Weekly Market Focus

HINDUJA BANK SWITZERLAND

10 October 2018

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ASSET CLASS REVIEW

Emerging Asia

A slowdown in China, made worse by the building trade war with the US, will create a challenging environment for Asian economies over the quarters ahead. While policymakers have room to provide support in many cases, regional growth is nonetheless likely to slow, rather than remain stable as the consensus expects. India should remain a bright spot.

• Although Asian exports have held up reasonably well over the past year, analysts forecasts for global growth suggest that they will slow before long, even without factoring in any additional drag from the trade war.

The US-China dispute has not yet had an impact on the region's exports. But with neither side looking likely to back down, the scale of tariffs and other trade restrictions is only likely to increase and the drag on growth will intensify. As well as China, countries that ship intermediate products to China would also be affected. Taiwan, Malaysia and Singapore are particularly exposed.

• Whatever happens on trade, China faces domestic headwinds as the lagged impact of the credit crackdown of the past two years continues to bite. Although officials are now starting to loosen policy, growth should not stabilise until the middle of 2019.

• In India, by contrast, economic growth has surged and one expect it to remain strong, supported by buoyant private and government consumption ahead of the general election that is due to be held in mid-2019.

• What's more, if oil prices weaken, it should offer some support to most of the region's economies, given their status as net oil importers. Malaysia is the main exception.

• Meanwhile, Hong Kong will also face higher interest rates if the US Fed continues to raise rates, as expected. As a result, it should trigger price falls in the territory's overvalued property market, which would weigh heavily on consumption and investment.

• Elsewhere, central banks are in little hurry to tighten, and policy rates should be left unchanged in Taiwan, Korea and Malaysia not just for the remainder of this year, but throughout 2019 as well. The consensus is expecting rate hikes in all three countries next year.

Inflation remains very low in all three economies, which suggests there is still plenty of spare capacity left. Meanwhile, sizeable current account surpluses, especially for Taiwan and Korea, mean their central banks will not be pushed into tightening policy by external factors.

Finally, in China analysts expect both fiscal and monetary easing to continue into the middle of next year until clear signs of economic stabilisation emerge.

Source: Capital Economics

FOREX

CAD

Even though the Bank of Canada (BoC) never seemed unduly concerned about an end of NAFTA it is nonetheless likely to have breathed a sigh of relief when the new USMCA deal was all sorted out. One risk less! Apart from that everything seems to be going to plan for the BoC at present. The economy is humming, the unemployment rate continues to fall with moderate wage growth, as the recent labour market report on Friday proved, and the various measures of core inflation are in the middle of the target range. The overall rate on the other hand is almost touching the upper limit. That means the BoC can continue with its rate hike cycle. On 24th October it will once again hike the key rate by 25bp to then 1.75%. However, this step is almost entirely priced in, so that this is likely to cause only limited upside pressure for CAD. What will probably be more important is whether the BoC is planning to accelerate the cycle or to extend it. At least the market can now once again fully concentrate on this matter, now that the USMCA agreement has been reached, so that wage and price data in particular is likely to become more important for CAD once again.

JPY

Just as in the US the markets in Japan were closed for a national holiday yesterday. The yen was nonetheless able to appreciate significantly. Increased JPY demand does not come as a surprise considering the uncertainty at the start of the week. In addition to the general concern as to how trading will resume on the Chinese onshore markets following the holiday, critical comments on the part of the US Treasury regarding the renminbi (see below) cause concerns that a further escalation of the trade conflict is imminent. As a result safe currency havens like the yen are in demand. In this situation it is easy to forget that higher yields for Japanese government bonds are also supporting the yen. Yields for 10-year JGBs have now risen to above 0.15% and yields for 30-year JGBs are edging closer to the 1% mark for the first time since the introduction of negative interest rates in early 2016. A steeper yield curve might make it more attractive for institutional Japanese investors to increasingly invest in domestic government bonds again and to save the costs arising from hedging currency risks when making foreign investments. That is exactly what we were worried about when the Bank of Japan eased its yield curve controls at the end of July. The signal that higher interest rate levels would be tolerated can cause capital flows even in the absence of a further normalisation of monetary policy. That is another reason why we expect to see a stronger yen.

