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Sovereign bonds come under pressure

Global equities extended gains into the second week of the year, mainly led by US equities. While the S&P 500 reported its first daily decline of this year on last Wednesday, buying momentum picked up in the latter part of the week, boosted by the strong retail sales data and better than expected US core inflation. On the other hand, European equities underperformed the most as hawkish interpretation of ECB minutes pushed the euro higher versus the dollar. Japanese equities ended the week lower as the yen appreciated on market fears that the Bank of Japan (BoJ) trimming down its long-dated purchases may be a sign of the central bank reducing its monetary stimulus. As such, the dollar ended the week lower versus the major currencies. Sovereign bonds across the globe came under pressure with the 10yr US treasury yield hitting a nine-month high of almost 2.6%. In addition to heavy supply week, the treasuries were first sold on BoJ action with the sell-off later exacerbated by reports of China reducing its purchases of US treasuries (denied by Chinese official authority) and hawkish ECB minutes. Finally, improvement in US CPI boosted bond yields at the end of the week. Elsewhere, gold prices rose during the week mainly driven by dollar weakness. Oil prices posted another stellar week, jumping to a four-year high of USD70/bbl as OPEC members and Russia reaffirmed their commitment to 2018 supply cuts.

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Don't fret over the BoJ or the ECB

Last week's sovereign bond sell-off is a clear indication of how the markets could behave when the major central banks of the world become less aggressive in expanding their monetary stimulus. We believe these market fears are far from likely to come true this year. Starting with Japan, the BoJ's action on reducing its long-dated sovereign bond purchases should not come as a surprise and definitely not regarded as a "policy shift" as interpreted by the markets. In fact, reduction of long-dated bond purchases is part of the central bank's "yield curve control" policy which targets to keep long-dated bond yields near 0% level. At the same time, the BoJ is unlikely to tolerate any significant yen appreciation which will only induce deflation pressures in the economy. On the other hand, the ECB minutes indicated at a broader revision of its policy guidance with the aim of emphasizing more on its interest rates expectations. While it does point to a hawkish tilt, this revision will only bring further clarity on central banks forward guidance, preparing markets well ahead in terms of future policy trajectory. We expect the ECB will remain focused on gradually tapering its asset purchase program until inflation inches closer to the central bank target level of 2%. The week ahead is light in terms of data releases in the US; focus will be mainly on the Eurozone and UK inflation releases. In emerging markets, market attention will be on the China 4Q GDP print.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,786.2	1.6	4.2
Dow Jones	25,803.2	2.0	4.4
Nasdaq	7,261.1	1.7	5.2
DAX	13,245.0	-0.6	2.5
Nikkei 225	23,653.8	-0.3	3.9
FTSE 100	7,778.6	0.7	1.2
Sensex	34,592.4	1.3	1.6
Hang Seng	31412.5	1.9	5.0
Regional Markets (Sunday to Thursday)			
ADX	4591.1	0.8	4.4
DFM	3494.6	0.7	3.7
Tadawul	7338.0	0.3	1.5
DSM	9135.9	4.4	7.2
MSM30	5087.47	-0.6	-0.2
BHSE	1316.9	-0.1	-1.1
KWSE	6560.6	0.9	2.4
MSCI			
MSCI World	2,185.3	1.3	3.9
MSCI EM	1,208.2	0.6	4.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	69.9	3.3	4.5
Nymex WTI USD/bbl	64.3	4.7	6.4
Gold USD/t oz	1332.0	1.4	2.2
Silver USD/t oz	17.1	-0.1	1.0
Platinum USD/t oz	992.4	2.6	6.9
Copper USD/MT	7070.5	-0.4	-1.2
Alluminium	2203.25	0.6	-2.4
Currencies			
EUR USD	1.2133	1.4	1.1
GBP USD	1.3694	1.2	1.3
USD JPY	111.24	-1.8	-1.3
CHF USD	0.9715	-0.8	0.3
Rates			
USD Libor 3m	1.7215	1.0	1.6
USD Libor 12m	2.1731	1.1	3.1
UAE Eibor 3m	1.8190	3.1	1.3
UAE Eibor 12m	2.5912	0.7	0.5
US 3m Bills	1.4370	3.1	4.5
US 10yr Treasury	2.5462	2.8	5.9

