

Weekly Update

C0 | EXTERNAL PUBLICATION

Dollar recovery – will it last?



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Since mid-April, the dollar has recovered around 5% after falling steadily since late 2016 (source: Bloomberg). But [has the tide really turned?](#)

Admittedly, [several factors have supported the US dollar.](#)

- *Slightly higher US yields.* Rising nominal rates and tame inflation have seen US real rates creep up and the 10-year real yield is approaching 1% for the first time since 2013;
- *Strong US growth prospects.* The tax boost is supporting business activity and the broader economy; and
- *A growing yield gap vs other developed markets.* Market expectations have risen for three more Fed hikes in 2018 and three in 2019.

And, [in the meantime, the euro has also been hit by:](#)

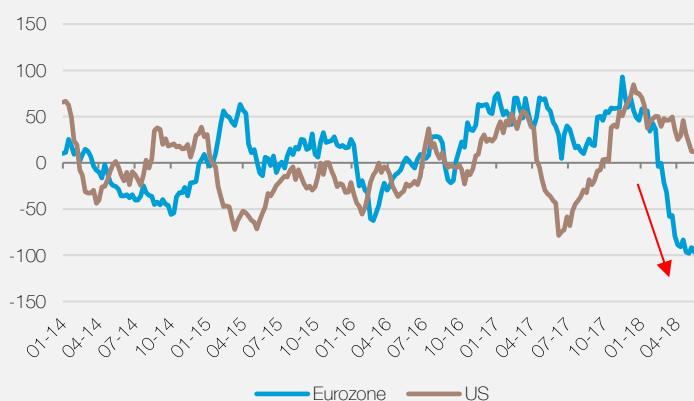
- *Disappointing growth data and weaker leading indicators.* Economic surprises have plummeted since early 2018;
- *Fear of budget slippage in Italy.* The formation of a eurosceptic coalition advocating a spending spree (up to 5.5% of GDP, according to Bloomberg) and the roll-back of structural reforms have seen Italian spreads widen by 80 basis points albeit with limited contagion effect in other peripheral countries; and
- *Doubts about when the European Central Bank will shift policy tighter.* Inflation remains stubbornly low and growth is losing momentum.

Furthermore, dollar strength and higher US rates have weighed on most emerging currencies and the negative effect has been strong enough to offset the positive impact of rising oil prices on commodity-related currencies.

Bottom line. [The dollar should continue to recover but only in the short term.](#) Despite the tax boost, we would not expect US growth to accelerate sharply in coming quarters and 2019 could even see a downturn that would encourage the US Federal Reserve to act more gradually. Moreover, recent dovish Fed minutes could signal that the US central bank may let inflation overshoot its target, which could dent into US real interest rates. Finally, US 10-year Treasury yields are left with limited upside after a pick-up in the first semester.

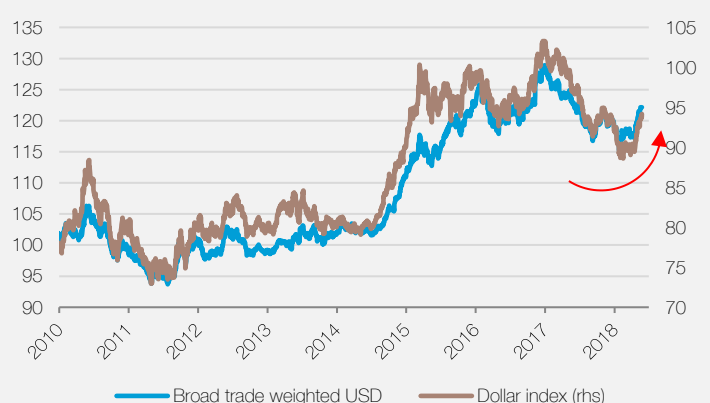
[Although we cut our 6-month EUR/USD target from 1.25 to 1.23 to take into consideration political and economic risks, we remain bulls on the euro and keep our 12-month target at 1.30.](#)

Eurozone economic data have surprised on the downside this year
Eurozone and US economic surprise indices (Citi)



Sources: SGPB, Bloomberg, 24/05/2018

Dollar recovering since mid-April
Broad trade-weighted dollar vs dollar index



Sources: SGPB, Bloomberg, 24/05/2018


This week and next

EUROZONE


- The soft patch in the eurozone was confirmed this week. After peaking at 60.6 in December, business confidence eroded further, from 56.2 to 55.5 in May. Sentiment also worsened in the services sector, hitting 53.9, while the consensus was for 54.7.
- Consumer confidence also deteriorated from 0.3 to 0.2 in May but remains in its 2018 range.

