The Week Ahead

Active is: Keeping an eye on capital markets

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„Markets in a hangover mood"

Market participants are still suffering from a major hangover caused not only by the lack of results at the EU Brexit summit, but also by the tensions between Saudi-Arabia and the US. And from the markets' vantage point, **Italy's** spending plans for the coming year are a major reason for concern. This time, the Commission does not seem to be willing to let things slide. It rejected the budget draft on Tuesday, and if the government in Rome does not make significant adjustments, the Economic and Financial Affairs Council may initiate an **excessive deficit procedure.** The tug of war between Brussels and Rome (a sequence of recommendations, countermeasures and possibly sanctions) will keep investors on their toes in the coming weeks.

These developments run counter to the trend of the last few years. Since 2011, austerity measures, the economic upturn and the low interest rates have helped to significantly reduce excessive deficits in the EU. After the French excessive deficit procedure was closed this year, only one member state – **Spain** – is still subject to the "corrective arm" of the Stability and Growth Pact, **down from 24 (!) EU countries back in 2011.** 13 member states, including Germany, even achieved a budget surplus last year. Overall, new debt fell from 1.7% of GDP in 2016 to 1.0%. Eurostat announced this week that aggregate public debt amounted to 81.0% at the end of the second quarter of 2018. This is a significant year-on-year decline by 2.4 percentage points.

In the short term, financial market participants will focus on the rating decision by **Standard & Poor's** on Friday. Their reaction – and that of the government in Rome – will depend on whether the rating agency downgrades Italy's rating to junk level or changes the outlook to the downside. During the past week, Moody's downgraded Italy to Baa3 (i.e. one notch above junk level), but kept the outlook stable. This decision was no major surprise.

Publications

"Equity market setbacks are normal"

The recent US equity market setback seems to be little more than a wobble. The global economy is not in recession, although it is slowing down, and monetary policy is still accommodative across the board. Nevertheless, this is cold comfort to investors who have become sensitive to even smallish corrections.

"Will US yields break out of their range?"

After staying stuck in a narrow band for much of 2018, 10-year Treasury yields have only recently stayed above the 3.05% barrier for a prolonged time. This could be the beginning of a sell-off in Treasuries that pushes yields higher, though other factors are putting downward pressure on yields as well.

"What investors need to know about trade wars "

With each new round of tariffs and trade deals, the financial markets are experiencing bouts of volatility as they reprice how economies could be affected. From Trumponomics to Brexit, our experts explore what it all means – and what the future may hold. (click here)

The Week Ahead

As perceived political risks have increased – just think of Italy's fiscal discipline, the possibility of a crash Brexit or the trade conflict between the US and China –, the global economic cycle has entered the mature stage and monetary policy normalisation is making progress, market participants (particularly in Europe) have become cautious after the major correction at the beginning of October. As a result, "safe havens" in the bond markets, such as US Treasuries and Bunds, are well supported.

During the coming week, attention will focus not only on political tensions, but also on **fundamentals**, namely the reporting season for the third quarter and several important leading indicators.

- **Reporting season**: With the markets subdued and several major profit warnings being released in Europe, **earnings figures** which meet more cautious expectations might be sufficient to stabilise the markets at their current levels.
- **Economic activity**: With growth still slightly above potential, divergences at the country level continuing and inflation gradually accelerating, the late-cycle environment remained unchanged at the beginning of autumn. In **China**, the Caixin manufacturing PMI should confirm on Thursday that momentum has slowed since the beginning of the year. In September, industrial activity momentum dropped to its lowest level since October 2017. On Thursday, the manufacturing ISM will show whether the **US** are still outperforming the rest of the world. And in **Europe**, attention will focus on the first GDP estimate for the third quarter due on Tuesday (consensus expectations are subdued) and on consumer price inflation figures for October due on Wednesday (the underlying trend towards reflation looks set to continue against the background of a firmer labour market). In this environment, both the European Central Bank and the Federal Reserve will continue their cautious normalisation. A sustained bond yield decline is therefore unlikely.
- **Politics**: With the Brexit negotiations hitting another bump in the road, the **Bank of England** is unlikely to announce a rate step on Thursday. The results of the European **bank stress tests** might once again redirect attention to Italy. While the share of non-performing loans in **Italian banks' balance sheets** has declined considerably in the last few quarters, from c. 15.2% in the fourth quarter of 2016 to 10.8% in the first quarter of 2018, the high share of Italian government bonds in Italian banks' assets (c. 9%) will cause headaches to some investors.

Active is:

Global growth remains robust, reflation is moderate and real interest rates are low or even negative. However, the global economic cycle is in its mature stage, monetary policy is being slowly normalised on both sides of the Atlantic, and political uncertainties have increased. All this is likely to increase volatility relative to the last few years. In this situation, finesse is required to distinguish between winners and losers in terms of asset allocation.

