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WHAT TO EXPECT NEXT WEEK

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HIGHLIGHTS

- The Fed's meeting (18) will be the important event of the week. We expect a 25bp drop in the Fed's main rate and nothing on the balance sheet policy.
  The important point will be Powell's explanation of this move at his press conference. In July, the main explanations of the 25 bp drop were external factors (trade, global growth). Will these elements remain the principal explanation ? What will be the new growth forecasts consistent with this new monetary policy stance ?
- The US industrial momentum (17) will be an important data as the ISM synthetic index for August dropped below the 50 threshold at 49.1. The consistency between the two indicators suggests that the industrial production index YoY change could go in negative territory. Will the industrial index follow this dynamics in August? The Empire state (16) and the PhilyFed (19) will give information on the economic situation in September
- The ZEW (17) in Germany for September will be key to anticipate the possibility of a German recession and therefore the possibility for a more proactive fiscal policy. Draghi, in his press conference last Thursday, said that a eurozone fiscal policy would be complementary to the ECB monetary policy to boost growth and inflation.
- Chinese number (16) will show how the economic policy efficiency of an arbitrage between an external negative shock and the necessity to feed the domestic demand to stabilize the economic activity. Industrial production was weak in July while retail sales were stronger than a few months ago.
- Retail sales in the UK (19) in the midst of a political mayhem. What has been consumers' behavior ? Have they increased their stocks to prevent the impact of a no deal Brexit ?
- US housing market with Housing starts (18) and Existing home sales (19)? The market is quite stable.
- In Brazil, the Selic will not be pushed down at the next monetary policy meeting (18) as the Brazilian central bank has had strong intervention on the forex market to limit the depreciation of the real.

NEXT WEEK'S MAIN DATA AND EVENTS

- **The most important event will be the Federal Reserve meeting on monetary policy. The statement and the Powell press conference will be on September the 18th.**

  We expect a drop of 25 bp of the fed funds rate. It will then be in the corridor 1.75 – 2.00%. The important point will be the expectations' profile of the Fed's rate in coming months. The dot graph will be informative. Investors expect three drops in rate this year (meaning another one in December) and two more in 2020. No change is expected on the balance sheet policy. The change on this point was announced at the July meeting.
  In July, Powell gave three reasons to explain the rate drop: trade uncertainty, global growth slowdown and low inflation expectations. Will the explanations be the same ? The interesting point, already mentioned last January, is that these explanations are not directly dependent on the US economic situation.
  In other words, this view in the conduct of the US monetary policy leads to a confusion between the early bird shift in the US monetary policy and the robustness of the US economy. The monetary policy suggests that the economy is a the eve of a rapid slowdown and that there is an absolute necessity to adapt the monetary stance to this state of the economy. Economic indicators are not a the level usually seen in the past that could be consistent with a change in monetary policy. In the past there is a good match between this change and the CFNAI converging to -0.7. The Chicago Fed National Activity Index (CFNAI) synthetizes 85 US economic indices in one. It's a good and balanced measure of the economic situation. When the index approaches -0.7 the risk of recession is high. This level is usually a trigger for the Fed. The last available number is July and its level is just -0.14, very far from the recession level. The interesting point at the Fed's meeting will be the new forecasts on growth, inflation and unemployment. Will they fit with a risk of recession that is include in the monetary policy stance ?

  Nothing is expected at the Bank of England meeting (September 19) nor at the Bank of Japan's (September 19) and at Bank of Brazil meeting due to to the real's depreciation

- **The focus will be on the industrial activity in the US (Industrial production (17) The Empire state survey (NY Fed (16) and the PhilyFed (19))**

  These number will be crucial for the US economy. First, the industrial production index for August will be released on the back of a weak ISM index for the manufacturing sector in August. Will both fit is an interesting question. Recent data suggest they will.. The Empire state survey and the PhilyFed will give information on the dynamics at the beginning of this fall.

- **The German ZEW will be released next Tuesday (17)**

  Germany is still a source of worry in the Euro area. Recent numbers on this indicator were bleak announcing a strong risk of recession in Germany. The ZEW is a financial analyst survey. The recent upside swing of long term interest may have changed their expectations leading to an improvement.

- **Chinese number on economic activity (Retail sales, Industrial production, Investment (16)**

  The arbitrage in China is between managing an external shock (seen on the contraction of exports in August and their lower momentum in recent months) and feeding domestic demand to limit the risk of a severe slowdown. The recent dynamics on the industrial production is low and much lower than a year ago. It is the contrary seen on retail sales. The dynamics is stronger than a few months ago but remains weaker by historical standard. Investment is weak now.

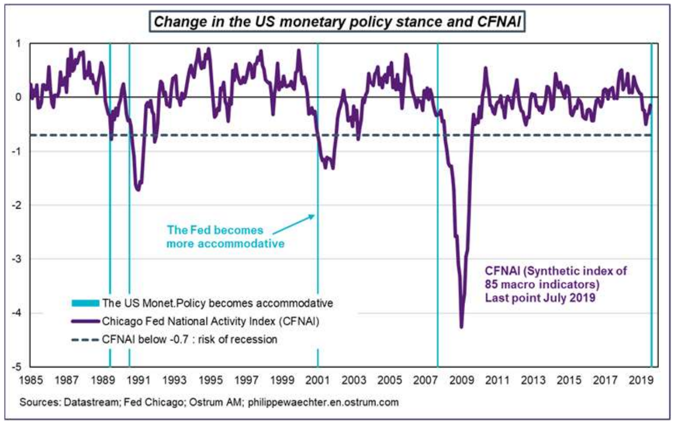
- **Retail sales in the UK (19) for August – What will be the impact of the political mayhem on consumers' behavior ?**

