# The Weekly Market View

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بنك أبوظبي التجاري
ADCB

## Diverging expectations for central banks' action across Atlantic

*Strong headline job data in the US pushed market expectations for September rate hike higher, as reflected through implied probabilities from the fed funds future market. However, we believe that the headline numbers conceal the slack that has been the reason behind the muted wage growth. The declining labour participation rate could potentially keep the interest rate trajectory low in the medium to long term. This is what the US Bond Market is suggesting as the 10yr yield eases despite higher rate hike probabilities (recent decline in the oil prices also a factor for the moment). On the other side of the Atlantic, Bank of England turns clearly dovish with its MPC statement and voting pattern. The MPC members voted 8-1 in favour of status quo as against market expectations of 8-2. It also dashed any expectation for the rate hike this year.*


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## China to be under focus again

*With important job data from the US and Fed event behind us, market is likely to increasingly focus on China and other emerging economies. Many important indicators are scheduled to be released this week which will provide us a clue about the ongoing economic adjustment in the second largest economy. There is possibility of disappointment which will influence sentiments in the commodity market. Almost all important indicators are scheduled to be released this week in India as well. Eurozone second quarter GDP growth and last month inflation are also scheduled for release, and we don't see possibility of surprises here.*


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## Past week global markets' performance

**Index Snapshot (World Indices)**

| Index | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| S&P 500 | 2,077.6 | -1.2 | 0.9 |
| Dow Jones | 17,373.4 | -1.8 | -2.5 |
| Nasdaq | 5,043.5 | -1.7 | 6.5 |
| DAX 40 | 11,490.8 | 1.6 | 17.2 |
| Nikkei 225 | 20,724.6 | 0.7 | 18.8 |
| FTSE 100 | 6,718.5 | 0.3 | 2.3 |
| Sensex | 28,236.4 | 0.4 | 2.7 |
| Hang Seng | 24552.5 | -0.3 | 4.0 |
| **Regional Markets (Sunday to Thursday)** | | | |
| ADX | 4835.5 | 0.0 | 6.8 |
| DFM | 4123.3 | -0.5 | 9.3 |
| Tadawul | 8654.6 | -4.9 | 3.9 |
| DSM | 11770.3 | -0.1 | -4.2 |
| MSM30 | 6430.29 | -2.0 | 1.4 |
| BHSE | 1333.0 | 0.1 | -6.6 |
| KWSE | 6249.3 | -0.1 | -4.4 |
| **MSCI** | | | |
| MSCI World | 1,747.3 | -1.0 | 2.2 |
| MSCI EM | 885.1 | -1.8 | -7.4 |

**Global Commodities, Currencies and Rates**

| Commodity | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| ICE Brent USD/bbl | 48.6 | -6.9 | -15.2 |
| Nymex WTI USD/bbl | 43.9 | -6.9 | -17.6 |
| OPEC Baskt USD/bbl | 47.1 | -6.7 | -9.4 |
| Gold 100 oz USD/t oz | 1094.2 | -0.2 | -7.6 |
| Platimum USD/t oz | 963.3 | -2.0 | -20.3 |
| Copper USD/MT | 233.3 | -1.3 | -17.4 |
| Alluminium | 1560.75 | -1.8 | -14.9 |
| **Currencies** | | | |
| EUR | 1.0967 | -0.2 | -9.3 |
| GBP | 1.5491 | -0.8 | -0.6 |
| JPY | 124.24 | 0.3 | -3.6 |
| CHF | 0.9839 | 1.8 | 1.1 |
| **Rates** | | | |
| USD Libor 3m | 0.3114 | 1.0 | 21.8 |
| USD Libor 12m | 0.8351 | 0.9 | 32.8 |
| UAE Eibor 3m | 0.7957 | 4.7 | 17.5 |
| UAE Eibor 12m | 1.1171 | 2.2 | 10.0 |
| US 3m Bills | 0.0610 | 0.0 | 71.8 |
| US 10yr Treasury | 2.1623 | -0.8 | -0.4 |

