-year German bond	42 bp	-10 bp ↓	8 bp	0 bp	3 bp
10-year French bond	81 bp	-7 bp ↓	18 bp	2 bp	0 bp
10-year UK bond	154 bp	-13 bp ↓	31 bp	35 bp	23 bp

Credit

	1wk	3mth	YTD	12mth
BAML EURO Corp. IG	0.3% ↑	-0.3%	-0.5%	-0.4%
BAML EURO Corp HY	0.0% →	-0.2%	-0.6%	-0.6%
BAML GBP Corp IG	0.8% ↑	-1.0%	-2.1%	-0.6%
BAML US IG	-0.3% ↓	-0.6%	-3.1%	-2.3%
BAML US HY	0.2% ↑	0.9%	1.6%	1.6%
JPM Global EM Sov. Plus	0.3% ↑	-1.5%	-5.6%	-5.0%

Exchange rates

	Last	1wk	3mth	YTD	12mth
EUR/USD	1.15	-1.2% ↓	-1.6%	-4.6%	-2.8%
EUR/CHF	1.14	-0.6% ↓	-1.9%	-2.6%	-1.4%
GBP/USD	1.30	-1.6% ↓	-0.4%	-3.6%	-1.4%
USD/JPY	112	0.0% →	-0.6%	-0.4%	-0.7%
USD/BRL	3.72	-1.6% ↓	-3.4%	12.4%	17.4%
USD/CNY	6.94	0.7% ↑	3.2%	6.6%	4.7%
USD/RUB	65.8	-0.8% ↓	4.4%	14.1%	14.5%

Government bonds*

	1wk	3mth	YTD	12mth
United States (3-7yr)	-0.1% ↓	-0.4%	-1.4%	-1.8%
United Kingdom (3-7yr)	0.6% ↑	-0.3%	-0.4%	-0.1%
Germany (3-7yr)	0.4% ↑	-0.4%	0.4%	-0.2%
Japan (3-7yr)	0.0% →	-0.2%	-0.2%	-0.1%

Equities*

	Last	1wk	3mth	YTD	12mth
MSCI AC World	494	1.1% ↑	-3.7%	-1.6%	2.3%
Eurostoxx 50	3,212	0.1% →	-7.5%	-5.3%	-8.1%
DAX	11,589	0.4% ↑	-9.2%	-10.3%	-11.2%
CAC 40	5,117	0.2% ↑	-5.9%	-0.8%	-1.9%
S&P 500	2,769	1.5% ↑	-1.2%	5.2%	10.2%
FTSE 100	7,027	0.3% ↑	-7.3%	-5.3%	-2.9%
SMI	8,779	1.6% ↑	-1.7%	-3.2%	-2.4%
Topix	1,705	0.2% ↑	-1.9%	-4.3%	1.0%
IBOV Brazil	83,847	1.1% ↑	8.4%	9.7%	9.5%
MICEX Russia *	2,379	0.5% ↑	3.7%	12.7%	13.6%
MSCI EM	971	1.7% ↑	-8.6%	-14.1%	-11.4%
SENSEX 30 India	34,780	2.3% ↑	-4.2%	3.9%	8.0%
Hang Seng (H-K)	25,455	0.8% ↑	-8.7%	-12.0%	-8.2%
Shanghai Composite	2,486	-3.8% ↓	-10.8%	-24.8%	-26.5%

Commodities

	Last	1wk	3mth	YTD	12mth
Brent	\$80	-1.6% ↓	10.7%	19.6%	37.7%
Gold	\$1,227	0.7% ↑	0.1%	-5.9%	-4.2%
Silver	\$14.6	0.3% ↑	-5.5%	-13.9%	-13.9%

Source: DataStream, on 19/10/2018. 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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