Weekly Outlook

Monday 10th September 2018 by Richard Perry, Market Analyst

Macro Commentary

A surprise jump in US wage growth should drive a dollar positive reaction this week. Higher Treasury yields are dollar supportive, however, this becomes an interesting test. If the dollar cannot break support of an old floor just above $1.1500 on EUR/USD, or resistance around 111/112 on USD/JPY, then there will be a feeling that the dollar bull run really is coming to an end. For months, traders have waited for sustainable traction in wage growth to be the final piece in the jigsaw for the Fed's tightening. However, time and again they have been disappointed. Inflation expectations have been subsequently anchored for much of 2018, helping to flatten the US yield curve. Will the longer end of the curve now begin to react higher? Two year Treasury yields pulled to 10 year highs on Friday above 2.70% as this wage growth improves the prospects of a fourth rate hike in December. However, will the 10 year Treasury yield similarly rise, back above 3% and help steepen the curve? Donald Trump's penchant for picking trade disputes around the world has strengthened the dollar in recent months, as it makes the US the biggest bully in the playground, pulling capital out of emerging markets. However, longer dated yields have been stubborn with apprehension over future growth. Another failure for the longer end to take off this week would be further sign that bond markets concerns are that Trump's trade policy will hurting US growth prospects outweigh the potential positive impacts of wage growth. This would bring the dollar bull run one step closer to its conclusion.

Must Watch for: US CPI

WHEN: Thursday 13th September, 1330BST

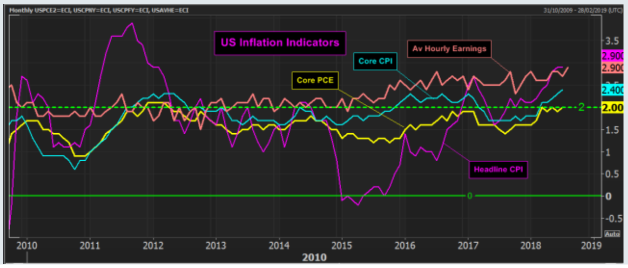
LAST: Headline +2.9%, Core +2.4%
FORECAST: Headline +2.8%, Core +2.4%

Impact: It is interesting to see that although US CPI has been ticking higher throughout 2018, the 5yr 5yr forward inflation expected rate has remained stuck in a sideways range (just as longer dated US yields are). Stubborn average earnings growth has been a factor here, but headline CPI inflation is expected to tick mildly lower this month back to 2.8% and although core CPI is expected to remain at +2.4%, any negative surprise will drive market volatility. US longer dated Treasury yields would react as would the dollar.

US inflation indicators

5yr 5yr forward expectations have been 2.1% to 2.3% this year

Wages could be set to move above headline CPI



Key Economic Events

Date	Time	Country	Indicator	Consensus	Last
Tue 11th Sep	0930BST	UK	**Unemployment / Av Weekly Earnings** (x b)	4.0% / +2.8%	4.0% / +2.7%
Tue 11th Sep	1000BST	Eurozone	**German ZEW Economic Sentiment**	-14.1	-13.7
Wed 12th Sep	1330BST	US	**PPI** (headline / core)	+3.2% / +2.8%	+3.3% / +2.7%
Wed 12th Sep	1900BST	US	**Fed Beige Book**	n/a	n/a
Thu 13th Sep	0230BST	Australia	**Unemployment**	5.3%	5.3%
Thu 13th Sep	1200BST	UK	**Bank of England monetary policy**	No change +0.75%	+2bps to +0.75%
Thu 13th Sep	1330BST	US	**CPI** (headline / core)	+2.8% / +2.4%	+2.9% / +2.4%
Fri 14th Sep	0300BST	China	**Fixed Asset Inv / Industrial Prod / Retail Sales**	+5.5% / +6.0% / +8.7%	+5.5% / +6.0% / +8.8%
Fri 14th Sep	1330BST	US	**Retail Sales** (MoM ex-autos)	+0.5%	+0.6%
Fri 14th Sep	1500BST	US	**University of Michigan Sentiment** (prelim)	96.6	96.2