*Please refer to the disclaimer at the end of this publication*

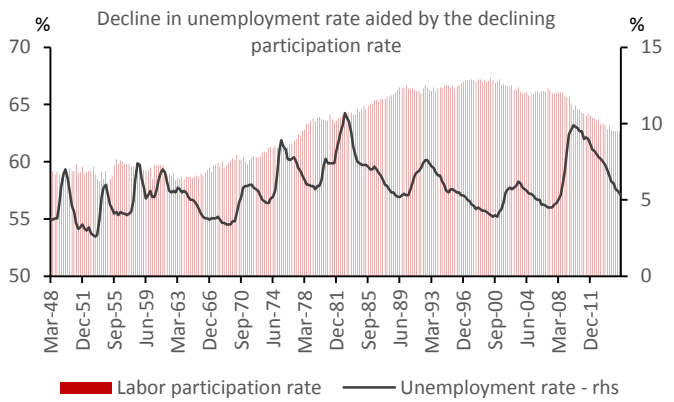
# US job data pushes market expectations for the Fed lift-off higher

## Headline numbers in line but wage gain "disappoints" again

Headline nonfarm payroll gains of 215k was largely in line with the market expectation of 225k while the unemployment rate remained stable at 5.3%. However, wage growth again missed the expectations (actual 2.1% vs expected 2.3%) which brings us back to the recent conundrum of muted labour earnings growth despite solid gains in the payroll over the last three years. The answer probably lies in existing labour market slack which is not being captured by these headline numbers.

If looked at over a longer term horizon, a large portion of the job gains represent the recovery from job losses during the Great Financial Crisis 2008-09. The net addition to the payroll since the last US recession started (Dec 2007 as officially announced by the NBER) is just 3.8 mn (41K per month).

A chunk of improvement in the unemployment rate has come from decline in the labour participation rate. The decline in the participation rate has taken almost 9-10 mn people away from the job market which means that even if they are in the working age group - can join the work force anytime – the unemployment rate will underestimate the slack (unemployment rate is based on how many working age people are looking for jobs). In more than the last half a century, the unemployment rate has not declined at such a rapid pace as it did in the last few years. The Chart below clearly shows that the labour participation rate aided significantly in the improvement of the unemployment rate.




Source: Bloomberg

There are two possible consequences of the lower participation rate – first, stabilization (or stabilization after little more decline) in the participation rate will result in lower potential GDP growth in the medium to long term which will require a lower level of interest rates in the medium to long term. This is the more likely scenario given the US demographics. Second, the participation rate turns around as people become more confident about improving job prospects. This will cap the improvement in the headline unemployment rate, again a factor which is likely to put downward pressure on interest rates.

## Nevertheless, market implied probability of the Fed hike in September higher post data release

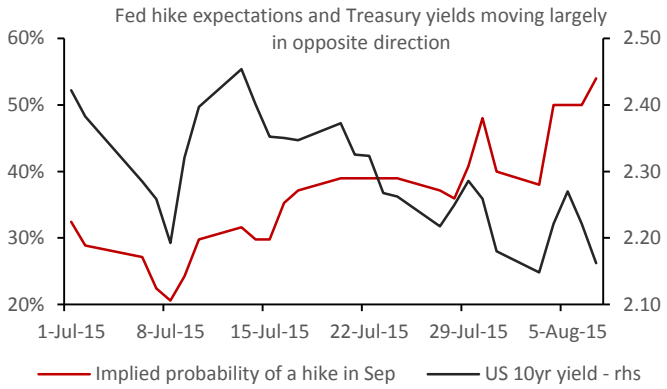
Another 200k+ job growth pushes the implicit market probability of the Fed rate hike in September higher, reflected through the fed funds future implied probabilities. Now, fed funds future traders suggest a more than 50% chance of the central bank hiking rate in September.

