



1 MONTH IN 10 SNAPSHOTS

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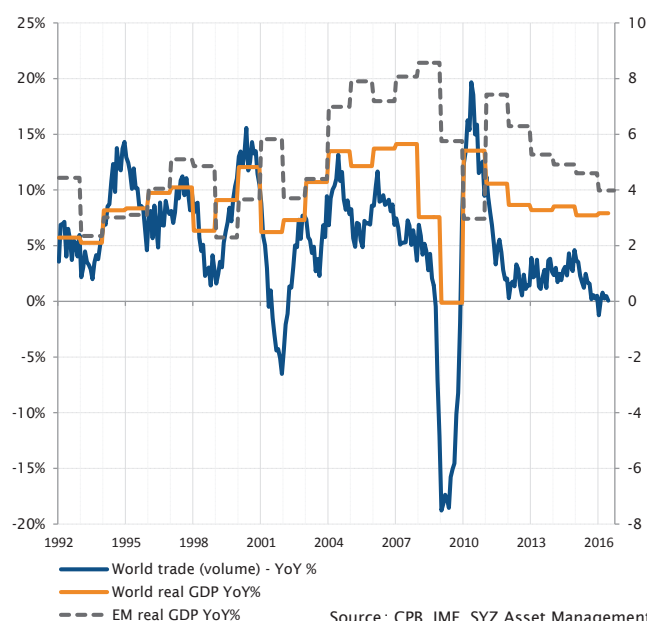
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1. Stagnant global trade weighs on EM growth

- The gap between GDP growth in emerging and developed economies had remained wide from the middle of the previous decade until the aftermath of the 2009 recession. Since then, however, it has been on a narrowing path. Some of the causes of this growth slowdown are idiosyncratic: a structural decline in China's GDP growth or a slowdown in the Brazilian credit boom. From 2011, the falls in commodity and energy prices and more recently US dollar strength have also acted as headwinds to EM economies at large. One common factor has been the weakness in global trade growth. Unlike the two previous decades when global trade was growing at 5-to-10% annual rates, actual traded volumes have been barely growing since 2011. This is the result of weaker final demand from large developed economies (especially Europe) and of a slowdown of the pre-2009 outsourcing trend resulting in a gradual narrowing of labour cost gaps.

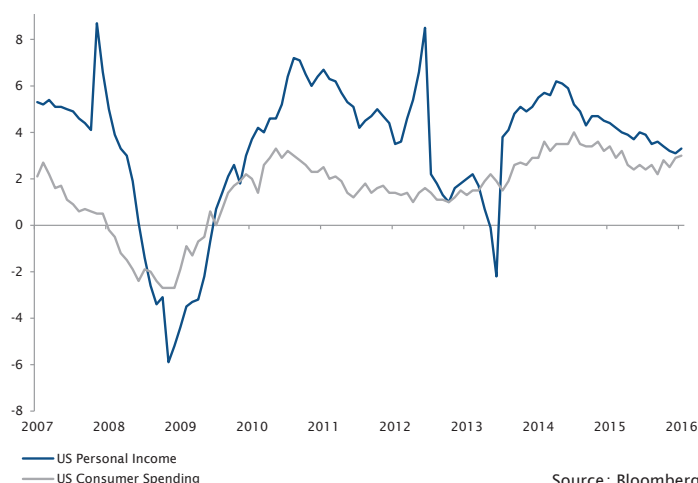
World trade volume, world and EM real GDP annual change



2. US consumer spending and personal income still solid

- While economic growth was revised slightly lower in the second quarter (1.1% versus 1.2% first estimated), domestic consumption and personal income continue to be robust and are helping to support economic activity.
- Consumer spending, which accounts for two-thirds of US GDP, rose for the fourth consecutive month and gained 0.3% in July, slightly lower than in June (+0.5%) but in line with expectations. This illustrates ongoing consumer confidence, which is supported by solid job gains in a low interest rate environment and low gasoline prices. The combination of consumer spending coupled with job creation and the current unemployment levels in the US could be seen as a sign that the Fed has reached its goal of normalization; investors may therefore start expecting another rate hike.

