SWISSQUOTE

WEEKLY MARKET OUTLOOK

24 - 30 December 2018

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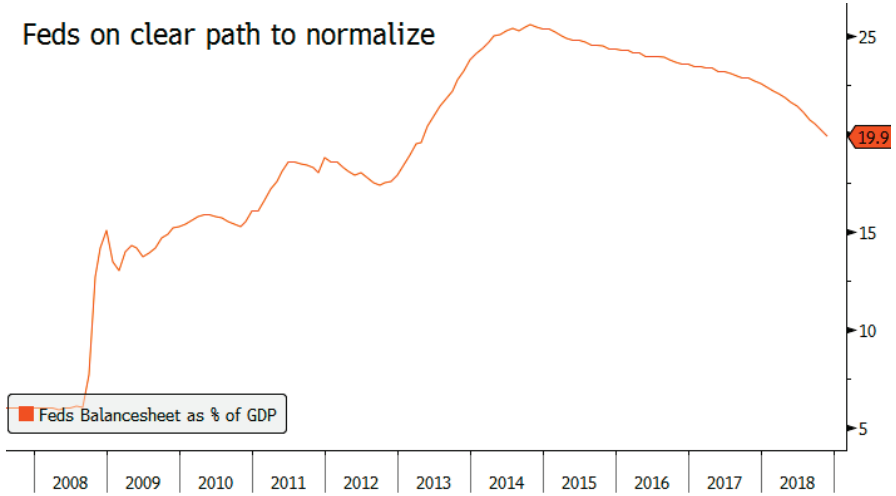
WEEKLY MARKET OUTLOOK - An Overview

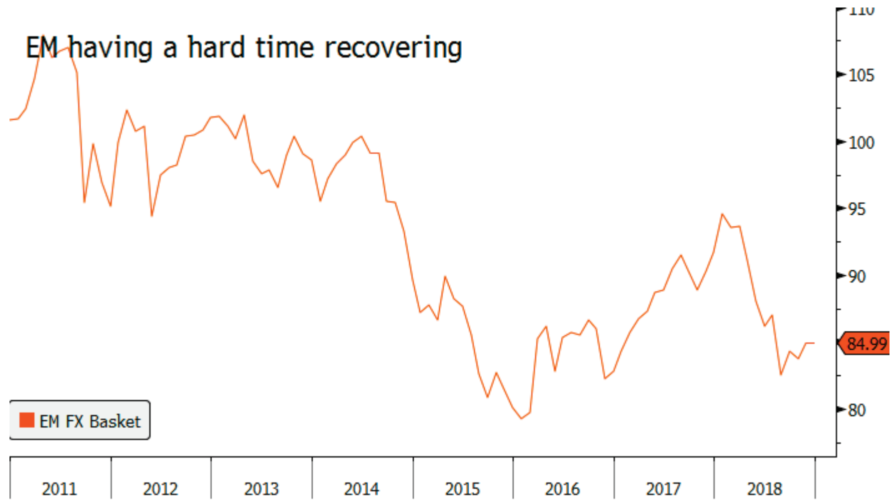
Economics

Central Banks & EM

Central bank policy in 2018 may have created the perception of inaction. However, key banks were steadily tightening liquidity. The US Federal Reserve allowed USD 400 billion to run off its balance sheet. Having bought more than EUR 2 trillion in government bonds, the ECB will wind down monthly asset purchases to zero, from EUR 60 billion a month: that added 0.75% to GDP growth, supporting the upturn in Eurozone activity over the last three years. The Bank of Japan has conducted “stealth tapering” by holding monthly purchases below USD 60 billion. Finally, the Bank of England’s asset purchase facility remained stable at EUR 435 billion. The trend is for a deeper reduction of central banks’ balance sheets. Increased expectations for tighter financial conditions result in lower demand on fixed income markets and generate a ripple effect into other asset classes.

Emerging markets were expected to be the big trade in 2018, coming off a slingshot of positive tailwinds in 2017. Rising commodity prices, faster growth, subdued inflation and strong risk appetite driven by loose monetary policy set the stage for a banner year. However, EMs suffered as a result of one negative development after the next in 2018. There is now growing divergence between developed and emerging economies. Countries with relatively solid fundamentals driven by commodity exports should continue to see growth improve. However, with higher yields in the US and rising energy prices, countries with high exposure to foreign debt, oil-importing countries and those with persistent macro-imbalances will fin





