The Weekly Market View

23 March 2015

Fed looks more patient in spite of dropping the word "patient"

The Federal Reserve surprised the market with its dovish tone even though it dropped the word "patient" from the statement. By dropping the word "patient" – to which Janet Yellen had in the past associated a specific time table for tightening policy – the Fed, in reality, wants to make its policy less tied to "forward guidance" as intended by Mrs Yellen's predecessor Ben Bernanke, thereby moving to policy triggers that are data- rather than time-dependent. Its downward adjustment of the economic assessment and policy rate trajectory become therefore more important and suggest that the central bank will remain patient in the near term. Financial markets took notice and yields and the US dollar retreated, while equities gained.

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Markets to focus on flash PMIs from the Eurozone and China

Financial markets are likely to focus on flash PMIs from the Eurozone and China. The former is expected to remain on the improving track, while the latter is expected to show slowdown. Markets will also look for inflation and housing data in the US where economic releases in the recent past have largely disappointed. Markets are expected to remain relatively stable and also the oil price might do well on the back of a weaker US dollar.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,108.1	2.7	2.4
Dow Jones	18,127.7	2.1	1.7
Nasdaq	5,026.4	3.2	6.1
DAX 40	12,039.4	1.2	22.8
Nikkei 225	19,560.2	1.6	12.1
FTSE 100	7,022.5	4.2	7.0
Sensex	28,261.1	-0.8	2.8
Hang Seng	24375.2	2.3	3.3
Regional Markets (Sunday to Thursday)			
ADX	4354.7	-3.3	-3.8
DFM	3457.1	-6.3	-8.4
Tadawul	9174.4	-5.3	10.1
DSM	11484.6	-4.6	-6.5
MSM30	6235.32	-2.8	-1.7
BHSE	1451.9	-1.6	1.8
KWSE	6418.8	-1.2	-1.8
MSCI			
MSCI World	1,774.6	3.2	3.8
MSCI EM	969.5	3.2	1.4

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	55.3	1.2	-3.5
Nymex WTI USD/bbl	46.6	2.0	-12.6
OPEC Baskt USD/bbl	50.2	-2.9	-3.5
Gold 100 oz USD/t oz	1182.5	2.1	-0.2
Platimum USD/t oz	1138.9	1.8	-5.7
Copper USD/MT	277.5	3.6	-1.8
Alluminium	1793.75	1.4	-2.2
Currencies			
EUR	1.0821	3.1	-10.6
GBP	1.4949	1.4	-4.0
JPY	120.04	-1.1	-0.2
CHF	0.9752	-3.0	2.0
Rates			
USD Libor 3m	0.2668	-1.4	4.4
USD Libor 12m	0.6974	-2.2	10.9
UAE Eibor 3m	0.7014	0.0	3.6
UAE Eibor 12m	1.0086	-0.4	-0.7
US 3m Bills	0.0000	-99.9	-100.0
US 10yr Treasury	1.9303	-8.7	-11.1

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Federal Reserve no longer committed to any time schedule for rate hikes

Fed acknowledges weaker economic and price dynamics, as well as deflationary impact of stronger dollar

Last week the Federal Reserve clearly distanced itself from any commitment to an early policy rate hike. It moved away from specific guidelines on the rate trajectory, and by dropping the word "patient" it moved to a more data-dependent "wait and see" stance. Technically, the central bank could raise the rate as early as June, according to its own interpretation of the word "patience". However, contrary to what the market was expecting from the dropping of the word "patient", the Fed in fact has turned more dovish by downgrading its economic assessment, in consideration of recent soft data releases. The most notable downward adjustments were inflation and growth expectations. Now the central bank members do not expect core PCE inflation (their preferred measure of inflation) to reach central bank's target of 2% in the next three years, unlike earlier expectations when it was expected to reach the target next year. The real GDP growth projection has also been revised downward for the next three years. Again, a notable point in the growth projection is that it is not expected to touch 3% in the forecast horizon.

In line with lower growth and inflation expectations, the policy rate trajectory was also shifted downwards. Now, the members' median forecast for the Fed funds rate at the end of 2015 is 0.625%, lower by 0.5% from the previous projection. This is an interesting number as it reflects two rate hikes of 25 bps this year. The next rate projection will come at the June FOMC meeting. We suspect that the "dot plot" projection could move further down especially for this year if our expectations of growth moderation and lower inflationary trajectory remain on track.

