



Julius Bär

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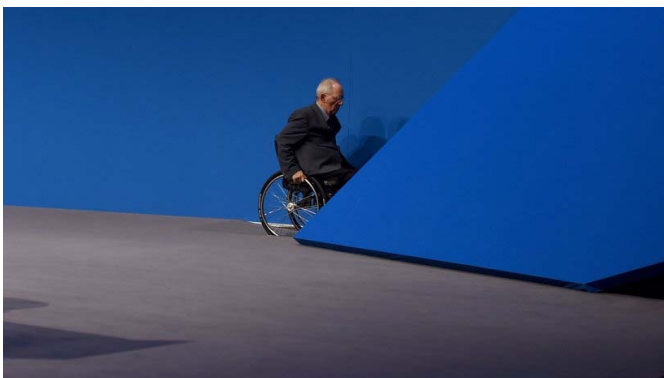
CURRENCIES & MORE OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Euro: We elaborate on Finance Minister Wolfgang Schäuble's potential successor
Yen: The Tankan report for Q3 was very solid but the Yen could not gain on this but weakened
Dollar: Core PCE – the Fed's preferred inflation gauge – rose only 1.3 percent in August

Euro: Who will be Germany's next Finance Minister?

As Wolfgang Schäuble is leaving his position as Finance Minister to become President of the Bundestag – the number-two position in Germany after the Federal President – the question arises who will be his successor. Gianni Pittella, Member of the European Parliament, once said that European politics are coined by the “evil hand of Schäuble”.

Wolfgang Schäuble is leaving



Source: Spencer Platt / Getty / The Atlantic

Well, Pittella might have opened a bottle of champagne last week but his hopes for a “softer” German Finance Minister might soon vanish into thin air. Whether one likes it or not, given the importance and economic power of Germany, the country's Finance Minister is one of the most important policymakers within the Euro-zone. Schäuble has often been described as “co-Chancellor” of Angela Merkel. In German politics, it is usually the case that the largest party chooses the Chancellor, and the second largest group picks the next post. As the Free Democrats received a slight larger voters share than the

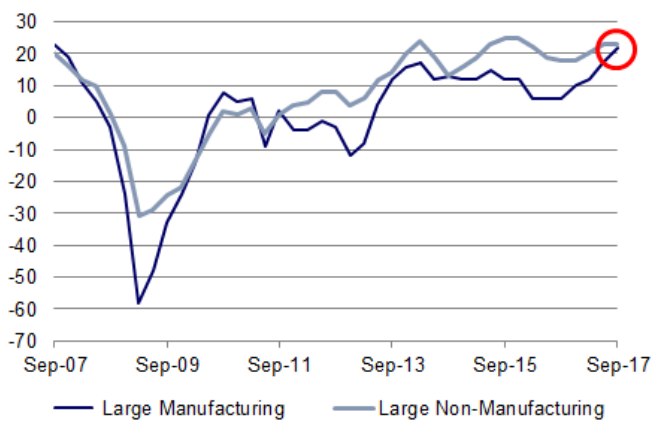
Greens (10.7 vs. 8.9 percent), they will probably claim the position of the Finance Minister. The Greens are likely to opt for the Foreign Ministry. Merkel has to offer two prestigious Ministries to the junior partners; otherwise she will have difficulties forming a coalition with them. Therefore, we think it is unlikely that a Christian Democrat will be at the helm of the Finance Ministry again, even though some argue Jens Spahn, State Secretary in the Ministry of Finance, could be Merkel's choice. There is a natural preference in the market for Christian Lindner, as he is party leader of the Free Democrats. We see a rather low probability for him as he has never had a ministerial post and the Chancellor is not thought to be a fan. Furthermore, he made some comments after the federal election which are unlikely to have pleased Merkel. For instance, he tweeted that “Germany does not need a new Finance Minister, but a new financial policy”. Some other comments from Lindner indicate that he prefers to stay outside of the new government and remain leader of the faction in order to keep some “legroom”, as he put it in an interview with “Die Welt”. Instead, Lindner is promoting Werner Hoyer, the President of the European Investment Bank. More likely, in our view, will be Wolfgang Kubicki or Volker Wissing. Kubicki would be ideal as he helped to forge a state government in Schleswig-Holstein this year with Merkel's Christian Democrats and the Greens, which will now serve as a national model (“Jamaica coalition”). He is a member of the Bundestag since 1990 and Vice Chairman of the Free Democrats since 2013. Wissing is Chairman of the party's finance and tax policy committee and has experience working with the Greens in Government in his home state Rhineland-Palatinate, where he is Economy Minister.

Conclusion: We think either Kubicki or Wissing will be Germany's next Finance Minister and both have the profile to follow in the footsteps of Schäuble. Both of them stand for a solid financial policy in Germany and the Euro-zone.

Yen: Strong Q3 Tankan

This morning, the BoJ released its Tankan Report for Q3. Especially the Large Manufacturer component is noteworthy as the index reached the highest level in a decade, almost catching up with the non-manufacturing counterpart which has stabilized at the level of the previous quarter (see chart below). Furthermore, also the Large Manufacturer’s outlook is rising, from 15 in Q2 to 19, topping expectations of 16. Interestingly, the Yen has not strengthened on this but weakened from 112.50 to 112.90 against the Dollar.

The Tankan report in the past 10 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The Tankan report was very solid.

QUICK NEWS HEADLINES (time in CEST)

The following three headlines might have an impact on currency markets today:

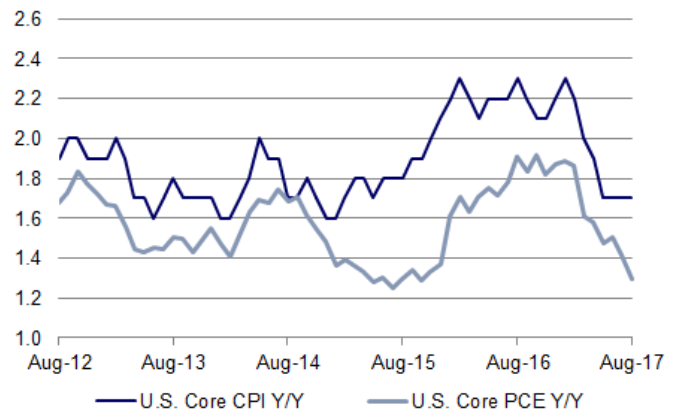
- Poland: The Manufacturing PMI for September is expected at 53.0 (09:00).
- Czech Republic: The Manufacturing PMI for September is expected at 55.1 (09:00).
- U.S.: The ISM Manufacturing for September is expected at 57½ (16:00).

Dollar: Personal Consumption Expenditures

Core PCE, the Fed’s preferred measure for inflation, has lagged its more popular counterpart core CPI for three years now (see chart below). The core PCE gauge, which – like core CPI – excludes volatile food and energy costs, increase 1.3 percent in August from a year earlier, Commerce Department figures showed Friday. We received questions from clients why there is such a wide spread between the two core measures. In our view, the divergence in the two core measures can be blamed largely on

the healthcare figures. While health is typically the most significant share of the core PCE gauge, it makes up less than 10 percent of the core CPI. Consequently, CPI covers Americans’ out-of-pocket spending on healthcare and the PCE measure is more impacted by congressional administered costs for Medicare and Medicaid. The larger share of health care costs better reflects reality than the less than 10 percent component in CPI, in our view.

Core CPI and PCE in the past 5 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: Core PCE is deviating further from the Fed’s 2-percent inflation target rather than converging to it.

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