The Weekly Market View

September 5 2016

بنك أبوظبي التجاري
ADCB

Fed rate hike hype likely to moderate with dimming growth outlook

Equity markets managed to pull off a positive week as weaker growth prospects seem to increase the likelihood that – in spite of much talk to the contrary – the policy stance of the Federal Reserve is going to remain accommodative going forward. In today's world of low to negative interest rate, however, even a single rate hike – most likely in December of this year – is enough to maintain in the short term some upward pressure on the US dollar. Not surprisingly, the Japanese equity market profited most this week, as the yen weakened substantially against the US dollar. Having said so, with the increase in global growth concerns, we would see the Fed at some point in time abandoning its hiking rhetoric, such that the US dollar will remain in its current trading range. As such the recent Japan and European equity markets outperformance is likely to peter out.

All eyes on China, as well as the UK

China, as well as other emerging markets, have been the main beneficiaries of the relatively weak US dollar in 2016. Following the weaker-than-expected labour market data from the United States, and generally disappointing global leading manufacturing data, in the week ahead most important data will come from China. Not so good Chinese data, combined with fears for a stronger US dollar, are therefore plausibly the largest risk factor for the week ahead. Thus, as the G20 meeting hosted by China will draw to its end, markets will pay close attention to China exports, foreign reserve flows, and monetary base growth. Disappointing China data – at a moment that global markets remain still braced for a potential further strengthening of the US dollar - might well trigger some corrections in commodity prices and generally in emerging markets. Markets will also look with interest at the UK industrial production figures for July, the first such data since the country voted to leave the European Union.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,180.0	0.5	6.7
Dow Jones	18,492.0	0.5	6.1
Nasdaq	5,249.9	0.6	4.8
DAX	10,683.8	0.9	-0.6
Nikkei 225	16,925.7	3.5	-11.1
FTSE 100	6,894.6	0.8	10.4
Sensex	28,532.1	2.7	9.2
Hang Seng	23266.7	1.6	6.2
Regional Markets (Sunday to Thursday)			
ADX	4480.7	-0.9	4.0
DFM	3511.8	0.6	11.4
Tadawul	6021.8	0.8	-12.9
DSM	10836.7	-2.7	3.9
MSM30	5714.35	-1.9	5.7
BHSE	1143.3	-0.3	-6.0
KWSE	5409.2	-0.4	-3.7
MSCI			
MSCI World	1,734.6	0.5	4.3
MSCI EM	899.6	-0.2	13.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	46.8	-6.2	25.6
Nymex WTI USD/bbl	44.4	-6.7	20.0
OPEC Baskt* USD/bbl	42.0	-8.1	34.4
Gold 100 oz USD/t oz	1325.2	0.3	24.9
Platinum USD/t oz	1063.8	-0.9	19.3
Copper USD/MT	4607.0	-0.3	-2.0
Alluminium	1579.25	-3.3	4.9
Currencies			
EUR	1.1156	-0.4	2.7
GBP	1.3294	1.2	-9.8
JPY	103.92	2.0	15.7
CHF	0.9809	0.3	2.2
Rates			
USD Libor 3m	0.8351	0.2	36.3
USD Libor 12m	1.5594	1.5	32.4
UAE Eibor 3m	1.1921	0.8	13.0
UAE Eibor 12m	1.7890	0.9	21.3
US 3m Bills	0.3196	1.6	96.4
US 10yr Treasury	1.6024	-1.7	-29.4

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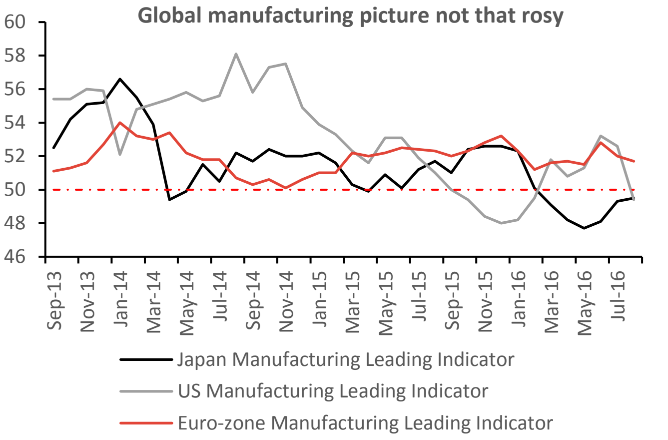
Growth doubts persist, all eyes on China

Growth doubts have not yet derailed rate hike expectations

Markets have been quick to brush aside the not so good global leading manufacturing indicators. We, on our side, have always insisted that a too significant tightening of monetary conditions in the United States, whether that be through a rate hike or through a strengthening of the US dollar, would quickly put pressure on US business conditions. Having said so, the sudden drop in the US leading manufacturing indicator (the ISM) came to us also as a surprise and, indeed, the August figure might ultimately play out to have been an outlier.



