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Market Update

20 November 2015

This week's update will be focus on the EU and Europe as a whole. So let's state the EU is an economic power house in progress.

Why is the EU and Europe so relevant to globe stability and to future economic growth? What the EU and Europe lack as a whole is geopolitical stability which makes it vulnerable to attacks. It is not a fire proof house like North America. It has a very unfriendly neighbour to the north which deeply regrets giving up the old European nation's behind the iron curtain. President Putin's desire to bring back to grandeur the Russian of old is real. The south of the continent is on the Mediterranean which has proven difficult to police and very porous to smugglers.

The old continent represents the cradle of western ideals, culture and pursuit of freedom. Even more so, it represents our attachment to the past. For Canadian families, which made the supreme sacrifice in the fight to over throw fascists and communist rule. The connections to Europe are very real and fresh in our minds. Unfortunately, our world is full of those who wish to take life, liberty and wealth from others to fuel their own very ill agenda's. We as Canadians are so fortunate to live in a society which rule of law is upheld and matters to us all.

The current events unfolding in the EU will be bellwether for how the American Federal Reserve will act in the months ahead. Based on the pattern of events in the old continent and the recent actions of the Bank of England are pointing to further deflation and quantitative easing resulting in interest rates going to zero.

The Euro zone represents the second largest and most affluent consumer base in the world. It is a vital part of total global consumption. China has the distinction of being the second largest economic engine and wealth is held only buy a select few. Consumptions rates per citizen are no where near America's. Even though the EU concept has played out many times in history, the actual formation of a binding union is new. As any newly minted union there will be growing pains, economic upheaval and defiant member states. It is also critical to note that the EU has the second most widely held and traded currency in the world, the Euro dollar. Two essential foundational pillars of any economy are consumer appetite for consumption and the tradability or worthiness of the underlying currency. The EU has both.

Let examine the latest action by Mario Draghi, president of the European Central Bank.

European Central Bank President Mario Draghi set the scene for further stimulus in two weeks' time, saying the institution will do what's necessary to reach its inflation goal rapidly. "If we decide that the

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current trajectory of our policy is not sufficient to achieve that objective, we will do what we must to raise inflation as quickly as possible," "In making our assessment of the risks to price stability, we will not ignore the fact that inflation has already been low for some time." These comments underline the ECB's concern that the inflation rate in the 28-nation euro area, currently 0.1 percent, will slip further from the ECB's target of just under 2 percent due to a high degree of economic slack and slumping oil prices.

Policy makers are weighing the need for an expansion to the 1.1 trillion-euro ($1.2 trillion) quantitative-easing program which started in March and add measures such as taking the deposit rate further below zero.

The yield on German 2-year bonds slid to a record low of minus 0.389 percent and the euro dropped. The single currency was down 0.4 percent at $1.0689 at 2:47 p.m. Frankfurt time.

Additional quantitative easing will be forth coming as clearly stated by Draghi comments: "If we conclude that the balance of risks to our medium-term price stability objective is skewed to the downside, we will act by using all the instruments available within our mandate." "In particular, we consider the asset-purchase program to be a powerful and flexible instrument, as it can be adjusted in terms of size, composition or duration to achieve a more expansionary policy stance."

Draghi said core inflation, which excludes energy and food, is also a signal of too-weak price pressures. The rate was 1.1 percent in October. While that's the highest reading in more than two years, it's still barely half the goal for the headline rate. This translates to not enough demand exists to allow prices to increase coupled by Europe being awash with cheap Asian goods.

The core concern in the EU and Europe is deflation and/or stagnation which as been extremely stubborn to stave off. As indicated by Draghi: "Low core inflation is not something we can be relaxed about, as it has in the past been a good forecaster for were inflation will stabilize in the medium-term." "While core industrial goods will receive support from the depreciation of the euro, an increase in core services inflation –- today close to an all-time minimum –- will depend on rising nominal wage growth. For that to pick up, the economy needs to move back to full capacity as quickly as possible."

Currently the ECB is buying 60 billion Euros a month of bonds and intends to do so through at least September 2016. The deposit interest rate is at a record-low minus 0.2 percent.

There is little room for doubt that the central bank is not only about to step up its monetary stimulus, but plans to do so decisively. Expect the ECB to step up the pace of QE by 20 billion Euros per month. A clear signal asset purchases will go on beyond September 2016. Additionally, the ECB will expand the eligible universe of asset buying to include regional bonds. Lastly to ensure all threats are stomped out the ECB will take action by reducing deposit rates by 10 basis points including guidance that it would cut rates further if necessary.

Bouts of deflation and stagnation are not new to global events with the most recent being in 2011.

The data coming out of Europe can be an indicator as to specific monetary policies coming from the American Federal Reserve in the months ahead. Such quantitative easing in the EU will only lead other nations to manage their currencies accordingly avoiding out of control fluctuations and rampant inflation in their respective countries.

For North America, raising interest rates in Canada or America while, the EU, the second largest consumption machine in the world has their central bank print money and buy assets like mad will only see a repeat of what Switzerland's saw their franc which wildly appreciate forcing the Swiss central bank to intervene. The American Federal Reserve will not allow this to happen. Doing so, would see American export fall out of favour globally and job creation will quickly turn into lay offs

Markets are showing strong resilience to geopolitical events and in the face of falling commodity prices. However, productivity rates in North America are not at necessary levels to allow such an upward swing interest rates pushing currency rates higher which intern would immediately impact the ability to remain competitive in the global export market and ultimately slowing economic growth in America. A move by the American Federal Reserve would also see the Bank of Canada follow suit.

The American Federal Reserve wants to move away from running the money printing press 24/7 which is a broad and general purpose tool to stimulate economic growth by transitioning to a very precise and limited tools of stimulating economic growth in specific areas. Such as infrastructure expansion which will allow for higher levels of production capacity in the decades to follow.

Europe is our oldest and dearest dance partner throughout history, not just politically.   It is unfortunate that due to the lack of cohesiveness of the ECB and the EU leadership have lead to a log jam in executing vital monetary and fiscal policy in a timely fashion.

One item is very certain, quantitative easing serves to move asset prices higher!

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