

The Weekly Market View

June 13 2021

Inflation says “boo!”, markets say “meh.”

Consumer price inflation in the US is the highest since 2008, and core CPI rose the fastest since 1992. China reported its highest producer price inflation in 12 years. Inflation in emerging markets like Russia and Mexico was higher than expected. ECB's updated forecasts pointed to higher rates of inflation for 2021. Yet, financial markets' reaction to this 'inflation scare' was surprising – 10Y UST yields dropped to their lowest level in three months, global equity benchmarks reached all-time highs with long-duration equities outperforming, and USD strengthened. VIX index fell to its new post-pandemic low.

In terms of data, industrial production in the UK, France and Germany, trade data in China and initial jobless claims in the US all surprised negatively. Other developments during the past week include the US Senate passing the Innovation and Competition Act of 2021 in an effort to strengthen the US leadership in science and innovation and also to counter China's growing tech influence. According to a Chinese Government statement, commerce ministers from China and the US agreed to push forward trade and investment links. In Europe, the ECB conducted its policy review – left its key policy measures unchanged and said that it would maintain emergency bond-buying at a higher pace for the next quarter. In its latest *Global Economic Prospects*, the World Bank highlighted that the global economy is set to expand 5.6% in 2021— its strongest post-recession pace in 80 years. The report also highlighted the divergence between advanced and emerging economies. At the same time, leaders of the G7 economies convening in the UK pledged to provide 1bn coronavirus vaccine doses to poorer countries as part of a plan to “vaccinate the world” by the end of 2022.

The ‘transitory camp’ and the over-crowding

Our regular readers would remember that we firmly held to the view **that inflation is the major risk facing financial markets this year, but persistent inflation is not a given**. We argued that the recent data has many outliers and has been higher due to base effects. The unemployment (and the wage growth) picture has been obscured by slack and disruptions. Tech spend is on rise and is likely to contribute to productivity growth. Moreover, the US output surpassed pre-pandemic levels with 7.7m missing from payrolls – making a case for the US Fed to remain patient. Impact of fiscal stimulus on future inflation is uncertain (owing to multipliers etc.). For sustainable inflation, consumer behaviour is key and here, savings can quickly change into wealth and the services pent-up demand follows no specific template. Moreover, China's experience suggests more muted consumption for economies as they emerge out of the pandemic. Overall, **we remain in Fed's ‘transitory’ camp** and believe that rise in price pressures is transient. However the risk is that, the upcoming inflation data could be higher than expected, putting this key risk in the spotlight.

Following some recent developments – like the consumer surveys, forecaster surveys, and TIPS breakevens now pointing to a higher short-term inflation, but a long-term inflation consistent with Fed's target; commodity prices starting to ease (lumber, industrial commodities, and food commodities); and used car prices falling too – many market participants recently seem to have embraced the view of a short-lived inflation. **We are watching this closely to see if our “transitory” inflation camp is becoming over-crowded. This has potential to turn the broader market more complacent to potential risks of higher inflation, especially with the SKEW index (a measure of the perceived tail risk) at its 30-year high.**

Global markets' performance snapshot

| Index Snapshot (World Indices) | | | |
|---------------------------------------|--------|----------|-------|
| Index | Latest | Weekly % | YTD % |
| S&P 500 | 4,247 | 0.4 | 13.1 |
| Dow Jones | 34,480 | -0.8 | 12.7 |
| Nasdaq | 14,069 | 1.8 | 9.2 |
| DAX | 15,693 | 0.0 | 14.4 |
| Nikkei 225 | 28,949 | 0.0 | 5.5 |
| FTSE 100 | 7,134 | 0.9 | 10.4 |
| Sensex | 52,475 | 0.7 | 9.9 |
| Hang Seng | 28,842 | -0.3 | 5.9 |
| Regional Markets (Sunday to Thursday) | | | |
| ADX | 6,716 | 1.7 | 33.1 |
| DFM | 2,842 | 0.7 | 14.1 |
| Tadawul | 10,796 | 0.9 | 24.2 |
| DSM | 10,723 | -0.3 | 2.8 |
| MSM30 | 4,030 | 2.5 | 10.1 |
| BHSE | 1,546 | 0.5 | 3.8 |
| KWSE | 6,305 | 0.8 | 13.7 |
| MSCI | | | |
| MSCI World | 3,013 | 0.5 | 12.0 |
| MSCI EM | 1,382 | 0.0 | 7.0 |