UNITED KINGDOM

- Headline inflation continued its decline from 3.1% YoY in November 2017 to 2.4% in April 2018. On a month-on-month basis, inflation rose 0.5% versus 0.1% in March.
- GDP growth printed at 0.1% QoQ in Q1, down from 0.4% in Q4 2017.
- Exports disappointed forecasts, hitting -0.5% QoQ in Q1 against an expected 0.4%. Imports fell 0.6% QoQ, while consensus was for 0.1%.

 Next week's key events

		Per.	Prev.	Cons.
31 May	Unemployment rate	Apr	8.5%	8.5%
31 May	Consumer prices, YoY	May P	1.2%	1.6%

 Next week's key events

		Per.	Prev.	Cons.
01 Jun	Manufacturing confidence	May	53.9	53.5

UNITED STATES


- Initial jobless claims hit 234k in May versus an expected 220k.
- The US Federal Reserve's national activity index pointed to slightly stronger economic activity in April, printing at 0.34 versus 0.32 in March.

ASIA & EMERGING COUNTRIES

- After a peak at 1.5% in February – the highest since 2015 – Japanese consumer price inflation fell to 0.6% versus 0.7% expected.
- Despite economic expansion, Japanese corporate confidence slipped in May, from 53.8 in April to 52.5.

 Next week's key events

		Per.	Prev.	Cons.
01 Jun	Unemployment rate	May	3.9%	3.9%
01 Jun	ISM Manufacturing	May	57.3	58.1

 Next week's key events

		Per.	Prev.	Cons.
30 May	Japan: retail sales, YoY	Apr	1.0%	0.9%
31 May	China: manufacturing confidence	May	51.4	51.4

Sources: Datastream, Bloomberg, 28 May 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets for currencies and commodities

	Thursday close	6mth target
EUR/USD	1.17	1.25
GBP/USD	1.34	1.40
EUR/CHF	1.16	1.18
USD/JPY	109	110
Brent	\$79.1	\$65
Gold	\$1305	\$1275

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not be seen as a guarantee of future returns.



COUNTRY VIEW
The "Chinese Dream" and reality

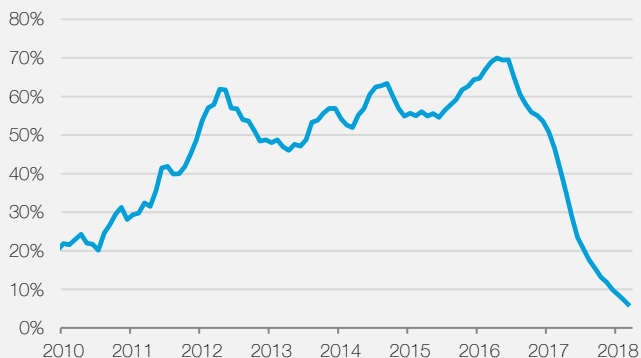
In a recent *Weekly Update*, we discussed the four main strategic initiatives and structural reforms the Chinese government intends to pursue. Financial stability is one those pillars.

A financial crisis would undermine China's stability and its ability to achieve its ambitions, perhaps even the party's absolute control. The authorities are aware of this and have made deleveraging a major priority. Shadow banking has become an increasingly important part of financing investments since 2010.

In June 2017, the President decided to create a new authority responsible for macro-prudential control and financial regulation. Since then, the pace of growth of lending to non-banks has slowed – see chart – and, in April this year, the central bank began to intervene to ease monetary policy, reducing reserve requirement ratios, given the slump in credit supply.

This highlights the inherent contradictions between China's ambitions (for example, reforms to reduce excess leverage) and her priorities (keeping policy sufficiently loose to avoid a shock to growth). It appears that when push comes to shove, China tends to prioritise growth over reform.

Interbank lending growth has collapsed to a decade low
Bank lending to non-bank financial institutions, YoY% growth (6mma)



Sources: SGPB, Gavekal, Macrobond, 01/01/2018.



EQUITIES
What is the outlook for Swedish equities?

Swedish economic growth is solid thanks to very accommodative monetary and fiscal policies. Last Autumn, the government announced new fiscal stimulus measures amounting to nearly 1% of GDP. In addition, ongoing global growth and the cheap currency support exports – Sweden is a very open economy, with the eurozone as its main trading partner.

In coming years, although the Swedish economy is expected to remain strong, growth should slow somewhat – global manufacturing PMIs have been softer, as has trade growth, while the decline in housing prices will lead to lower residential investment and construction.

The Swedish equity market should continue to benefit from the ongoing global economic expansion, notably exporters thanks to capital spending growth, improved terms of trade and high international competitiveness. Indeed, the main index, the OMX, is biased toward cyclicals (over 50% of total market capitalization, with Industrials representing 38% of the index) and more than 80% of revenues are generated abroad.

However, corporate profits are only expected to grow modestly this year – +2.1% compared with +5.7% in 2017 for the MSCI Sweden – dragged down by the expected fall in earnings of the financial sector.

