Weekly Market Summary

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Could Lower Oil Prices and Chinese Equities Derail A Broadening Economic Recovery ?!
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Back in early 2016, I noted that China's weakening currency and equity markets – coupled with a rout in oil and a withdrawal of stimulus by the US Federal Reserve – had conspired to create a risk-off environment where traders aggressively sold equities and commodity currencies for fear of lower growth and higher market volatility, and at the same time moved out of high yielding bonds into the safety of G-7 government paper ("*flight to quality*"). As a result, more than US$ 3 trillion was wiped from the value of global equities, volatility in the broadest stock gauges jumped sharply (the VIX index - which measures the implied volatilities of a wide range of S&P 500 index options - rallied from a low of 16.0 to a high of 28.0 between January and February 2016, a 75% monthly jump) and commodity prices slumped.

Fast Forward to May 2017 …

Strong signs are emerging that the Chinese government's renewed drive to curb financial leverage is starting to bite. The system-wide contraction is a result of a series of government measures over the past month that included ordering banks to bolster risk controls, stepping up scrutiny of shadow financing and cracking down on wrongdoings among senior bureaucrats. The Chinese government might have anticipated that the solid growth momentum over the past two quarters would allow the economy to absorb the negative impact of deleveraging. However, a bigger-than-expected drop in the official factory order gauge this week have taken the shine off a recent run of solid data points, and the most recent decline in the purchasing managers indices over the past 48 hours is another indication of the delicate balance the government faces in maintaining growth, whilst curbing the leverage that helped fuel that expansion. The recent regulatory moves have erased more than US$ 300 billion of stock-market value from Chinese markets and sent bond yields to the highest level in nearly two years as investors speculate that the crackdown will curtail the amount of funds available for investment in financial markets. And while those moves have rocked China's financial markets, the government seems determined to send a clear signal with regards to the importance of curbing the estimated US$ 28 trillion debt pile that poses a risk to China's economic stability.

On the commodity front, WTI oil prices have collapsed below US$ 45 a barrel overnight – the first time since OPEC agreed to cut output last November - as surging U.S. shale output continued to confound the producer's group attempts to prop up prices. Weekly data released yesterday by the EIA (U.S. Energy Information Administration – *mind you that some analysts refer to this body as the Department of Energy's Disinformation, given that a lot of their reporting / produced statistics often gets sharply revised*!) showed US crude production continued rising (to 9.29 million barrels). Oil prices have collapsed close to 9% this week, sliding to the lowest since November 15th - two weeks before the Organization of Petroleum Exporting Countries signed a six-month deal to curb production aimed at easing a global glut. Whilst OPEC's curbs drove oil in early January to their highest level since July 2015, that increase encouraged U.S. drillers to pump more: The result has been 11 weeks of expansion in American production in the longest run of gains since 2012. While OPEC is likely to agree on prolonging curbs for a further six months when it meets on May 25th in Vienna, American shale supply remains a concern, according to Nigeria's oil minister. "*There is disappointment that the production cuts we have seen from OPEC and others have not had any impact at this stage on global inventory levels*," said Ric Spooner, a chief market analyst at CMC Markets in Sydney. "*The market seems to be much further away from a balanced situation than some had previously forecast. There is a possibility that oil could be headed to the low US$ 40s range from here*."

Despite the above upsetting developments, it is not all bad news for the global economy! On the contrary, there are strong signs that global growth is gathering momentum, whilst political/geopolitical uncertainties slowly dissipate. Below is a summary of positive (at times amusing!) stories we have been monitoring at our end over the past few days:

- **US Fed Meeting:** The US Federal Reserve met last Wednesday and decided - as widely expected - to leave its short term Fed Funds rate unchanged at 0.75% --1.00%. A news release acknowledged that the economy had been expanding at a slower pace of late, though it stated that the US job market and other indicators of the economy's health continue to be strong. It added that the Fed expects the economy to "*evolve in a manner that will warrant gradual increases*" in its interest rate, the same language it has used in previous months. In its release, the Fed also mentioned that consumer prices, excluding energy and food, declined in March, as inflation continued to run somewhat below the central bank's 2% target, though "*inflation measured on a 12-month basis recently has been running close to the committee's 2% longer-run objective*". Most Fed officials, as well as economists, believe that the weaker readings constitute a temporary blip due to seasonal measurement issues and the quirks of spring weather. If the string of disappointing figures continues, however, that could persuade the Federal Reserve to hold off on raising rates while the economy strengthens further. After all, the US central bank has emphasized that the pace of rate hikes will largely depend on the state of the economy.

- **French Elections:** 2 more days to go and the outcome of the French presidential election will be known. Emmanuel Macron is a centrist, pro-European (and pro-American), candidate facing the nationalist Marine Le Pen and her far-right National Front (FN). However, millions of French voters from across the political spectrum has suggested they would rather abstain or spoil their ballots than vote for either candidate on Sunday, May 7th. Analysts believe turnout is key to an election that has already defied expectations. While Mr. Macron is as much as 20 percentage points ahead, according to the latest polls, a high abstention rate could eat away at his majority or even — if it was extreme enough — turn the tide and hand victory to Mrs Le Pen. Abstention typically helps the FN because their die-hard supporters are more likely to vote.

