WEEKLY MARKET OUTLOOK

15 - 21 October 2018

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WEEKLY MARKET OUTLOOK - An Overview

FX Market

Expect Abenomics To Entrench Not Disappear

USDJPY spent the summer recoupling with interest rates. The JPY weakness helped the Nikkei rise nearly 2000 point in September. Yet, recent risk-sell, which supported JPY, eliminated most of the stock markets early gains. Outside of market volatility, there are real signs that the effect of "Abenomics" are fading and real economy is slowing.

Since the BoJ Tankan surveys released in September there has been clear deceleration in key activity areas. Current business conditions index for large manufacturers has fallen by 2 points while industrial production remained weak. Perhaps the lone bright spot for Japan, and the global economy, is exports orders embed in manufacturing PMI (which increased 1.2 to 50.9). While read is just marginally above expansion territory, Nikkei bulls will take it.

Elsewhere, inflation remains weak limiting the impact of the current uptick in price pressures. The BoJ's prefer measure of core-core inflation indicates that prices in Tokyo increased by 0.7% in September. However, the result of higher prices across the board was likely the effect of stronger energy prices rather than growth driven.

Markets have been speculating that Japanese policy makers might change the economic policy mix. Specifically ending the current accommodating monetary policy stance and by default trigger the start of normalization. However, the negative direction of growth and positive movement of inflation suggests that nothing meaningfully will be adjusted. Prime Minster Shinzo Able landslide victory on 20th September indicates that Abenomics will be maintained for the remainder of this tenure. Overall, despite marginal momentum in inflation trend, the BoJ remains a distance from its 2% inflation target.

Markets should not expect any material changes from yield curve control policy with newly adopted forward guidance. With policy a core reason for JPY weakness (and Nikkie strength) the renewed support for Abenomics should create momentum for further JPY weakness (recoupling with historically dominate US-JP interest rate spread). That said, geopolitical uncertainty, and fears of US protectionism and higher US interest rates could easily trigger renewed safe-haven seeking and stronger JPY. USDJPY was able to stage a recovery bounce off 50 d MA at 111.85 potentially target 113.39 range resistance.

Economics

Italy/EU clash to take centre stage over the weekend

The stock market rout took centre stage last week with investors watching the value of their investments melt like snow under the sun. The reasons behind this sell-off are various and range from worsening global growth outlook, trade war jitters to rising bond yields, in addition to persistent political uncertainties, especially in Europe. Despite that the fact that the clash between Italy and the EU has moved into the background during the second part of the week. However, Italian lawmakers came back under the spotlight ahead of the weekend as they decided to defy the European Union and IMF by approving a budget law that in breach of EU's fiscal discipline rules.

Indeed, both the Senate and the Chamber of Deputies approved the new budget targets that will bring the Italian budget deficit to 2.4% for 2019. The government is expected to sign off the plans next Monday, which would most likely trigger a strong reaction from the EU. According the new law, the budget deficit would climb to €22 billion next year. So far, European Union officials haven't reacted to the latest development. We anticipate that European politicians would voice their disagreement over the weekend. Therefore, investors should not be surprise if Italian assets suffer another sell-off on Monday. After losing 4.40% over the first half of the week, Italian equities stabilised on Friday. The FTSE MIB was 0.80% ahead of the week.

In the FX market, the single currency is at risk of further escalation of the clash between Italy and the European Union. Lately, market participants have paid little attention on the Italian situation as they chose to focus on rising bond yields and the equity sell-off. Nevertheless, the improvement in the risk overall sentiment would allow Italy to take centre stage again. EUR/USD could come under renewed pressure, which could send the currency pair back to the 1.15 level.

Economics

Chinese Economy Robust But Challenges Remain

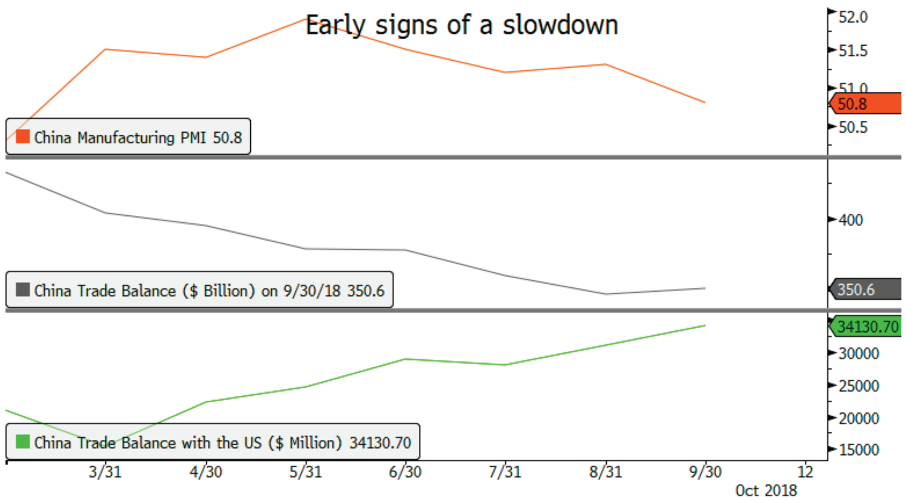
The Chinese economy has proven to be resilient since the beginning of the year and particularly since the US Trade Representative office implemented first tariffs against Chinese steel and aluminum imports. The measure, effective since 23. March 2018, consists of tariffs worth 25% and 10% on steel and aluminum respectively, estimated along $ 3 billion in total, a rather small amount compared to $ 200 billion tariffs implemented since 24. September 2018, as trade sanctions are escalating. However, although Chinese exports to the US continues to write records, the trend should be changing for the coming months, as the impact of tariffs is starting to weigh on the economy.

Indeed, as the People's Bank of China (PBoC) is trying to keep the economy in place, with dragging issues related to the shadow banking system and the underlying risk of a credit crunch while safeguarding economic growth, external shocks (i.e. US trade duties and Fed tightening cycle) are necessary not welcomed.

Domestically, in order to address current concerns, Chinese authorities are expected to initiate an expansionary fiscal policy, consisting of a relief in tax levy with the purpose of compensating current credit tightening conditions, as China is becoming more and more a consumption-driven economy. Additionally, Chinese regulators are also willing to increase the number of systematically important financial institutions from 20 to 50, including large insurers, lenders and brokerages that will be subject to stricter capital requirement rules and potentially additional regulations.

On the external side, the PBoC, in order to ease the CNY from further depreciation pressures, continues to make use of its counter-cyclical factor which consists of a daily fixing rate that the Chinese central bank is willing to tolerate on the forex market. And for now, the measure along with the imposition of a 20% reserve requirement ratio on CNY short positions for financial institutions as of early August 2018 appear to be effective.

Accordingly, as both US and Chinese President Donald Trump and Xi Jinping are expected to discuss trade matter during next G20 meeting from 30.November – 1.December 2018, the USD/CNY currently trading along 6.92 is expected to trade range-bound ahead of this major event.



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