Weekly Market Summary

4th of March 2016

Forecasting Financial Trends Was Never Simple! Especially When Sudden Shifts in Sentiment Rule! Fadi Nasser (SVP – Head of Treasury Sales)

The rally in equity and commodity markets has persisted this week, with Asian shares and oil both rising to eight-week highs and US/European stock indices consolidating recent gains. The MSCI Asia Pacific Index of shares and crude are both set for weekly advances of more than 5.5%, whilst a Bloomberg gauge of developing nation's currencies climbs for a fifth day as a wide range of emerging market currencies - from the Indonesia's rupiah to the Chinese yuan – continue their ascent against the US greenback. Gold prices remain on an upward trend, rising to a high of US$ 1,274 this morning and entering a bull market (defined as a rise in excess of 20% from recent lows).

Global equities have recouped more than half of this year's losses since sinking to a 2 -/2 year low on February 11th, amid improving U.S. data and monetary stimulus in China. Today's report on U.S. nonfarm payrolls will give investors further insight into the health of the world's biggest economy and the likelihood of further interest-rate hikes by the Federal Reserve, while China is expected to announce its plans to revive growth when an annual meeting of the National People's Congress gets under way on Saturday. "*U.S. data continues to shine, oil continues to firm and risk appetite is coming back into all aspects of the markets*," said Angus Nicholson, market analyst at IG Ltd. in Melbourne.

Chinese authorities seem to finally be getting through to investors after months of confusion about the nations' economic policies helped drive a US$9 trillion global equity rout. Recent moves such as ruling out the possibility of a one-off yuan devaluation, appointing a new head of the securities regulator, increasing the money available for lending and lowering the banks' reserve requirement ratio (by 0.5% effective march 1st) appear to be winning back some confidence. Fresh data last Tuesday - showing a further slowdown in the world's second-largest economy (for both factory output and services) - barely made a dent in a broad market rally. Even a Moody's Investors Service downgrade to the country's credit-rating outlook to negative the next day – on the back of a surging debt burden and uncertainties over the government's ability to enact reforms – did little to halt a sharp rally in Chinese stocks. And now expectations will be quite high for an announcement of significant further fiscal spending from China's National Party Congress, while Chinese Premier Li Keqiang is likely to confirm this weekend a shift in the monetary policy stance from "prudent" to "prudent with a slight easing bias. "*We panicked about China for much of this year*," Michael Metcalfe, global head of macro strategy at State Street Global Markets, a unit of the world's largest money manager for institutions, said. "*The market is beginning, just beginning to regain some faith, perhaps, in policy*."

Oil prices are also on the rise. West Texas Intermediate crude for April delivery is last trading at $34.70 a barrel, extending this week's advance to 6.0%. Key OPEC members intend to meet with other producers in Russia on March 20th to renew talks on an agreement to freeze output.

And there will be a "*dramatic price movement*" when that takes place, Nigerian Minister of State for Petroleum Resources Emmanuel Ibe Kachikwu said yesterday (not sure whether I should trust Ali Al-Naimi or Emmanuel Kachikwu on that one!).

Elsewhere, the US dollar has lost its shine in the past 48 hours, trending lower versus the British pound and Euro. Such retracement is both healthy and normal within the large macro trend as it gives markets the time to breathe. It also serves as an opportunity to shake out any weak handed investors. However, once the selling pressure abates or disappears completely, the old trend takes off like a rocket. Presumably this latest correction will prove to be very short in nature as the European Central Bank (ECB), the UK Monetary Policy Committee (MPC), the US Federal Open Market Committee (FOMC) and the Bank of Japan (BOJ) all meet in coming weeks, with the ongoing divergence in monetary policies still expected to send the US dollar on its rampage higher over the medium term. In Europe, inflation expectations have recently fallen to record lows, growth concerns remain elevated, equities are more than 10% lower and credit spreads are distinctively wider. With such fragile economic backdrop, the ECB is widely expected to deliver on its promises for further easing. And whilst the bar is high again for the European Central Bank to beat buoyant market expectations, we still foresee a 10-15 bps cut in the deposit rate (which banks use to make overnight deposits with the ECB, last at -0.30%) and an increase in QE volumes by € 15 billion/month (on top of the current € 60 billion monthly bond purchases) for six months alongside promises of more to come if needed – that should support risk sentiment going forward, whilst depressing the value of the Euro.

With regards to the US central bank, Fed officials continue pointing at further rate hikes should employment, growth and inflation parameters edge higher throughout the year. At its December 2015 FOMC meeting, they have called for four hikes in 2016. Yet markets (forward US yield curves) are hardly pricing a full 25 bps hike in the Fed funds rate between now and December-end. Investors are effectively calling the Fed's bluff (or that is what they currently believe!), as the Fed's forward guidance policies fall apart. But Fed officials would still want to maintain their credibility, and will likely interpret any economic data with rose colored glasses (mind you that US data releases are still quite healthy!). Additionally, there is always an added incentive to try and hike sooner than later so that they have some dry powder for when the economy inevitably slips into recession again. All that has led RBC Chief Economist - Tom Porcelli – to say earlier this week that the Federal Reserve will be acting in defiance of its most steadfast guidance if it does not raise interest rates at its March meeting. "*For all of the effort the Fed has put into communicating to markets that monetary policy decisions are data dependent, a no move at the March meeting (our base case) will prove the exact opposite*," wrote Mr. Porcelli. With the Federal Reserve's preferred gauge of inflation (core PCE last at 1.7%) now running hotter than what the median policymaker projected it would be at the end of 2016, and the jobless rate at 4.9% - the middle of the FOMC's range for full employment - US central bankers should be in a position to drive short term rates higher. "*A no hike in March reaffirms that monetary policy remains less about U.S. domestic realities and more about the perceived risks from the commodity price collapse and broad global malaise. Perhaps data dependence applies more to financial market and global economic metrics than is commonly appreciated*", Porcelli concludes.

A final reminder with respect to this afternoon February US payroll data: The BLS announcement will come at 4:30 pm Bahrain local time. Bloomberg's consensus is for a 195,000 increase in jobs on the month (following a 151,000 increase the previous month), an unchanged unemployment rate and average workweek (at 4.9% and 34.6 hours respectively), as a flat month-on month reading in average hour earnings (2.5% year-on-year) following a strong +0.5% monthly showing for the month of January. US 5-year and 10-year UST yields last trading at 1.34% and 1.83% respectively!

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