Weekly Update

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Istan-bears


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After months of market and media focus on US trade tariffs, this week another device in Washington's foreign policy toolbox has come to the fore – economic sanctions.

As widely anticipated, on Monday August 6 President Trump confirmed the reimposition of sanctions on Iran. The US has banned trade with Iran in cars, gold and metals as well as preventing the country from using the US dollar. And further sanctions are planned in November, on Iranian oil exports and on financial institutions doing business with its central bank. In anticipation of these measures, the Iranian rial has already fallen more than 50% against the dollar year-to-date (source: Financial Times).

Then on Wednesday 8, the US announced further sanctions on Russia, after those imposed in April on several Russian businessmen and large companies. This time, Washington has targeted Russian purchases of technologies with national security implications. And more is in the pipeline – a new sanctions bill before Congress could potentially ban dealing with Russian state-owned banks and purchases of new Russian sovereign bonds. Here again, the currency has tumbled, down 6.4% versus USD since end July and some 13.8% year-to-date.

But it is US sanctions on Turkey which have triggered the sharpest moves, with the lira (TRY) down 17% against the dollar since the start of August, taking this year's losses to 36%. The sanctions against two Turkish ministers in protest at the imprisonment of a US cleric are negligible in scope, but highly unusual between NATO allies. However, they have come when the Turkish economy already appeared highly vulnerable.

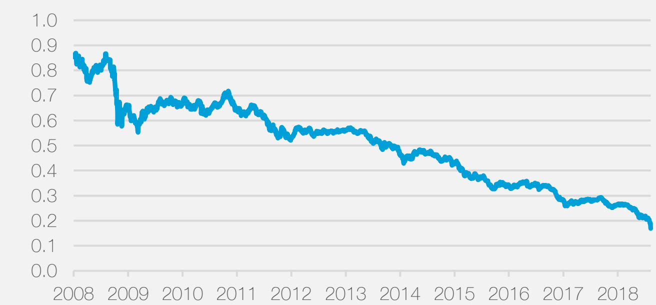
Turkey's current account deficit reached 6.3% of GDP in Q1 2018, underlining the country's heavy dependence on foreign financing. In addition, the most recent report on non-financial corporate liabilities from the Turkish central bank (TCMB) estimated foreign-exchange liabilities in May at USD 337bn– since then, the TRY has shed 23.9% against the USD, dramatically adding to the debt burden. And currency weakness has pushed inflation uncomfortably high –consumer prices were up 15.8% year-on-year in July, more than three times the official target.

In many other emerging markets, central banks have reacted to spiraling inflation and currency weakness by hiking interest rates. However, the TCMB failed to raise interest rates in July, potentially under political pressure. President Erdogan, long a critic of high rates, was returned with new executive powers in June's election, since when he has tightened his grip over the economy by appointing his son-in-law as economy and finance minister.

Putting it all together. In addition to the currency weakness, Turkey's financial markets have come under selling pressure – 5-year credit default swaps, which measure the cost of insuring against default, are up from 155 at the start of the year to 400 at present; 5-year sovereign bond yields have shot up from 12% at end-2017 to 21.3% at present; and the MSCI Turkey index is down 18.2% year-to-date. On Friday 10, these fears spilled over to the European banking sector, given many lenders' exposure to the country.

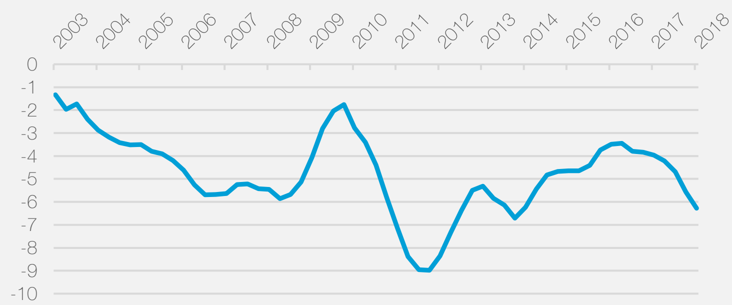
While many of Turkey's problems are self-inflicted, the current environment of dollar strength and rising US rates is typically challenging for emerging economies, especially those most dependent on external financing. US sanctions – and of course protectionism – only add to the pressure. In this context, we continue to suggest caution on emerging assets.

Turkish lira loses further ground vs dollar



Sources: SGPB, Bloomberg, 10/08//2018.

Turkey's current account deficit has worsened recently



Sources: SGPB, Bloomberg, 10/08/2018.

This week and next

EUROZONE

- In June, eurozone retail sales grew 0.3%, below expectations, while May was revised from 0% MoM to 0.3%.
- The Sentix investor confidence index continue to improve in August (14.7), moving further away from June's 20-month low.
- German industrial production (including construction) fell 0.9% MoM in June after a 2.4% increase in May, while factory orders were down 4% MoM, below forecasts.

