بنك أبوظبي التجاري ADCB

The Weekly Market View

October 24 2016

Mr. Draghi remains committed to QE in spite of “no action”

Global financial market started last week with a seemingly perceived notion that China’s growth momentum is intact, as the third quarter growth was same as the second quarter one and matched the consensus expectation. As the week progressed, companies’ earnings for the third quarter, especially in the US were somewhat positive. To supplement the sentiment further, ECB quelled the doubt over the QE tapering and indicated that announcement of the QE extension will likely happen in December. Besides these developments in developed market, two major emerging markets’ central bank (Brazil and Indonesia) reduced the policy rate. Market seems to have ignored the underlying of China’s growth dynamics which is still pushed through more investments amid these positive developments. Market seems to have also ignored strength in the dollar as we see EM outperforming DM last week.

US third quarter growth and global preliminary PMIs to guide the market

In the midst of the third quarter earnings, which off course would be an important driver of the equity market in the near term, third quarter GDP number and global PMIs are likely to have influence as well. Any large surprises in the details of the US third quarter GDP could have implication for the global financial market if it leads to readjustment in the Fed hike expectations this year. Global manufacturing PMIs, which are expected to remain around the last month’s level also provide a sense of industrial cycle in the developed countries. Moreover, the third quarter GDP in the UK will also throw a light on the early impact of the Brexit on the country’s economy, where high frequency data over the last three months have not indicated any significant impact.

Rahmatullah Khan
Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Wietse Nijenhuis
Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Prerana Seth
Fixed Income Strategist
Tel: +971 (0)2 696 2878
prerana.seth@adcb.com

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Past week global markets’ performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,141.2	0.4	4.8
Dow Jones	18,145.7	0.0	4.1
Nasdaq	5,257.4	0.8	5.0
DAX	10,710.7	1.2	-0.3
Nikkei 225	17,184.6	1.9	-9.7
FTSE 100	7,020.5	0.1	12.5
Sensex	28,077.2	1.5	7.5
Hang Seng	23374.4	0.6	6.7
Regional Markets (Sunday to Thursday)			
ADX	4294.5	-1.2	-0.3
DFM	3340.5	0.2	6.0
Tadawul	5651.8	-0.7	-18.2
DSM	10438.5	0.5	0.1
MSM30	5562.31	-1.7	2.9
BHSE	1151.8	0.6	-5.3
KWSE	5321.5	-0.1	-5.2
MSCI			
MSCI World	1,701.2	0.4	2.3
MSCI EM	911.2	1.6	14.7

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	51.8	-0.3	38.9
Nymex WTI USD/bbl	50.9	1.0	37.3
OPEC Baskt* USD/bbl	48.5	-0.2	55.1
Gold 100 oz USD/t oz	1266.5	1.2	19.4
Platinum USD/t oz	934.0	-0.2	4.8
Copper USD/MT	4637.0	-0.8	-1.4
Alluminium	1619.75	-3.1	7.6
Currencies			
EUR	1.0884	-0.8	0.2
GBP	1.2234	0.4	-17.0
JPY	103.80	-0.4	15.8
CHF	0.9937	0.3	0.8
Rates			
USD Libor 3m	0.8818	0.0	43.9
USD Libor 12m	1.5718	-0.9	33.4
UAE Eibor 3m	1.2677	0.1	20.2
UAE Eibor 12m	1.8293	0.2	24.1
US 3m Bills	0.3247	12.3	99.6
US 10yr Treasury	1.7347	-3.5	-23.6

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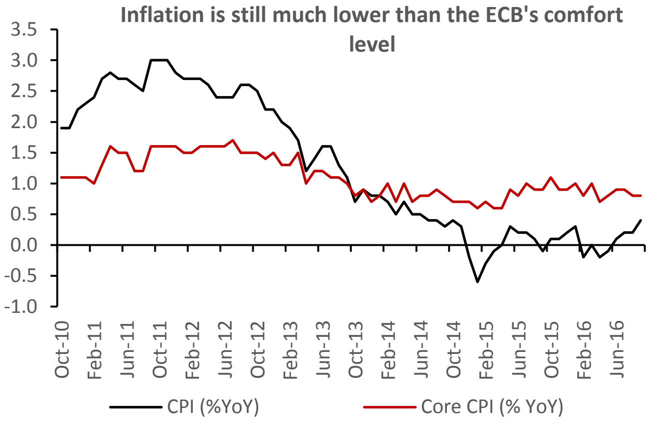
ECB gives hope despite "no action"