Global Commodities, Currencies and Rates

| Commodity | Latest | Weekly % | YTD % |
|-------------------|----------|----------|-------|
| Brent USD/bbl | 72.7 | 1.1 | 40.3 |
| WTI USD/bbl | 70.9 | 1.9 | 46.1 |
| Gold USD/t oz | 1,877.5 | -0.7 | -1.1 |
| Silver USD/t oz | 27.9 | 0.4 | 5.7 |
| Platinum USD/t oz | 1,150.9 | -1.6 | 7.3 |
| Copper USD/MT | 10,029.0 | 1.8 | 29.5 |
| Alluminium | 2,465.2 | 0.7 | 24.6 |
| Currencies | | | |
| EUR USD | 1.21 | -0.5 | -0.9 |
| GBP USD | 1.41 | -0.4 | 3.2 |
| USD JPY | 109.66 | 0.1 | -5.8 |
| CHF USD | 0.90 | -0.1 | -1.5 |
| Rates | | | |
| USD Libor 3m | 0.12 | -7.2 | -50.1 |
| USD Libor 12m | 0.24 | -2.7 | -30.0 |
| UAE Eibor 3m | 0.38 | -19.8 | -26.8 |
| UAE Eibor 12m | 0.46 | -11.7 | -30.3 |
| US 3m Bills | 0.02 | 60.0 | -65.2 |
| US 10yr Treasury | 1.45 | -6.5 | 59.0 |