US consumer spending and personal income yearly change



3. Fed funds futures implied the possibility of a hike to 0.5% - 0.75% at the September FOMC meeting

- Little happened last month to disturb the summer lull in financial markets. The main global driver was the higher probability of a Fed rate hike in the next few months (September and December), triggered first by the very strong US payrolls report for July at the beginning of the month and then by the more hawkish than expected speeches by some Fed members, in particular the vice chairman Stanley Fischer. However, a rather weak employment report for August and disappointing ISM numbers suddenly lowered markets' expectations for a Fed rate hike this year. The window of opportunity that had opened earlier in August may therefore be slowly disappearing.
- The September FOMC meeting will be closely scrutinized by the market. Before that, however, some important data such as retail sales or the Empire State Manufacturing Survey of the New York Fed could move Fed fund futures and the implied possibility of a Fed rate hike.

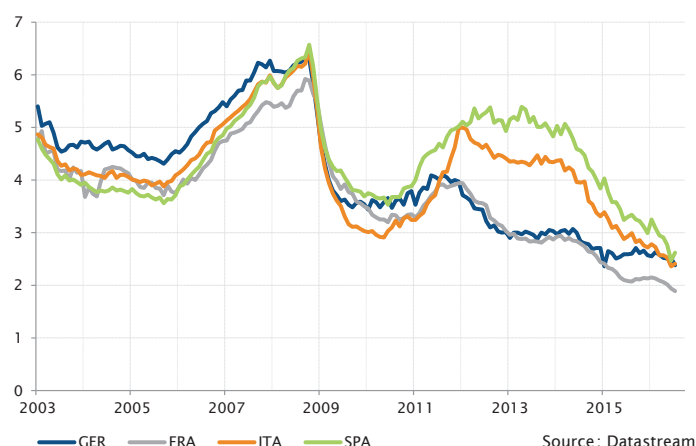
Implied probability of a 25bp hike on September 21st



4. Financing costs for euro area companies have converged

- Large divergences in national financing costs appeared during the sovereign crisis, which reinforced the growth gap between “core” and “peripheral” economies already caused by fiscal consolidation. Narrowing this financing cost gap has been one of the primary goals of the ECB. Ensuring a widespread and efficient transmission of the ECB’s very accommodative monetary policy has been the driver of policies such as negative deposit rates, conditional liquidity injections or corporate bond purchases. And it has succeeded! Whilst bank loan rates for commercial lending were markedly higher in Italy or Spain than in Germany two years ago, they are now at similar levels.
- This easing in financing conditions has allowed for a resumption in credit growth, albeit at a slow pace. Constraints remain both on the supply and demand side of the credit equation. But ECB policies have managed to create an environment where liquidity is available at attractive rates when banks and corporates need it.

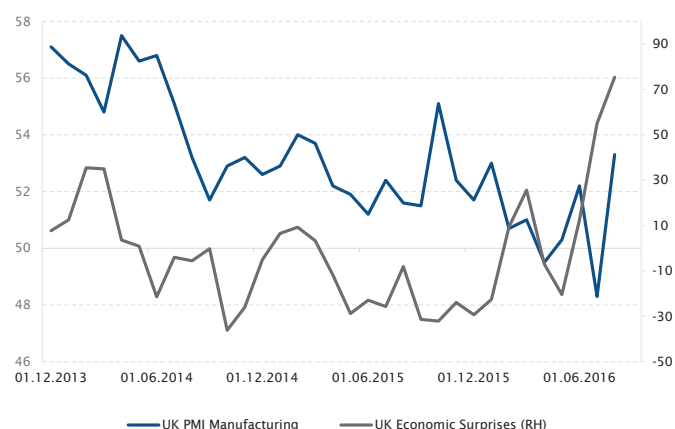
*Average rate of bank loans
to non-financial corporate by country*



5. Limited impact of the Brexit on the UK economy...for now

- Following the Brexit vote in June, uncertainty remains high in the United Kingdom because of fears surrounding the future negotiation process with Europe and the ambiguous effects that it will have.
- In the UK, economic data collapsed immediately after the vote but two months later have already recovered (UK PMI manufacturing and UK Economic Surprises indices for example). The UK Economic Surprises index computed by Citi has even reached the highest level in the last three years.
- Moreover, UK retail sales were recently much stronger than expected. The weaker currency combined with better weather in July contributed to some of the improvement. All these indicators suggest that for the time being the British economy is more resilient than anticipated but the situation remains fragile until we have more clarity on the impact of the vote and when and how the result will be implemented.