ECB did not discuss tapering nor extension of QE but likely to extend in the next meeting

European Central Bank's president Mario Draghi managed market expectations well, despite stating that there was no discussion on tapering or extension of the ongoing QE during the meeting last week. Note that the ongoing QE under which the ECB purchases assets worth EUR 80bn per month is scheduled to expire in March 2017, about five months from now. Mr Draghi's clarification on tapering was quite comforting for the market as rumours had circulated that the ECB governing council could discuss tapering in view of logistical issues. On top of that there was enough hint from the president during the Q&A of the press conference that some announcement is likely in December. We believe that economic conditions in the common currency area have not yet strengthened sufficiently to warrant the scaling back of monetary stimulus. GDP Growth in the area has slowed in the second quarter and third quarter growth is unlikely to have been much stronger. On the inflation side, which is the main objective of the central bank, price gains are still far from the target of around 2%. In fact, inflationary dynamics in the euro area are the weakest among the major developed countries (after Japan). Any hint from Mr Draghi that his QE program will not be extended will likely lead to an appreciation in the euro, further jeopardizing the central bank's effort to boost inflation. This makes us believe that the announcement of the QE extension is likely in the next meeting.



Source: Bloomberg

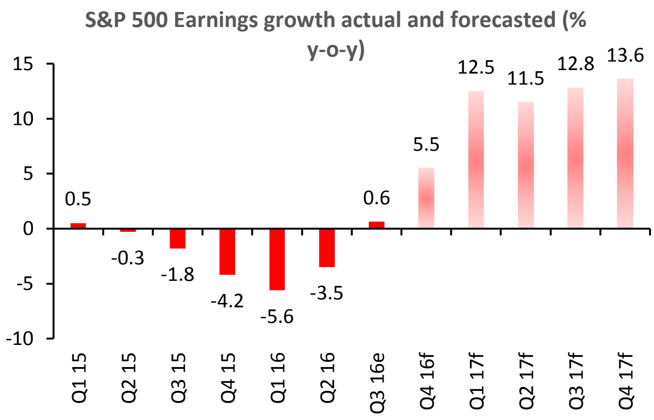
What does it mean for the euro?

Initial reaction to the hint that the QE program may be extended in the December meeting led to a depreciation in the euro. However, we believe that downside for the euro is limited. Just as is the case in Japan where the yen has become virtually impervious to additional monetary stimulus, so too is there likely to be a limit to euro weakness. Since the ECB announced its intention to purchase assets in late 2014 which led to the euro depreciation, the Eurozone's current account surplus has ballooned from less than 2% to almost 3.3% of GDP. This suggests that some of the region's growth in recent quarters has come at a cost to growth in the Eurozone's trading partners. As growth in the rest of the world continues to slow, the ability for the Eurozone to grow via currency depreciation is more limited. Moreover, on a purchasing power parity and the trade weighted real effective exchange rate basis the euro seems to be undervalued. Therefore, we believe that this undervaluation and the region's large current account surplus will keep the euro from further significant depreciation.

US earnings recession coming to an end?

The consensus expects that the five consecutive quarters year-on-year of earnings contraction for S&P 500 companies will come to an end this Q3 earnings season - expectations are for a 0.6% gain from a year earlier. The mere end in the sequence of contracting earnings growth is nothing to be excited about; as recently as March, the consensus expected earnings growth of around 5% in Q3, this has therefore been revised down quite sharply. Initial earnings announcements seem to be beating estimates. Almost one fourth of S&P 500 companies have reported earnings till now. The major positive surprises in the current earning season have come from financial companies with a growth of 10.6%. However, we classify these as "weak beats" given that it has been driven mostly by stronger trading revenues rather than a more sustainable pick up.

Expectations of a sharp pick-up in earnings beyond the third quarter are unrealistic in our view, especially if the US dollar remains strong as it has been in the past several weeks. Moreover, a sluggish economic growth backdrop in which the Federal Reserve remains seemingly intent on hiking rates once in 2016 (likely in December) does not support the earnings outlook. In such an environment, and in the absence of strong earnings growth, already expensive valuations will likely continue to cap any potential rally in US equities.