Next week's key events	Per.	Prev.	Cons.
14 Aug GDP, YoY	Q2 P	2.5%	2.1%
17 Aug Headline inflation	Jul F	2%	2.1%

UNITED KINGDOM

- On first estimates, the UK economy grew 0.4% QoQ in Q2 as expected – after 0.2% in Q1. This reversed the downward trend for year-on-year growth over the past six quarters.
- Retail sales rose 0.5% MoM in July after +1.1% a month before.
- The RICS housing market price balance survey pointed to a firmer trend, rising for the third month in a row (from 3 to 4 in July).

Next week's key events	Per.	Prev.	Cons.
14 Aug Unemployment rate	Jun	4.2%	4.2%
15 Aug Inflation, YoY	Jul	2.4%	2.5%

UNITED STATES

- The US trade deficit worsened to $-46.3bn in June after some improvement in May.
- Job creation remained strong in July, 224k on average over last three months, sending the unemployment rate from 4% to 3.9%. Average earnings growth remained unchanged at 2.7% YoY.
- ISM non-manufacturing confidence fell from 59.1 to 55.7 in July, 2.9 pp below expectations.
- Contrary to expectations, producer price inflation (ex. food & energy) declined from +0.3% to +0.1% MoM in July, sending Yoy figures down from 2.8% to 2.7%.

Next week's key events	Per.	Prev.	Cons.
15 Aug Retail sales, MoM	Jul	0.5%	0.3%
17 Aug University of Michigan sentiment	Aug P	97.9	98.0

ASIA & EMERGING COUNTRIES

- Japanese GDP growth printed at +0.5% in Q2 after -0.2% QoQ in Q1. New machinery orders excluding volatile items plunged from a strong +16.5% YoY in May to +0.3% YoY in June. A tight job market drove cash earnings up 3.6% YoY in June, the highest since 1997.
- In China, inflation surprised on the upside, climbing to 2.1% YoY in July from 1.9% in June. Producer prices rose 4.6% YoY vs 4.7% the month before. Exports grew faster-than-expected (12.2% YoY) but imports surged +27.3% YoY, narrowing the trade surplus from $41.5bn to $28.1bn.
- Indonesia's GDP rose at its fastest pace since 2013 (5.3% YoY in Q2 vs 5.1% in Q1).

Next week's key events	Per.	Prev.	Cons.
16 Aug Japan: Trade balance (bn ¥)	Jul	720.8	-41.2
14 Aug China: Industrial production, YoY	Jul	6%	6.3%

Sources: Datastream, Bloomberg, 10 August 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

	Thursday close	6mth target
EUR/USD	1.15	1.20
GBP/USD	1.28	1.35
EUR/CHF	1.15	1.18
USD/JPY	111	110
Brent	$72.3	$75
Gold	$1213	$1250

No change to our 6-month targets this week.

Question time

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

ECONOMICS
Revised US personal saving rates figures, what impact?

US households put more money aside in recent years than previously estimated.

Every five years, the US Bureau of Economic Analysis (BEA) issues a comprehensive update of the previously published National Income and Product Accounts (NIPAs), integrating new measures of economic growth and estimates for price data. It also uses detailed industry and commodity data together with new information from the Internal Revenue Service (IRS) and the Department of Agriculture. The major update this year was to income, with relatively little adjustment to expenditure.

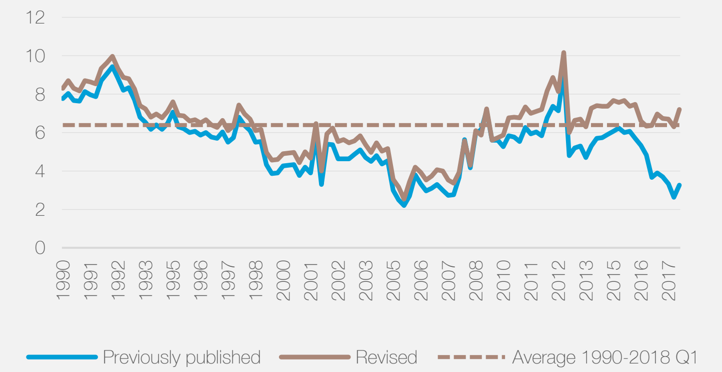
This means that the personal savings rate (the difference between disposable income and personal expenditure) has been revised upwards over most of its history. The updated data show savings remained rather stable between 2013 and 2017 at 6.9% of disposable personal income on average in contrast to the previous pattern of declines. As shown on the chart, Americans saved considerably more than previously thought. The household savings rate was revised higher in 10 of the last 11 years.

Why was income much higher than previously thought? The main factors were (a) an extra $650bn of proprietors' income (profits made by sole proprietorships and partnerships) from 2012 to 2017, an annualized 8% revision, and (b) higher income from dividends.

This update has little impact on GDP data for 2012-2017 with growth still up 2.2% on average. On the new estimates, the economy grew 2.2% last year down from 2.3%.

