The Weekly Market View

March 6 2017

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March Federal Reserve rate hike odds soar

Equities extended gains during the week that saw President Trump deliver his most "presidential" moment thus far, his address to congress. Even though the content of his speech was long on promises and short on details, it did not prevent markets from continuing their upward march. Optimism did not extend to emerging market equities which underperformed badly during the week on the back of rising expectations of a March Fed funds rate hike. Hawkish comments from Fed Chair Janet Yellen as well as other senior members of the FOMC pushed the market implied probability of an interest rate hike in March to 94% from 50% at the start of the week. This is also what caused gold to give back almost all of the previous week's gains. 10-year US Treasury yields rose 17bps but remained in their recent 2.30%-2.50% range. Currencies were volatile, the Japanese yen and British pound both depreciated c1.5% against the US dollar, whereas the euro which had also been on a weakening trajectory rallied sharply to finish the week 0.6% stronger vs. the greenback.

Friday's jobs figures to seal the deal?

In our last weekly note we said we were sceptical about the Fed delivering on its projection of three 25bps interest rate hikes in 2017. This is because in both 2015 and 2016 the Fed projected four quarter-point hikes but in both instances delivered just one. In addition to this, the heavy European political calendar this year could induce further caution among FOMC members. For the upcoming Fed meeting in March, this Friday's payrolls figures could seal the deal. The Fed does not like to surprise the markets and in this context a strong jobs report will likely all but guarantee the Fed will make its first move of the year at its next meeting. This also suggests that the Fed is not very worried about the French elections in April and May. The Dutch general elections will be held on March 15, but are generally accepted to be less worrisome for Europe given that even if the far right PVV (Freedom party) wins, they are unlikely to be able to form a government.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,383.1	0.7	6.4
Dow Jones	21,005.7	0.9	6.3
Nasdaq	5,870.8	0.4	9.1
DAX	12,027.4	1.9	4.8
Nikkei 225	19,469.2	1.0	1.9
FTSE 100	7,374.3	1.8	3.2
Sensex	28,832.5	-0.2	8.3
Hang Seng	23552.7	-1.7	7.1
Regional Markets (Sunday to Thursday)			
ADX	4585.9	-1.2	0.9
DFM	3553.6	-1.4	0.6
Tadawul	7015.4	-0.4	-2.7
DSM	10721.2	-1.9	2.7
MSM30	5822.39	-0.6	0.7
BHSE	1341.5	-0.6	9.9
KWSE	6817.7	-0.6	18.6
MSCI			
MSCI World	1,849.0	0.4	5.6
MSCI EM	931.1	-1.3	8.0

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	55.9	-0.2	-1.6
Nymex WTI USD/bbl	53.3	-1.2	-0.7
Gold USD/t oz	1234.8	-1.8	7.6
Silver USD/t oz	18.0	-2.2	12.9
Platinum USD/t oz	998.8	-2.8	10.6
Copper USD/MT	5910.0	0.5	7.4
Alluminium	1884.75	0.0	11.3
Currencies			
EUR USD	1.0622	0.6	1.0
GBP USD	1.2291	-1.4	-0.4
USD JPY	114.04	1.7	2.6
CHF USD	1.0079	0.0	1.1
Rates			
USD Libor 3m	1.1017	4.5	10.4
USD Libor 12m	1.8082	3.9	7.3
UAE Eibor 3m	1.3943	1.3	-5.5
UAE Eibor 12m	2.1361	2.0	2.0
US 3m Bills	0.6957	38.4	39.9
US 10yr Treasury	2.4780	7.2	1.4

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Soaring rate hike odds send dollar up and EM down

Mrs Yellen steals the spotlight from President Trump

Mr Trump has dominated headlines even before he became the president of the United States, but his coverage understandably only accelerated following the November 8 elections. Ms Yellen, the chair of the US Federal Reserve was forced to take a back seat. Last week started with the markets focussing on President Trump's address to congress, in which investors had hoped he would reveal details of his growth boosting policies. However, once again the president's words were long on sound bites and short on details. Markets shrugged their shoulders, the President's honeymoon period seemingly continuing.