UK PMI Manufacturing & UK Economic Surprises



6. The BoE pushes UK rates to new historical lows

- Following the Brexit referendum in June, a reaction by the Bank of England had been widely expected after its repeated warnings of the likely negative impact of an exit vote. The BoE chose to wait in July but finally announced in August a large package of monetary policy easing.
- The BoE not only cut the short term rate by -25bp to a new low of 0.25%. It also announced the resumption of its asset purchase program, including government and corporate bonds for a total of GBP 70bn. Finally, it launched a scheme designed to provide liquidity at very low rates to banks willing to lend to the real economy. A package that very much resembles the existing ECB current policy. Following this announcement, GBP rates dropped to new historical lows. Corporate spreads also compressed markedly.

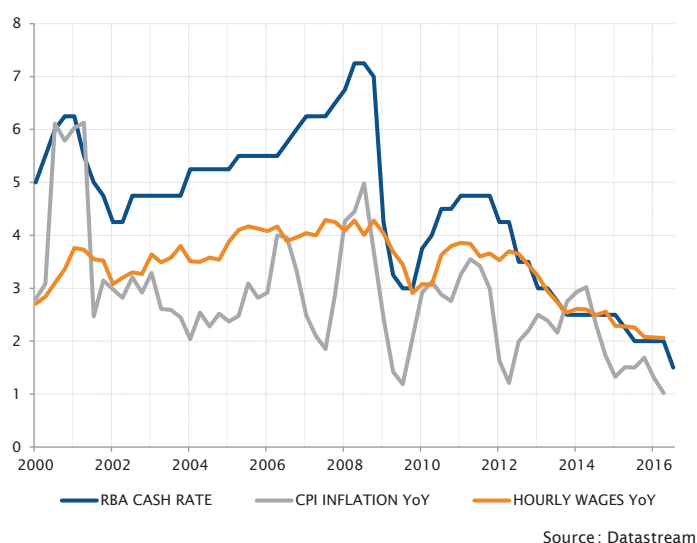
UK government 10-year and 5-year rates



7. Australia is converging toward the “new normal”

- The Australian economy has fared significantly better than its developed economy peers in the post-2009 era with, on average, GDP growth close to 3% and inflation at 2%.
- However, China’s slowdown and the decline in commodity prices are appearing to finally drag the Lucky Country to the “new normal” of low real and nominal growth.
- To offset the negative impact of lower exports to China and weak business investment, the central bank has regularly eased monetary conditions bringing the cash rate to a historically low of 1.5% in August. This easing has supported domestic demand but has not prevented wage growth from slowing down. Up until last year, the AUD’s depreciation had kept inflation around 2% but the currency’s strengthening this year is adding to disinflationary pressures. Despite all of the central bank’s efforts and the fact that growth still remains higher than in the western world, Australia appears to be following inexorably the same pattern experienced by Japan, Europe and more recently the US.

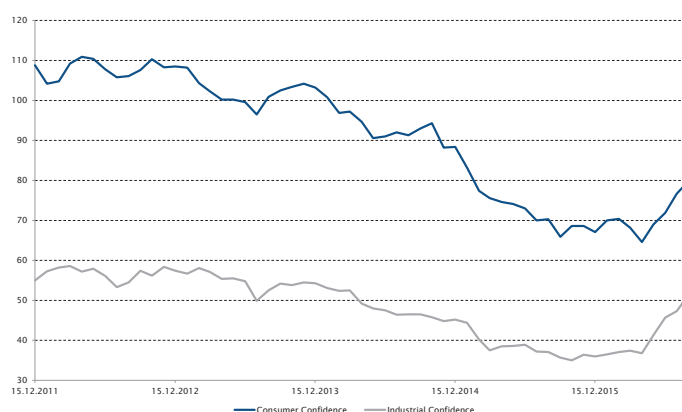
Australia price and wage inflation and central bank cash rate



8. The Brazilian economy has bottomed out

- The Brazilian economy showed some signs of improvement in the last few months. Industrial production increased this summer after two years of nearly non-stop decline. Consumer and industrial confidence are continuing to edge higher and the IMF recently revised up its projection for 2017 GDP for a modest expansion of +0.5% (vs. nil growth before).
- On the political front, the senate officially voted to impeach Dilma Rousseff following the corruption scandal in the Brazilian government. This will allow Temer's more pro business government to begin the expected reforms that are needed.
- On the monetary policy side, the BCB is turning more dovish which suggests a possible easing cycle in the coming months.
- Nevertheless, on the negative front, consumers are still suffering as incomes continue to fall and the unemployment rate rises above the 11% threshold. Moreover, the president will also face the difficult task of reducing the budget deficit.
- Ultimately, the performance of the Brazilian economy and its stock market next year will largely depend on the evolution and implementation of the most important reforms.

