Weekly Update

C0 | EXTERNAL PUBLICATION

Triple B – Budget, BoE and Brexit

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The UK's annual budget – setting out the government's tax and spending plans – coincided this week with the Bank of England (BoE) Monetary Policy Committee. With Brexit now less than four months away, what is the outlook for the UK economy and its financial markets?

One positive surprise in the UK this year has been the sharp increase in tax receipts, enabling a £68bn windfall in forecast borrowing requirements according to the Office for Budget Responsibility (OBR) and giving Chancellor Hammond room for manoeuvre ahead of the Budget. He duly announced an increase in public spending (notably for healthcare), higher personal income tax allowances, more generous welfare benefits and a 4.9% hike in minimum wages. This largesse provides near-term fiscal stimulus but also cancels out the forecast improvement in government borrowing needs.

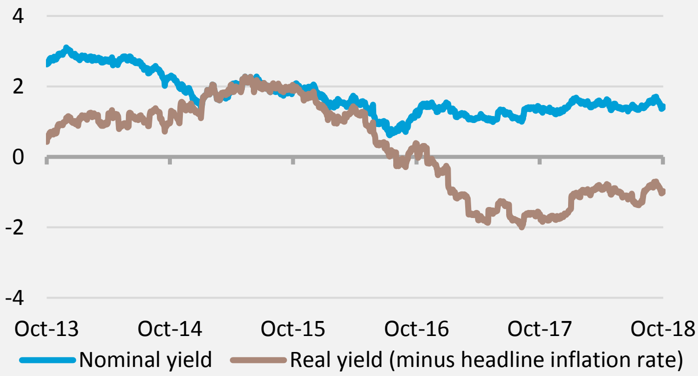
There were no surprises from the BoE on Thursday as rates were held steady at 0.75%. The bank indicated that a smooth Brexit would mean faster rate hikes, a more hawkish stance than expected. However, Governor Carney highlighted the risks of a disorderly Brexit, cautioning "there is little monetary policy can do" to mitigate the impact. We therefore expect the BoE to hold off from hikes until visibility improves.

Carney's wariness did little to stop sterling moving higher across the board as optimism strengthened in the UK that a Brexit deal was within reach. Brexit Secretary Dominic Raab suggested that a deal could be finalised by November 21, while a press article intimated that an agreement on equivalence in trade in financial services was likely. However, there is little sign that this optimism is shared in Brussels – no November summit has been called so far and EU negotiators continue to bemoan the lack of progress on the Irish border question. We would not set too much store on an imminent breakthrough – much remains to be settled before the arduous process of ratification by national governments can begin.

Bottom line. Brexit uncertainties continue to cloud the skies over the UK and hamper business investment plans. Economic growth has slowed – the OBR cites studies suggesting that the UK economy is 2-2.5% smaller due to the Brexit vote – though the fiscal boost should provide some support. With the BoE on hold, we do not expect sharp rises in long-dated bond yields – however, inflation-adjusted yields are still negative. Sterling's bounce against dollar this week has taken it back to the mid-point of the recent range at around 1.30. In this context, we maintain a neutral stance on UK equities, given the lack of catalysts for sustained outperformance.

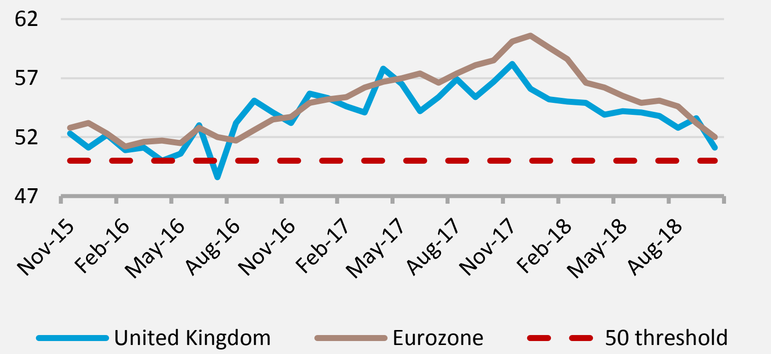
All data retrieved from Bloomberg (01/11/2018).

