UOB Economic-Treasury Research

Monday, 16 June 2014

Weekly Update

Weekly Review (for week ending 13 June 2014)

Global Markets:

The highlight for the US (and financial markets) this week (16- 20 Jun) will definitely be the US Federal Reserve's 2-day (17-18 June) FOMC meeting and decision (due at Thursday 19 June 2014, 2:00am Singapore time). The decision will be accompanied by Fed Chair Janet Yellen's post-FOMC press conference and a review of the latest FOMC economic projections.

Meanwhile, the key US data for the week will garner only secondary interest and revolve around the May CPI inflation (17 Jun) and the US housing market including **May NAHB housing market index (16 Jun)**, weekly MBA mortgage applications (18 Jun), May housing starts (17 Jun), and May Building permits (17 Jun). Other than the housing data, the other US economic data releases this week will include the **June Empire manufacturing survey (16 Jun), May industrial production (16 Jun), May capacity utilization (16 Jun)**, the June Philadelphia Fed business outlook survey (19 Jun), the May leading index (19 Jun), the usual weekly initial jobless claims on Thursday (19 Jun) and 1Q current account balance (18 Jun). There are no significant US data releases on Friday (20 Jun). **We will also be watching for US political developments this week** following the surprise primary election loss by US House Majority Leader Republican Eric Cantor for his Richmond, Virginia seat to Tea Party-backed David Brat on 11 June. Cantor was seen as a key prospect to succeed John Boehner of Ohio as the future Speaker of the House.

The key economic data from developed economies include **the final print for euro-zone May CPI (16 Jun)**, Japan May machine tool orders (17 Jun), UK May CPI, RPI and PPI (17 Jun), euro-zone April construction output (18 Jun), Japan May export, import, trade balance, and May department store sales (all on 18 Jun), Japan April coincident & leading indices (19 Jun), UK May retail sales & June CBI trends for total orders & selling prices (all on 19 Jun), UK May public sector net borrowing (20 Jun), German May PPI (20 Jun), the euro-zone June consumer confidence and April current account balance (both on 20 Jun).

The US stock markets rebounded on Friday (13 Jun) after a 2-day losing streak despite a weaker-than-expected US consumer confidence & continued sectarian unrest in Iraq pushing oil prices to new 9-month highs last Friday. The sentiment was already weighed lower initially by the lackluster May US retail sales and surprise climb in the latest initial jobless claims but subsequently, everything was about Iraq. The US dollar was broadly stronger against the euro, yen and most other major currencies on Friday (12 Jun) after BOJ Governor called on the Japanese government for more reform while BOJ kept policy unchanged on Friday again since the past one year. The exception was the GBP which continued to make gains against the USD as investors continued to focus on BOE Governor Mark Carney's hawkish address to bankers at the Mansion House in London with the expectations now for the BOE rate normalization to "happen sooner than markets currently expect." Another positive for the pound was that S&P lifted its outlook on UK credit rating to stable from negative on Friday (13 Jun), citing the broad recovery and progress in consolidating public finances, and also confirmed UK's top "AAA" rating. US Treasuries eased lower on Friday as investors returned to equity and eased slightly out of the safe demand of US government debt despite the uncertainty of developments in Iraq & a slightly disappointing US consumer confidence result. US and Brent crude oil prices surged higher to another new 9-month high on the Iraq situation.

Central Bank Outlook

The US Federal Reserve's 2-day (17-18 June) FOMC meeting and decision (due at Thursday 19 June 2014, 2:00am Singapore time) will be accompanied by Fed Chair Janet Yellen's post- FOMC press conference and a review of the latest FOMC economic projections. While the markets may already anticipate the Fed will continue to taper its monthly QE by another US$10bn, to US$35bn, and making minimal language changes to the text of the FOMC statement, it will be interesting to see whether they will do away with the "Dot-plot" chart or replace that with something else to convey FOMC member's short interest rates projections. (Recall it was the "Dot-plot" chart in the March 2014 FOMC that showed 13 of the 16 Fed officials predicting the benchmark rate, the Fed Funds Target Rate (FFTR at 0-0.25% presently), would start to rise in 2015 as they factored in greater improvements in the US labour market, and the median expectation is for the FFTR to rise at least to 1% by end-2015 and to 2.25% by end-2016, higher than the previous forecasts of 0.75% in 2015 and 1.75% in 2016.)

