Weekly Market Summary

3rd of June 2016

The Fed and Markets Are Now Preoccupied With The UK Brexit Referendum … And Will Soon Shift Focus to US Presidential Elections! Fadi Nasser (SVP – Head of Treasury Sales)

June is set to be a very busy month despite little price movements in past days. Yesterday witnessed two important meetings, though investors – let down by lack of surprises from OPEC's and the European Central Bank decisions – have fast turned their attention to this afternoon US payroll release, the US FOMC meeting on June 15th, Bank of Japan policy decision on June 16th and results of the "Brexit" referendum on June 23rd (not to mention a Spanish election in between!).

To start with yesterday's meetings, the European central Bank left rates unchanged as widely expected (as a refresh, the repo rate stands at zero, the marginal lending rate at 0.25%, and the rate on bank overnight deposits at -0.40%). It also announced that it will begin buying corporate bonds as part of its ongoing asset purchase program on June 8th, moving at a rate of EUR 80 billion a month (80 billion here, 100 billion there… who's really counting ?!). ECB president Mario Draghi suggested that the Eurozone economic recovery will proceed at a moderate but steady pace, although with various downside risks. "*The latest data point to ongoing growth in the second quarter, though possibly at a lower rate than in the first quarter*," Draghi said. "*Risks to the Euro area growth outlook remains tilted to the downside,*" and mainly relate to developments in the global economy, the upcoming June 23rd U.K. referendum on European Union membership and other geopolitical risks. Asked specifically about '"*Brexit*", Draghi said the ECB has a view that the U.K. should remain in the EU because it would be beneficial both sides but is ready for "*any outcome*." However, he gave assurances that "*the ECB is ready towards contingencies*" should the vote go the other way. The Euro hardly moved on those remarks - trading in a tight 1.1140 – 1.1170 range against the US greenback – while 10-year German bund yields dropped 3 bps (from 0.14% to 0.11%).

Elsewhere, OPEC members – also meeting in Vienna yesterday – decided to stick to their policy of unrestrained production, rejecting a proposal to adopt a new output ceiling (prior to this meeting, rumors circulated that Saudi Arabia had floated the idea of restoring a group production ceiling as a gesture to show it had no plans to flood the market and it was serious about making the meeting a success). Still, ministers were united in their optimism that global oil markets are improving. "*The atmosphere in today's meeting was calm without any tensions*," Iranian Oil Minister Bijan Zanganeh, whose disagreements with his Saudi counterpart had unsettled previous meetings, said. There is "*very good unity*" among members, he added. While analysts agree supply and demand in the global oil market is much closer to balance than December, hurdles remain to OPEC regaining the market power it once enjoyed. Relations between the group's two most powerful members -- Saudi Arabia and Iran -- remain strained by their regional rivalry, global stockpiles are at record levels and the field outages in Canada and Nigeria that have helped drive prices higher may prove temporary. Whilst crude prices dipped briefly on news no OPEC output agreement had been reached, they soon climbed again to a seven-month high in London after the U.S. reported a drop in stockpiles.

Currency and bond investors will now focus their attention on this afternoon's U.S. jobs report release. The latter should help determine whether the Federal Open Market Committee sees a strong-enough economy to raise interest rates on June 15th , especially following the more hawkish tone of Fed officials in past weeks. Economists in a Bloomberg survey forecast that the Labor Department's May Non-Farm Payrolls report will show employers added 160,000 jobs for the second straight month, representing a slowdown from last year's average monthly growth of 229,000 jobs. The unemployment rate is expected to fall to 4.9% from 5% and average hourly earnings should continue running at a 2.50% annual rate (Mind you that a Verizon workers' strike that lasted for more than 6 weeks could reduce growth in May's payroll number by more than 40,000, and its impact on average hourly earnings and aggregate hours worked is yet not clear!).

Whilst an unexpected turmoil in Chinese and global markets led the Fed to refrain from raising rates earlier this year, a similar scenario could develop in coming weeks with investors and financial decision makers heavily preoccupied with the outcome of UK's EU referendum. With just under three weeks to go until the referendum, campaigning is getting increasingly bitter, and both camps have been accused of smears and overstating the facts. While the "Remain" camp has relied on reports from bodies including the Treasury, the Bank of England and the International Monetary Fund portraying the dire economic consequences of an exit (Chancellor of the Exchequer George Osborne will later today announce that hundreds of thousands of jobs may be lost in the service sector if the country leaves the European Union), the "Leave" campaign has switched its focus to the government's failure to curb immigration. Two ICM polls, carried out both online and by telephone, put "Leave" ahead this week, suggesting its strategy may be working. Meanwhile, in a sign that the government's economic message has not cut through, an Ipsos Mori poll on voter attitudes found 58% of respondents saying they do not think leaving the EU would affect their own standard of living.

Soon, markets will recognize UK voters' preference! When that happens and passes, do not be surprised with market commentators' focus shifting to upcoming US presidential elections (and so on … who knows, maybe some renewed attention on the Zika virus too!!).

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