Weekly round up (Week 43)

Investors spent most of last week in “wait-and-see” mode, ready to adjust their expectations and positions as news on domestic and geopolitical developments, growth and inflation data, and bank and corporate earnings were expected to provide greater visibility on the future trajectory of the global economy and asset prices.

In Japan, Parliament elected Sanae Takaichi as the country's first female prime minister. In her inaugural address to the legislature, Ms. Takaichi pledged to prioritize tackling the cost-of-living crisis and strengthening national defense, with a goal of raising defense spending to 2% of GDP. The next stimulus package, estimated at more than US$92 billion, will be financed mainly by higher-than-expected tax revenues and unspent funds from previous budgets, according to the new finance minister.

The first inflation report since Takaichi took office highlighted why tackling the rising cost of living is at the top of his political agenda. Japan's key inflation indicator has remained at or above the Bank of Japan's (BoJ) 2% target for three and a half years. Headline inflation accelerated to 2.9% year-on-year in September from 2.7% in August, in line with forecasts, mainly due to higher energy costs. The core consumer price index (CPI) also rose from 2.7% to 2.9%.

The good news is that service inflation, which is a key concern for the BOJ, fell slightly from 1.5% to 1.4%, probably due to the removal of childcare fees and slower price growth in the restaurant sector following the decline in rice prices. However, in terms of purchasing power, the price of rice still rose by 49.2% year-on-year.

The BOJ is expected to keep rates unchanged at its next monetary policy meeting on October 30, with the overnight interest rate swap market pricing in an 86% probability of a 25 basis point (bp) hike at the January meeting. Meanwhile, the Japanese yen was the weakest currency of the week, as macroeconomic investors revised down their rate expectations and questioned the sustainability of Japan's long-term debt.

Elsewhere in Asia, observers in China closely followed news from the Fourth Plenum in Beijing, where leaders are expected to set out development plans for the next five years. The GDP growth target is expected to be between 4.5% and 5.0%.

Chinese leaders were greeted with good news at the opening of the Plenum: the economy grew by 4.8% year-on-year in the third quarter, bringing cumulative growth to 5.2% since the beginning of the year, well above the 5% target. Annualized growth of 4.5% in the fourth quarter would now be enough to reach the annual target. However, warning signs remain, with growth slowing (after 5.2% in the second quarter) and becoming increasingly unbalanced, relying heavily on exports and industrial production in emerging sectors such as digital products, drones, electric vehicles (NEVs), and robotics. Deflation persists, with the GDP deflator at -1.0% year-on-year, marking the tenth consecutive negative quarter.

In the short term, Chinese growth remains supported by exports and manufacturing, but persistently weak demand, deflationary pressures, and the slowdown in the real estate sector highlight the structural challenges facing the economy. Investors are therefore watching the Fourth Plenum closely: an explicit inflation target, a commitment to increase the share of consumption in GDP, or new measures to support the real estate sector would be welcome.

In Europe, it was a positive week for the UK. As investors eagerly await the autumn budget, the government and the gilt market received encouraging news. Inflation remained stable in September after the first fall in food prices in 16 months. The headline CPI remained at +3.8%, below the +4.0% expected, while the core CPI fell unexpectedly to +3.5%, compared with +3.7% forecast. [6] This prompted investors to raise the probability of a Bank of England rate cut in December to 65%, up from 40% previously, and helped make the gilt market the best-performing government bond market of the week, with 10-year gilt yields falling by 9 basis points.

The government should also be relieved by the positive surprises in both the Purchasing Managers' Index (PMI) and retail sales. The composite PMI rose from 50.1 to 51.1. Retail sales rose for the fourth consecutive month, up 0.5% month-on-month and 1.5% year-on-year. These data suggest an unexpected acceleration in growth in the third quarter, providing welcome support for the economy and public finances.

US investors are still waiting for signs of a resolution to the government shutdown, now the second longest in history. The Senate has failed 12 times to pass its funding bill.

Despite the shutdown, President Trump's public statements continue. Trade negotiations with Canada have been suspended, apparently in response to an advertisement against tariffs funded by the Ontario government.

More significantly, the White House appears to be initiating a diplomatic shift: Trump is scheduled to meet with Chinese President Xi on October 30, on the sidelines of the APEC summit, while announcing new sanctions against Russian oil companies Rosneft and Lukoil, accusing Russia of not seriously engaging in a peace process in Ukraine.

Oil prices have rebounded, rising more than 8% over the week, reflecting the changing supply dynamics. Given that much of the global oil trade relies heavily on US-based financial and insurance services, concerns are emerging about the ability of buyers to continue purchasing Russian oil. Russia exports about 7.3 million barrels per day, or 7% of global crude and refined products, with India and China currently the largest buyers, accounting for nearly 3.6 million barrels per day (see chart of the week). Indian refiners have already announced plans to suspend almost all purchases of Russian crude oil, while Chinese state-owned companies, including Sinopec, have canceled some Russian sea shipments following the announcement of sanctions.

Finally, the release of some notable economic data for the US economy: the consumer inflation report, which had been delayed. The overall CPI rose 0.31%, while the core CPI rose 0.23%, both slightly below forecasts. Inflation slowed for both goods and services. According to Bloomberg, the tariff pass-through rate stood at 0.26% in September, virtually unchanged from the previous three months, indicating that for every US dollar of increased tariff costs, businesses passed on about 26 cents to consumers. Investors now expect a 99% probability that the Federal Open Market Committee will ease its policy by 25 basis points at each of its last two meetings in 2025.

Despite the government shutdown, the private sector remains active: the third-quarter earnings season is in full swing, with 25.1% of the S&P 500's market capitalization having already reported their figures. Earnings are exceeding forecasts by 7.7% on average, and 84% of companies have exceeded expectations. Earnings per share (EPS) are growing at a rate of 10.2%.

It has been a positive week for investors. Geopolitical developments have taken a favorable turn, with global authorities increasing pressure on Russia to end the conflict in Ukraine, while the announcement of a meeting between Xi and Trump has reduced fears of a trade escalation between the world's two largest economies.

Equity markets rose sharply worldwide, with Asia leading the way, buoyed by both an improved geopolitical climate and the pro-growth policy of Japan's new prime minister.

At the same time, economic data was encouraging for bond markets, with investors finding some comfort in signs of easing inflationary pressures and a limited pass-through effect from tariffs, giving central banks more room to support growth and employment by gradually easing their restrictive policies.

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