- **Housing starts (18) and Existing home sales in the US (19). The market stabilized recently**

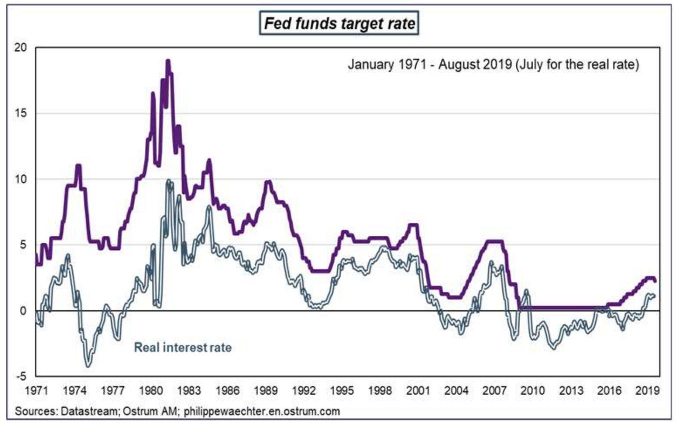
- **Other points**

  Trade balance in Japan (18), Housing price in China (17), Industrial orders in Italy (29), Current Account in the Euro Area (19), Japan CPI (20), Confirmation of the CPI in the EA (18) and

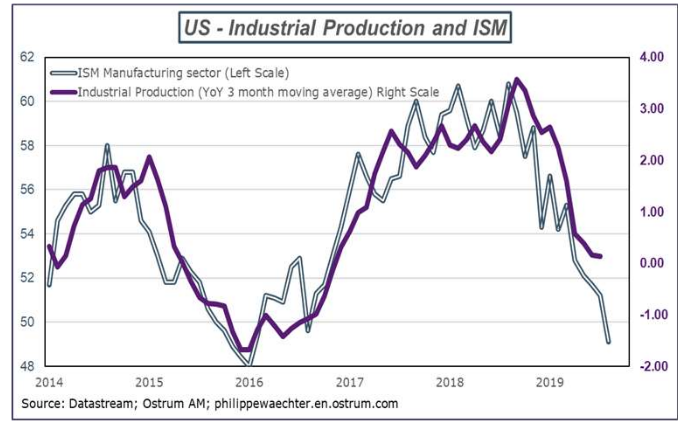
MAIN GRAPHS



The change in the monetary policy stance is not consistent with the US macroeconomic backdrop. In the past, except in 2008 where liquidity was missing, the Fed becomes accommodative when the economy is converging to a recession. What are the current drivers? Equity market? If true it’s a Fed's failure

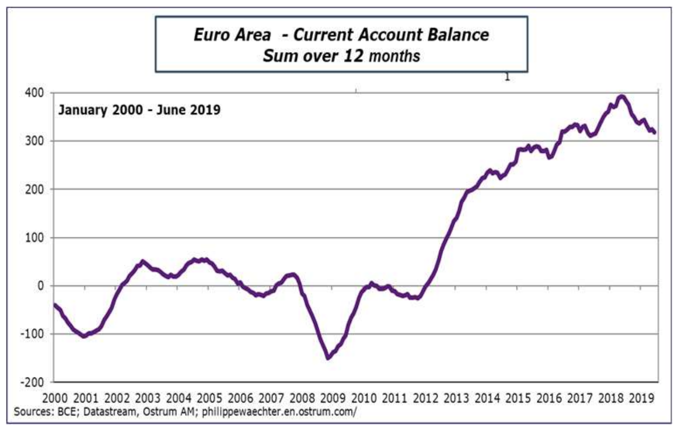


It the threat is a higher risk of recession, then the Fed can push down its interest rate by at least 1% as real rate is still positive. From 2010 to July 2018, it was negative. It would be consistent with the expected 4 drops by investors in 2019 and 2020 (still 2 in 2019 and 2 in 2020°

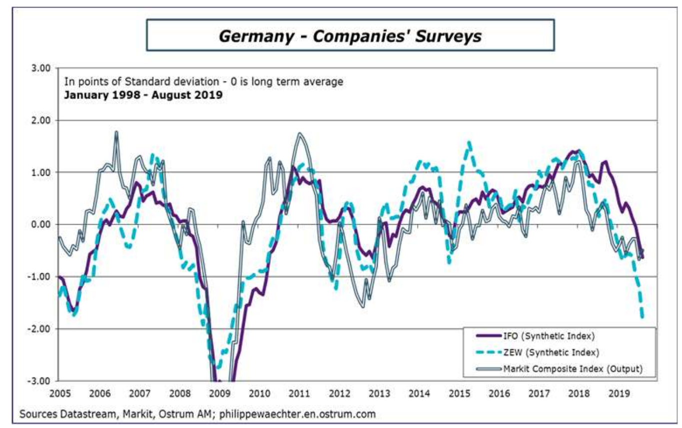


The recent drop of the ISM index for the manufacturing sector puts the industrial production momentum at risk. The two indicators are a representation of the business cycle and both profiles are consistent. The rapid drop below 50 for the ISM is a clear alert for the US economy.

The Chinese industrial production index has a kind of stable growth since 2015? Nevertheless, the recent dynamics suggests that the trend is no on the downside. It can't be totally independent with the US trade war.



When we discuss the possibility for a stronger fiscal policy, we must have this graph in front of our eyes. Since 2012, the Eurozone current account (19 for July) is ballooning, representing circa 3% of the GDP. This means too much saving compared to investment. We have to spend more and the answer is in Germany.



German surveys are rapidly trending downward. All of them are below their long term average (below 0 in the graph). The ZEW index(17) is specifically negative. A higher number for September wouldn't mean a rapid and strong recovery.

ADDITIONAL NOTES

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