Upcoming Political Events 2018

30 - 31 Oct: BoJ meeting

1 Nov: BoE monetary policy meeting

5 Nov: BoJ minutes

Overview political events 2018
(click here)

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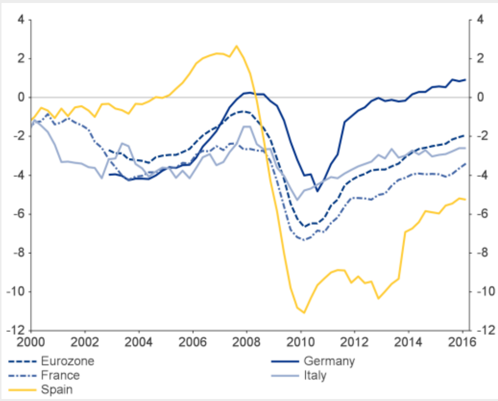
Chart of the Week

Eurozone: The number of deficit sinners is shrinking – a phenomenon from the past?



Source: Allianz Global Investors Global Capital Markets & Thematic Research. Data as of 24 October 2018.

Calendar Week 44:

Monday			Consensus	Previous
IT	PPI YoY	Sep	--	5.1%
JN	Retail Sales MoM	Sep	--	0.9%
UK	M4 Money Supply YoY	Sep	--	1.2%
US	Personal Income MoM	Sep	0.4%	0.3%
US	Personal Spending MoM	Sep	0.4%	0.3%
US	PCE Deflator YoY	Sep	--	2.2%
US	PCE Core YoY	Sep	2.0%	2.0%
US	Dallas Fed Manf. Activity	Oct	29	28.1

Tuesday				
EC	Economic Confidence	Oct	--	110.9
EC	Business Climate Indicator	Oct	--	1.21
EC	Industrial Confidence	Oct	--	4.7
EC	Services Confidence	Oct	--	14.6
EC	GDP SA QoQ	3Q P	--	0.4%
FR	GDP QoQ	3Q P	--	0.2%
FR	Consumer Spending YoY	Sep	--	1.3%
GE	Unemployment Change	Oct	--	-23k
GE	Umemployment Rate	Oct	--	5.1%
GE	CPI YoY	Oct P	--	2.2%
IT	GDP WDA QoQ	3Q P	--	0.2%
IT	Consumer Confidence Index	Oct	--	116
IT	Economic Sentiment	Oct	--	103.7
JN	Jobless Rate	Sep	--	2.4%
US	Conf. Board Consumer Confidence	Oct	136.8	138.4

Wednesday				
CH	NBS Non-manufacturing PMI	Oct	--	54.9
CH	NBS Manufacturing PMI	Oct	--	50.8
EC	Unemployment Rate	Sep	--	8.1%
EC	CPI Core YoY	Oct A	--	0.9%
EC	CPI YoY	Oct P	--	2.1%
FR	CPI YoY	Oct P	--	2.5%
IT	Unemployment Rate	Sep P	--	9.7%
IT	CPI YoY	Oct P	--	1.5%
JN	Industrial Production YoY	Sep P	--	0.2%
JN	Consumer Confidence Index	Oct	--	43.4
JN	Construction Orders YoY	Sep	--	0.5%
JN	BoJ Interest Rate	Oct 31	--	-0.10%
JN	BoJ 10-Yr Yield Target	Oct 31	--	0.00%
UK	GfK Consumer Confidence	Oct	--	-9
US	ADP Employment Change	Oct	194k	230k
US	Chicago Purchasing Manager	Oct	61.2	60.4

Thursday				
CH	Caixin Manufacturing PMI	Oct	--	50
JN	Vehicle Sales YoY	Oct	--	-3.1%
UK	Markit Manufacturing PMI	Oct	--	53.8
UK	Bank of England Bank Rate	Nov 01	--	0.75%
UK	BoE Asset Purchase Target	Nov	--	435b
US	Unit Labor Costs YoY	3Q P	1.4%	-1.0%
US	Initial Jobless Claims	Oct 27	--	--
US	Continuing Claims	Oct 20	--	--
US	Construction Spending MoM	Sep	0.0%	0.1%
US	ISM Manufacturing	Oct	59.5	59.8

Friday				
IT	Markit Manufacturing PMI	Oct	--	50
JN	Monetary Base YoY	Oct	--	5.9%
UK	Markit Construction PMI	Oct	--	52.1
US	Trade Balance	Sep	-$52.0b	-$53.2b
US	Change in Nonfarm Payrolls	Oct	190k	134k
US	Unemployment Rate	Oct	3.7%	3.7%
US	Average Hourly Earnings YoY	Oct	--	2.80%
US	Factory Orders MoM	Sep	-0.3%	2.3%
US	Factory Orders ex. Transport MoM	Sep	--	0.1%