Economic Insights- Last week in global markets: QE or not QE

Last week in global markets: QE or not QE?
Speculation over the size of a QE II programme in the US set the pace everywhere but there were some local variations as the previous week's risk aversion did not return. The expectations of Monday turned into doubts on Tuesday and Wednesday but revived on Thursday and grew further on Friday after the first cut of Q3 GDP contained no surprises.

By the end of the week most equity markets were close to their opening levels. The best performer (up 1.6%) was Brazil's Bovespa which pulled back half the ground lost the previous week because of government attempts to restrict hot money flows. The Nasdaq Composite (up 1.1%) deserves honourable mention as on Friday it got within 17 points of its 2010 peak of 2522 on April 26th. The Dow managed on Monday to surpass its April 26th peak to reach 11234 but slipped back later in the week. Also on Monday the FTSE 100 got within 36 points (0.6%) of its 2010 peak on April 15th but was undermined by the view that the solid Q3 GDP data was enough to defer QE II in the UK and ended 1.1% down on the week. The Hang Seng had a good October but fell by 1.8% as mixed corporate results encouraged some profit taking. Bottom of the class was the Nikkei (down 2.4%) which suffered from the usual cocktail of faltering growth, disinflation and a very firm yen.

Gold rose and fell and rose again with the US QE II story as did Treasuries but gilt prices were knocked back by the lack of a UK QE story. German bund prices slipped for another week and euro money market rates crept up a few more basis points. Appetite for the euro remains confined below $1.40 and is driven by twists in the US QE II story and traders were also coy last week about retesting parity for the aussie as it swung in a chunky 3.1% range. The yen ground out another 1% gain vs. the dollar and, as further evidence of the erosion of the EUR/JPY cross-rate's status as an indicator for equity prices, gained 1.3% vs. the euro. Liberated for the time being from the prospect of more QE, the pound had an excellent week gaining over 2% on most other currencies.

Last week in the UK: no QE II for now
The Q3 GDP figure was the main story and we might (very) briefly blow our own trumpet in pointing out that our forecast of +0.6% was much closer to the actual +0.8% than the consensus. Much more important, of course, is the rationale for our forecast: employment holding up, manufacturing output strengthening and consistent, steady survey data. Needless to say, both the current and previous governments are claiming credit for the very welcome outcome but in reality neither deserves more than one or two cheers. Labour's much proclaimed stimulus never amounted to a lot more than a temporary Vat cut as the deficit was already looming large but they can take (yet) another bow for saving the banking system. The coalition has not been in office long enough to have had much impact on growth but it has at least made it a lot easier for the private sector to plan. The undoubted good news is that the UK economy is proving to be stronger and more resilient at a time when fiscal tightening is going to start to hurt.

One could be forgiven for thinking the 'good' GDP figure was the reason for the pound to dazzle last week but that would be too simple an explanation. The dip in UK equity and gilt prices point to the real market mover: QE II. The MPC is known to be divided on whether more QE would stimulate much growth and, even if it might, on what would be the best time to roll it out and in what quantum. Labour's much proclaimed stimulus never amounted to a lot more than a temporary Vat cut as the deficit was already looming large but they can take (yet) another bow for saving the banking system. The coalition has not been in office long enough to have had much impact on growth but it has at least made it a lot easier for the private sector to plan. The undoubted good news is that the UK economy is proving to be stronger and more resilient at a time when fiscal tightening is going to start to hurt.
some stickiness in shifting new gilt issues. Unless and until that happens the pound is more likely to move with other currencies vs. the dollar, gilt prices to stabilise and equity prices to reflect global growth prospects.

**Last week in Europe: still plenty to quarrel over**

Another soap opera developing nicely is the revamping of the Stability and Growth Pact (SGP). After backing down over the issue of automatic penalties Mrs Merkel is persisting with her demand for new EU treaty provisions to underpin the proposed permanent bailout arrangements. It is thought she is concerned that the German Constitutional Court may otherwise rule against the SGP but, of course, almost all other countries are aghast at the prospect of new treaty ratification. Meanwhile, ECB President Trichet is affronted that his objections to excluding automatic penalties and to exposing private bondholders to sovereign defaults have been almost completely ignored.

Another potential soap opera is the row over the EU central budget but it may not run for long as the Big Three of Germany, France and the UK are in accord (a 2.9% increase) and already have the support of at least 10 others. Things seem to be quietening down in France now that the retirement age law has been passed by both chambers and the unions are split over what to do next. Sweden remains ahead of the economic ‘game’ and the Riksbank felt sufficiently confident of normality returning to nudge rates up another ¼% to 1%.

**Last week in US: launch day approaches**

Despite good durable goods orders and slightly better housing data, attention was focused on the first cut of Q3 GDP, which came out on Friday and, at an annualised rate of 2%, was judged not to be good enough to delay the launch of QE II. Opinion is hardening today with the release of the latest month of the FOMC’s preferred measure of inflation: Core Personal Consumption Expenditure Prices which actually fell in September by 0.1% taking the annual rate to +1.2% and further away from the target range of 1.7-2.0%.