We are factoring US$10bn reduction at each subsequent FOMC and a US$15bn cut as the last step, so we expect the QE to be fully terminated by the 28-29 October 2014 FOMC. And while we expect to see the first FFTR hike to take place in 1Q 2015, recent Fed guidance/comments and market expectations are gravitating to a later date during 2015 (possibly middle of the year or even later in 2H 2015) for the rate normalization to take place. Admittedly, the risk is increasingly pointing to a later date rather than sooner although the recent good run of non-farm payrolls is still making the Fed rate normalization a very difficult call to make.

And as we reported last week, the US Senate confirmed **Lael Brainard**, a former US Treasury undersecretary for international affairs, as a Federal Reserve governor with a 61-31 vote, while **Jerome Powell** was confirmed for a second term with a 67-24 vote. **Stanley Fischer**, who was already approved to the Fed board of Governors in May, was finally confirmed as the Fed vice chairman with a Senate vote of 63-24. Brainard's confirmation was especially material as it means five of the seven Fed board seats have been filled before the June 17-18 monetary policy meeting. In addition, Jeremy Stein exited the Fed board on 28 May 2014 while Cleveland Fed President Sandra Pianalto was succeeded by Loretta Mester on the 1 June 2014. With some new people added to the FOMC voting committee, this June FOMC decision could hold some surprises.

Equities

The US stock markets rebounded on Friday (13 Jun) after a 2-day losing streak despite a weaker-than-expected US consumer confidence & continued sectarian unrest in Iraq pushing oil prices to new 9-month highs last Friday. The sentiment was already weighed lower initially by the lackluster May US retail sales and surprise climb in the latest initial jobless claims but subsequently, everything was about Iraq. The Dow Jones Industrial Average (DJIA) broke the 2-day trip-digit loss and advanced 41.55 points (0.25%) to 16,775.74. while S&P 500 rose by 6.05 points (0.31%) to 1,936.16. The NASDAQ also rebounded by 13.02 points (0.3%) to close at 4,310.65. The CBOE volatility Index (VIX) edged lower but still stayed above 12 and closed at 12.18 (from 12.56 previously).

US Treasuries

US Treasuries eased lower on Friday as investors returned to equity and eased slightly out of the safe demand of US government debt despite the uncertainty of developments in Iraq & a slightly disappointing US consumer confidence result. The 10Y US Treasury yield edged 0.8bps higher and closed at 2.603% while the 5Y UST was 1bps higher at 1.693% while the 2Y UST yield was 1.2bps higher at 0.4493%. **As for US Treasury auction activity this week, it will be a usual start with the auctions limited on the short end with the US Treasury selling 3- and 6-month bills on Monday (16 Jun), and 4-week bills on Tuesday (17 Jun). Later in the week, the US Treasury will tap on its longer-dated bond auction market with a 30-year Treasury Inflation Protected Securities (TIPS) reopening on Thursday (19 Jun).**

Commodities

US and Brent crude oil prices surged higher to another new 9-month high on the Iraq situation. US Nymex futures increased by US$0.38 to close at US$106.91while the London Brent oil futures rose by a similar US$0.39 at $113.412/bbl. This resulted in the premium spread more or less unchanged at US$6.50 (from US$6.49 previously).

The gold price held firm on Friday and edged marginally higher for the 4th straight session as some investors still sought gold as safe haven assets from the escalating Iraqi violence. It gained US$0.10 and closed at US$1,273.70 on 13 Jun 2014.

Economic News and Data

The US June Prelim University of Michigan consumer confidence survey came in lower at 81.2 from last month's 81.9. Markets were expecting a higher reading of 83.0.

The **US May PPI** also unexpectedly contracted 0.2%m/m, from an increase of 0.6% in April and went below market's low expectation for an 0.1%m/m increase. As a result, the PPI increased at 2.0%y/y in May, easing from 2.1%y/y in April.