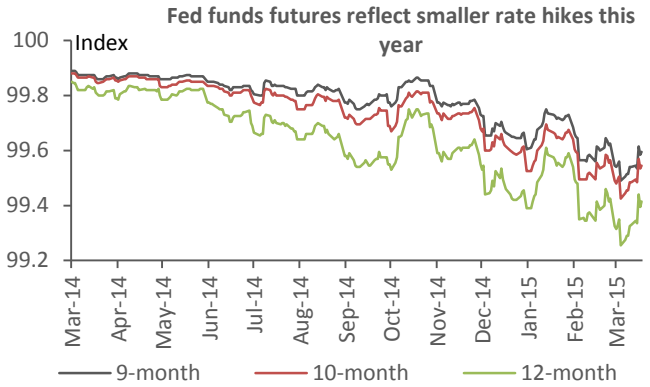
Federal Reserve Board Members economic and policy rate projection (in %)

	2015	2016	2017
Real GDP growth	2.3-2.7	2.3-2.7	2.0-2.4
December projection	2.6-3.0	2.5-3.0	2.3-2.5
Unemployment rate	5.0-5.2	4.9-5.1	4.8-5.1
December projection	5.2-5.3	5.0-5.2	4.9-5.3
PCE Inflation	0.6-0.8	1.7-1.9	1.9-2.0
December projection	1.0-1.6	1.7-2.0	1.8-2.0
Core PCE inflation	1.3-1.4	1.5-1.9	1.8-1.9
December projection	1.5-1.8	1.7-2.0	1.8-2.0
Appropriate pace of policy firming (at the end of year)	0.625	1.625	3.125
December Projection	1.125	2.5	3.625

Source: Federal Reserve

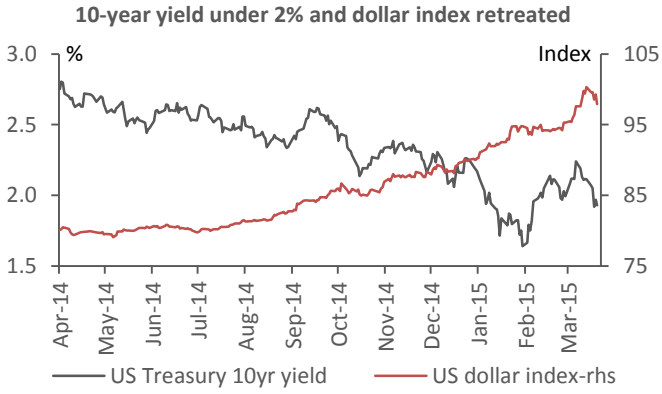
Market reacts on dovish Fed statement and projections

A dovish Fed resulted into Fed funds futures ticking up, reflecting expectations of smaller rate hikes later this year. Now the Fed funds future for nine-month shows the Fed funds rate (main policy rate) at 40 bps at the end of the year (effectively one rate hike of 25 bps) while one-year rate puts the rate to be around 60 bps (another rate hike of 25 bps by March 2016).



Source: Bloomberg

In line with the smaller rate hike projection, both from the market (through Fed funds futures) and Fed members (dot projections), sovereign yields eased in the US. The Treasury 10-year yield retreated again under the 2% mark. At the same time, Chairperson Yellen mentioned US dollar strength impacting export growth. No wonder the US dollar weakened significantly, especially against euro.



Source: Bloomberg

Improvement remains on track in the Eurozone

Amid all the posturing between Greece on one hand and its lenders on the other, economic data continue to show improvement in the currency bloc. ZEW survey expectations index jumped almost 10 points to 62.4 in March while February data for new car registrations further accelerated.