Ms Yellen, however, was able to have a much more meaningful impact on markets. On Friday the Fed's top official talked up the prospect of a rate hike at the Fed's 14-15 March meeting. Ms Yellen said the Fed was very close to achieving both its inflation and employment goals and that barring any major surprises a rate increase at the next meeting would likely be warranted. Investors took this as a concrete signal that the first rate hike of the year was all but guaranteed. The only remaining hurdle being Friday's US jobs numbers.

Odds of a 25bps Fed funds rate hike in March

Source: Bloomberg, HSBC

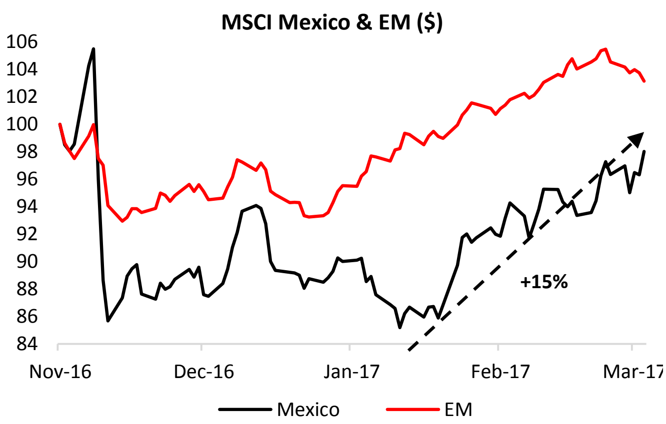
The above chart shows the market implied probability of a March hike in the Fed funds rate. Having started the week around 50%, it quickly jumped to above 90%. The impact of this shift was visible in several asset classes, the dollar rallied, Treasury yields rose and EM equities suffered. Not only have the odds of a March rate hike increased, but given how early in the year the first rate hike might come, it has increased the likelihood of the Fed delivering on its projection of three hikes this year. Markets for the most part had been predicting just two hikes.

EM equities which had been the star performers so far this year, were the biggest losers during the past week, falling 1.3%. Heavyweights Brazil and Russia being hit the hardest, both losing over 4%.

We have been unconvinced by the EM equity market rally this year and remain so. Mr Trump's ability to talk the US dollar down appears to be limited, while almost all of his policies are consistent with a stronger greenback (creating jobs, deregulation, infrastructure spending, attracting capital, etc). If we are correct and the US dollar continues to strengthen, pressure on EM equities will again intensify.

One market which has stood out in EM recently is Mexico. We implemented a tactical overweight call on Mexican equities in the run-up to the US elections, believing that a Mrs Clinton victory would induce a rally in Mexican assets. The rest is history and after a period of strong underperformance, Mexican assets have sustainably rallied since the middle of January.

Despite the underperformance, we were hesitant to remove our call on the market before Mr Trump took office on January 20 for the simple reason that so much negativity had been baked into Mexican share prices, that any clarity the new US administration would provide would likely be a positive surprise relative to expectations. The Mexican peso has strengthened from 22.00 to the US dollar at one point to around 19.60 at the time of writing. This has also allowed equities to rally 15% from their mid-January lows. We continue to monitor the market closely with a view to minimising the losses.