Yields remain negative in real terms
Gilt nominal and real 10-year yields (%)



Sources: SGPB, Macrobond, data as of 31/10/2018

Industry confidence weakened both in the eurozone and the UK
Manufacturing PMIs



Sources: SGPB, Macrobond, data as of 31/10/2018

Forecast figures are not a reliable indicator of future performance

This week and next

EUROZONE

- Q3 Gross Domestic Product (GDP) growth slowed from 0.4% QoQ to 0.2% on preliminary data, missing expectations for 0.4%. YoY economic growth is down from 2.2% to 1.7% and unlikely to reach the ECB's 2% forecast for 2018. France grew 0.4% QoQ in Q3, twice as fast as in Q2, while Italy stagnated. German GDP will be released later this month.
- Flash estimates for headline inflation rose in October from 2.1% YoY to 2.2%, driven by energy prices. Core inflation (excl. volatile items) outperformed expectations, up from 0.9% YoY to 1.1%.
- Both economic sentiment and business climate indicators missed expectations in October, printing at their lows since mid-2017.
- However, consumer confidence improved from -2.9 to -2.7, still well above its long-run average of -12.1. The September unemployment rate remained unchanged at 8.1%.

Next week's key events		Per.	Prev.	Cons.
5 Nov	Investors sentiment index	Nov	11.4	--
6 Nov	Composite PMI (F)	Oct	54.1	52.7

UNITED KINGDOM

- PMI Manufacturing confidence slid 2.5 points to 51.1 in October, a 27-month low given weaker output growth, declining new order inflows and employment.
- Bank of England members unanimously decided to keep rates unchanged at 0.75%.
- Despite recent lower retail prices and rising wages, GfK consumer confidence declined from -9 to -10 in October as the prospect of a no-deal/hard Brexit still weighs on sentiment.
- Despite the Brexit backdrop, the housing market is solid with additional £3.9bn in mortgage lending in September, up from £3.1bn in August. The annual growth rate in mortgage lending was unchanged at 3.2%.

Next week's key events		Per.	Prev.	Cons.
9 Nov	GDP 3M/3M	Sep	0.7%	--
9 Nov	Manufacturing output YoY	Sep	1.3%	--

UNITED STATES

- Conference Board Consumer Confidence rose from 135.3 to 137.9 in October, an 18-year high and above expectations.
- Personal Consumption Expenditure (PCE) data for September showed real growth in consumer spending at 0.3% MoM after 0.4% in August, taking YoY growth to 3.0%. Core PCE inflation – the Fed's favourite measure – rose 2.0% YoY for the fifth consecutive month.
- October ISM manufacturing confidence slid again to 57.7, still high but down from August's 14-year high at 61.3.
- Nonfarm unit labour costs rose 1.5% YoY in Q3, while labour productivity increased 1.3% YoY (output was up 3.7% while the number of hours worked rose 2.4%).

Next week's key events		Per.	Prev.	Cons.
6 Nov	Job openings (million)	Sep	7.1	--
9 Nov	Uni. of Michigan consumer surveys	Nov	98.6	--

ASIA & EMERGING COUNTRIES

- Japan's unemployment rate declined to 2.3% in September, just above the 26-year low reached in May, while retail sales rose 2.1% YoY in September, down from 2.7% in August. October PMI manufacturing confidence rose to 52.9, a 4-month high.
- In China, manufacturing confidence surveys diverged in October. The Caixin PMI inched up from 50 in September to 50.1 while the national PMI series declined from 50.8 to 50.2.
- Activity slowed sharply in South Korea with industrial production down -8.4% in September from August's +2.5%.

Next week's key events		Per.	Prev.	Cons.
6 Nov	Japan: Household spending YoY	Sep	2.8%	--
8 Nov	China: Trade balance surplus ($bn)	Oct	31.7	36.3

Sources: Datastream, Bloomberg, 2 November 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	1.14	1.15
GBP/USD	1.30	1.32
EUR/CHF	1.14	1.09
USD/JPY	113	110
Brent	$72.8	$80
Gold	$1231	$1220

Forecast figures are not a reliable indicator of future performance

Our 3-month targets are unchanged this week.

