The Weekly Market View

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بنك أبوظبي التجاري
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Yuan devaluation to put further pressure on EM currencies

China's move on its currency created a ripple effect across the global financial markets last week. Although official communication positions it as a move towards more flexible currency regime, we suspect that it's also an acceptance of a dire economic situation in the country where authorities believe that the economy needs a weaker currency. Markets also seem to believe the same as reflected through further weakness in the commodity prices. Further evidence of a slowdown in the world's second largest economy and its currency devaluation are going to have implications for regional economies as well as currencies. The devaluation of an "anchor" currency in the region which was not devalued even during the Asian financial crisis is going to weigh negatively on the regional currencies. This is likely to create volatility in the currency markets and likely to affect equity fund flows in coming months.

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Yuan is expected to remain under focus

After the last week surprise move by the People's Bank of China, global markets are likely to keep a watch on the yuan and regional currencies movement. Most regional currencies are trading lower this morning along with the Chinese yuan. Housing market data in the US, which are expected to be slightly on the softer side, will be important for the movement in the Fed hike expectations. After disappointing second quarter growth, preliminary manufacturing PMI from the Eurozone will also be important to determine the trend in the business cycle.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,091.5	0.7	1.6
Dow Jones	17,477.4	0.6	-1.9
Nasdaq	5,048.2	0.1	6.6
DAX 40	10,985.1	-4.4	12.0
Nikkei 225	20,519.5	-1.0	17.6
FTSE 100	6,550.7	-2.5	-0.2
Sensex	28,067.3	-0.6	2.1
Hang Seng	23991.0	-2.3	1.6
Regional Markets (Sunday to Thursday)			
ADX	4730.3	-2.2	4.4
DFM	3985.4	-3.3	5.6
Tadaw ul	8683.7	0.3	4.2
DSM	11858.0	0.7	-3.5
MSM30	6318.62	-1.7	-0.4
BHSE	1334.5	0.1	-6.5
KWSE	6301.1	0.8	-3.6
MSCI			
MSCI World	1,743.9	-0.2	2.0
MSCI EM	863.8	-2.4	-9.7

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	49.2	0.9	-14.2
Nymex WTI USD/bbl	42.5	-3.1	-20.2
OPEC Baskt USD/bbl	47.3	0.7	-9.1
Gold 100 oz USD/t oz	1115.1	1.9	-5.9
Platimum USD/t oz	992.3	3.0	-17.9
Copper USD/MT	235.2	0.8	-16.8
Alluminium	1551	-0.6	-15.4
Currencies			
EUR	1.1109	1.3	-8.2
GBP	1.5642	1.0	0.4
JPY	124.31	0.1	-3.6
CHF	0.9757	-0.8	1.9
Rates			
USD Libor 3m	0.3205	4.1	25.4
USD Libor 12m	0.8349	1.0	32.8
UAE Eibor 3m	0.7957	0.0	17.5
UAE Eibor 12m	1.1171	0.0	10.0
US 3m Bills	0.0811	33.0	128.5
US 10yr Treasury	2.1977	1.6	1.2

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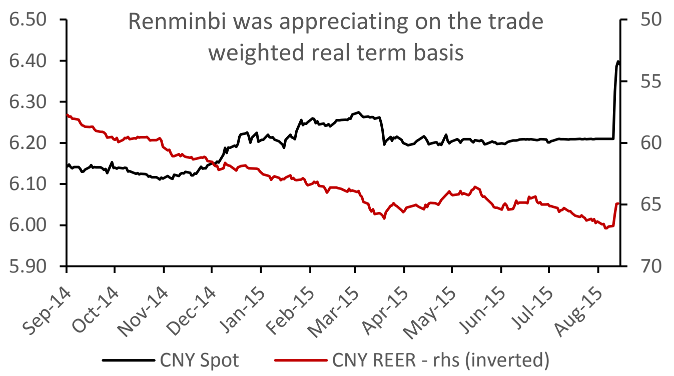
Markets likely to remain under shock despite PBoC assurance

PBoC shocks the market and then reassures

People's Bank of China's action of devaluing its currency sent a ripple effect across the global financial markets as many believed it to be the beginning of a deeper devaluation. Markets also anticipated a competitive currency devaluation by other countries in the region. However, in a rare public assurance by the central bank, it termed the market expectations of a sharp currency devaluation as "non-sense". Even though the regional emerging market currencies had depreciated against the dollar even before the yuan devaluation, they reacted sharply over the devaluation news. This reflects the vulnerability of the regional currencies to the movement in the yuan.