| Meeting | Probability of Move | 0-0.25 | 0.25-0.5 | 0.5-0.75 | 0.75-1 | 1-1.25 | 1.25-1.5 | 1.5-1.75 |
|---|---|---|---|---|---|---|---|---|
| Sep-15 | 54.0% | 46.0% | 54.0% | | | | | |
| Oct-15 | 58.6% | 41.4% | 53.2% | 5.4% | | | | |
| Dec-15 | 76.8% | 23.2% | 48.0% | 26.4% | 2.4% | | | |
| Jan-16 | 80.5% | 19.5% | 44.0% | 29.9% | 6.2% | 0.4% | | |
| Mar-16 | 89.9% | 10.1% | 32.2% | 36.7% | 17.6% | 3.2% | 0.2% | |
| Apr-16 | 91.7% | 8.3% | 28.3% | 35.9% | 21.0% | 5.8% | 0.7% | |
| Jun-16 | 95.8% | 4.2% | 18.3% | 32.1% | 28.4% | 13.4% | 3.3% | 0.4% |
| Jul-16 | 96.9% | 3.1% | 14.6% | 28.5% | 29.4% | 17.3% | 5.9% | 1.1% |
| Sep-16 | 98.3% | 1.7% | 9.5% | 22.4% | 29.0% | 22.6% | 10.9% | 3.2% |
| Nov-16 | 98.8% | 1.2% | 7.1% | 18.4% | 26.9% | 24.6% | 14.5% | 5.6% |

Source: Bloomberg (probabilities as on 8th August 2015)

## Muted response from the bond market

Despite higher implied probability of the Fed hike in September, US Treasury yields have softened in the recent past. A sharp correction in the commodity prices could be a reason for further easing of long term yields as the market adjusts its inflation expectations. This means that even though the market has increased the rate hike expectations in the near term, it has adjusted the interest rate trajectory lower in the medium term.




Source: Bloomberg

## Bank of England turns clearly dovish

On the contrary to the market expectations and recent statements by the BoE officials, the central bank statement turns clearly dovish. It believes that the resource underutilization remains in the economy along with inflation below the target. According to the central bank, the near-term outlook for inflation is muted as lower energy prices will continue to bear down on inflation until the middle of next year. The voting pattern of 8-1 in favour of status quo was also dovish as market was expecting at least 7-2 (in 9 members MPC). The unexpected dovish statement is likely to weigh on the currency in the near term.

## Summary market outlook

| | |
|---|---|
| **Global Yields** | Despite increasing market expectations of the Fed hike in September, US Treasury yields closed the week largely unchanged. Yields are likely to remain around the current levels as lower commodity prices (thus lower inflation expectations) and higher rate expectations balance each other. Watch oil price movement this week for a clue for yield trend. European yields ticked up as core inflation threw some positive surprise along with other economic releases. |
| **Stress and Risk Indicators** | The VIX index ticked up slightly last week as equity markets turned lower. The ongoing uncertainty related to the Fed hike and the global growth concerns are likely to weigh on the risk indicator, pulling it higher. Sovereign CDS spreads were largely stable in major economies except Brazil where the spread widened by 32bps. |
| **Precious Metals** | Precious metals remained largely stable last week as well. Gold price seems to have found a trading range of $1080-1100 per oz. We remain cautious on the outlook despite the recent price correction. |
| **Local Equity Markets** | Most GCC equity markets, with the exception of the Saudi market, reflected resilience last week despite sharp decline in the oil price. The Saudi market corrected by almost 5%, giving away most of its YTD gains. We remain cautious on the regional markets in the near term due to the oil price volatility. |
| **Global Equity Markets** | Despite lower commodity prices and largely positive surprises in earnings global equity markets declined led by the US equities. Global equities face risk from the uncertainty in China's growth and the rising expectations for the Fed rate hike in the near term. |
| **Energy** | Energy prices remained under pressure last week as cloud continues to thicken around China's economic outlook and persistent over supply. Although we remain constructive on the energy prices in the medium term, caution is needed in the near term. |
| **Industrial Metals** | Uncertainty around the Emerging Economies growth, in particular China's, continues to weigh heavily on the industrial metals. |