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Summary market outlook

| | | | | | |
|----------------------------|--|--------------------|--------------------|--------------------|--------------------|
| Global Yields | 10Y UST yields dropped to their lowest level in three months. Eurozone government bond yields too fell as the ECB committed to continuing its bond-buying program at the current pace for another quarter. UK gilt yields broadly tracked yield in core markets. Overall, we recommend a lower duration stance (5Y US Treasuries) in anticipation of interest rate volatility in the near term. | | | | |
| Stress and Risk Indicators | VIX index fell to its new post-pandemic lows while the SKEW index rose to its highest level at least since 1990. We think the VIX index is unlikely to fall back to the pre-pandemic levels until the virus comes fully under control. | | | | |
| Equity Markets | | | | | |
| Local Equity Markets | Regional equity markets performed in line with broader global equities, but outperformed their EM counterparts last week – reflecting the optimism from higher oil prices. Within the region, with the exception of Qatar, all major markets posted gains. UAE equities outperformed led by Abu Dhabi banks. Equity benchmark in Oman continued to do well on the potential for a rare cross-Gulf bank tie-up involving one of the Omani banks. We remain neutral GCC equities within our global equity framework. Stable to higher oil prices, potential for revival in growth and scope for reversing the underperformance of 2020 are all balanced by lack of structural growth plays. | | | | |
| Global Equity Markets | Global equities delivered small positive returns last week but ended at new all-time highs. Last week saw DMs outperform EMs. Within DMs, Europe and US outperformed while Japan and Canada underperformed. Sector-wise, health care, real estate, and IT outperformed the most while financials, materials and industrials underperformed. Our equity strategy is to overweight US and UK, and underweight Eurozone and EM outside Asia. We are neutral Asia and prefer structural growth opportunities there. By sector we prefer IT and communication services as long-term plays and energy as a cyclical play. We have also identified industry level opportunities to play the vaccine availability in the medium-term. Our strategic preference is for large cap non-cyclical growth with focus on quality. 'Build back better' themes including green recovery, digitalization and health care innovation are likely to do well. | | | | |
| Technology Segments | Technology segments performed strongly last week as long-term bond yields fell, giving the high duration sectors a tailwind. Nasdaq-100 index gained c2% as the US Senate passed the US Innovation and Competition Act intended to boost the country's ability to compete with Chinese technology. In China while the HK Tech index lost c1%, ChiNext gained 1.7%. | | | | |
| Commodities | | | | | |
| Precious Metals | Gold prices have moved sideways in June after having rebounded strongly from their late-March lows. Last week, gold prices fell on broader risk-on tone in financial markets and the USD strength. We keep our overweight in gold as a hedge against potential risks on the horizon. | | | | |
| Energy | Helped by improving outlook for demand (rising vaccination rates and IEA's upbeat assessment) but still contained supply (OPEC+ complying and slow increase in rig count), oil prices rose for a third straight week to hit two-year highs. Overall, we believe that oil prices will remain sustained as the market approaches a balance. | | | | |
| Industrial Metals | Industrial metal prices, stuck between positive surprises on inflation data and concerns regarding price controls in China, were volatile but ended the week higher. While another commodity super-cycle appears difficult, demand for commodities linked to environmental friendly green infrastructure is likely to sustain. | | | | |
| Currencies | | | | | |
| EURUSD | EURUSD fell to its one month low last week on strong data in the US and rising EU-UK collision risks. We believe that movements in major currencies will be influenced by re-opening, incoming data and the policy support. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 1.2400</td> <td>R1 → 1.2255</td> <td>S1 → 1.1975</td> <td>S2 → 1.1840</td> </tr> </table> | R2 → 1.2400 | R1 → 1.2255 | S1 → 1.1975 | S2 → 1.1840 |
| R2 → 1.2400 | R1 → 1.2255 | S1 → 1.1975 | S2 → 1.1840 | | |
| GBPUSD | Cable was weaker as investors remain worried that UK may delay plans to end restrictions fully on June 21. We expect the cable to be driven by how the re-opening plays out over the near-term and to decouple from the EUR. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 1.4499</td> <td>R1 → 1.4303</td> <td>S1 → 1.3856</td> <td>S2 → 1.3605</td> </tr> </table> | R2 → 1.4499 | R1 → 1.4303 | S1 → 1.3856 | S2 → 1.3605 |
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| USDJPY | Risk-on tone in financial markets and demand for USD resulted in USD strength relative to JPY. Over the medium-term, we believe that BoJ yield curve targeting should put downward pressure on JPY. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 111.43</td> <td>R1 → 110.55</td> <td>S1 → 108.56</td> <td>S2 → 107.45</td> </tr> </table> | R2 → 111.43 | R1 → 110.55 | S1 → 108.56 | S2 → 107.45 |
| R2 → 111.43 | R1 → 110.55 | S1 → 108.56 | S2 → 107.45 | | |

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

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Forthcoming important economic data/events

United States



| Indicator | Period | Expected | Prior | Comments |
|--|---------------|--------------------|--------------------|--|
| 06/15/21 Retail Sales Advance MoM | May | -0.60% | 0.00% | FOMC meeting is the key event this week. Whilst markets do not expect a change in the interest rate policy, updated economic forecasts from the Fed, and discussion about potential tapering of bond purchases will be in focus. Retail sales, industrial production, housing market data, regional surveys, and jobless claims are other key data releases this week. |
| 06/15/21 Empire Manufacturing | Jun | 22.0 | 24.3 | |
| 06/15/21 PPI Final Demand MoM | May | 0.50% | 0.60% | |
| 06/15/21 Industrial Production MoM | May | 0.60% | 0.70% | |
| 06/15/21 NAHB Housing Market Index | Jun | 83 | 83 | |
| 06/16/21 MBA Mortgage Applications | 11-Jun | -- | -3.10% | |
| 06/16/21 Building Permits | May | 1,730k | 1,760k | |
| 06/16/21 Housing Starts | May | 1,640k | 1,569k | |
| 06/16/21 FOMC Rate Decision | 16-Jun | 0.00%-0.25% | 0.00%-0.25% | |
| 06/17/21 Philadelphia Fed Business Outlook | Jun | 31.0 | 31.5 | |
| 06/17/21 Initial Jobless Claims | 12-Jun | 360k | 376k | |
| 06/17/21 Continuing Claims | 5-Jun | 3,421k | 3,499k | |