The **euro-zone April trade balance** remained in surplus but was a smaller EUR 15.7bn (from 16.7bn in March and below the forecast for EUR 16.3bn).

AFP reported that Ukraine failed to reach a breakthrough with Moscow in talks to avert a Russian gas cut on Monday (16 Jun) that would hit Europe and add further urgency to the worst East-West crisis (Ukraine receives half its gas supplies from Russia and transports 15% of the fuel consumed in Europe). According to a Ukrainian source close to the negotiations, the EU-brokered meeting ended "without a result" nor any agreement about when the sides might meet again. It was not immediately clear if the gas cut would go ahead as threatened at 0600 GMT on Monday (2:00pm Singapore time).

Asian Markets:

Today, India will be releasing May wholesale prices where it is estimated to edge higher by growing 5.4% y/y, compared to the 5.2% y/y a month ago. Also, the Philippines will report April overseas workers' remittances.

On Tuesday, Singapore will report May non-oil domestic exports (NODX) where market is forecast no growth on a year-on-year basis, near to the 0.9% y/y expansion in the previous month. Singapore's electronics NODX will also likely see the same level of contraction (-8.8% y/y) as the previous month (-8.7% y/y). On the same day, Hong Kong will report May unemployment rate 3.1%, same as April) while Thailand will report May car sales numbers.

This Wednesday, the most closely watched event is Bank of Thailand's (BOT) monetary policy decision, but market thinks that the BOT will continue to maintain its current benchmark interest rate of 2%. Else, China will release May property prices and MNI June business indicator while South Korea will report May PPI.

On Thursday, the Philippines central bank (BSP) will have their monetary policy meeting and it is also widely believed that the BSP will keep its overnight borrowing rate unchanged at 3.5%. The Philippines will also report May Balance of Payments data.

Then on Friday, we will see May export orders from Taiwan, May inflation numbers from Malaysia, and Jun foreign reserves figures from both Malaysia and Thailand.

Central Bank Outlook

There will be no other major central bank policy decision this week but we do have Bank of Japan (BOJ) 20/21 May MPM minutes and the Bank of England (BOJ) MPC minutes both on 18 June. There is no Fed official scheduled to speak in public events ahead of and after the 17-18 Uniform decision but we will have the former Fed Chairman Ben Bernanke speaking in Zurich coincidentally around the same time when the Fed releases its FOMC statement (18 Jun). BOJ GovernorKuroda will be speaking in Tokyo on 20 June.

18th June: Bank of Thailand Benchmark Interest Rate = 2% (same as previous)
19th June: Bangkok Sentral ng Pilipinas Overnight Borrowing Rate = 3.5% (same as previous)

Equities

As of the close of trading day last Friday, North Asian markets generally performed better than their South Asian counterparts. In North Asia, the NIKKEI 225 (+0.83%), Hang Seng (+0.62%), Shanghai Composite (+0.93%), closed higher, while the TAIEX (-0.09%), and KOSPI (-1.03%) closed lower. Poor performance in the utilities (-2.78%), and consumer goods (-1.53%) sectors dragged on the KOSPI index.

In South Asia, the SENSEX saw a 1.36% decline, while the SET (-0.07%), JCI (-0.16%), and the PSEi (-0.36%) closed lower. Only the STI (+0.01%), and the KLCI (+0.15%) held their fort.

The MSCI Asia Pacific Index fell 0.3% over June 12 and 13, paring its fifth straight weekly advance. Nikkei 225 futures were bid at 15,040 by 8:05 a.m. in the pre-market, after closing at 15,140 June13. Futures on Australia's S&P/ASX 200 Index and on the Kospi index in Seoul rose less than 0.1%on June 14, while contracts on Hong Kong's Hang Seng and the Hang Seng China Enterprises Index added 0.1% in most recent trading. Separately, it was reported that the cost of hedging against losses in the iShares China exchange-traded fund, the largest Chinese ETF in the U.S., has slipped to a record low this month amid optimism government stimulus in Asia's largest economy will help sustain growth. The Hang Seng rose 1.6 percent last week, while the Shanghai Composite Index of mainland Chinese shares soared 2 percent. The yuan strengthened 0.5 percent in offshore trading last week, the most since January 2012.