N.B. Please note all times are British Summer Time (BST) i.e. GMT +1. Data: Reuters

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Foreign Exchange

The two tier performance of the US dollar is becoming a growing feature of forex markets. The dollar has been increasingly strong against emerging markets currencies. Current account deficit currencies such as Argentinian peso, South African Rand, Turkish Lira and Indonesian Rupiah have all been hit by a capital drain out of emerging markets reliant on foreign funding, and moving it into the US. Escalating trade tensions drive this. However, against lower risk majors, dollar performance has been less strong recently. The Japanese yen and Swiss franc are being seen as better performing safe havens during the risk aversion. The market has been hugely long the dollar and short Treasuries positioning in futures markets, suggesting the market is stretched. According to Deutsche Bank, the dollar is the most overvalued currency in the world and this is ripe for a correction. This comes as the Chinese yuan has steadied, whilst the outlook for sterling has seemingly turned a corner as the mood music on Brexit has become increasingly positive. This has been surprisingly driven by constructive rhetoric from the EU, in the last two weeks, Michel Barnier has seemed more amenable to a deal and on the Irish border issue. There seems to be a floor forming on sterling now. As for the euro there is less of a positive outlook now, with Benoit Coeure talking of mounting risks to the Euro area, German factor orders falling sharply and the uncertainties of the Italian budget adding to headwinds to a stronger euro.

WATCH FOR: Politics of trade remain key, also US inflation and retail sales, also Bank of England

FX Outlook

EUR/USD

Watch for: *The bulls need to build on the support band $1.1505/$1.1530 to begin to form a recovery*

Outlook: There is a medium term trading band forming, as the market is failing in the $1.1700s but the support above $1.1500 is holding, for now. This ranging outlook is reflected in the momentum indicators which is increasingly neutrally configured, with the RSI oscillating around 50 and MACD lines around zero. How the market responds to Friday's Payrolls (of dollar strength) could be key to the near to medium term outlook, but holding on to the support above $1.1500 would suggest that the prospect of a recovery can continue to develop.

GBP/USD

Watch for: *Cable continues to build for a potential recovery*

Outlook: Holding on to the higher low around $1.2800 will be a key technical feature of a recovery in the coming weeks. This comes as momentum indicators take on a far more improved configuration and the 21 day moving average turns up for the first time since the big bear move set in from April. If a rally can pull above the falling 55 day moving average (c. $1.3020) then this would also be a key medium term improvement. Whilst there is much still to be done before a recovery can be confidently called, the resistance at $1.3045 will be paramount for the bulls to breach this week as a stepping stone along the way. The support at $1.2800 would then be a key higher low.

Equity Markets

Outside of earnings season, equity markets look for catalysts in newsflow. Unfortunately for the bulls, at the moment, the newsflow is dominated by the escalation of the trade dispute. Discussions between Canada and the US over the renegotiation on NAFTA have dragged and remain unresolved. However it is the prospect of Trump enacting tariffs on $200bn of Chinese imports and perhaps even a further $267bn to go “all in”, that is the real threat to sentiment. This would represent a significant game changing ramp up in tensions with China, mostly because China would not be able to reciprocate dollar for dollar and would therefore need to respond in different ways (red tape regulation, encouraging a boycott of US goods etc). However this impacts more on the countries as part of the supply chain. How negative would the impact be on trade in the Asia Pacific region? The China PMIs already are starting to show a slowdown in new export orders. In Europe, German factory orders dropped unexpectedly in July and means that year on year orders are falling at -0.9% amid signs that the trade dispute is really hitting. The DAX is an export heavy index and has been under huge selling pressure in the past couple of weeks. However, with technicals stretched and signs of the sell-off slowing, can this continue? How the DAX reacts to the next ramp up in the trade dispute will be telling of the near to medium term outlook. The market looks ripe for a technical rally this week, so an inflection point could be close. FTSE 100 has got a strengthening sterling to contend with also. It certainly seems as though every time positive newsflow over Brexit hits the media, the negative correlation of sterling and FTSE 100 resumes (latterly pulling FTSE 100 lower).

