AQUILA

Flash

8 points for Q2 2015

- **The US economy will rebound quickly from the growth slowdown in Q1**
- **The Chinese government has scope to boost the economy if it needs to**
- **A June rate rise from the Fed is not yet completely “off the table“**
- **The ECB will implement its bond-buying (QE) program as announced**
- **The Bank of Japan is set to pump liquidity into the system at an even faster rate**
- **Athens can still reach a deal with the rest of the EU**
- **The Ukrainian crisis looks set to spread**
- **UK elections could upset UK markets but should not have a wider impact**

Overall, the macro and monetary policy environment remains favorable for “risk assets”. Although the Fed might start raising rates sooner than markets now expect, and despite the various risks associated with Greece and the Ukraine, we retain our overweight stance in equities for the time being.

The disappointing performance of the US economy in Q1 reflects mainly one-off factors.

GDP figures for the US in Q1 are likely to show a sharp fall-off in growth. They will reflect bad weather, a ports strike on the US West coast, poor trade flow data as well as a lower rate of investment in the energy sector. For several reasons we expect the economy to show a good recovery in Q2 and stick with our view that a growth rate of near 3% will be achieved for 2015 as a whole.

The Chinese economy will grow in line with official requirements.

The Chinese economy is shifting from an investment-led growth process to one based on consumer spending. In this context the trend growth rate will fall yet again this year. We are not forecasting a property collapse in China. Nor do we predict a credit crunch. Rather, we believe that the government has enough room for maneuver, in terms of fiscal and monetary policy and its approach to regulation, that an overall growth rate in line with targets can be achieved.

A Fed rate move in June is still a possibility.

The words “patient in removing accommodation“ were dropped from the statement released following the Fed’s FOMC March meeting, indicating that a June rate rise is possible. But it is not inevitable. The Fed will remain cautious in its approach to policy tightening. That said, and given our expectations that the US economy will improve in Q2, we think a June rate move has a higher probability than markets are now discounting.

Despite its critics and the clear improvement in the European economy, the ECB will implement QE in line with its announced plans.

On January 22nd of this year the ECB announced an extensive program to purchase bonds. Purchases will be in the range of EUR60bn. a month until at least September 2016, by which time over EUR1.1trillion should have been pumped into markets. Although the Eurozone economy may well surprise positively in coming months, and despite the prominent critics of the ECB’s plans, we believe that the announced QE program will not be curtailed in any way.

The Bank of Japan will yet again expand its bond-buying program.

The Bank of Japan (BoJ) is currently pumping USD 60bn. worth of yen per month into the markets, buying mainly Japanese government bonds. But its own estimates suggest that inflation is stuck at around 0%, well short of the BoJ’s 2% target. As a result, we expect the BoJ will yet again expand its QE program, already the most aggressive in central bank history, if not in April then in July.

Athens can still reach a deal with the rest of the EU.

The latest estimates suggest that Greece will run out of money by the end of April and substantial debt repayments are scheduled for the summer months. Our view is that some sort of compromise between Athens and the rest of the EU is still more likely than a Greek exit from the Eurozone and from the EU. It is also conceivable that the Greeks would comply with their international obligations but that domestic liabilities would be covered through specific debt instruments involving a sort of parallel currency.

The conflict in the Ukraine will spread.

The conflict in the Ukraine has slipped out of the headlines. But the situation has not gotten better. We expect the struggle to intensify in coming months, with the separatists making gains both to the south-east and to the north-east of the area they presently control.

Either way, the elections in the UK are likely to have negative consequences

The forthcoming UK general election in early May is unlikely to produce a single winner with a working majority in the House of Commons. Any Labour-led coalition is unlikely to be business-supportive. On the other hand, a Conservative-led coalition will probably be committed to holding a referendum on the UK’s continued membership of the EU by 2017.

For the time being we remain overweight in equities.

The positive macro-economic and monetary policy environment for financial market “risk assets“ remains broadly in place. Despite the risk that US rates may rise more quickly than the market now expects and the potential for trouble to emanate from Greece or the Ukraine, we are staying overweight in equities for the time being. The UK elections could result in a weaker sterling, but we think their immediate impact will be restricted to UK markets. Given the widening divergence of monetary policy, with the US set to tighten on the one hand and the ECB and BoJ set to continue either very, or even more, expansionary policies on the other, we expect that the US dollar will continue its appreciating trend against both the euro and the yen. Partly for this reason, we continue to prefer European and Japanese stocks to American stocks.

Aquila & Co. AG, 15. April 2015