CNY

Chinese equities and the yuan played catch-up at the re-open yesterday after a week of holidays. The markets may have hoped for a positive response after PBoC’s latest RRR cut but the Shanghai Composite Index still slumped nearly 4% and USD-CNY rose nearly 1% to 6.9307. It closed above 6.90 for the first time since the spike in mid-August. PBoC’s mid-point fix today was also set above 6.90 for the first time since May-2017. Are we about to see a sustained bout of CNY weakness and shift in PBoC’s policy stance? Probably not as this may incur the wrath of the US. There were also press reports yesterday that a senior Treasury official said the US is closely monitoring the developments in the yuan and remain concerned about the recent depreciation. He added that “more broadly, we’re concerned about China’s turn away from more market-oriented policies and continued reliance on non-market mechanisms that impact the macroeconomic and trade environment”. In other words, the yuan is one aspect of the wider trade tensions and PBoC would need to tread cautiously. On a bilateral basis, CNY is down around 6% vs USD year-to-date but on a trade weighted or CFETS basis, it is down only around 3%. This suggests USD strength is one reason behind USD-CNY’s rise. Nevertheless, US officials will keenly track the pace of CNY weakness from here.

EUR

If the FX market has learned one thing from the euro debt crisis then that is that the ECB will do "whatever it takes" within its mandate to support the euro. Since 26th July 2012 this promise has had a decisive impact on how the euro reacts to national crises within the euro zone. That is why the euro's reaction yesterday was rather cautious when Italian government bonds recorded another steep rise in yields. As long as Mario Draghi's "whatever it takes" promise is in place, national crises within the euro zone will only cause serious currency turbulence if they attack the systemic foundation of the single currency in a manner which the ECB's monetary policy is unable to deal with. That would be the case for example if one member state leaving the single currency would result in the threat of it breaking apart. However, that is not an issue at present at least. Yesterday's yield rise above all reflects the market's scepticism towards Italian fiscal policy. As long as this scepticism is limited to Italian assets we see no reason to revalue the euro on a sustainable basis. As international investors have sufficient other attractive investments to choose from there is no reason to withdraw capital from the euro zone as long as investor do not question the stability of the euro zone in general.

VIEWS FROM THE TRADING FLOOR

Equity

S&P was down 1.47% last week, with a significant increase of volatility the VIX index moving from 12.05 to 15.95. There was no significant rise last week. On the downside, we find paper packaging down 11%, while housewares & specialties and auto parts &equipment were down more than 8%.

The Brexit negociations will still be the center of attention this week as Prime Minister May seems willing to negociate on the Northern Ireland border issue. A solution to this different will probably open the way to a Brexit deal. The deal reached between USA, Mexico and Canada on the trade side eliminates on the short term at least the risk of a deepening trade war in North America.

S&P 500: The index corrected to test the 2870 support we were mentioning last week but remains on track to reach its 2950 target. A break of 2865 will lead to the 2800-2790 support area before 2780 (the bottom of the uptrend initiated in February 2016).

Eurostoxx 50: The index is back to the bottom of its trading range around 3275-3260. A close below 3260 will quickly lead to 3214 before 3190 and potentially 3105. The best side of the trade is to go long on these levels with 3430 target and 3260 stop loss levels.

EQUITY

Developed countries

		Total return - 1 Week
SMI	⬇	-2.3%
Euro Stoxx 50	⬇	-3.3%
DAX	⬇	-3.7%
FTSE 100	⬇	-4.0%
S&P 500	⬇	-2.1%
Dow Jones	⬇	-2.0%
Nikkei 225	⬇	-3.2%

Developing countries

Russia/Micex	⬇	-2.5%
India/Nifty 50	⬇	-3.7%
China (HK)	⬇	-3.3%

⬆ - Upward move ⬇ - Downward move

FIXED INCOME

Developed countries

	2-year Yield	10-year Yield
USA	2.9%	3.2%
UK	0.9%	1.7%
Germany	-0.5%	0.6%
France	-0.4%	0.9%
Italy	1.3%	3.5%
Spain	-0.2%	1.6%
Switzerland	-0.7%	0.1%

Developing countries

	2-year Yield	10-year Yield
Russia	3.8%	5.1%

COMMODITIES

		Total return - 1 Week
Crude Oil	⬆	10.2%
Gold	⬇	-0.7%

CALENDARS

Economic Events

Date of release	Domicile	Event	Period	Actual	Estimated
10 Oct 2018	US	PPI Final Demand MoM	September	0.2%	0.2%
11 Oct 2018	US	Jobless Claims	September	207k	209k
11 Oct2018	Spain	CPI YoY	September	0.8%	0.9%
10 Oct 2018	Netherlands	Industrial Sales YoY	August	8.4%	12.8%

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