Please refer to the disclaimer at the end of this publication

Summary market outlook

Bonds	
Global Yields	US treasury yields rose on hawkish ECB commentary and BoJ action along with better than expected inflation data. The yield curve flattened again as 2yr bond yields rose higher with market expectations of a March rate hike firming up. Overall, we expect long-end US treasuries to remain resilient unless inflation surprises significantly on the upside. European bonds underperformed the most with German bund yields rising to a 2-year high on hawkish interpretation of ECB minutes. Recent markets' reaction to central bank commentary and action appears exaggerated amidst low inflation pressures and a reversal is likely in the near term.
Stress and Risk Indicators	The VIX moved slightly higher than last week as markets participants turned jittery over hawkish central bank commentary. However, volatility is unlikely to stay low given the backdrop of ongoing geopolitical risks.
Equity Markets	
Local Equity Markets	GCC equity markets performed well, tracking the rise in oil prices. We remain neutral on GCC equities given the potential for further dollar strength and range-bound oil prices. We maintain our tactical call on Saudi equities on the back of their inclusion onto the MSCI watch list for potential promotion into the MSCI Emerging Markets index.
Global Equity Markets	US equities continued to break new records, driven by a weaker dollar and strong economic data. Weaker dollar also helped the emerging market equities to post weekly gains. On the other hand, European equities underperformed the most on the back of euro strength and hawkish ECB minutes. Yen also appreciated versus the dollar, causing the Japanese equities to end lower over the week. Overall, we continue to believe that strong economic fundamentals along with robust corporate earnings growth will support global equities.
Commodities	
Precious Metals	Gold prices rose over the week on the back of dollar weakness. We remain overweight on gold as a risk hedge against ongoing political and (potential) inflationary risks.
Energy	Oil prices jumped higher, touching the highest level of USD70/bbl since December 2014, as OPEC members and Russia reaffirmed their commitment to oil production cuts. Supply concerns added to the rally with the further decline seen in US crude inventories. We expect oil to continue trading in the broad range seen over the past 12 months. A break out at the upper end will be challenging given US production will likely act as a ceiling on oil prices.
Industrial Metals	Industrial metals were mixed in spite of a weaker dollar. Longer-term we do not recommend industrial metals exposure due to concerns around Chinese growth prospects post the Party Congress.
Currencies	
EURUSD	The euro strengthened against the dollar on the breakthrough in German coalition talk and hawkish ECB minutes. We expect the euro to remain under pressure as the US dollar regains ground.
GBPUSD	The pound strengthened against the dollar, jumping to the strongest level since the Brexit referendum on the sign of a softer Brexit deal. We expect sterling to remain under pressure due to political uncertainty, economic weakness and Brexit negotiations.
USDJPY	The yen rallied as the BoJ reduced the size of its long-dated bond asset purchases. However, we believe there will remain a bias for yen weakness given divergent monetary policies between Japan and the US.

Critical levels	R2	R1	S1	S2
EURUSD	1.2340	1.2271	1.2081	1.1959
GBPUSD	1.3882	1.3805	1.3591	1.3453
USDJPY	112.00	111.53	110.75	110.44

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
01/17/2018	MBA Mortgage Applications	12-Jan	--	8.3%	NAHB housing market, and capacity utilization will be the main releases.
01/17/2018	Capacity Utilization	Dec	77.30%	77.10%	
01/17/2018	NAHB Housing Market Index	Jan	72	74	
01/18/2018	Housing Starts	Dec	1275k	1297k	
01/18/2018	Housing Starts MoM	Dec	-1.70%	3.30%	
01/18/2018	Initial Jobless Claims	13-Jan	250k	261k	
01/19/2018	U. of Mich. Sentiment	Jan P	97	95.5	

Japan

	Indicator	Period	Expected	Prior	Comments
01/15/2018	Machine Tool Orders YoY	Dec P	--	46.8%	The focus will be on PPI and Tertiary industry index.
01/15/2018	PPI YoY	Dec	3.20%	3.50%	
01/15/2018	Tertiary Industry Index MoM	Nov	0.30%	0.30%	
01/17/2018	Industrial Production MoM	Nov F	--	0.60%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
01/17/2018	CPI Core YoY	Dec F	0.90%	0.90%	All eyes will be on Eurozone CPI.
01/17/2018	CPI YoY	Dec F	1.40%	1.50%	
01/17/2018	Trade Balance	Nov	10.0b	9.8b	
01/17/2018	Consumer Confidence Index	4Q	--	-11	
01/19/2018	PPI YoY	Dec	2.30%	2.50%	
01/19/2018	ECB Current Account SA	Nov	--	30.8b	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
01/14/2018	Rightmove House Prices MoM	Jan	-	-2.60%	Attention will be on CPI and retail sales.
01/14/2018	CPI YoY	Dec	3.00%	3.10%	
01/16/2018	CPI Core YoY	Dec	2.60%	2.70%	
01/16/2018	RPI YoY	Dec	3.90%	3.90%	
01/19/2018	Retail Sales Ex Auto Fuel YoY	Dec	2.60%	1.50%	
01/19/2018	Retail Sales Inc Auto Fuel MoM	Dec	-0.90%	1.10%	

China and India

	Indicator	Period	Expected	Prior	Comments
01/14/2018	Exports YoY (IN))	Dec	--	30.60%	All eyes will be on china GDP, retail sales and industrial production. In India, WPI will be important.
01/15/2018	WPI YoY (IN)	Dec	4.00%	3.93%	
01/18/2018	GDP YoY (CH)	4Q	6.70%	6.80%	
01/18/2018	Retail Sales YoY (CH)	Dec	10.20%	10.20%	
01/18/2018	Industrial Production YoY (CH)	Dec	6.10%	6.10%	
01/18/2018	Fixed Assets Ex Rural YTD YoY (CH)	Dec	7.10%	7.20%	

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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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