However, there was more impact on quarter-to-quarter data. For example, 2017 figures were revised substantially (e.g. Q1 from 1.2% to 1.8% vs Q4 from 2.9% to 2.3%).

US savings rate now and before



Sources: SGPB, Bloomberg, 10/08//2018.

Interestingly, first quarter growth figures were upgraded from 1.2% to 1.6% on average between 2002 and 2017. Additionally, growth for Q1 2018 was revised up from 2 to 2.2%. Economists have long suspected that seasonal adjustment of Q1 data was imperfect – perhaps the new estimates have gone some way to correcting this.

Bottom line. The savings rate is no longer close to historic lows but back around the average since 1990. This lifts one of the recurring worries about the sustainability of household spending in light of the falling savings rate. Unfortunately, these statistical revisions do not mean all Americans have been able to save. According to a recent Bankrate estimate, about one in four Americans has no emergency savings at all.

Market performance

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

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	0 bp	→	0 bp	-1 bp	0 bp
3mth Euribor (EUR)	-32 bp	0 bp	→	1 bp	1 bp	1 bp
3mth Libor (USD)	234 bp	0 bp	→	-2 bp	64 bp	103 bp
3mth Libor (GBP)	81 bp	0 bp	→	12 bp	29 bp	52 bp
10-year US Treasury bond	294 bp	-4 bp	↓	-6 bp	53 bp	70 bp
10-year German bond	38 bp	-8 bp	↓	-18 bp	-5 bp	2 bp
10-year French bond	61 bp	-9 bp	↓	-19 bp	-5 bp	-11 bp
10-year UK bond	135 bp	-7 bp	↓	-15 bp	12 bp	20 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.4%	↑	0.4 %	0.0 %	0.5 %
BAML EURO Corp HY	0.2%	↑	0.0 %	0.1 %	1.4 %
BAML GBP Corp IG	0.7%	↑	0.9 %	-1.0 %	-0.5 %
BAML US IG	0.3%	↑	1.4 %	-2.2 %	-0.7 %
BAML US HY	0.4%	↑	1.8 %	1.6 %	3.3 %
JPM Global EM Sov. Plus	-0.5%	↓	0.6 %	-4.9 %	-2.3 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.15	-0.5 %	↓	-2.7 %	-4.0 %	-2.0%
EUR/CHF	1.15	-0.7 %	↓	-3.9 %	-2.2 %	1.1%
GBP/USD	1.28	-1.5 %	↓	-5.3 %	-5.0 %	-1.4%
USD/JPY	111	-0.5 %	↓	1.2 %	-1.4 %	0.9%
USD/BRL	3.80	1.4 %	↑	5.8 %	14.8 %	20.5%
USD/CNY	6.82	-0.3 %	↓	7.2 %	4.8 %	2.2%
USD/RUB	66.7	5.2 %	↑	5.8 %	15.6 %	10.9%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.2 %	↑	0.8 %	-1.0 %	-1.8 %
United Kingdom (3-7yr)	0.3 %	↑	0.8 %	-0.3 %	-1.0 %
Germany (3-7yr)	0.3 %	↑	0.9 %	0.6 %	0.2 %
Japan (3-7yr)	0.0 %	→	-0.2 %	-0.2 %	-0.1 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	522	0.9 %	↑	2.3 %	3.4 %	11.9 %
Eurostoxx 50	3 494	0.8 %	↑	-0.6 %	2.8 %	4.3 %
DAX	12 676	1.0 %	↑	-2.1 %	-1.9 %	4.3 %
CAC 40	5 502	0.8 %	↑	1.1 %	6.5 %	10.4 %
S&P 500	2 854	1.0 %	↑	6.3 %	8.0 %	17.6 %
FTSE 100	7 742	2.7 %	↑	2.4 %	3.7 %	8.0 %
SMI	9 146	-0.1 %	↓	1.9 %	0.8 %	4.8 %
Topix	1 740	-0.7 %	↓	-1.7 %	-3.1 %	9.9 %
IBOV Brazil	78 768	-1.1 %	↓	-6.5 %	3.1 %	16.4 %
MICEX Russia *	2 310	0.6 %	↑	0.3 %	9.5 %	16.9 %
MSCI EM	1 079	1.1 %	↑	-4.4 %	-5.0 %	3.6 %
SENSEX 30 India	38 024	2.3 %	↑	8.4 %	13.4 %	20.9 %
Hang Seng (H-K)	28 607	3.2 %	↑	-4.5 %	-2.0 %	6.8 %
Shanghaï Composite	2 794	1.0 %	↑	-11.5 %	-15.5 %	-14.7 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$72	-1.4 %	↓	-6.5 %	8.5 %	38.2 %
Gold	$1 213	-0.1 %	→	-7.7 %	-6.9 %	-4.7 %
Silver	$15.5	0.3 %	↑	-6.7 %	-9.2 %	-8.4 %

Source: DataStream, on 10/08/2018. 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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