| **Currencies** | **Commentary** | **Critical levels** |
|---|---|---|
| **EURUSD** | Decent set of economic data continues to support the euro despite rising market expectations of the Fed hike last week. Strong external balance of the Eurozone with non-Eurozone countries also remain a support to the currency. We reiterate our last week call that the euro is likely to remain in the range of 1.09-1.11 in the near term. | R2 - 1.1085<br>R1 - 1.1026<br>S1 - 1.0878<br>S2 - 1.0789 |
| **GBPUSD** | A largely dovish statement by the Bank of England after its policy meeting last week weakened the pound. The voting pattern (8-1) and the commentary on inflation suggest that the rate hike in the UK is still sometime away. Bond yield also retracted post meeting. We see some further weakness in the pound in the near term. | R2 - 1.5748<br>R1 - 1.5620<br>S1 - 1.5394<br>S2 - 1.5296 |
| **USDJPY** | Negative surprise in labour earnings pushed the yen slightly lower. However, status quo from the Bank of Japan contained the weakness. We continue to believe that any large movement on either side in the currency is less likely in the very near term. | R2 – 125.64<br>R1 – 124.94<br>S1 – 123.67<br>S2 – 123.10 |

## Forthcoming important economic data

### United States

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 08/11/2015 | Nonfarm Productivity | 2Q P | 1.6% | -3.1% | Retail sales and sentiment survey will reflect how consumer spending trend is moving while industrial production will show the business cycle strength. |
| 08/11/2015 | Unit Labor Costs | 2Q P | 0.0% | 6.7% | |
| 08/13/2015 | Retail Sales Advance | Jul | 0.6% | -0.3% | |
| 08/14/2015 | PPI Ex Food and Energy YoY | Jul | 0.5% | 0.8% | |
| 08/14/2015 | Industrial Production MoM | Jul | 0.3% | 0.2% | |
| 08/14/2015 | Univ. of Mich. Sentiment | Aug P | 93.6 | 93.1 | |

### Japan

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 08/10/2015 | Current Account (BoP basis) | Jun | ¥786B | ¥1880B | External balance and machine orders numbers are important to see if the recovery is on track. |
| 08/10/2015 | Trade Balance (BoP basis) | Jun | ¥119B | -¥47.3B | |
| 08/12/2015 | PPI YoY | Jul | -2.9% | -2.4% | |
| 08/13/2015 | Machine Orders YoY | Jun | 17.6% | 19.3% | |

### Euro zone

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 08/11/2015 | ZEW Survey Expectations | Aug | NA | 42.7 | Second quarter growth number is important for the market along with last month inflation data. |
| 08/12/2015 | Industrial Production MoM | Jun | -0.1% | -0.4% | |
| 08/14/2015 | GDP SA QoQ | 2Q A | 0.4% | 0.4% | |
| 08/14/2015 | CPI YoY | Jul F | 0.2% | 0.2% | |
| 08/14/2015 | CPI Core YoY | Jul F | 1% | 1% | |

### China and India

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 08/10/2015 | New Yuan Loans (China) | Jul | 725B | 1279B | China's data would reflect how real economic activity was doing in the first month of the current quarter. India's number will also be watched closely for overall assessment of the economic activity. |
| 08/12/2015 | Retail Sales YoY (China) | Jul | 10.6% | 10.6% | |
| 08/12/2015 | Industrial Production YoY (China) | Jul | 6.6% | 6.8% | |
| 08/12/2015 | Fixed Assets Investment YTD YoY (China) | Jul | 11.5% | 11.4% | |
| 08/10/2015 | Exports YoY (India) | Jul | NA | -15.8% | |
| 08/10/2015 | Imports YoY (India) | Jul | NA | -13.4% | |
| 08/10/2015 | Local Car Sales (India) | Jul | NA | 162677 | |
| 08/12/2015 | Industrial Production YoY (India) | Jun | NA | 2.7% | |
| 08/12/2015 | CPI YoY (India) | Jul | NA | 5.4% | |

## 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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