Economic News

Japan's Government Pension Investment Fund (GPIF) which is worth US$1.26trn and keeps the majority of its cash in Japanese government bonds (JGB) could be on the verge of dramatic change, as Prime Minister Shinzo Abe shuffles into place the next piece of his "Abenomics" jigsaw puzzle which will free managers of GPIF to reduce their holding of low-yield sovereign bonds and go in search of higher, but riskier returns, which send a new flood of liquidity into the global financial markets.

The Singapore Ministry of Manpower reported that Singapore's 1Q 2014 unemployment rate (seasonally adjusted) was 2%, slightly lower than what the market had expected (2.1%), but higher than the 1.8% a quarter ago Nevertheless, such level of unemployment rate is considered quite low and this shows that Singapore's labour market conditions remain tight. The Manpower Ministry said that the slightly higher unemployment rate could be due to increased job search activity as more residents, especially the less educated, were encouraged to enter the labour force, given more job openings and an increase in wages, with the tightening of foreign manpower controls. Another indicator to show that the labour market remains tight will be the "job vacancies to unemployed persons ratio", standing at 1.33 in 1Q 2014, although smaller than the 1.43 a quarter ago. This shows that for every 1 unemployed person, there are 1.33 jobs that remain vacant and waiting to be filled.

Last Friday also saw Singapore releasing April retail sales figures, where it contracted 9% y/y, compared to the revised 3.8% y/y contraction a month ago. Again, the contraction, as with the past months, was due mainly to the decline seen in total car sales values resulting from the car financing measures implemented by the central bank in Feb last year. If we strip out the car sales component, retail sales ex-motor vehicles still declined 1.3% y/y in the month of April, showing a general weakness in Singapore's retail industry. One of the segments in retail sales stood out with a larger-than-usual contraction – the watches and jewelry segment, with a 16.3% y/y contraction. In fact this segment had declined for the past 8 months (except for Jan 2014 due to the Chinese New Year. We think that a possible reason for the weakness is due to the decline in Chinese visitors to Singapore since Oct 2013, when the Thai political crisis started. The lesser take-up in the popular Sin-Ma-Thai group packages showed up as a cumulative decline of 21.5% y/y in Chinese visitor arrivals in the Oct-Mar 2014 period compared to the same period a year ago (latest March 2014 data showed a 19.5% y/y contraction in Chinese visitor arrivals). With the average Chinese visitor spending 33% of their total expenditure on watches/clocks/genuine jewelry each time they are in Singapore (survey data from the STB as of 2012), the decline in their visitorship over the past few months had impacted the retail sales performance of the luxury goods industry in Singapore. It is thus hopeful that the on-going Great Singapore Sale would tempt more Chinese visitors to come to Singapore on non-group packaged tours.

China's May retail sales remained strong and grew 12.5% y/y, compared to the 11.9% y/y a month ago, and the 12.1% y/y consensus estimates. With regards to the previous point on Singapore's retail sales, this showed that the Chinese are still spending, just that not enough of them are coming to Singapore to do so.

China's May industrial production, as closely-watched indicator, showed that manufacturing activities expanded 8.8% y/y, slightly better than the 8.7% y/y rate a month ago and reiterating that China would probably not be facing any risk of a hard-landing anytime as yet.

China's property industry extended its slump last month as sales and construction dropped and investment growth slowed, threatening to drag on a recovery in the world's second-biggest economy. Home sales in the January-to-May period fell 9.2% from a year earlier by area, after an 8.6% decline in the first four months, National Bureau of Statistics data showed yesterday. New property construction dropped 18.6% this year through May and residential housing starts fell 21.6% by area. The sinking real-estate market may undermine Premier Li Keqiang's mini-stimulus policies aimed at arresting a slowdown that's thrown his 2014 growth target into question. The property industry is the biggest downside risk to China's economy, according to Societe Generale SA.