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Federal Reserve caution unnerves markets

Over the last years, whenever the Federal Reserve spoke it has always exercised a stabilizing impact on financial markets. Of course, it is too early to say how things will exactly work out over the next months, let alone this week. Yet, it is clear that the US monetary authorities find themselves in a difficult transition and that markets are now more aware of it than before. The fact that Mrs. Yellen and her colleagues could not muster the courage to hike rates by only 25 basis points from the current zero rate level, means that they are seriously concerned that slower growth in China and Asia might well determine more bad surprises for the US economy, specifically slower growth and continuing downward pressure on prices. Little wonder that equity markets got nervous.

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Markets to remain nervous, yields to stay low as important data looming

This week we will see important PMI data from most major economies. PMI data reflect the mood of producers and they are plausibly the most used leading indicator for the business cycle. They are expected to move downward and, as such, equity markets might well face continuing downward pressure. Critical will be the movement of the US dollar. If the US dollar appreciates against the euro and the yen, that is good news for the Euro-zone and Japan, as well as for Euro-zone and Japan equities. If the US dollar, however, continues to appreciate also against emerging market currencies, emerging markets will continue to suffer. This is so because many emerging market companies hold significant amounts of US dollar denominated debt, and as such a stronger US dollar will continue to induce capital outflows from emerging markets.

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Past week global markets' performance

Index Snapshot (World Indices)			
Index	**Latest**	**Weekly Chg %**	**YTD %**
S&P 500	1,958.0	-0.2	-4.9
Dow Jones	16,384.6	-0.3	-8.1
Nasdaq	4,827.2	0.1	1.9
DAX 40	9,916.2	-2.0	1.1
Nikkei 225	18,070.2	-1.1	3.5
FTSE 100	6,104.1	-0.2	-7.0
Sensex	26,218.9	2.4	-4.7
Hang Seng	21920.8	1.9	-7.1
Regional Markets (Sunday to Thursday)			
ADX	4479.1	-1.3	-1.1
DFM	3625.2	0.1	-3.9
Tadawul	7470.2	-3.2	-10.4
DSM	11418.7	-3.7	-7.1
MSM30	5744.76	-1.0	-9.4
BHSE	1283.7	-0.6	-10.0
KWSE	5714.0	-0.9	-12.6
MSCI			
MSCI World	1,630.7	0.2	-4.6
MSCI EM	829.9	3.4	-13.2

Global Commodities, Currencies and Rates			
Commodity	**Latest**	**Weekly Chg %**	**YTD %**
ICE Brent USD/bbl	47.5	-1.4	-17.2
Nymex WTI USD/bbl	44.7	0.1	-16.1
OPEC Baskt USD/bbl	45.1	1.0	-13.3
Gold 100 oz USD/t oz	1139.2	2.8	-3.8
Platimum USD/t oz	981.8	1.2	-18.7
Copper USD/MT	239.7	-2.6	-15.2
Alluminium	1631.25	0.6	-11.0
Currencies			
EUR	1.1298	-0.4	-6.6
GBP	1.5536	0.7	-0.3
JPY	119.98	-0.5	-0.2
CHF	0.9690	-0.0	2.6
Rates			
USD Libor 3m	0.3192	-5.3	24.9
USD Libor 12m	0.8246	-3.6	31.1
UAE Eibor 3m	0.8257	0.0	21.9
UAE Eibor 12m	1.1571	0.0	13.9
US 3m Bills	-0.0152	-160.2	-142.8
US 10yr Treasury	2.1336	-2.5	-1.7

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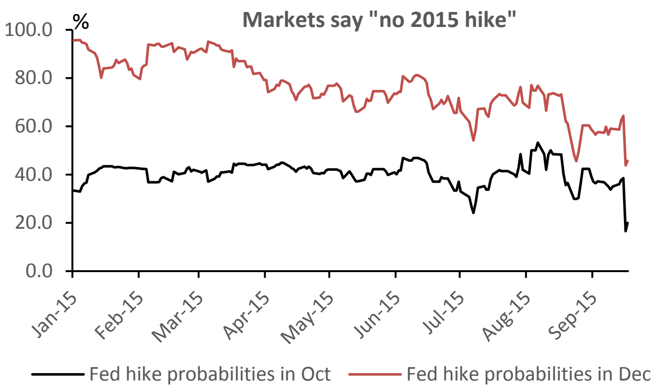
Federal Reserve in unusual recognition of risks "from abroad"

Fed even more dovish than expected

In our last ***Weekly*** we had expressed serious doubts about the Federal Reserve's determination to hike rates come September 17th. We had thus argued that if the Federal Reserve would in the end have hiked rates, it would have done so with abundant dovish qualifiers. Instead not only did the Federal Reserve not hike rates (our base case call), but also its accompanying statement as well as the press conference of Mrs. Yellen were as dovish as one could have expected.

