Weekly Market Summary

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Super Mario Moving in Baby Steps! Killing QE Softly ... With His Words (& Sexy Italian Accent!)

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On January 22nd 2015, the European Central Bank ("ECB") Governing Council left its key interest rates unchanged whilst its President Mario Draghi unveiled bigger-than-expected quantitative easing measures. Those included monthly asset purchases to the tune of €60 billion, starting in March 2015, for a total programme size in excess of €1.0 trillion. "*Purchases are intended to be carried out until end-September 2016 and will in any case be conducted until we see a sustained adjustment in the path of inflation which is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term*", Draghi noted. Back then, markets reacted favorably to the announcement, with yields on German and other Euro debt falling by roughly 10 bps on the day (10-year GE yields traded down to 0.40%). The EUR also traded lower against peers, dropping to 1.1350 against the US Dollar, whilst European and US equity markets rallied sharply on the news.

2-1/2 years later, very little has changed: With European inflation running at a 1.5% annual rate (core inflation @ 1.1% YoY), slightly in excess of € 2.0 trillion in asset purchases (billions, trillions…who is counting really?!) and trillions of Euro debt in negative-yielding territory, the ECB met yesterday - in what was anticipated to be a key moment for the continent's financial markets and a turning point for Europe's quantitative easing experiment - and opted to reduce its stimulus by half starting in 2018, but cushioned the effect by suggesting it would continue to reinvest proceeds from maturing securities, as well as reiterating a pledge to boost QE in size and length if and when needed (Mario Draghi's "*QE Infinity*" pledge). Interest rates will remain "*at the present levels for an extended period of time, and well past the horizon of our net asset purchases*," the ECB concluded.

For those analysts who speculated that maybe – just maybe – the ECB could surprise on the hawkish side and sound more optimistic on its outlook for future European growth and inflation in the Eurozone, the ECB decision came surely as a total disappointment! Draghi's key message was that the ECB has to stay prudent, persistent and patient while euro-area inflation remains subdued. The central bank's own forecasts do not see consumer-price growth returning to the goal of just-under 2% until at least late 2019. As a result, market reaction was very orderly and even cheerful: Traders piled into European government bonds and stocks (the beauty of excess liquidity!) and sent the euro markedly lower (last at $1.1625, down from $1.1810 prior to the ECB decision). German 10-year bund yields sold-off sharply, and were last sitting at 0.40% (Simply Surreal!! When taking into consideration German's annual inflation @ 1.8% and annual growth above 2.0%!).

Elsewhere, the following main news stories have made the headlines in past days and will surely have a sizable market impact over the coming weeks/months:

- Saudi Arabia's Crown Prince Mohammed Bin Salman ("MBS") has announced plans to build a new city on the Red Sea coast, as he seeks to remake the Kingdom in a time of dwindling resources. MBS said the city project, to be called "*Neom*", will operate independently from the "existing governmental framework" with investors consulted at every step during development. The project will be backed by over US$ 500 billion from the Saudi government, its sovereign wealth fund and local and international investors, according to a statement released on Tuesday at an international business conference in Riyadh arranged by Saudi's main sovereign wealth fund, the Public investment Fund ("PIF"). The ambitious plan includes a bridge spanning the Red Sea, connecting the proposed city to Egypt and the rest of Africa. In a separate statement, the Saudi Crown Prince backed the extension of OPEC production cuts beyond March 2018, making it all but certain the cartel and its allies will roll over the curbs at a meeting next month in Vienna (November 30th). The prince, who has become the Kingdom's dominant political force, said in an interview with Bloomberg News that "*of course*" he wanted to extend the cuts into 2018. "*We need to continue stabilizing the market*," he added.

- U.S. House Republicans narrowly adopted a budget resolution yesterday, unlocking a fast-track process to achieve their long-sought goal of cutting Americans' taxes by the end of the year. The next step will be releasing a draft tax measure on November 1st. The 216-212 vote allows Congress to enact tax cuts later that increase the federal deficit by up to US$1.5 trillion over 10 years (great news for US bond holders! NOT!). The bill could pass the Senate with just 50 votes - plus a tie-breaker from Vice President Mike Pence - bypassing the need for any Democratic support. "*Big news - Budget just passed*!" President Donald Trump wrote on Twitter minutes after the vote. House Ways and Means Chairman Kevin Brady of Texas said the budget "*just provided the legislative runway*" for the tax bill his committee will consider during the week of November 6th. Stocks – especially bank shares - reached record highs after the vote, whilst 10-year UST yields jumped to 2.45%. Democrats said the budget will set up a rushed vote on a tax plan that would increase the deficit and ultimately lead to cuts in social spending that helps the elderly and poor.

- Japanese equities are on a roll! The Nikkei 225 stock average index has now gained for 20 straight days, its longest winning streak on record, as Prime Minister Shinzo Abe's ruling coalition retains its majority at last Sunday's general election, in turn signalling continuity with his platform of fiscal spending and monetary easing. It ended this morning at 22,008, the highest close since July 1996, as the ruling coalition's landslide win - retaining its two-thirds majority in the 465-member lower house - cements expectations the Bank of Japan's monetary policy stance would not change. The prime minister's policy of Abenomics has spurred a more-than 20% decline in the Japanese Yen (last at 114.00; shows how popular and strong Shinzo Abe is!!☺) since he took office in 2012, whilst the Nikkei 225 has more than doubled.

- In what is proving to be a tumultuous end for the week, Spain's prime minister urged the country's Senate earlier today to grant special constitutional measures that would allow the central government to take control of Catalonia's autonomous powers to try to halt the region's independence bid. What is happening in Catalonia is "*a clear violation of the laws, of democracy, of the rights of all, and that has consequences*," Mariano Rajoy said. He added that the special measures were the only way out of the crisis, and that the government's first move would be to dismiss Catalan President Carles Puigdemont and his ministers if the Senate approves the Spanish government's use of Article 155 of the Constitution in a vote later Friday. But in Barcelona, separatist lawmakers filed a proposal for Catalonia's regional parliament to vote later in the day on whether to establish an independent republic, as Spain's biggest political crisis in decades appeared headed for a showdown. Thousands of pro-secession supporters gathered near the parliament building in anticipation. The parliamentary sessions in Madrid and Barcelona are likely to last several hours before each votes on their resolutions. Catalonia represents a fifth of Spain's gross domestic product. Polls show its 7.5 million inhabitants are roughly evenly divided over independence.

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