Source: Thomson Reuters

Summary market outlook

Bonds	
Global Yields	10-year US Treasury yields rallied 17bps during the week, but remained within the 2.30%-2.50% range which they have occupied for several months. Ms Yellen's strong signals that the Federal Reserve would increase interest rates at their next meeting was the main driver. We do not expect 10-year yields to meaningfully breach the 2.50% level in the near-term.
Stress and Risk Indicators	Volatility remained subdued in spite of rising global political risks. We expect volatility to increase.
Equity Markets	
Local Equity Markets	GCC equity markets followed emerging markets down, hampered by the likelihood of a March interest rate hike in the US and resulting stronger dollar. We remain neutral on GCC equities given the potential for further dollar strength and limited upside in oil prices.
Global Equity Markets	Global equities finished the week slightly up, but the bigger move came in emerging market equities which suffered severely from Fed Chair Janet Yellen's hawkish comments. EM equities have enjoyed a strong start to the year but got a reality check last week, underperforming developed markets by 1.7%. We expect global equities to remain resilient in light of continuing robust macro data, but expect emerging equities to underperform as the stronger dollar theme resumes.
Commodities	
Precious Metals	Gold gave back most of the previous week's gain due to the soaring probability of a March interest rate hike in the US. We stick to gold as a risk hedge against ongoing political risks.
Energy	Brent oil prices were little changed during the week, but WTI prices fell over 1% on the back of record high US oil inventories and rising rig counts in the US. This is also what we believe will cap oil prices in the near to medium term.
Industrial Metals	Industrial metals were resilient in spite of the stronger US dollar. We argue against any sustainable increase as weak China demand will eventually weigh on metal prices
Currencies	
EURUSD	The euro bucked the trend against the US dollar, strengthening on the back of strong Eurozone inflation data, suggesting that the ECB may turn more hawkish in its upcoming monetary policy committee meeting. We expect the euro to remain weak given the upcoming political calendar in key Eurozone countries.
Critical levels	R2 1.0719 · R1 1.0670 · S1 1.0534 · S2 1.0447
GBPUSD	The pound fell against the greenback as the government's Brexit timetable (to trigger Article 50 by the end of this month) took a knock as the house of Lords voted to amend the Brexit bill.
Critical levels	R2 1.2608 · R1 1.2450 · S1 1.2174 · S2 1.2056
USDJPY	The risk on mood in global markets saw the Japanese yen weaken versus the dollar thereby providing a boost to Japanese equities. Major risk-off episode aside, we expect the yen to weaken.
Critical levels	R2 116.55 · R1 115.30 · S1 112.24 · S2 110.43

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Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
3/6/2017	Factory Orders	Jan	1.00%	1.30%	Non-farm payrolls on Friday will be the most important final data point before the Fed's March FOMC meeting.
3/6/2017	Durable Goods Orders	Jan F	1.00%	1.80%	
3/8/2017	ADP Employment Change	Feb	185k	246k	
3/10/2017	Change in Nonfarm Payrolls	Feb	190k	227k	
3/10/2017	Unemployment Rate	Feb	4.70%	4.80%	
3/10/2017	Average Hourly Earnings YoY	Feb	2.80%	2.50%	

Japan

	Indicator	Period	Expected	Prior	Comments
3/8/2017	GDP SA QoQ	4Q F	0.40%	0.20%	GDP the only major release.

Eurozone

	Indicator	Period	Expected	Prior	Comments
3/7/2017	Household Cons QoQ	4Q	0.50%	0.30%	GDP and Thursday's ECB monetary policy committee meeting will be the region's most important events of the week.
3/7/2017	GDP SA YoY	4Q F	1.70%	1.70%	
3/9/2017	ECB Main Refinancing Rate	9-Mar	0.00%	0.00%	
3/9/2017	ECB Asset Purchase Target	Mar	EU80b	EU80b	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
3/7/2017	Halifax House Prices MoM	Feb	0.40%	-0.90%	A light data week in the UK, focus will be on Brexit negotiations.
3/10/2017	Industrial Production YoY	Jan	3.20%	4.30%	
3/10/2017	Manufacturing Production YoY	Jan	2.90%	4.00%	

China and India

	Indicator	Period	Expected	Prior	Comments
03/07/2017	Foreign Reserves (CH)	Feb	$2969.0b	$2998.2b	Chinese foreign reserves will be closely watched, so too Chinese imports and exports.
03/08/2017	Imports YoY (CH)	Feb	20.00%	16.70%	
03/08/2017	Exports YoY (CH)	Feb	14.00%	7.90%	
03/08/2017	Trade Balance (CH)	Feb	$27.50b	$51.35b	
3/9/2017	CPI YoY (CH)	Feb	1.80%	2.50%	
3/9/2017	PPI YoY (CH)	Feb	7.50%	6.90%	
3/10/2017	Industrial Production YoY (IN)	Jan	--	-0.40%	
3/10/2017	Trade Balance (IN)	Feb	--	-$9841m	

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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