Source: Bloomberg

Yuan devaluation reflects economic reality

Despite economic growth concerns, the trade weighted yuan real exchange rate had appreciated by more than 7% (YTD) before the devaluation last week. This was primarily due to the yuan being effectively pegged to the dollar and latter had appreciated against major currencies during the period. Most Asian regional currencies – those having large direct trade relationships with China as well as those competing with Chinese products in the third countries – have depreciated in the recent past. At the same time, Chinese authorities seem to have been struggling to provide support to the sliding economy. Economic data released last week confirmed the weakness in the economic activity. Industrial production grew at just 6.3% YoY in the first seven months while Caixin manufacturing PMI has largely been below 50 this year, suggesting a contraction in the manufacturing sector. This is also corroborated by the decline in exports for most of the months this year. Weaker activity is also highlighted by the decline in imports this year, though some of the decline can be attributed to the lower commodity prices. Therefore, we believe that the central bank's action is an acceptance of a deeper problem in the economy by the authorities.

Country Spot	Last week	YTD
Hong Kong Dollar	0.0	0.0
Taiwanese Dollar	-1.6	-1.5
Chinese Renminbi	**-2.8**	**-2.9**
Indian Rupee	-1.8	-3.0
Philippine Peso	-0.9	-3.2
Offshore Chinese Renminbi	-3.6	-3.6
Japanese Yen	-0.1	-3.6
Singapore Dollar	-1.6	-5.8
Thai Baht	-0.2	-6.5
South Korean Won	-1.1	-7.6
Indonesian Rupiah	-1.8	-10.1
Malaysian Ringgit	-3.8	-14.3

Source: Bloomberg

Implications for the regional economies

With the currency now being more market driven (at least this is what Chinese authorities claim now), even a slower downward movement is likely to put further pressure on regional currencies. Note that any possible rate hike by the Federal Reserve is only likely to add to the depreciating pressure on regional currencies. The yuan devaluation will not only have the direct impact on countries with higher trade relations with China directly but those who compete in the third country. Taiwan and South Korea have large trade relationship, exporting almost one-quarter of their exports to China. At the same time, they compete in the third country for their similar manufacturing products. South Korea's export is already suffering due to a sharp depreciation in the Japanese yen over the last years. This will add pressure on the authorities to allow Korean Won to depreciate. Similarly, Taiwanese dollar was quite stable but the yuan devaluation could create pressure on the currency due to high competition in third countries for their products. Malaysia and Indonesia ship around 12% of their exports to China. However, these two countries rely on foreign inflows to support their respective currencies. These countries are likely to suffer due to the change in global investors' sentiments as the risk to regional currencies are higher. The Chinese economic slowdown, highlighted again by the devaluation, will continue to have a negative impact on the commodity exporting currencies.

This creates a possibility of higher currency volatility not only regionally but globally, especially in the emerging market space. Higher volatility will deter carry trade investors largely from the countries with ultra-loose monetary policies and ongoing quantitative easing. This requires a caution on risky assets in even in countries in EM space which are relatively better positioned in terms of macroeconomic fundamentals.

