Weekly Market Summary

23rd of September 2016

Bank of Japan and US Federal Reserve Monetary Policy Decisions …. Same Old Thing, Once More !!

Fadi Nasser (SVP – Head of Treasury Sales)

In last Friday's economic piece, we indicated that recent soft US economic releases would most likely imply a US Federal Reserve on hold when it meets on Wednesday, September 21st - though pointed to the high likelihood that 1 or 2 Fed officials would dissent in favor of an immediate 25 basis point hike in the US Fed funds rate.

Nonetheless, two Federal Reserve primary dealers (banks that are permitted to trade with the New York Fed in its implementation of monetary policy) – Barclays and BNP Paribas - insisted on betting against their peers and the bond market in general, predicting that Fed officials would raise rates on Wednesday. "*There is no perfect time - there will always be some uncertainties in the data*," said Laura Rosner, senior U.S. economist in New York at BNP. "*Despite a multitude of shocks through the last nine months, which have delayed the Fed, hiring has continued to be robust. There is a window of opportunity for the Fed to continue normalizing, and we think it will take it*."

And whilst futures traders headed into the FOMC meeting pricing in just a 20% likelihood the Fed will hike its policy rate by 25 bps, many felt the central bank's credibility was at stake after US policy makers began the year projecting four rate increases - following a liftoff from near zero in December - yet remained on hold time and again because of economic circumstances in the U.S. and abroad. Late last month, Fed Chair Janet Yellen and Vice Chairman Stanley Fischer hinted that the US central bank could still raise rates twice this year (prompting us to release a note entitled "*A Well Telegraphed 25 bps US Rate Hike in Less Than 20 Days .. Markets Still In Full Denial !!*"), and Barclays' senior US economist Rob Martin took comfort in that, stating that "*we have kept our conviction on September because we think that is what the FOMC has communicated to us – that is what we think the Chair and the Vice Chairman were talking about at Jackson Hole*."

Under those circumstances, the Fed was bound to disappoint whatever it chooses to do! A surprise rate hike would have possibly shocked financial markets and sparked steep sell-offs in bond and equity markets. A Fed on hold, after several warning shots on rates in recent speeches, could confirm the notion that the Fed always chickens out when sensitive policy decisions have to be implemented (so why talk the talk, if it can't walk the walk?!). Indeed, running the U.S. Federal Reserve had never been an easy job, and the degree of difficulty was only getting higher. Eight years after the crash, the economy is still sending confusing signals, and the Fed's policy makers are not sure what those mean. Still, such sounds awkward, when the one thing investors want from Fed's meetings is clarity with regards to the forward path of interest rates.

In any case, the Fed opted to keep US interest rates unchanged at last Wednesday's meeting, and Federal Reserve Chair Janet Yellen braved mounting opposition inside and outside the U.S. central bank to give the economy more room to run. "*The economy has a little more room to run than might have been previously thought,*" Yellen told a press conference in Washington after the Fed's two-day meeting, as she explained the decision to keep rates on hold. "*That is good news*." The decision to stand pat drew dissents from three voting members of the Federal Open Market Committee - the first time that has happened since December 2014. It also comes on the heels of an accusation by Republican Party presidential nominee Donald Trump that Yellen is deliberately keeping rates low to help make President Barack Obama look good in his final year in office. "*We had a rich, deep, serious, intellectual debate about the risks and the forecasts for the economy, and we struggled mightily with trying to understand one another's points of view*," Yellen stated.

However, the Fed chair made it clear that the central bank still intends to raise rates this year. "*I would expect to see that, if we continue on the current course of labor market improvement and there are no major new risks that develop*," she said, though bond traders opted to focus on the scaling back for the number of hikes the Fed expects for 2016 and 2017 (to one from two for the former & two from three for the latter) according to the median forecast of FOMC participants released after the conclusion of the two-day meeting. The yield on US 10-year US treasuries felt 6 basis points on the day, whilst stocks and commodities rallied sharply.

Elsewhere, the Bank of Japan (BOJ) shifted the focus of its monetary stimulus away from a rigid target for expanding the supply of money, to controlling the shape of yields across different maturities. Governor Haruhiko Kuroda also led his board on Wednesday in keeping the benchmark rate for a share of bank reserves at -0.10%. The central bank said that the monetary base target, which previously had been set at annual increases of 80 trillion yen ($780 billion), may now fluctuate in the short term as policy makers seek to control the yield curve. In addition, the BOJ scrapped a target for the average maturity of its government bond holdings. Board members also pledged to expand the monetary base until inflation is stable above the 2% target - committing to an overshoot of consumer-price gains. The yen initially weakened sharply against the U.S dollar, trading to a low of 102.78 before reversing its early losses and closing the day stronger at 100.70.