Question time

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

CHINA - PMIs CLOSE TO THE 50-THRESHOLD

Measuring the impact on the economy

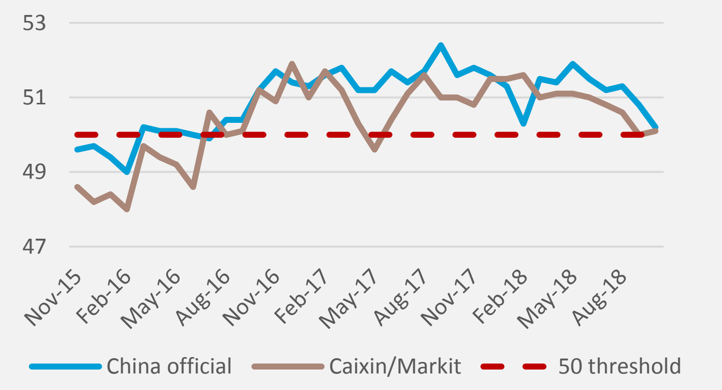
China has started to show signs of economic weakness following months of trade tensions with the Trump administration. The official Manufacturing PMI indicated weaker momentum with a sharp slide from 51.3 in August to 50.2 in October, its lowest level since July 2016. And after dipping to 50 in September, the Caixin Manufacturing PMI edged back up to 50.1 in October, only just above the 50-point threshold between expansion and contraction.

The trade war has started to take its toll on the outlook with a significant drop in new export orders. However, the US trade deficit with China has barely narrowed so far as US importers have front-loaded imports ahead of the expected higher tariff rates effective from next January. In addition, US tax cuts stimulus has fostered private consumption, thus boosting demand for imports.

Q3 was the weakest quarter for Chinese GDP growth since the financial crisis (6.5% YoY). The latest PMI numbers underline that the picture remains downbeat for the months ahead as the trade war is set to continue. As of January, the US has threatened to increase tariffs on USD200bn of imports from 10% to 25%, unless China bows to their demands. According to current estimates, if the US were to impose 25% tariffs on all imports from China, Chinese GDP growth could be cut by up to 1% per annum.

Business surveys signal weakness in China

China manufacturing PMIs



Sources: SGPB, Macrobond, data as of 31/10/2018

In this context, it is hardly surprising that recent rumours that a possible trade deal could be unveiled at the G20 meeting in Buenos Aires this month have boosted markets. In addition, China recently conducted an auction in Hong Kong of CNH 10 billion in 3-month bills and CNH 10 billion in 1-year bills, the first time it has used offshore markets to mop up liquidity in what looks like an attempt to defend the yuan's exchange rate ahead of the summit.

However, China has already begun to implement growth-supportive measures to mitigate the impact of the trade war, including:

1. Yuan devaluation vs. dollar (-10.5% in the six months to October) to make exports more competitive – the currency recently neared 7 yuan per dollar. The yuan could see some further weakness in coming months despite People's Bank of China (PBoC) fears that further devaluation could accelerate capital flight.
2. Local bond issuance to prop up domestic growth via infrastructure investment.
3. Four cuts to banks' reserve requirement ratio (RRR) this year to 14.5% to sustain credit growth and inject liquidity into the economy.
4. Household tax cuts, such as deductions for healthcare, education, or mortgage interest expenses, to spur domestic consumption. President Xi also recently decided to cut corporate taxes, in particular for small-and medium-sized enterprises and start-ups.

All in all, these measures should limit the downside to growth (which we do not expect to breach 6.0%) and China still has room to ease further if necessary – *i.e.* no hard landing for China.

