The Weekly Market View

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بنك أبوظبي التجاري
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ECB and PBoC lead the stimulus rally

Mr. Draghi's Thursday commitment to increase the length, size of the ECB's QE, as well as alter its composition, plausibly already in December was followed on Friday by the decision of the PBoC to cut its reference rate for the sixth time in 12 months, and to reduce the reserves that banks have to hold. These decisions to increase stimulus come at a time that markets are increasingly doubtful that the Federal Reserve will stick to planned interest rate hikes. Not surprisingly, equity markets – and in particular European equity markets – rallied. US and Japan PMI preliminary indicators were up, indicating that global growth – whilst likely to remain sluggish – will not fall off a cliff. The current revaluation rally might well last through the end of the year.

Fed, US third quarter growth and German IFO to set the tone

Markets will be first and foremost scrutinizing the FOMC's Wednesday statement to verify if the Fed is effectively increasingly doubtful of hiking rates already in December. The US economy is expected to have grown by a meagre 1.5% in the third quarter. Past quarter growth is of course less important than forward leading indicators, such as the PMI. Yet markets are likely to pay close attention to the composition of the overall GDP number. A rise in inventories would put some doubts on the sustainability of growth, whatever the total figure. Likewise, a reduction in exports would highlight the risks of further rate hikes as they are more likely to destabilize emerging markets. Markets will also pay close attention to German IFO expectations, arguably the best leading indicator for growth in Germany. German data have not been that good lately. The IFO indicator is expected to come down. A further deterioration of the German economic cycle is likely to make it easier for Mr. Draghi to convince the hawks on the ECB board to pursue more, rather than less, accommodation.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,075.2	2.1	0.8
Dow Jones	17,646.7	2.5	-1.0
Nasdaq	5,031.9	3.0	6.2
DAX	10,794.5	6.8	10.1
Nikkei 225	18,825.3	2.9	7.9
FTSE 100	6,444.1	1.0	-1.9
Sensex	27,470.8	0.9	-0.1
Hang Seng	23151.9	0.4	-1.9
Regional Markets (Sunday to Thursday)			
ADX	4485.4	-1.2	-1.0
DFM	3588.5	-3.0	-4.9
Tadawul	7382.6	-4.1	-11.4
DSM	11584.8	-1.6	-5.7
MSM30	5905.74	-0.1	-6.9
BHSE	1254.1	-0.3	-12.1
KWSE	5780.8	0.9	-11.6
MSCI			
MSCI World	1,706.6	1.4	-0.2
MSCI EM	868.6	0.4	-9.2

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	48.0	-4.9	-16.3
Nymex WTI USD/bbl	44.6	-5.6	-16.3
OPEC Baskt USD/bbl	43.4	-5.0	-16.5
Gold 100 oz USD/t oz	1164.5	-1.1	-1.7
Platimum USD/t oz	1001.4	-1.3	-17.1
Copper USD/MT	235.0	-2.2	-16.8
Alluminium	1467.75	-5.2	-20.0
Currencies			
EUR	1.1018	-2.9	-8.9
GBP	1.5314	-0.8	-1.7
JPY	121.47	1.7	-1.4
CHF	0.9786	2.6	1.6
Rates			
USD Libor 3m	0.3229	1.8	26.3
USD Libor 12m	0.8319	0.8	32.3
UAE Eibor 3m	0.8457	1.5	24.9
UAE Eibor 12m	1.1971	0.4	17.9
US 3m Bills	0.0000	0.0	-100.0
US 10yr Treasury	2.0866	2.6	-3.9