Economics

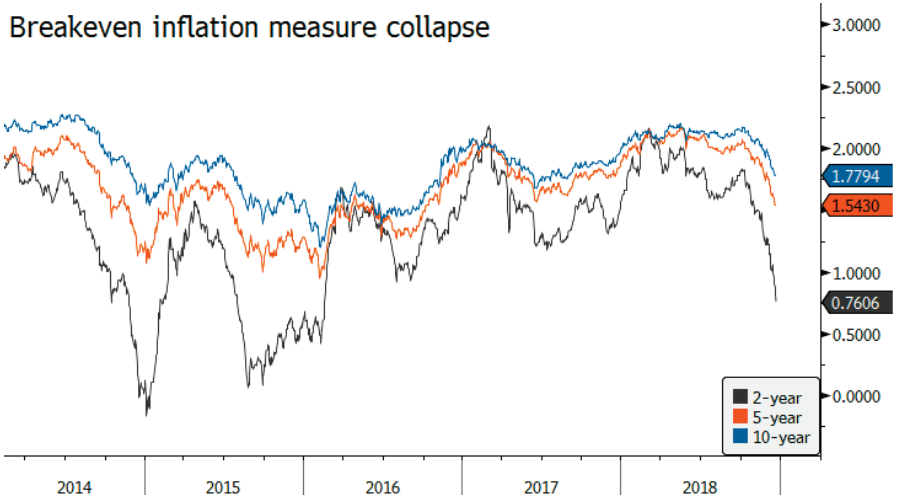
Powell Defies Trump

As widely expected the Federal Reserves lifted interest rates for the fourth time this year, completely ignoring Donald Trump's call for a more accommodative monetary policy stance. As discussed last week, Jerome Powell delivered a dovish hike and suggested during the press conference that the pace of increase could slow down significantly next year. The statement was little changed; however, a key sentenced was added: "The Committee judges that risks to the economic outlook are roughly balanced, but will continue to monitor global economic and financial developments and assess their implications for the economic outlook." In other terms, it means that the Fed will embrace a wait-and-see approach next year and retains maximum flexibility.

Looking at the dot-plot, one notices that the Fed is now expecting two rate hikes next year, compared to three at the September meeting. Nevertheless, the market's reaction suggested that investors were expecting a more dovish response from the Fed. The 2-year breakeven inflation fell to 0.78%, the lowest level since February 2016. The 5-year measure hit 1.54%, while the 10-year one slid to 1.78%.

Finally, the last batch of economic data painted a gloomy picture. Third quarter GDP growth was downwardly revised to 3.4%q/q (annualized) from 3.5%, while personal consumption grew only 3.5%q/q (annualized) versus 3.6% first estimate. November's durable goods orders rose 0.8%m/m compared to 1.6% expected and -4.3% in the previous month. The Fed's favourite measure of inflation, core personal consumption expenditure, accelerated to 1.9%y/y, which helped to calm somewhat investors.

In our view, this is not the end of the sell-off yet as the Fed continues to withdraw liquidity from the market at a pace $50bn a month. Therefore, the US economy will have no choice but to deleverage, which means that equities are not out of the wood yet.



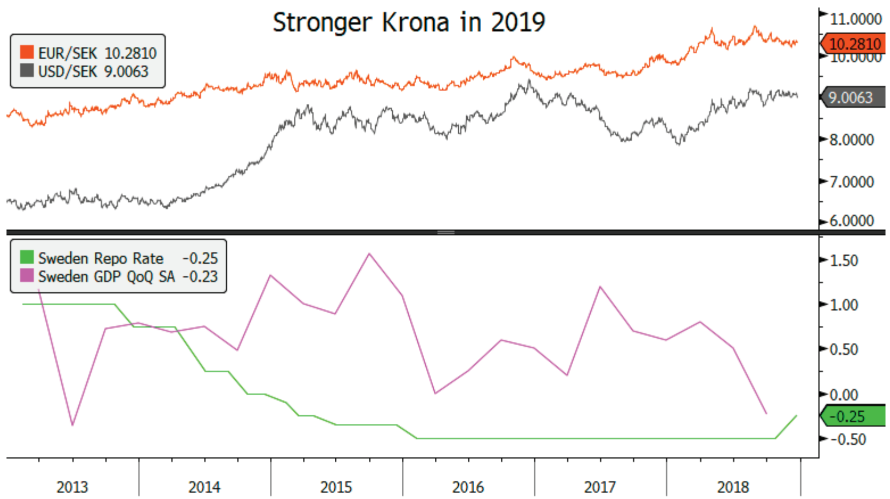
Economics

The Riksbank Leads The Way Before ECB

Against all expectations, the Swedish central bank (Riksbank), during its policy committee from last Thursday, has been surprising market participants, raising interest rates by 0.25% after a period of hike abstention of 7 years, bringing its repo rate at -0.25%. Unlike recent speech from ECB Governor Mario Draghi who confirmed a maintenance of both the main and deposit rates at both 0% and -0.40% due to muted global economic outlook and a dragging Sino-American trade conflict, Riskbank Governor Stefan Ingves has been defending the decision by highlighting decade-low unemployment numbers, casting shadow over downtrend in global growth.