Source: Bloomberg

Our doubts about the sustainability of higher (more than 2% YoY) economic growth in the United States, has been compounded by the continuing subdued growth rate of wages, as well as the likelihood that job creation will come down in the United States as the economy is hitting a ceiling in terms of the employment of skilled labour. Wage and thus income growth remains subdued as there are many part-time workers that are unable to find a full time job. Since this also indicates that there is little inflationary pressure, we expect the Federal Reserve to maintain a relatively accommodative stance, and the US dollar strengthening potential to be relatively marginal.

What next in China?

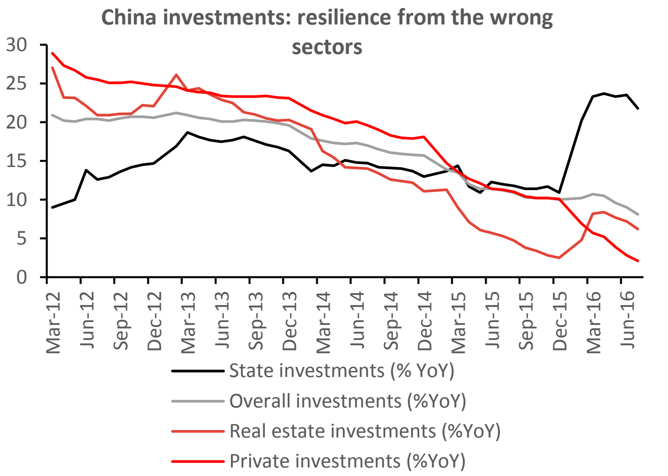
We have taken in July an overweight stance on emerging markets. This stance was based on an accommodative global monetary stance following Brexit (in particular by the Federal Reserve), which in turn would have alleviated the situation in emerging markets in general, and in China in particular. Thus our preference for emerging markets was purely tactical and more based on external factors (a continuing accommodative Fed pursuing a range bound US dollar), rather than emerging markets fundamentals themselves. For the moment we stick to this call since we are (as explained above) not too much buying into the Fed rate hike hype.

China growth story not convincing

This week's exports and imports are still expected to come down on a yearly basis, whilst the monetary base including bank deposits is expected to continue to grow at a rate that is substantially lower than the monetary base excluding those deposits (notes and coins in circulation). Yet, although this confirms that Chinese households and consumers remain extremely cautious, foreign reserves held at the central bank remain relatively stable, boding well for financial stability. Having said so, we are more concerned about the prospective weak trade figures, combined with the reduced monetary expansion, than we are relieved by the stabilization in foreign reserves. As we have stressed before, the latter is likely more determined by the weaker US dollar than by anything else.

China growth story remains the old (wrong) one

China's August PMI data has been greeted by the market as a sign that the manufacturing sector is finally turning around. Leaving aside some stark differences between the "official" and the Caixin indicator (and thus the reliability of all China PMI indicators), we would like to stress that China confidence indicators are likely boosted for the wrong reasons. Investment growth over the last months has been tremendous in the traditional (and inefficient) sector of State-owned enterprises as well as real estate projects, rather than the new private sector where it has virtually collapsed.



Source: Bloomberg

In sum, China's highly trumpeted rebalancing towards a more consumer-driven service economy is not occurring. On the contrary, the country is using the weak US dollar environment to grow its debt in an unstainable way, by investing in a persistent bubble of real estate and real investment assets. Our call on emerging market assets remains a tactical one, geared at temporarily exploiting the continuing accommodative stance of global central banks, combined with relatively high yields in emerging markets. Nothing more than that.