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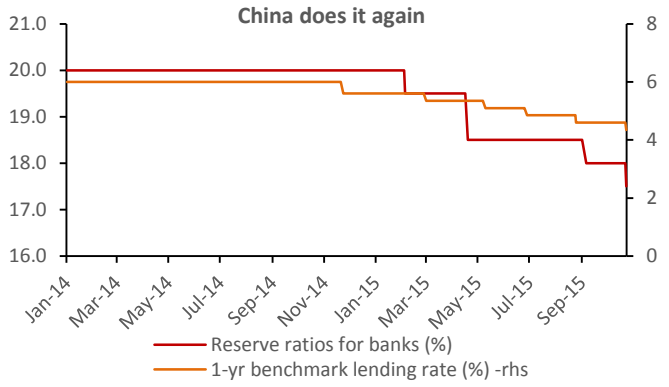
The PBoC needs the Fed to be on hold to be able to provide further stimulus

China does it again

For the sixth time in twelve months the People's Bank of China (PBoC) reduced its benchmark one-year bank lending rate by 25 basis points to 4.35%, and the one-year deposit rate to 1.5% (the lowest on record). In addition the PBoC reduced the banks' Reserve Requirement Ratio (RRR), effectively injecting 90 billion US dollars in the country's banking system



Source: Bloomberg

China's efforts to stimulate the economy – and in particular allow the banks to support struggling industrial firms – are a clear confirmation of the downward pressure its economy continues to face.

It is easier to reduce rates when the Fed is on hold

The reduction of the RRR in particular reflects the authorities' attempts to offset the negative impact of the capital outflows that continue to erode the country's monetary base. In order to defend the country's peg with the US dollar, in fact, the PBoC is still forced to buy significant amounts of its own currency against the US dollar, thereby reducing Renminbi in circulation. The reduction of the RRR only partially offsets this mechanism since part of the newly released cash will in fact result in additional capital outflows.

In this regards the decision of the Federal Reserve not to hike rates for the moment is for sure helping the PBoC, as it has a dampening impact on the speed at which capital flows out of China in particular, and emerging markets in general. As can be seen from the below chart total international reserves have been coming down since the summer of 2014, when the Federal Reserve's hiking plans became increasingly clear. The chart also illustrates that global growth is coming down at a time when total international reserves are coming down. It is still to be seen if the prospective increase of ECB QE, and the Fed being on hold, will be sufficient to halt the slide in reserves. We have our doubts. In other words we still believe that at some point in 2016 China will be forced to allow its currency to devalue. For the moment, however, we believe that China stimulus – without devaluation – will be able to temporarily lift the value of Chinese equities, as we have illustrated in our recent *Investment Strategy Note* on Chinese equities.

Source: Bloomberg

Draghi not so helpful in stabilizing China's policy mixture

Mario Draghi's announcement that he is willing to increase the size and length of QE, as well as alter its composition, clearly illustrates the dilemma in which Chinese policy makers find themselves. The Euro-zone is China's biggest client. As such, increased Euro-zone demand (induced by stimulus) is clearly a good thing for China. Yet, the ensuing depreciation of the euro against the US dollar puts again downward pressure on China's competitiveness – and industrial profits – precisely because its currency remains pegged to the US dollar. We believe that the euro – US dollar exchange rate will remain confined between 1.05 and 1.15, as that is a level with which both the Euro-zone and the US economies can live. The 1.05 cap of the US dollar against the euro is thus also putting some limit to a further – and plausibly unsustainable – deterioration of China's competitiveness. At the same time the prospect of a further stabilization in China is particularly favourable to German equities as we have highlighted in our most recent *Investment Strategy Note*.