Summary market outlook

Global Yields	US Treasury yields eased significantly following the dovish FOMC statement, and its softer economic assessment. To the extent that economic data continues to soften, yields will face further downward pressure. Eurozone sovereign yields ticked up in the run up to the Fed statement but ended the week largely flat. Further easing is not ruled out especially in periphery yields.
Stress and Risk Indicators	A dovish Fed pushed the risk indicators including VIX lower. Although the current level of the index is closer to the lowest level touched in 2014, further declines cannot be ruled out as global monetary policy accommodation stands to increase rather than come down. Sovereign CDS spreads were largely stable with some easing in Latin American spreads. Rumours that the Venezuelan government would be negotiating a USD 10bn loan with China, and that the country could get USD 5bn as early as in April, helped the Venezuelan CDS to retreat by almost 1500 bps, remaining at a very high absolute level of 4100 bps.
Precious Metals	The dovish Fed seems to have helped the gold price as well. The precious metal witnessed some gains as the cost of carry is likely to remain low with a dovish Fed. Having said that, precious metal prices will remain volatile as long as the Federal Reserve will not become more explicit about rate hikes.
Local Equity Markets	Local equity markets declined further as oil price outlook remains subdued. The dovish Fed induced some gains in the oil price later in the last week. However, sentiment in the oil market remains downbeat which is likely to weigh on the local equities in the near term.
Global Equity Markets	A dovish Fed pushed global equity markets higher last week. We are sceptical about a general rally in the global equity markets as initial euphoria of dovish Fed fizzles.
Energy	Energy prices gained as the US dollar retreated after the FOMC statement. We remain cautious on the energy prices as the demand supply dynamics do not support significant near term gains.
Industrial Metals	The China-driven secular downward trend will continue, but the pace might stall to the extent that US dollar strengthening might have a “technical” pause.

Currencies	**Commentary**	**Critical levels**
EURUSD	“A trigger for some gains could be a dovish Fed” is what we said last week. The currency pair is still looking for a stability in the post ECB QE and dovish Fed. The pair could be volatile and data dependent next week.	R2 - 1.1359 R1 - 1.1090 S1 - 1.0505 S2 - 1.0189
GBPUSD	A dovish Fed, and the resulting US dollar weakness, halted the drop in the British pound last week. We expect that the relative strength of the economic releases will determine the currency movement. If it breaches 1.50 level, it could gain further.	R2 - 1.5448 R1 - 1.5198 S1 - 1.4667 S2 - 1.4386
USDJPY	The Japanese yen moved towards its trading range of 118-120 per dollar as global US dollar strength abated. We believe that it could further strengthen slightly. However, major movements are unlikely.	R2 – 122.51 R1 – 121.27 S1 – 119.05 S2 – 118.07

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
03/23/2015	Existing Home Sales	Feb	4.92mn	4.82mn	The housing sector data as well as consumer sentiment data are important. Any large surprise in inflation and GDP data could have some impact on financial markets
03/24/2015	CPI Core YoY	Feb	1.7%	1.6%	
03/24/2015	CPI YoY	Feb	-0.1%	-0.1%	
03/24/2015	New Home Sales	Feb	467k	481k	
03/25/2015	Durables Ex-Transportation	Feb	0.3%	0.0%	
03/27/2015	GDP Annualized QoQ	4Q	2.4%	2.2%	
03/27/2015	Univ. of Mich. Sentiment	Mar F	92.0	91.2	

Japan

	Indicators	Period	Expected	Prior	Comments
03/27/2015	Jobless Rate	Feb	3.5%	3.6%	Consumer spending is expected to remain sluggish, while the job market is expected to improve further.
03/27/2015	Job-to-Applicant Ratio	Feb	1.15	1.14	
03/27/2015	Household Spending	Feb	-3.2%	-5.1%	
03/27/2015	CPI YoY	Mar	2.3%	2.4%	

Euro zone

	Indicators	Period	Expected	Prior	Comments
03/23/2015	Consumer Confidence	Mar A	-6	-6.7	Flash PMIs in the region are expected to show improvement.
03/24/2015	Markit Mfg PMI	Mar P	51.5	51.0	
03/24/2015	Markit/BME Mfg PMI (Germany)	Mar P	51.5	51.1	
03/25/2015	IFO Business Climate (Germany)	Mar	107.3	106.8	
03/24/2015	Markit Mfg PMI (France)	Mar P	48.5	47.6	

China and India

	Indicators	Period	Expected	Prior	Comments
03/24/2015	HSBC Mfg PMI (China)	Mar P	50.4	50.7	No very good numbers are expected from the two major emerging economies.
03/27/2015	Industrial Profits YoY (China)	Feb	NA	-8.0%	
03/25/2015	Infra Industries YoY (India)	Feb	NA	1.8%	

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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