Now we clearly don't see a Fed hike in 2015

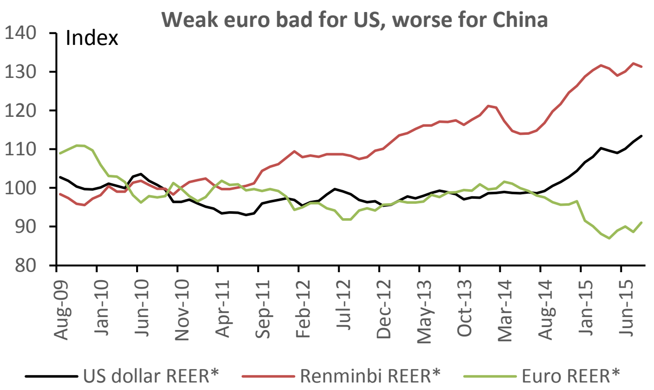
The concerns which Mrs. Yellen raised with regard to the global economy, and above all its potentially negative spill-over into the US economy, are unlikely to subside in December, let alone October. So the Fed is likely to wait well into 2016. Futures markets are thinking in that direction too, with the implied probability of a rate hike by December now at 46%, down from 64% before Mrs. Yellen's press conference.



Source: Bloomberg

Dovish central bank now bad for equity markets

One could have expected that a dovish Federal Reserve would have pushed up equity markets. Instead the opposite happened. As we have been pointing out for quite some time now, however, today the concern for equity markets is not higher rates but lower growth.

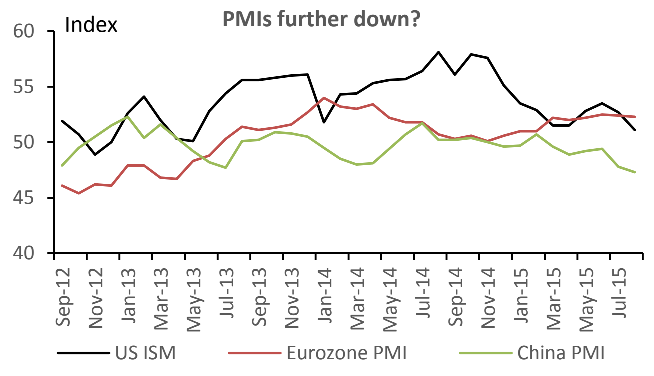


Source: Bloomberg
* REER – Real Effective Exchange Rate

A small rate hike would paradoxically have injected confidence in the markets as it would have confirmed that the US economy is relatively immune from the slowdown in China and Asia, and thus China growth is still on track. Unfortunately slower growth in the emerging world is to a large extent the result of the real effective appreciation of the Chinese Renminbi. The strong US dollar is making things harder for the Chinese because the Renminbi is quasi-pegged to the US dollar. The stronger US dollar is already deflationary for the US economy and things would get worse if (as we expect at some point will happen) the Chinese feel forced to abandon their quasi-peg with US dollar.

Critical week ahead: PMI indicators to confirm slowdown?

Weaker equity prices and wider credit spreads are likely to have bitten into global PMI indicators, plausibly the most used leading indicators for the business cycle. The extent to which the PMIs for September will come down is likely to have a further impact on markets. Stronger than expected (see our upcoming data section on page 4) PMI corrections might put significant further downward pressure on equities. Relative stable PMIs – or even some surprise upticks – would have the opposite effect. Whilst it is difficult to make such predictions over the time span of a week, we remain over the next months very cautious about equity markets because we still think that growth will remain globally under pressure, and that China will ultimately have to devalue its currency.



Source: Bloomberg

US dollar works differently across different markets

Whilst a stronger US dollar is unequivocally good for advanced economies such as Japan and the Euro-zone, the case for emerging markets is different. True, a weaker Indonesian Rupiah will be good for Indonesian exports. Yet, unlike advanced economies, many emerging market companies hold significant amounts of US dollar – denominated debt. Thus a strong appreciation of the US dollar cannot but have a widening impact on emerging market spreads, thus reducing credit growth in emerging markets. It will be therefore important to monitor the US dollar going forward. If the US dollar will be relatively strong against the euro and the yen, but relatively stable – possibly weaker – against most emerging market currencies, then we should see some stability over the shorter horizon. The longer horizon remains less rosy.