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Summary market outlook

Bonds	
Global Yields	US Treasury 10yr yields barely moved despite soft US economic data last week. We would say that the bond market did not believe hawkish statement from Mrs. Yellen a week ago. The yield is likely to remain around the current level in the very near term in the absence of any important data release this week.
Stress and Risk Indicators	The VIX index moved slightly further down on the less than expected job growth in the US as probabilities on the Fed rate hike came lower. We see possibility of an up move in the index in the very near term as it is very close to the lower bound. The dollar strength further pushed EM sovereign CDS a bit higher. However, we do not expect much run-up in these spreads.

Equity Markets	
Local Equity Markets	Despite a sharp correction in the oil price, GCC equity markets were largely resilient last week. We see regional markets largely being range bound in the near term.
Global Equity Markets	Global equity markets continued to feel the pressure from a stronger dollar last week as EM equities were further down. European and Japanese equities, on the other hand, benefitted from their weaker currencies. We believe that the pressure on the broader global equity market will remain in the near term.

Commodities	
Precious Metals	The gold price stabilized last week after a decline in the previous week. We believe that the price will benefit when the markets' attention refocuses on economic fundamentals.
Energy	The oil price declined last week, mainly on rising US oil inventory and rig counts. However, we believe that the oil price is likely to be in a range bound in the medium term.
Industrial Metals	Industrial metals continued to decline last week. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	The euro further gave up strength on the hawkish Fed chair statement. A set of disappointing US economic data is likely to put a break on dollar strength. Therefore, the euro is expected to see some stability ahead.							
Critical levels	R2	1.1306	R1	1.1231	S1	1.1102	S2	1.1048
GBPUSD	Cable benefitted on better than expected economic releases, especially the manufacturing PMI and house price index last week. At the same time, disappointing US economic data also supported cable strength. We believe that purely on momentum basis, the currency could gain a bit further in the near term.							
Critical levels	R2	1.3527	R1	1.3411	S1	1.3119	S2	1.2943
USDJPY	The Japanese yen weakened further against the US dollar during the week, mainly on policy action expectations from the BoJ. We believe that the currency will continue to react to these expectations and until this month's BoJ meeting, it is likely to remain range bound with relatively higher volatility.							
Critical levels	R2	105.89	R1	104.91	S1	102.35	S2	100.77

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
9/06/2016	ISM Non-mfg Composite	Aug	55.0	55.5	In a relatively light data week, the service sector growth indicator will be important for the market.
9/08/2016	Initial Jobless Claims	Sep 3	265K	263K	
9/09/2016	Wholesale Inventories MoM	Jul F	0.1%	0.0%	

Japan

	Indicator	Period	Expected	Prior	Comments
9/05/2016	Labour Cash Earnings	Jul	0.4%	1.4%	Labour earnings and tertiary index are important.
9/05/2016	Nikkei PMI Services	Aug	--	50.4	
9/08/2016	GDP SA QoQ	2Q F	0.0%	0.0%	
9/09/2016	Tertiary Industry Index MoM	Jul	0.4%	0.8%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
9/05/2016	Markit Services PMI	Aug F	53.1	53.1	PMIs are to be the main focus of the market.
9/06/2016	GDP SA QoQ	2Q F	0.3%	0.3%	
9/08/2016	ECB Policy Meeting	Sep 8	No change		
9/07/2016	Industrial Production MoM (GE)	Jul	0.1%	0.8%	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
9/07/2016	Markit/CIPS Services PMI	Aug	50.0	47.4	House price and industrial production will provide a gauge of the Brexit impact.
9/07/2016	Halifax House Prices MoM	Aug	-0.1%	0.1%	
9/07/2016	Industrial Production MoM	Jul	-0.2%	0.1%	
9/09/2016	Construction Output SA MoM	Jul	-0.5%	-0.9%	

China and India

	Indicator	Period	Expected	Prior	Comments
9/07/2016	Foreign Reserves (CH)	Aug	$3191B	$3201B	External trade numbers from both countries and foreign reserves from China will be important.
9/08/2016	Exports YoY (CH)	Aug	-3.9%	-4.4%	
9/08/2016	Imports YoY (CH)	Aug	-5.0%	-12.5%	
9/09/2016	CPI YoY (CH)	Aug	1.7%	1.8%	
This Week	New Yuan Loans CNY (CH)	Aug	750B	463.6B	
This Week	Imports YoY (IN)	Aug	--	-19%	
This Week	Exports YoY (IN)	Aug	--	-6.8%	

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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