Market Update

Week 45: 05 November 2018

UK Monetary Policy

- Unanimous

Last week, the Bank of England's Monetary Policy Committee – tasked with maintaining inflation close to the 2.0% target – voted unanimously to maintain Bank Rate at 0.75% and its stock of gilt purchases at £435 billion. By now, policymakers have settled into an easily defined narrative. One which sees supply and demand in balance if output growth is sustained at a year-on-year rate of 1.5%. Anything faster than that sees inflation risks rise and anything slower sees inflation risks fall.

Currently, the British economy is growing at 1.2%… ergo no rate rise. The prospect of faster growth is stifled by Brexit-related uncertainty. It follows then, that an orderly exit – with a deal of some kind – will encourage increased growth and further increased rates. Simples.

China Manufacturing Output

- Slowing less quickly

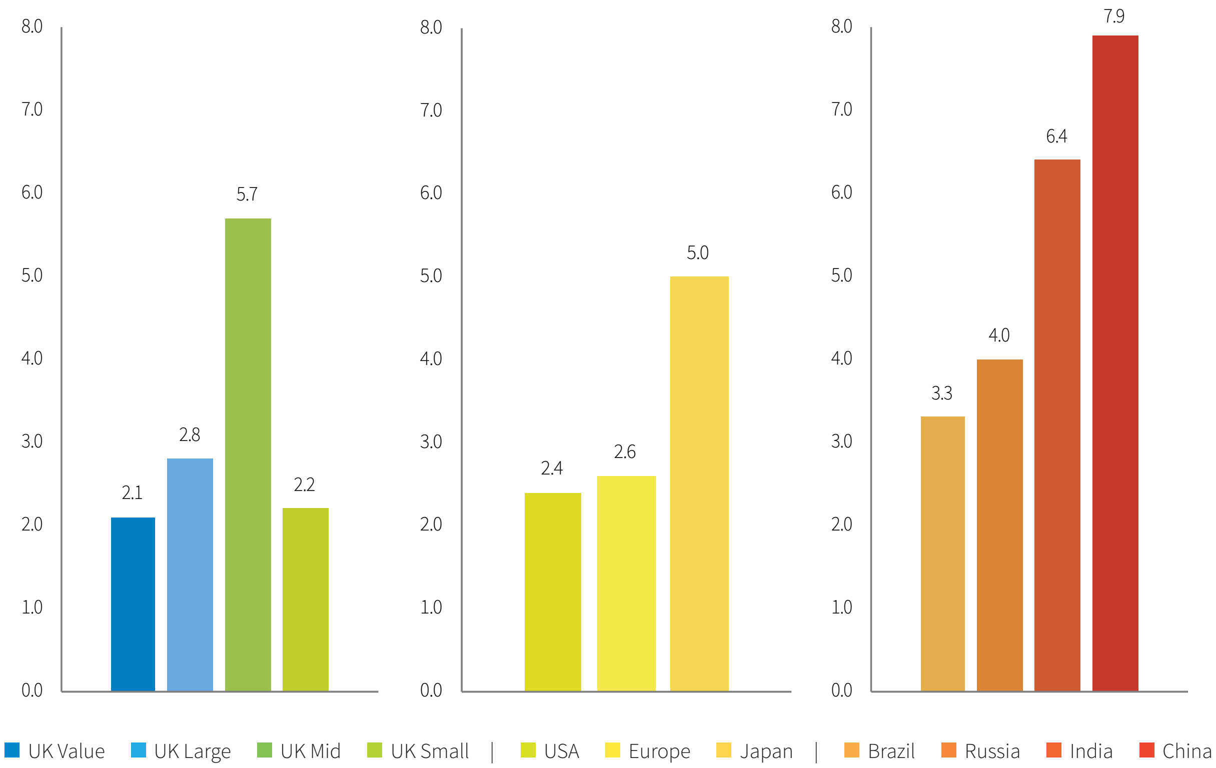
The official Purchasing Managers' Index reading fell from 50.8 in September to 50.2 in October – a shade above the neutral 50.0 mark. Meanwhile, the unofficial index, compiled by Caixin, rose a little from 50.0 to 50.1.

Taken together, these readings present compelling evidence of a slowdown in Chinese manufacturing output. That's not good.

The cavalry is on the way though. Policymakers are busy sprinkling a liberal dose of stimulus – measures to encourage more borrowing and yet more infrastructure spending – which will likely have the effect of boosting output in the short-term. Of course, what feels good in the short-term is often detrimental in the long-term. Policymakers cannot carry on like this forever.

Last Week

In Markets



Other Developments

USA Employment Situation and Inflation

The consensus called for an additional 188,000 jobs in the October non-farm payroll report. In the event, the Bureau of Labor Statistics counted a whopping 250,000. Meanwhile, unemployment – at 3.7% – remains at the lowest level in 49 years and further good news comes in the form of accelerated wage rises. Salaries are growing at an average rate of 3.1% year-on-year.