To think that most analysts view the BOJ as being the most daring of global central banks in using monetary stimulus to confront deflationary pressures and stagnation! I honestly agree that desperate times for the Japanese economy warrant desperate measures, although markets will soon realize that Voodoo monetary decisions and flawed short term policies/fixes are surely not the ones we should be getting!

Disclaimer

It is important that you only use this report if you are the intended recipient of this report and you have satisfied yourself that you are eligible to receive such information. This report is provided to you because you are one of our esteemed customers and have previously shown interest in receiving the type of information contained in this report.

The Treasury and Investment Management department of Gulf International Bank B.S.C. ("GIB") have compiled the information in this report. GIB is incorporated in the Kingdom of Bahrain and is licensed by the Central Bank of Bahrain (the "CBB") as a conventional wholesale bank. GIB's head office is located at Al-Dowali Building, P.O. Box 1017, 3 Palace Avenue, Manama, Kingdom of Bahrain.

This report is intended for the accredited investors, as defined in the Investment Business Code of Conduct published by the CBB. This information has not been reviewed by the CBB or any other regulatory authority in any jurisdiction and neither CBB nor any other regulatory takes any responsibility for the correctness or accuracy for the information contained in this report.

The information contained herein is not directed at or intended for use by any person resident or located in any jurisdiction where (1) the distribution of such information is contrary to the laws of such jurisdiction or (2) such distribution is prohibited without obtaining the necessary licenses or authorizations by the relevant branch, subsidiary or affiliate office of GIB and such licenses or authorizations have not been obtained. The recipient of such information is responsible for ensuring that this information has not been received by it in breach of laws and regulations of any jurisdiction.

This report contains publicly available information only, which has only been complied by GIB. The information provided herein is on "as is" and "as available" basis and without representation or warranty of any kind. GIB hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall GIB or its subsidiaries, affiliates, shareholders or their directors, officers, employees, independent contractors, agents and representatives (collectively, "GIB Representatives") be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting there from, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of information or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of GIB or any GIB Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. The information here is, and must be construed solely as, compilation of information (unless expressly stated otherwise) and not statements of fact as to credit worthiness or recommendations or opinions of GIB.

This report does not provide individually tailored investment advice. Any materials contained herein have no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. The document is provided for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. GIB makes every effort to use reliable, comprehensive information, but we do not represent that it is accurate or complete. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the materials, nor are they a complete statement of the securities, markets or developments referred to herein. Recipients should not regard the materials as a substitute for the exercise of their own judgement. Any opinions are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of GIB as a result of using different assumptions and criteria. GIB is not under any obligation to update or keep current the information contained herein.

The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.

The information contained in this report is just for informational purposes. Information does not constitute a solicitation, an offer, or a recommendation to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. GIB does not intend to provide investment, legal or tax advice through this report and does not represent that any securities or services discussed are suitable for any investor. When making a decision about your investments and business, you should seek the advice of professional advisors.

The report may contain statements that constitute "forward looking statements". While these forward looking statements may represent GIB's judgment and future expectations, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from GIB's expectations. GIB is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise. The historical information is provided for information purposes only. Performance figures are calculated before tax (if any) and after deducting ongoing fees and expenses. The performance figures are historical and past performance is not necessarily an indication of future results. Certain amounts (including %ages) included in this document may have been subject to rounding adjustments. Accordingly, figures may not be an exact arithmetic aggregation of the figures to which they relate. The values and forecasts shown represent our current indicative valuations and forecasts of the relevant transactions, currencies, interest rates, commodities or securities as at the date shown. Any value or forecast shown herein is not an indicative price quotation. We expressly disclaim any responsibility for the accuracy of the values or forecasts shown, any errors or omissions in the report

With the exception of information regarding GIB and save as otherwise specifically indicated, the information set out in this report is based on public information. We have, where possible, indicated the primary source of information. We strongly recommend the recipients consult the primary source of information. Facts and views in this report have not been reviewed by, and may not reflect information known to, professionals in other GIB business areas.

This Report, and the information contained herein (save to the extent that such information is publicly available) is confidential and may not be disclosed by you to any other person outside of your organization without our consent.