Weekly Market Summary

5th of August 2016

Markets Craving for Additional Central Bank Support...Bank of England Delivers!
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Mark Carney did what was expected of him yesterday, and then some, by cutting the Bank of England's ("BOE") benchmark lending rate and promising to deploy tens of billions of additional dollars into the country's financial system. With markets addicted to cheap money, the knee-jerk reaction saw the British pound selling off sharply (down from 1.3350 to 1.3100), whilst stocks rallied to end the day at their highest level since mid-August 2015. UK 10-year bond ("Gilts") yields dropped 18 basis points to 0.63%, a new record low (*such should soon threaten the solvency of many pension funds and insurers!*).

Yet the details of the announcement underline the uncertainty the central bank now has to contend with, and the limits to the tools it can use. How the Brexit-beaten economy behaves going forward remains unclear!

Mark Carney and his colleagues met private-sector forecasts for a 25 bps cut in the key borrowing level, taking it to 0.25% - the first drop since the 2009 financial crisis and marking a historic low for the country's trendsetting rate. The Bank said the lending rate could fall even lower this year, but ruled out moving into negative territory. The former head of the Bank of Canada, who joined the BoE in 2013, also announced an "*exceptional*" stimulus package valued at 170 billion pounds (US$223 billion). This includes another 60 billion pounds in purchases of U.K. government bonds, taking the existing Asset Purchase Facility to 435 billion pounds (who is counting really ?!), along with a new plan to buy up to 10 billion pounds in corporate bonds. The combined program goes further than previous efforts and exceeds what many economists and market players had anticipated. As well as the much larger buying effort, the BoE plans to loan private banks as much as 100 billion pounds in a move to ensure that lenders have enough liquidity to continue funding households and businesses in the fallout from the June 23 referendum that showed voters narrowly in favour of the U.K. exiting the European Union - a move that could lead the country into recession. "*We took these steps because the economic outlook has changed markedly*," Carney said. "*The Bank continues to stand ready to take whatever action is needed to achieve its objectives for monetary and financial stability as the U.K. adjusts to new realities, and moves forward to seize new opportunities, outside the EU*," Bank Governor Carney told reporters in London following the BoE announcement. "*By acting early and comprehensively*," he said, monetary policymakers can "*reduce uncertainty, bolster confidence, blunt the slowdown and support the necessary adjustments*" in the economy.

But the effectiveness of Thursday's action plans is still in question, as is the country's economic outlook. Indeed, much more work lies ahead for Carney, who will remain central bank governor until at least 2018.

"*Indicators have all fallen sharply, in most cases to levels last seen in the financial crisis, and in some cases to all-time lows*," Carney said, so "*there is a clear case for stimulus, and stimulus now, in order to have an effect when the economy really needs it*." The BoE, however, is not yet at the point of accepting that a recession is inevitable - even as it acknowledges business investment and consumer spending, including house purchases, will likely weaken both this year and in 2017. Still, policymakers insist growth will reach 0.8% next year, down from the previous estimate of 2.3%, while the forecast for 2018 has been lowered to 1.8% - also down from an earlier forecast of 2.3%.

"*This cut in interest rates was widely expected, but it is really a token gesture which is unlikely to help the economy much in the current situation*," said Andrew Sentance, a senior economic adviser at PwC and one-time member of the BoE's decision-making counsel. "*Savings rates are already near-zero and borrowing costs for business and homeowners are extremely low*," Sentance told Reuters. "*The uncertainty created by the Brexit referendum result cannot be addressed by small changes in interest rates or other monetary measures. It requires a political response from the government, to make clear the nature of our future relationship with the EU, which will inevitably take time,*" he added. The fall in the pound complicates matters in another way, by pushing up prices. The Bank expects inflation to rise a little above its 2% target - causing some to suggest that the new stimulus goes too far and would soon lead to the overshoot of inflation (guess for now central bankers are not at all bothered with the upcoming bond bubble burst, a matter of concern left to your devoted GIB Banker!).

Today sees the market stop for the biggest show on earth where many of us from around the world will be glued to our screens. Still, traders will first be busy with the all-important US payroll release (3:30 pm Bahrain time) before switching their attention to the 2016 Olympic games opening ceremony in Rio (2:00 am Saturday morning Bahrain time). Economists are looking for US payrolls growth to return in July to its 2016 average following a flip & flop picture in the past 2 months (June was very strong at +287,000 versus a terribly low +11,000 number for the month of May). "*If the July number is relatively normal, I think the conclusion that people will draw is that whatever July prints is more or less the new trend,*" said Stephen Stanley, chief economist at Amherst Pierpont Securities LLC in New York. Bloomberg consensus is for July payrolls rising by 180,000 (versus an average 172,000 a month gain in the first half of this year). As always, it is also worth keeping an eye on the other important elements of the report including the unemployment rate (expected to decline one-tenth to 4.8%), average hourly earnings (+0.2% mom / +2.6% yoy is anticipated there), the participation rate and average weekly hours.

**The US job market showed further strength in July (in contrast to the week second quarter US GDP release last Friday), registering another month of respectable hiring, and upside surprises across the board. Payrolls jumped 255K alongside 18K in combined upward revision to prior months, fueled by balanced gains across various sectors The jobless rate only held at 4.9%, but that was due to a rise in the participation rate that were offset by big gains in the household survey employment measure. Hourly earnings gains 0.3%, although that only managed to hold the yearly rate steady at 2.6%. Other details on aggregate hours were also very healthy. This recent hiring spree suggests better output figures ahead and a strong print for 3rd quarter GDP. It should also revive market fears for a 25 bps rate hike at September 21st FOMC meeting (though between now and then, markets will receive more updated August job data). Overall, the number is bearish for US Treasuries (lower prices/higher yields), bullish for the USD (stronger US Dollar versus peers) and neutral to positive for US stocks.*

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