Indeed, despite a slowdown in Sweden's 3Q GDP growth number given at -0.20%, the first negative QoQ number since June 2013, largely explained by a sharp drop in household consumption and a decline in consumer confidence, it seems that the decision to hike the policy rate arrives a bit early at first sight. Additionally, the current deceleration in inflation also cast doubt on current forward guidance. However, as clearly stated by the monetary institution, the monetary policy is to become less expansionary in the future, with a rate hike not expected before first half of 2019.

Accordingly, after the frenzy at the announcement date, the rise in Swedish krona is easing, suggesting that investors read the Riksbank's "dovish increase" appropriately. Looking forward, we would therefore expect a slight krona appreciation against the single currency in 2019 (EUR/SEK: 10.30; year-to-date: +4.54%).

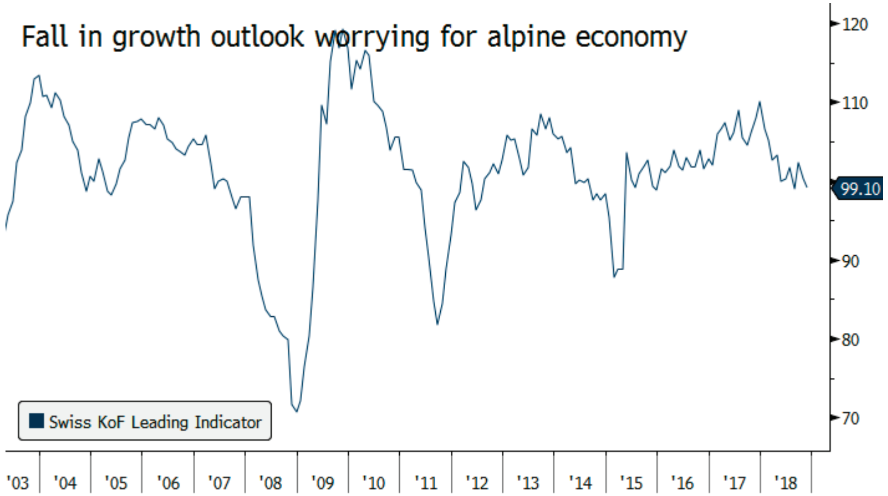


Geopolitics

Swexit meets Brexit

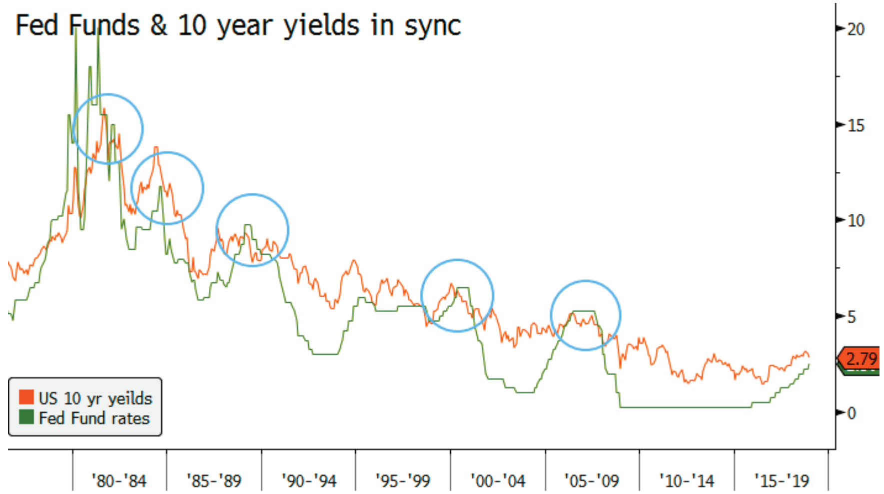
Switzerland is extremely exposed to the result of the UK-EU Brexit negotiations. Switzerland has its own bilateral deals with Brussels, agreed over two decades, after the Swiss decided in 1992 not to join the EU. A hard Brexit would end these Swiss-British agreements! Even after a soft Brexit, the Swiss cannot secure their own trade, customs or movement of people agreements directly with the UK, until the UK has come to an agreement with the EU. Switzerland and the UK are among each other's largest trading partners. The UK is Switzerland's 5th largest overseas market with exports of over CHF 11 billion. UK exports to Swiss are valued at CHF 28 billion. Bilateral CH-UK talks cleverly dubbed "Mind the Gap" have been happening for years, yet nothing can be finalized without EU permission: this could spell trouble, if things turn bad between the UK and the EU.