Summary market outlook

Global Yields	Global risk aversion induced by the yuan devaluation pushed the US Treasury 10yr yield close to 2% before it recovered to end the week almost flat. With housing data not expected to be particularly strong this week, yields are likely to move in line with the oil price - a recent trend. European sovereign yields closed slightly lower as the euro appreciated. They are expected to trade in a narrow range with some downward bias in the near term.
Stress and Risk Indicators	The VIX index closed the week almost flat despite a spike earlier during the week. The current level is close to the lower bound. Therefore, the possibility of upside move is higher than that of downward move. Sovereign CDS spreads for the European periphery countries (Spain, Italy and Portugal) ticked up slightly.
Precious Metals	Gold prices benefitted on the global risk aversion induced by the yuan devaluation as it breached its trading range. A report from the World Gold Council last week suggested that the gold demand for Jewellery and bar & coins declined in the second quarter. We remain cautious on the precious metal.
Local Equity Markets	GCC equity markets were mixed with the UAE and Oman markets on the declining side. At this level of the oil price, regional equities could be volatile in the near term as market is in the re-assessment mode.
Global Equity Markets	Global equity markets reacted sharply on the yuan devaluation. US equities recovered their losses but most other markets closed in the red last week. Euro strength weighed on the European equities last week. Resumption of the euro weakness could be positive for the regional equities. EM equities could witness some more volatility if the yuan moves lower from the current levels.
Energy	Energy prices remained under pressure last week as cloud continues to thicken around China's economic outlook and persistent over supply. Although we remain constructive on the energy prices in the medium term, caution is needed in the near term.
Industrial Metals	Uncertainty around the Emerging Economies growth, in particular China's, continues to weigh heavily on the industrial metals.

Currencies	**Commentary**	**Critical levels**
EURUSD	A new trend emerged in the currency market last week when the euro gained sharply as the risk aversion spiked with the yuan devaluation and it turned lower with the easing in the risk aversion. For that reason, the common currency also breached its recent upper trading range, crossing even 1.12 mark momentarily. Decline in the September Fed hike probability also helped the currency. We expect the euro to move lower in the very near term as above factors move back.	R2 - 1.1372 R1 - 1.1240 S1 - 1.0951 S2 - 1.0794
GBPUSD	The British pound gained against the dollar despite weaker than expected economic data releases as traders reassessed their Fed hike expectations. The currency is likely to resume its downward move in the wake of dovish Bank of England and disappointment in economic releases.	R2 - 1.5789 R1 - 1.5715 S1 - 1.5513 S2 - 1.5385
USDJPY	Although the Japanese yen closed almost flat last week, it moved very closed to the year's low earlier in the week. The yuan devaluation is unlikely to have any impact on the BoJ policy stance for the moment. Therefore, we remain of the view of stability	R2 – 125.95 R1 – 125.13 S1 – 123.64 S2 – 122.97

in the currency in the near term while we expect a gradual depreciation over the medium term.

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
08/17/2015	NAHB Housing Market Index	Aug	61	60	Housing data to be the main focus of the week.
08/18/2015	Housing Starts	Jul	1186K	1174K	
08/18/2015	Building Permits	Jul	1230K	1337K	
08/19/2015	Core CPI YoY	Jul	1.8%	1.8%	
08/20/2015	Existing Home Sales	Jul	5.43	5.49	
08/21/2015	Markit Mfg PMI	Aug P	53.8	53.8	

Japan

	Indicators	Period	Expected	Prior	Comments
08/17/2015	GDP SA QoQ	2Q P	-0.5%	1%	The second quarter growth number will be under scrutiny by the market.
08/19/2015	Trade Balance	Jul	-¥53B	-¥70.5B	
08/19/2015	Exports YoY	Jul	6.5%	9.5%	
08/19/2015	Imports YoY	Jul	-6.9%	-2.9%	
08/19/2015	All Industry Activity Index MoM	Jun	0.4%	-0.5%	

Euro zone

	Indicators	Period	Expected	Prior	Comments
08/17/2015	Trade Balance	Jun	€23.1B	€21.2B	In a relatively light data week in the Eurozone, market will focus on the PMIs.
08/21/2015	Markit Mfg PMI	Aug P	NA	52.4	
08/21/2015	Consumer Confidence	Aug P	-6.9	-7.1	
08/21/2015	GfK Consumer Confidence (GE)	Sep	10.1	10.1	
08/21/2015	Markit/BME Mfg PMI (GE)	Aug P	NA	51.8	

China and India

Indicators	Period	Expected	Prior	Comments
				No data is scheduled to be released in 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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