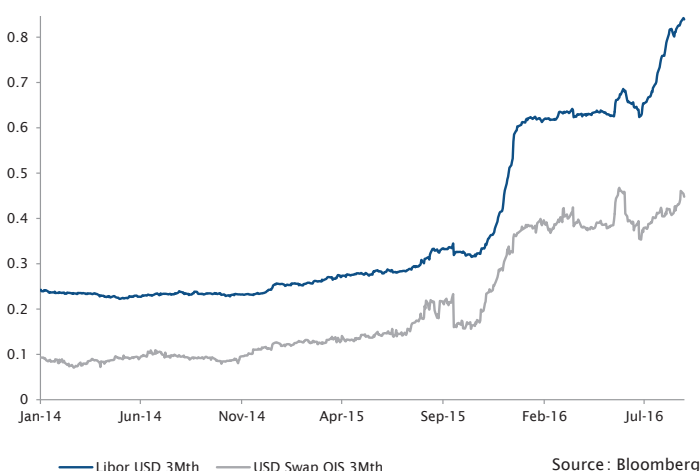
Brazilian Consumer and Industrial Confidence Indices



9. Libor-OIS spread widening

- The Libor-OIS spread, which is the difference between an interest rate with a credit component and an interest rate with no credit risk, has recently been flashing up on investors screens.
- A number of investors are beginning to question if the upward move in the spread could be interpreted as an advanced indicator of stress building up in the market. On the one hand, as the Libor rate is coming from an extremely low base, the increase could be due to technical factors such as the fact that less market participants are purchasing in that market relative to other markets. On the other hand, the SEC has put in place a new set of rules for money-market fund regulation which is likely to slow down buying of short term corporate bonds and accelerate buying of short term government bonds, leading to an increase in spreads.
- Although both explanations make sense, investors should continue to closely monitor the Libor-OIS spread.

USD Libor 3-month and USD Swap OIS 3-month

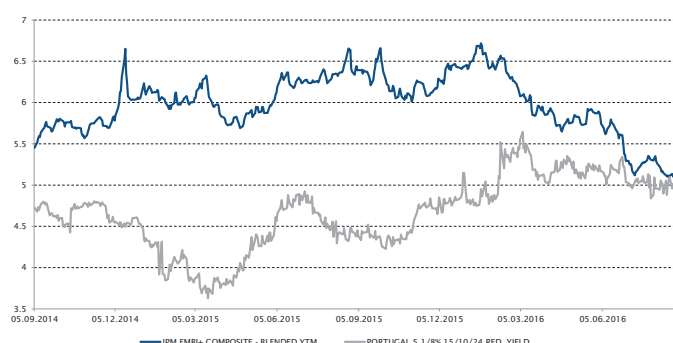


Source: Bloomberg

10. EM debt has become a very crowded trade

- After a difficult beginning to the year, the return of risk appetite has led to a strong performance of emerging market assets since February. Emerging market debt is one of the best performing asset classes with debt denominated in local currencies and in hard currencies respectively up +10.2% and +14.6% YTD (compared to the US broad market up +6.0%).
- The combination of a weaker dollar, central banks' accommodative stance in most countries and emerging economies that have healthier fundamentals than in the past has attracted investor flows.
- This rally in emerging market assets could quickly become precarious if the Fed becomes more aggressive in its rate hike cycle, the first consequence of which would be a stronger dollar. This would pile pressure on emerging market currencies and equity markets and lead to increased capital outflows, etc.
- On the other hand, some peripheral bonds (e.g. Portuguese dollar denominated debt) are currently trading on a yield equivalent to some hard currency emerging market bonds, offering scope for relative value analysis.

JPM EMBI+ Composite Index YTM & Portugal 5.125% 2024 YTM



Source: Bloomberg