So, more QE looks more or less definite but the amount and timing is still subject to much debate. Mr Bernanke was thought to be up for at least $1tn if not $2tn but will still be hearing the echoes of the ear-bashing he got at the G20 preparatory meeting in Korea when he was told to keep extra liquidity to himself. The smart money is backing the proposal from the emollient James Bullard of the St Louis Fed to authorise purchases of $100bn between the six-weekly FOMC meetings with no overall cap but also subject to review at each meeting. This proposal is probably by now priced into equity and Treasury markets and it will be the dollar that reacts most when the announcement is made on Wednesday. Any postponement or launch of a programme in excess of $500bn would have a major impact on markets in the US and overseas.

Corporate America as well as Wall Street has decided that Mr Obama does not like them and will be rooting for a GOP victory in the mid-term elections. The House of Representatives’ turning red (Republican) is already discounted but not the Senate’s. A huge swing to the right in both national and state elections would probably spark rallies in US equities and bonds but the dollar is not so easy to call: a rally anticipating a surge in corporate investment or …er……not much different?

**China Chugging**

The start of a new week and month has seen the Shanghai and Hong Kong markets blast off again after a relatively tame end to October. Some, but not a lot, justification comes from solid numbers in the two regular PMI Manufacturing Surveys and the more plausible cause is that these markets are catching up on the US QE II story. The likelihood is that a good portion of any increase in liquidity in the US will find its way rather quickly into China and Hong Kong as well as the other Asia Pacific economies (except Japan), which also had a good day today.

**Rousseff Results**

The Brazilian Presidential Election turned out not to be close after all as Dilma Rousseff won easily with 56% of the vote. She is a grandmother, an economist, has never run for political office before and was once tortured by a previous military dictatorship. However, it is not unfair to attribute her rise to power to the enthusiastic backing of retiring President Lula who is bowing out after eight years with an unprecedented 80% popular approval rating. Mr Lula’s recipe for success has been to raise living standards for many of the poorest without interfering unduly in the booming market economy. He has campaigned tirelessly for Ms Rousseff so that she can carry on his work but his retirement appears to be genuine. A huge bonus for the new President is the release of data on the Libra oilfield (100 miles
offshore from Rio), which when added to the figures for the vast Tupi oilfield mean that Brazil will become a major oil exporter. (The recent gargantuan Petrobras right issue is for funding faster exploitation of Tupi.)

Nestor Kirchner RiP
At the risk of being disrespectful, Mr Kirchner’s unexpected death at the age of 60 could be a good thing for Argentina, which has been ill-served by its leaders for much of the last 70 years. He was widely expected to stand again for president in 2012 when his wife Cristina Fernandez completes her term and he might well have won. He was both popular and populist domestically but also venal and nepotistic. Internationally, his main ally was Hugo Chavez of Venezuela and other leftist South American leaders and he was best known for his cavalier treatment of the IMF and bondholders. It is time Argentina returned to the prosperity it enjoyed up to the Second World War.

Coming up this week
Normally the US Non-Farm Payrolls would dominate global markets and they are due out on Friday. However, this week the main event will, of course, be the publication of the FOMC Statement on Wednesday evening (UK time). Also relevant are the ISM surveys, construction spending, factory orders and consumer credit. The mid-term elections are yet another factor, especially if the Republicans do even better than expected.

It is also central banks’ week elsewhere with the MPC, ECB, RBA and BoJ meeting but the RBA is the only one that will debate raising rates (we think, like the RBNZ, not this month but it is a close run thing ). There is a clutch of Purchasing Managers’ surveys in the UK, Canada, Australia, Germany and the rest of the EZ, Unemployment in Canada and factory orders in Germany that could move exchange rates but only if they are unexpectedly weak.

All in all a lively week in prospect with the half full glass folks most likely to stay in charge by the end of it. After all, the earnings season is still going well.

Proactive Investors facilitate the largest global investor network across 4 continents in 4 languages. With a team of analysts journalists & professional investors Proactive produce independent coverage on 1000's of companies across every sector for private investors, private client brokers, fund managers and international investor communities.

Contact us  +44 (0)1202 770386  action@proactiveinvestors.com

No investment advice

Proactive Investors is a publisher and is not registered with or authorised by the Financial Conduct Authority (FCA). You understand and agree that no content published constitutes a recommendation that any particular security, portfolio of securities, transaction, or investment strategy is suitable or advisable for any specific person. You further understand that none of the information providers or their affiliates will advise you personally concerning the nature, potential, advisability, value or suitability of any particular security, portfolio of securities, transaction, investment strategy, or other matter.

You understand that the Site may contain opinions from time to time with regard to securities mentioned in other products, including company related products, and that those opinions may be different from those obtained by using another product related to the Company. You understand and agree that contributors may write about securities in which they or their firms have a position, and that they may trade such securities for their own account. In cases where the position is held at the time of publication and such position is known to the Company, appropriate disclosure is made. However, you understand and agree that at the time of any transaction that you make, one or more contributors may have a position in the securities written about. You understand that price and other data is supplied by sources believed to be reliable, that the calculations herein are made using such data, and that neither such data nor such calculations are guaranteed by these sources, the Company, the information providers or any other person or entity, and may not be complete or accurate.

From time to time, reference may be made in our marketing materials to prior columns and opinions we have published. These references may be selective, may reference only a portion of an column or recommendation, and are likely not to be current. As markets change continuously, previously published information and data may not be current and should not be relied upon.