Japan



| Indicator | Period | Expected | Prior | Comments |
|---|---------------|---------------|---------------|--|
| 06/14/21 Industrial Production YoY | Apr F | -- | 15.40% | On the BOJ policy, markets do not expect any changes in both the policy rate and the yield target. However, focus will be on whether the COVID-19 lending measures will be extended, which otherwise will expire in September. |
| 06/16/21 Exports YoY | May | 50.90% | 38.00% | |
| 06/16/21 Imports YoY | May | 26.50% | 12.80% | |
| 06/16/21 Core Machine Orders YoY | Apr | 8.00% | -2.00% | |
| 06/18/21 Natl CPI YoY | May | -0.20% | -0.40% | |
| 06/18/21 BOJ Policy Balance Rate | 18-Jun | -0.10% | -0.10% | |
| 06/18/21 BOJ 10-Yr Yield Target | 18-Jun | 0.00% | 0.00% | |

Eurozone



| Indicator | Period | Expected | Prior | Comments |
|--|--------------|---------------|---------------|---|
| 06/14/21 Eurozone Industrial Production | Apr | 37.40% | 10.90% | Eurozone industrial production growth in April is expected to be stronger supported by favourable base effects. Bloc's CPI is expected to have moved slightly higher in May – confirmed by the final print. |
| 06/15/21 Germany CPI YoY | May F | 2.50% | 2.50% | |
| 06/15/21 France CPI YoY | May F | 1.40% | 1.40% | |
| 06/17/21 EU27 New Car Registrations | May | -- | 218.60% | |
| 06/17/21 Eurozone CPI YoY | May F | 2.00% | 1.60% | |
| 06/18/21 Germany PPI YoY | May | 6.40% | 5.20% | |

United Kingdom



| Indicator | Period | Expected | Prior | Comments |
|--|------------|---------------|---------------|--|
| 06/15/21 Jobless Claims Change | May | -- | -15.1k | Labour market in the UK continued to improve with the unemployment rate having fallen for three consecutive months to March. Bloomberg consensus expects the unemployment rate to fall further in April. Other data releases for the week include CPI and retail sales – both for May. |
| 06/15/21 Average Weekly Earnings 3M/YoY | Apr | 4.90% | 4.00% | |
| 06/15/21 ILO Unemployment Rate 3Mths | Apr | 4.70% | 4.80% | |
| 06/16/21 CPI YoY | May | 1.80% | 1.50% | |
| 06/16/21 RPI YoY | May | 3.30% | 2.90% | |
| 06/16/21 PPI Output NSA YoY | May | 4.50% | 3.90% | |
| 06/16/21 PPI Input NSA YoY | May | 10.60% | 9.90% | |
| 06/16/21 House Price Index YoY | Apr | 12.20% | 10.20% | |
| 06/18/21 Retail Sales Inc Auto Fuel YoY | May | 29.00% | 42.40% | |

China and India



| Indicator | Period | Expected | Prior | Comments |
|---|------------|---------------|---------------|---|
| 06/14/21 India Wholesale Prices YoY | May | 13.40% | 10.49% | India CPI growth is expected to have increased further in May thanks to higher food and energy prices. In China, data releases like retail sales, industrial production and fixed asset investments are key to watch. |
| 06/14/21 India CPI YoY | May | 5.40% | 4.29% | |
| 06/15/21 India Exports YoY | May | -- | 195.70% | |
| 06/15/21 India Imports YoY | May | -- | 167.10% | |
| 06/16/21 China Retail Sales YoY | May | 13.80% | 17.70% | |
| 06/16/21 China Industrial Production YoY | May | 9.20% | 9.80% | |
| 06/16/21 China Fixed Assets Ex Rural YTD YoY | May | 17.00% | 19.90% | |

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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