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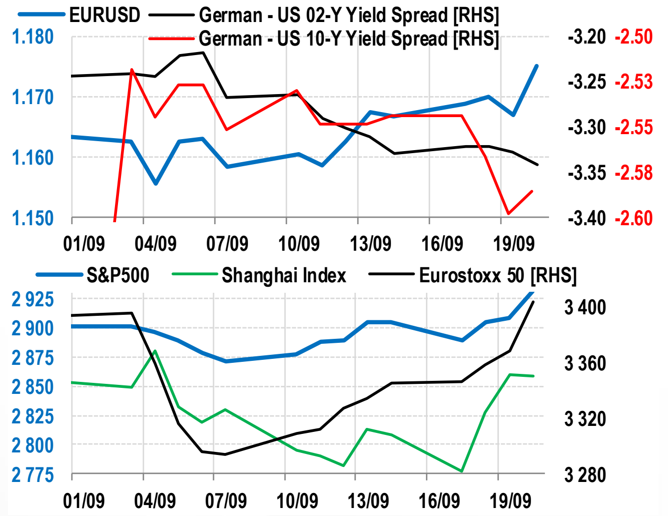
Markets feeling better though nothing has changed

■ Judging by the recent developments in financial markets, investors feel more upbeat ■ On the economic front (growth and the outlook for monetary policy) nothing has really changed ■ The euro has benefitted from the 'risk-on' environment despite a widening interest rate differential with the US

Looking at the recent developments in equity markets it seems investors are feeling better. At first sight one wonders why. President Trump has announced that 10% tariffs would be imposed on USD 200 bn of Chinese imports. These could be increased further to 25% in the absence of a satisfactory outcome of the bilateral negotiations. China reacted promptly with tariffs targeting USD 60 bn of US imports. Surprisingly, the Shanghai stock market moved higher, a reflection that a lot of bad news was alread priced in, as well as a sign of hope that in the end common sense will prevail and a deal will be reached. On the data front, the US economy continues to do very well and this has been a support for Wall Street. In recent weeks, the Federal Reserve Bank of Atlanta's nowcast, a real-time estimate for growth, has fluctuated between 3.8 and 5.0% annualised quarterly growth for the third quarter. Currently it is at 4.4%. Unsurprisingly, US treasury yields have increased, crossing the psychologically important 3.00% mark on the back of a higher term premium (the risk premium required by investors to buy long-dated paper), but also a higher likelihood (77.8% at the time of writing) that, at the December meeting of the FOMC, the federal funds rate would be raised again (markets are pricing in a 100% probability that at next week's meeting there will be a hike). In the eurozone on the other hand, the story is more about growth stabilisation after a slowdown in the first half. The Markit PMI composite indicator for September declined but only slightly so (54.2 versus 54.5 in August). The message from last week's ECB meeting didn't really change either. The difference in economic momentum has contributed to a widening of the interest rate differential between the US and Germany but this didn't stop the euro from strengthening against the dollar. This at first sight counterintuitive development is another illustration that investor risk appetite has picked up. One can expect that in due course the focus will shift back to sources of uncertainty like Brexit negotiations, US mid-term elections, the protectionist threat and the situation in certain emerging markets.

DOLLAR, RATES, STOCK MARKETS



Source: Bloomberg, BNP Paribas.

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