Summary market outlook

Global Yields	The US Treasury 10yr yield ticked up slightly at the end of the last week. The FOMC statement and the third quarter GDP growth number will determine the direction this week. We suspect that the FOMC tone will remain dovish to keep the yield contained. With talk of additional stimulus by the ECB, European sovereign yields, in particular periphery countries' yields, are likely to trend further lower.
Stress and Risk Indicators	Risk indicators further eased as risky assets gained last week. The VIX index has reached the lowest level since August. The trend is likely to continue in the near term. Monetary events from the ECB and the PBoC have eased the global risk aversion as reflected in the lower CDS spreads for the European and EM sovereigns.
Precious Metals	Easing in global risk aversion resulted into a slight decline in the precious metal prices. We have maintained a cautious note on the asset class for some time and remain with the same view.
Local Equity Markets	Following the oil price GCC equities declined last week. The oil price remaining volatile, we maintain a cautious approach on regional equities.
Global Equity Markets	Monetary policy events in the Eurozone and China reignite the flagging global equity rally. Markets are likely to continue the upward movement in the near term. However, major companies scheduled to release third quarter earnings, and the FOMC tone is also expected to have influence on the market direction.
Energy	The oil price corrected further last week, second week in continuation as the inventory story takes centre stage in the oil market. With the ongoing rebalancing process in the oil market, we remain cautious in the near term and expect volatility to persist.
Industrial Metals	Notwithstanding the recent gains in industrial metal prices, uncertainty around emerging economies' growth, in particular China's, is likely to continue to weigh on industrial metals.

Currencies	**Commentary**	**Critical levels**
EURUSD	The euro moved almost one-way since Mr. Draghi's press conference where he clearly indicated that more monetary stimulus is on its way in the Eurozone. The currency is likely to see further downside before market starts pondering upon the size of the additional stimulus.	R2 - 1.1524 R1 - 1.1271 S1 - 1.0881 S2 - 1.0744
GBPUSD	The pound weakened despite strong retail sales data largely to follow its neighbour currency, the euro. Movement in the currency pair is likely to be directed by the relative strength of economic data this week as both countries are scheduled to release third quarter GDP numbers.	R2 - 1.5577 R1 - 1.5446 S1 - 1.5245 S2 - 1.5175
USDJPY	The global equity rally pushed the Yen lower, also supported by the expectations of more stimulus from the BoJ. A clear indication from the ECB for more stimulus has raised the same expectations from the Japanese central bank. So, the Yen is expected to see some further depreciation.	R2 – 123.04 R1 – 122.25 S1 – 119.91 S2 – 118.36

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
10/26/2015	New Home Sales	Sep	550k	552k	Markets will focus on the FOMC statement and the third quarter GDP growth this week to see if Fed view is in line with the market's view on prospective rate hikes.
10/27/2015	Durable Goods Orders	Sep	-1.3%	-2.3%	
10/28/2015	FOMC Rate Decision	Oct	No	change	
10/29/2015	GDP Annualized	3Q A	1.5%	3.9%	
10/29/2015	Core PCE QoQ	3Q A	1.4%	1.9%	
10/30/2015	Personal Spending	Sep	0.2%	0.4%	
10/30/2015	Univ. of Mich. Sentiment	Oct	92.5	92.1	

Japan

	Indicators	Period	Expected	Prior	Comments
10/28/2015	Retail Sales MoM	Sep	1.1%	0.0%	Amid weakening growth indicators, market will focus on all the releases this week.
10/29/2015	Industrial Production YoY	Sep P	-2.6%	-0.4%	
10/30/2015	Jobless Rate	Sep	3.4%	3.4%	
10/30/2015	Job-To-Applicant Ratio	Sep	1.24	1.23	
10/30/2015	National Core CPI	Sep	0.9%	0.8%	

Euro zone

	Indicators	Period	Expected	Prior	Comments
10/27/2015	M3 Money Supply YoY	Sep	5.0%	4.8%	Markets will look at the money supply number for the euro area and the IFO survey for Germany.
10/29/2015	Unemployment Rate	Sep	11.0%	11.0%	
10/30/2015	CPI Core YoY	Oct A	0.9%	0.9%	
10/26/2015	IFO Expectations (Germany)	Oct	102.4	103.3	
10/30/2015	Retail Sales MoM (Germany)	Sep	0.4%	-0.6%	

China and India

	Indicators	Period	Expected	Prior	Comments
10/27/2015	Industrial Profits YoY (China)	Sep	NA	-8.8%	Not many important economic releases are scheduled from China and India.
11/01/2015	Mfg PMI (China)	Oct	NA	49.8	
This week	Infra Industries Growth YoY (India)	Sep	NA	2.6%	

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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