Consequently, we see no reason why the Fed would refrain from raising rates in December. Not even with a wibbly-wobbly stock market. Indeed, we suspect that Jerome Powell, Chair of the Fed Open Market Committee, will not be at all unhappy about what is a relatively mild decline in asset prices.

There are those that think that the current expansion will end with high inflation and high rates of interest; that the Fed will bring about a recession as a by-product of their attempts to cool runaway inflation. We're not one of those. And neither, we suspect, is Jerome Powell. We think the greatest risks come in the form of a financial imbalance – some kind of asset price bubble perhaps.

Inflation certainly isn't a problem right now. The core rate of inflation – as measured by the Personal Consumption Expenditure index – remains in line with the target in spite of accelerated GDP growth. The Fed don't expect that to change much. Their projection materials see core inflation rising to around 2.1%, but not much higher.

Nevertheless, policymakers at the US central bank are keen to raise rates to some level which might be considered normal. In doing so they will mitigate the risks associated with runaway asset prices and they will be better positioned to fight the next downturn.

> President Trump hasn't called Fed Chairman Jerome Powell to directly express his frustration with the central bank's interest-rate increases and currently has no intention of replacing the Fed chief, the top White House economic adviser said. Lawrence Kudlow said that the president's repeated criticism of Mr. Powell's decision to raise rates three times so far this year is a simple expression of opinion, but that Mr. Trump hasn't taken any steps to shake up the Fed's leadership.

Wall Street Journal
02 November 2018

This Week

Monday

US ISM non-manufacturing PMI

Tuesday

Australia interest rate decision

US mid-Term elections

Wednesday

Europe ECB non-monetary policy meeting

Thursday

China balance of trade

Germany balance of trade

US Federal Reserve interest rate decision

Friday

China inflation

UK balance of trade

UK GDP

US consumer sentiment

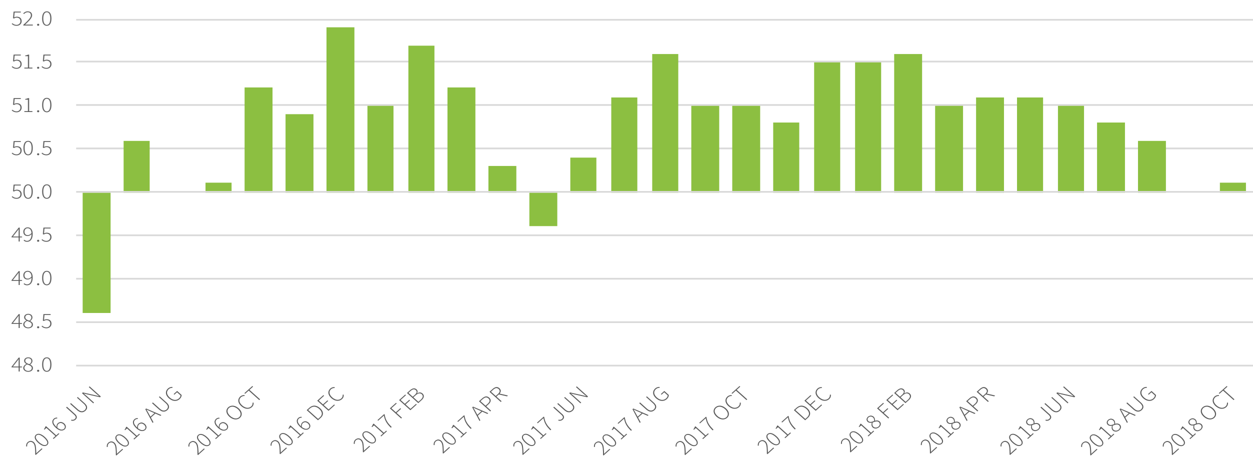
Market Dashboard

Bank Base Rate	–	**0.75%**
Inflation (Y-o-Y)	–	**2.4%**
Unemployment Rate	–	**4.0%**
Wage Growth	–	**2.7%**
House Prices	▼	**£214,534**
3 Month Trade (£B)	–	**-2.8**
GDP (Y-o-Y)	▼	**1.2%**

Market Data ▲▼

Equity Index Levels		
FTSE 100	▲	**7,094**
S&P 500	▲	**2,723**
Stoxx Euro 600	▲	**364**
Nikkei 225	▲	**22,244**
Bond Yields		
10 year UK Gilt	▲	**1.49**
10 year US Treasury	▲	**3.21**
10 year German Bund	▲	**0.43**
10 year Japanese GB	▲	**0.13**
Commodity Prices ($)		
Brent Crude	▼	**72.6**
Gold Bullion (per t oz)	–	**1,235**

China Caixin Manufacturing PMI



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