Summary market outlook

Global Yields	A dovish Fed caused the US Treasury yield to come down and close slightly lower on the week. It might well come further down this week if economic data releases remain subdued. European periphery and core yields also came further down, as in addition inflation data was weaker than expected.
Stress and Risk Indicators	The VIX index moderated slightly over the week but remained elevated as compared to its recent levels (prior to the sell-off). The higher level continues to reflect risk US equity markets in the near term. Sovereign CDS spreads were largely stable with some further easing in Asian countries' spreads.
Precious Metals	The gold price got support from the Fed's "no action" last week. We have been maintaining that the gold price could benefit in the near term due to the global economic uncertainty. However, we remain cautious on the precious metal over the longer term.
Local Equity Markets	GCC equity markets turned volatile along with the oil price last week. With the further decline in the oil price on Thursday and Friday, we could see a weaker start of the week for these markets. However, they are expected to move largely in sync with the oil price in the near term.
Global Equity Markets	Global equity markets gained last week on the back of recovery in the Emerging Markets. Emerging markets could see some further upside in the very short term as the Fed stayed put. However, with no sign of improvement in fundamentals of the Chinese and the US economy, we remain cautious.
Energy	Despite signs of US crude production slowing, demand concerns have kept the oil price under pressure. The same factor is likely to keep the oil price volatile in the near term.
Industrial Metals	Uncertainty around the Emerging Economies growth, in particular China's, continues to weigh heavily on industrial metals.

Currencies	**Commentary**	**Critical levels**
EURUSD	A short rally in the euro immediately after the Fed decision fizzled on Friday. Global growth concern are likely to trigger further Euro-zone QE. A near term short-lived rally in EM equities could further push the euro lower.	R2 - 1.1570 R1 - 1.1434 S1 - 1.1188 S2 - 1.1078
GBPUSD	The British pound continued to gain on stronger labour market- and retail sales data. It is likely to gain further if important US data releases this week disappoint.	R2 - 1.5837 R1 - 1.5687 S1 - 1.5358 S2 - 1.5179
USDJPY	After staying stable for the larger part of last week, the Japanese yen gained slightly on the dovish Fed. If EM equities gain this week on the dovish Fed, we could see the yen depreciate further. However, from the medium term perspective, the currency is resisting significant depreciation.	R2 – 121.94 R1 – 120.96 S1 – 119.03 S2 – 118.08

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
09/21/2015	Existing Home Sales	Aug	5.5M	5.59M	After the Fed staying put, markets will closely scrutinise all economic data to be released this week, in particular PMI indicators.
09/23/2015	Markit Mfg PMI	Sep P	52.8	53.0	
09/24/2015	Initial Jobless Claims	Sep 19	275K	264K	
09/24/2015	Durable Goods Orders	Aug	-2.3%	2.2%	
09/24/2015	Durables Ex-Transport	Aug	0.1%	0.4%	
09/24/2015	New Home Sales	Aug	515K	507K	
09/25/2015	GDP Annualized QoQ	2Q T	3.7%	3.7%	
09/25/2015	Univ. of Mich. Sentiment	Sep F	86.5	85.7	

Japan

	Indicators	Period	Expected	Prior	Comments
09/24/2015	Nikkei Mfg PMI	Sep P	51.2	51.7	Preliminary PMI and inflation data will be important for markets to see if there is any rebound in economic activity.
09/25/2015	All Industry Activity Index MoM	Jul	0.0%	0.3%	
09/25/2015	CPI YoY	Aug	0.1%	0.2%	
09/25/2015	Core CPI YoY	Aug	0.7%	0.6%	

Euro zone

	Indicators	Period	Expected	Prior	Comments
09/22/2015	Consumer confidence	Sep A	-7.0	-6.9	Preliminary PMIs and IFO would be important for the market.
09/23/2015	Markit Mfg PMI	Sep P	52.0	52.3	
09/25/2015	M3 Money Supply YoY	Aug	5.3%	5.3%	
09/23/2015	Markit/BME Mfg PMI (Germany)	Sep P	52.8	53.3	
09/24/2015	IFO Expectations (Germany)	Sep	101.4	102.2	

China and India

	Indicators	Period	Expected	Prior	Comments
09/23/2015	Caixin Mfg PMI (China)	Sep P	47.6	47.3	Preliminary private sector PMI in China is likely to confirm slowdown in the economy.

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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