WATCH FOR: Trade tariffs news for DAX, Brexit developments on FTSE 100

Index Outlook

DAX Xetra

Watch for: *Can the bulls stem the tide of selling pressure?*

Outlook: The sell-off has accelerated to multi-month lows in the past week, but there are signs that a potential technical rally could be seen this week. The momentum indicators are negatively configured, but the RSI is at 30 again. Since the March key lows, each of the major technical rallies have come with the RSI around 30. Is this enough to drive a recovery this week? There is still room for a further slip to the March low at 11,726 but recent candles have reflected muted real selling pressure. Resistance of the old key support at 12,104 would play a key role in how a technical rally could shape up.

FTSE 100

Watch for: *Can the bulls start to form support around 7200/7300?*

Outlook: September has not been kind to FTSE bulls so far as the selling pressure that had been mounting during August has cranked up a notch or two. However the market is now into the support band 7200/7300 which were key pivots from 2017 into the early months of this year. Can these pivots begin to hold the sell-off this week? Momentum indicators are negative coming into the new week, but equally the RSI looks stretched, with the drop back to 30. The concern is that unless the bulls can start to find support early this week, the sell-off could quickly accelerate to 7060 with the March low at 6866. A technical rally has much to unwind and 7430/7500 would not be ruled out.

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Other Assets: Commodities & Bonds

There does seem to have been a subtle shift in how **gold** is trading in the past week or so. Suddenly gold seems to be less negatively responsive to dollar strengthening. The position of gold reacting as a safe haven during times of elevated market fear seems to be resuming. This is helping gold to start to build support and rather than consistently being sold into strength as it has dome throughout the summer, it is now starting to form higher lows. Subsequently the support at $1189 is an increasingly important protection of the $1183 low.

Oil is moving on the trade story which is having a negative impact on the outlook for global demand. The escalation of the trade dispute is negative for supply lines and impacts on the demand for oil, pulling the price lower. The impact on supply from the sanctions on Iran are a key risk factor for the coming months and have the potential to pull the price higher once more. Saudi Arabia noting that they are comfortable with an oil price between $70/$80 suggests the broad stability seen in recent months could be taking hold.

Nonfarm Payrolls helped to pull US Treasury **bond** yields higher on Friday, with the 2 year yield pulling above 2.69% to new 10 year highs and it will be interesting to see if this maintains traction this week. The payrolls report certainly seems to have bolstered the expectation for a fourth Fed hike in December, but also flattening the yield curve again. Watch the Bund/BTP spread for political risk from Italy hampering the euro.

WATCH FOR: Trade dispute developments, US inflation and retail sales

Markets Outlook

Gold

Watch for: *A higher low above $1183 would be key for the recovery.*

Outlook: Gold is holding above the support at $1189 which will be seen as key this week. The market has drifted back from $1214 but the higher low at $1183 remains intact and the bulls held up well in the face of a dollar strengthening payrolls report on Friday. The momentum indicators are important with the RSI above 40 being a key reflection of the improving outlook this week. If the bulls can begin to close consistently above $1200 then a realistic challenge of $1214 could be seen.

Brent Crude oil

Watch for: *The pivot at $75.25 is supportive in the middle of the range.*

Outlook: Since Brent Crude oil topped out at $80.50 the market has seen an increasingly rangebound outlook forming. The support of the August low at $70.30 has become the key low in the range but momentum indicators are playing out oscillations within the range and the market has simply retreated towards what has been the basis of a pivot at $75.25 which sits broadly in the middle of the band. Moving averages are sitting under the price as we move into this week but how the market reacts to the support of the pivot will be the key factor this week and will determine what the outlook will be over as the market falls back again.

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