Market performance

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

Interest rates

Interest rates	Last	1wk	3mth	YTD	12mth
EONIA (EUR)	-35 bp	2 bp	1 bp	-1 bp	0 bp
3mth Euribor (EUR)	-32 bp	0 bp	0 bp	1 bp	1 bp
3mth Libor (USD)	258 bp	7 bp	23 bp	89 bp	120 bp
3mth Libor (GBP)	83 bp	2 bp	2 bp	30 bp	38 bp
10-year US Treasury bond	314 bp	1 bp	rke	73 bp	77 bp
10-year German bond	40 bp	0 bp	-10 bp	-3 bp	3 bp
10-year French bond	76 bp	-2 bp	-3 bp	-3 bp	-1 bp
10-year UK bond	145 bp	1 bp	7 bp	27 bp	11 bp

Credit

Credit	1wk	3mth	YTD	12mth
BAML EURO Corp. IG	-0.1%	-0.3 %	-0.7 %	-1.3 %
BAML EURO Corp HY	0.2%	-1.1 %	-1.1 %	-1.7 %
BAML GBP Corp IG	-0.1%	0.1 %	-1.6 %	-0.2 %
BAML US IG	-0.3%	-0.9 %	-3.5 %	-2.8 %
BAML US HY	-0.1%	-0.3 %	0.9 %	0.9 %
JPM Global EM Sov. Plus	-0.1%	-2.2 %	-6.2 %	-5.3 %

Exchange rates

Exchange rates	Last	1wk	3mth	YTD	12mth
EUR/USD	1.14	0.3 %	-2.2 %	-5.0 %	-1.8%
EUR/CHF	1.14	0.5 %	-1.2 %	-2.3 %	-1.9%
GBP/USD	1.30	1.5 %	-0.9 %	-3.7 %	-1.8%
USD/JPY	113	0.3 %	0.9 %	0.1 %	-1.3%
USD/BRL	3.70	-0.1 %	-1.3 %	11.7 %	13.3%
USD/CNY	6.92	-0.4 %	1.5 %	6.4 %	4.9%
USD/RUB	65.7	0.1 %	4.2 %	13.9 %	12.7%

Government bonds*

Government bonds*	1wk	3mth	YTD	12mth
United States (3-7yr)	0.1 %	0.3 %	-1.0 %	-1.4 %
United Kingdom (3-7yr)	-0.1 %	0.6 %	0.0 %	0.5 %
Germany (3-7yr)	0.0 %	0.3 %	0.4 %	-0.2 %
Japan (3-7yr)	0.0 %	0.2 %	-0.1 %	0.0 %

Equities*

Equities*	Last	1wk	3mth	YTD	12mth
MSCI AC World	489	1.8 %	-5.2 %	-2.5 %	0.7 %
Eurostoxx 50	3,204	1.3 %	-8.4 %	-5.5 %	-10.2 %
DAX	11,469	1.4 %	-10.0 %	-11.2 %	-14.8 %
CAC 40	5,086	1.1 %	-7.3 %	-1.4 %	-4.8 %
S&P 500	2,740	1.3 %	-2.1 %	4.1 %	8.3 %
FTSE 100	7,115	1.6 %	-5.9 %	-4.1 %	-1.0 %
SMI	9,017	3.6 %	-1.6 %	-0.6 %	0.7 %
Topix	1,632	2.0 %	-7.0 %	-8.4 %	-6.7 %
IBOV Brazil	88,419	5.2 %	11.5 %	15.7 %	19.8 %
MICEX Russia *	2,359	1.2 %	1.9 %	11.8 %	13.3 %
MSCI EM	971	2.4 %	-10.1 %	-14.0 %	-11.5 %
SENSEX 30 India	34,432	2.2 %	-8.0 %	3.0 %	3.7 %
Hang Seng (H-K)	25,416	1.7 %	-9.5 %	-12.1 %	-8.0 %
Shanghaï Composite	2,606	0.1 %	-7.7 %	-21.2 %	-23.3 %

Commodities

Commodities	Last	1wk	3mth	YTD	12mth
Brent	$73	-5.3 %	0.3 %	9.4 %	19.9 %
Gold	$1,231	0.2 %	1.1 %	-5.5 %	-3.6 %
Silver	$14.7	0.5 %	-4.8 %	-13.6 %	-14.0 %

Source: DataStream, on 01/11/2018. 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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