- **Greek Bailout Talks:** Markets in Greece soared earlier this week after the nation resolved the latest impasse over the terms of its bailout program with international creditors, unlocking the way for debt-relief talks and the disbursement of the next tranche of emergency loans. Last Tuesday late-night breakthrough ended months of negotiations with the euro area and the International Monetary Fund, according to Bloomberg News. The Greek government yielded to a number of demands including pension cuts and a lower tax-free threshold of around 5,700 euros ($6,221) to 6,000 euros from 8,636 euros now. Greece 10-year bonds yields fell below 6% for the first time since 2014. The country needs an instalment of about 7 billion euros in aid to repay lenders next July, yet some euro-area governments, notably Germany, refuse to pay out until the IMF comes on board. The fund has said it won't join the latest bailout program until Greece's debt burden is eased.

- **North Korea**: President Donald Trump told Bloomberg News last Monday that he would be "*honoured"* to talk to Kim Jong-un, and while it is not the first time he has signalled a willingness to meet with perhaps the world's weirdest dictator - it may provide an important glance into his North Korea strategy. Several top Trump administration officials have repeatedly stressed an "all options" approach to North Korea, at different times emphasizing military action, collaboration with China for harsher sanctions, and now finally direct talks! "*Not many 27-year-old men could go in and take over a regime ... say what you want, but that's not easy… especially at that age*," Trump said in a past interview with Reuters. In another interview with CBS' "Face the Nation," Trump called Kim a "*pretty smart cookie*." During the campaign, Trump openly said he would talk to Kim, citing a 10 to 20% chance he would talk him out of his nuclear program, possibly over hamburgers J. Yun Sun, a senior associate at the Stimson Center, told Business Insider that Trump may be speaking highly of Kim to signal that his goal is not regime change, but only neutralizing the nuclear threat. Sun characterized Trump's apparent course as a "*pretty classic carrot and stick*" approach. Meanwhile, the USS Carl Vinson aircraft carrier sits off North Korea's coast, and Chinese and South Korean diplomats are meeting to discuss tightening sanctions on North Korea. According to Sun, these actions are likely to pressure the Kim regime while showing that there is a realistic, not totally humiliating off ramp on the road to a nuclear confrontation.

- **South Korea:** Moon Jae-in, a 64 years human-rights lawyer, is now set to become the most powerful person in South Korea, after Park's daughter Park Park Geun-hye was ousted as president in March. The son of North Korean refugees is the frontrunner in the May 9th election, an outcome that would end nine years of conservative rule and probably bring a softer touch to relations with Kim Jong-un's regime. Moon this week blasted a U.S. push to install a missile shield in South Korea before the election, saying the decision should be reviewed by the next president. Moo has long said he is prepared to meet Kim under the right conditions. He also sees the policy of the past nine years as a failure and wants China to take more action and favours a two-track approach of sanctions and dialogue. For Moon, the North Korean issue is deeply personal: His parents fled the country during the Korean War in a U.S. warship. In 2004, he visited North Korea with his mother, who met her younger sister for the first time in decades as part of a family reunion program.

- **"Safe Zones" in Syria:** Turkey, Russia and Iran, the main sponsors of the Syria peace talks in Kazakhstan, have just signed a deal to create "safe zones" inside the war-torn country, in one of the most concrete steps yet to ending the conflict. Ankara, chief backer of the Syrian opposition, Moscow and Tehran, which provide military support for Bashar al-Assad's government, agreed to establish four "de-confliction zones" which will be monitored by international troops. However parts of the rebel delegation, which is not a signatory, stormed out the room as the document was being signed in the Kazakh capital Astana on Thursday, objecting to the memorandum which they said "violated the country's territorial sovereignty." The deal, which will see the use of all weapons banned and flights grounded from Saturday, covers four of the country's most contested areas: Idlib province, largely controlled by rebel groups, Eastern Ghouta - a Damascus suburbs besieged by government forces, a pocket north of the central city of Homs and southern Syria along the Jordanian border. US President Donald Trump campaigned for the creation of safe zones throughout his presidential campaign and is understood to have discussed the proposal with Russian president Vladimir Putin in a telephone call earlier this week.

Last, traders will be focused later this afternoon on the all-important US payroll release*. Bloomberg consensus is for April payrolls rising by 190,000 (versus the weak print of 98,000 in March). As always, it will also be worth keeping a close eye on the other important elements of the report, namely the unemployment rate (expected to stay unchanged at 4.5%, or possibly move one-tenth higher to 4.6%), average hourly earnings (+0.3% mom /+2.7% yoy), the participation rate (last at 63.0%) and average weekly hours (expected unchanged at 34.3 hours).

**A turnaround in the data flow was necessary to see the Fed revive chances of a rate hike at their next meeting on June 14th, and this afternoon's payroll report should get the ball rolling! Non-Farm Payrolls increased 211,000 in April, a solid rebound from the downwardly revised 79,000 seen in the prior month. The unemployment rate dropped one-tenth to 4.4%, its lowest level since December 2006. The broader U-6 measure of unemployment fell to 8.6% from 8.9%, showing continued improvement and it is now not far from pre-crisis lows. The only real disappointment was on the annual rate of wage growth which declined to 2.5% despite a monthly gain of 0.3% which was in line with consensus expectations (March's data saw a downward revision). Overall, the headline gain in payrolls and decrease in unemployment rate is a step in the right direction and confirms the tightness of the US labour market. However the wage figures might limit some of the market reaction.*

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