Source: Bloomberg

Summary market outlook

Bonds	
Global Yields	A slightly less than expected rise in inflation acted as a moderating factor on the US Treasury yield despite rising odds to December rate hike. We reiterate that the 10yr yield is unlikely to rise significantly in the near term as growth concerns will continue to weigh. Watch out the third quarter GDP number this week.
Stress and Risk Indicators	A relatively stable equity market pushed the VIX index lower over the last week. We see the index largely sideways in the very near term with upside bias. Sovereign CDS spreads in EM were mixed, depending on the domestic dynamics. A rising dollar could potentially push the spreads slightly higher. However, we see a limited rise in the dollar.

Equity Markets	
Local Equity Markets	GCC equity markets were mixed, largely influenced by third quarter earnings. Regional markets will continue to be strongly influenced by earnings news in the very near term.
Global Equity Markets	Global equity markets got a comfort from the third growth number in China, ignoring the dollar strength. ECB's dovish tone also supported the sentiment. Earnings and the US third quarter GDP numbers will be important factors in the very short term.

Commodities	
Precious Metals	Despite dollar strength last week, gold price gained. We believe that the price will benefit more significantly when the risk-off mood will re-emerge more strongly.
Energy	Energy prices remained resilient despite the dollar strength. However, we believe that the price has run its course on talk of a production freeze/cut and see limited upside beyond USD 55/bbl until OPEC meets in November. A sideways movement is likely in the near term.
Industrial Metals	Industrial metals declined largely on stronger dollar last week, despite economic releases from China matched expectation. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	Despite "no action" from the ECB and no clear commitment on the extension of QE, market believed that the announcement will come in December meeting which pushed the euro lower. However, we believe that the euro is unlikely to depreciate much from here, though volatility could be higher if US economic data turn stronger.							
Critical levels	R2	1.1107	R1	1.0996	S1	1.0816	S2	1.0747
GBPUSD	The British pound stabilized despite a broader dollar strength last week. We believe that Brexit concerns will continue to hang over the economic outlook and the currency in the near to medium term.							
Critical levels	R2	1.2436	R1	1.2335	S1	1.2130	S2	1.2026
USDJPY	General dollar strength is helping the BoJ as it has taken appreciation pressure off the yen. The currency was largely stable which closed the week with a small gain. We see largely sideways movement in the near term. However, we expect that in the absence of significant dollar strength, the Japanese yen will trend slightly higher.							
Critical levels	R2	105.02	R1	104.41	S1	103.18	S2	102.56

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
10/24/2016	Markit Mfg PMI	Oct P	51.5	51.5	Besides monthly data, third quarter GDP growth and details will be focus of the market.
10/25/2016	FHFA House Price MoM	Aug	0.5%	0.5%	
10/26/2016	Wholesale Inventories MoM	Sep P	0.1%	-0.2%	
10/26/2016	Markit Service PMI	Oct P	52.4	52.3	
10/26/2016	New Home Sales	Sep	600k	609k	
10/27/2016	Durable Goods Orders	Sep P	0.1%	0.1%	
10/28/2016	GDP Annualized QoQ	3Q A	2.5%	1.4%	
10/28/2016	Univ. of Mich. Sentiment	Oct F	88.2	87.9	

Japan

	Indicator	Period	Expected	Prior	Comments
10/24/2016	Exports YoY	Sep	-10.8%	-9.6%	Market will look into how PMI and inflation data come up.
10/24/2016	Nikkei Mfg PMI	Oct P	--	50.4	
10/28/2016	Jobless Rate	Sep	3.1%	3.1%	
10/28/2016	CPI YoY	Sep	-0.5%	-0.5%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
10/24/2016	Markit Mfg PMI	Oct P	52.7	52.6	Surveys will looked at by the market closely.
10/24/2016	Markit Services PMI	Oct P	52.4	52.2	
10/25/2016	IFO Expectations	Oct	104.5	104.5	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
10/27/2016	GDP QoQ	3Q A	0.3%	0.7%	Inflation, job data and consumer spending to be focal points
This Week	Nationwide House Price MoM	Oct	0.2%	0.3%	

China and India

Indicator	Period	Expected	Prior	Comments
				No major data from China and India.

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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