In addition, valuations are not particularly attractive – the 12-month forward PE is 16.1x, at the high end of its range over the last decade and 12% above its 10-year median. Conversely, the Swedish market offers an attractive dividend yield (3.2% for the OMX index).

Overall, we suggest a neutral exposure on Swedish stocks due to recent weakening in eurozone PMIs and the risk of further weakness in the housing market.

Market performance

Past performance should not be seen as a guarantee of future returns.

Interest rates

	Last	1wk	3mth	YTD	12mth
EONIA (EUR)	-36 bp	0 bp →	0 bp	-2 bp	-1 bp
3mth Euribor (EUR)	-32 bp	0 bp →	0 bp	1 bp	1 bp
3mth Libor (USD)	232 bp	-1 bp ↓	36 bp	63 bp	112 bp
3mth Libor (GBP)	61 bp	-1 bp →	4 bp	9 bp	31 bp
10-year US Treasury bond	298 bp	-15 bp ↓	11 bp	57 bp	73 bp
10-year German bond	47 bp	-17 bp ↓	-13 bp	4 bp	6 bp
10-year French bond	76 bp	-12 bp ↓	-6 bp	9 bp	-9 bp
10-year UK bond	144 bp	-16 bp ↓	-10 bp	21 bp	43 bp

Credit

	1wk	3mth	YTD	12mth
BAML EURO Corp. IG	0.2% ↑	-0.3%	-0.6%	1.1%
BAML EURO Corp HY	-0.5% ↓	0.0%	-0.5%	2.6%
BAML GBP Corp IG	0.5% ↑	0.1%	-1.9%	-0.5%
BAML US IG	0.8% ↑	-0.8%	-3.2%	-0.1%
BAML US HY	0.0% →	0.4%	-0.2%	2.5%
JPM Global EM Sov. Plus	0.6% ↑	-2.6%	-4.5%	0.0%

Exchange rates

	Last	1wk	3mth	YTD	12mth
EUR/USD	1.17	-0.6% ↓	-4.7%	-2.4%	4.5%
EUR/CHF	1.16	-1.6% ↓	0.9%	-0.7%	6.4%
GBP/USD	1.34	-1.0% ↓	-4.2%	-0.9%	3.1%
USD/JPY	109	-1.4% ↓	2.2%	-3.0%	-2.0%
USD/BRL	3.65	-1.3% ↓	12.7%	10.2%	11.3%
USD/CNY	6.38	0.2% ↑	0.6%	-2.0%	-7.4%
USD/RUB	61.6	-0.9% ↓	9.4%	6.8%	9.0%

Government bonds*

	1wk	3mth	YTD	12mth
United States (3-7yr)	0.6% ↑	-0.1%	-1.6%	-1.8%
United Kingdom (3-7yr)	0.6% ↑	0.5%	-0.7%	-1.4%
Germany (3-7yr)	0.6% ↑	0.8%	0.1%	-0.2%
Japan (3-7yr)	0.0% →	0.0%	0.0%	-0.1%

Equities*

	Last	1wk	3mth	YTD	12mth
MSCI AC World	515	-0.4% ↓	-0.9%	1.5%	14.0%
Eurostoxx 50	3 522	-1.6% ↓	4.4%	2.8%	1.5%
DAX	12 855	-2.0% ↓	3.0%	-0.5%	1.7%
CAC 40	5 548	-1.1% ↓	6.1%	6.2%	7.1%
S&P 500	2 728	0.3% ↑	-0.2%	2.8%	15.7%
FTSE 100	7 717	-0.9% ↓	7.9%	2.3%	6.9%
SMI	8 771	-2.4% ↓	1.3%	-3.4%	0.4%
Topix	1 776	-1.8% ↓	1.8%	-1.4%	15.1%
IBOV Brazil	80 122	-4.2% ↓	-8.2%	4.9%	26.7%
MICEX Russia *	2 294	-1.3% ↓	-1.8%	8.7%	17.5%
MSCI EM	1 135	-0.7% ↓	-6.2%	-1.3%	15.9%
SENSEX 30 India	34 663	-1.4% ↓	1.6%	2.7%	15.8%
Hang Seng (H-K)	30 760	-0.3% ↓	-0.9%	3.9%	25.7%
Shanghai Composite	3 155	0.0% →	-4.1%	-4.6%	3.0%

Commodities

	Last	1wk	3mth	YTD	12mth
Brent	\$79	-1.7% ↓	18.1%	18.8%	46.0%
Gold	\$1 305	1.3% ↑	-1.8%	0.1%	4.1%
Silver	\$16.6	1.0% ↑	0.6%	-2.2%	-2.5%

Source: Datastream, on 24 May 2018. 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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