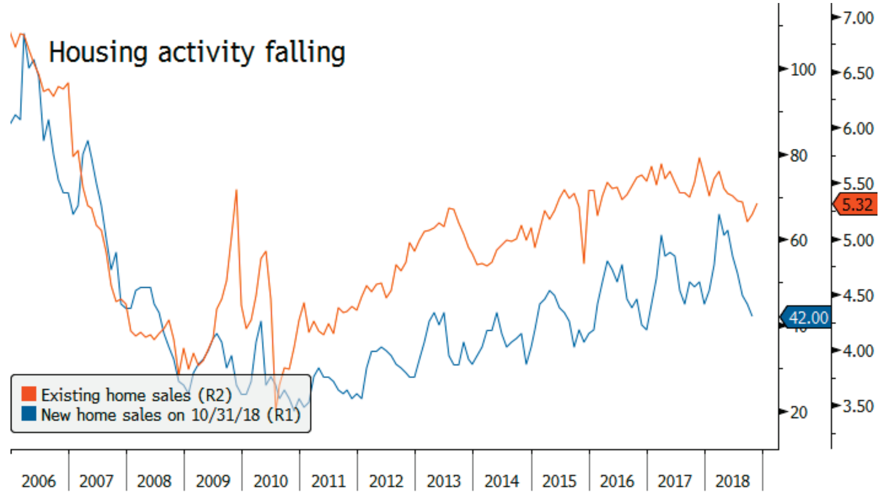
Brexit has also brought forward the importance of the EU and Switzerland renegotiating their bilateral framework to consolidate and replace the 120 different treaties bind them currently. The new framework will be more restrictive than the old, so Switzerland-EU relations aren't an example for countries looking to leave the EU. The negotiations are at a stalemate: an agreement in the near term is unlikely. Disagreements over the free movement of people are a critical issue. A hard Brexit could see the Swiss lose a major trading partner and force the EU to make stringent demands for further access to the single market.



Economics

Interesting Charts for Start of 2019





Economics

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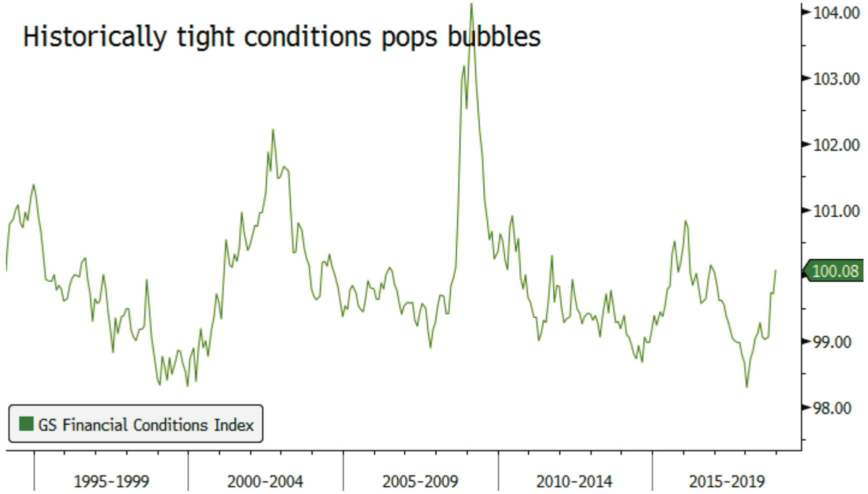

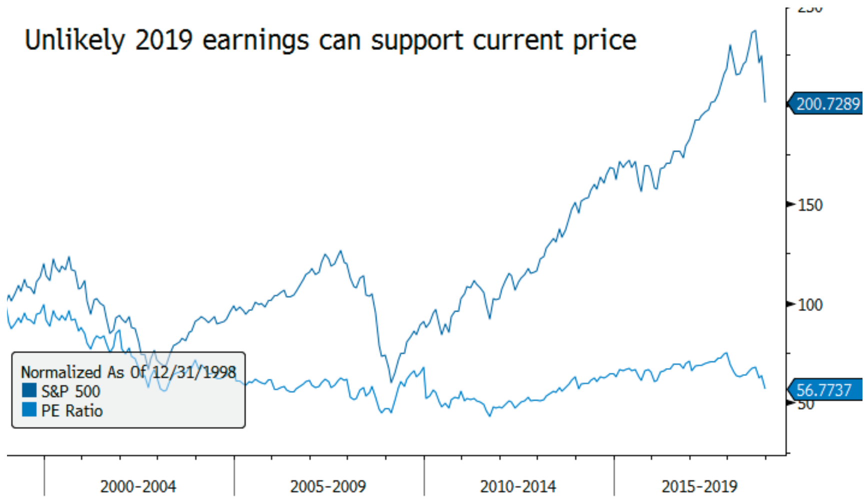

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