Economy & Market Watch
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Slower Road to Normalization

Deepak Mehra
Head of Investment Products and Chief Economist
Treasury, Asset Management and Global Markets

Central banks across the developed markets increased interest rates in May as inflation remains far above their target levels. Mixed data and statements from various central bank officials kept the debate about the future of monetary policy alive.

ECONOMIC UPDATE

More rate hikes: Major central banks continued to tighten monetary policy in the month of May. On the 3rd of May, the Fed delivered a 25bps hike taking the Fed fund rate to 5% - 5.25%, with Chair J. Powell signaling that they may have reached the peak rate of interest; a day later, the European Central Bank hiked rates by 25bps, taking the deposit rate to 3.25% while clearly signaling more in the coming meetings; Bank of England also increased rates by 25bps taking the base rate to 4.5%. Meanwhile, the Reserve Bank of Australia shocked the markets with a surprise hike after pausing in its previous meeting.

US Fed Fund Rate
5%-5.25%

Pegged currency ensures the UAE rates are in lockstep with the US monetary policy:

Hike #	Date	Rate Hike bps	US Fed Fund Rate	CBUAE Base Rate
			0% - 0.25%	0.15%
1	17-Mar-22	+25	0.25% - 0.50%	0.40%
2	5-May-22	+50	0.75% - 1.0%	0.90%
3	16-Jun-22	+75	1.50% - 1.75%	1.65%
4	27-Jul-22	+75	2.25% - 2.5%	2.40%
5	21-Sep-22	+75	3.0% - 3.25%	3.15%
6	2-Nov-22	+75	3.75% - 4.0%	3.90%
7	14-Dec-22	+50	4.25% - 4.5%	4.40%
8	1-Feb-23	+25	4.50% - 4.75%	4.65%
9	22-Mar-23	+25	4.75% - 5.00%	4.90%
10	3-May-23	+25	5.00% - 5.25%	5.15%
11	14-Jun-23		70% probability of a pause	

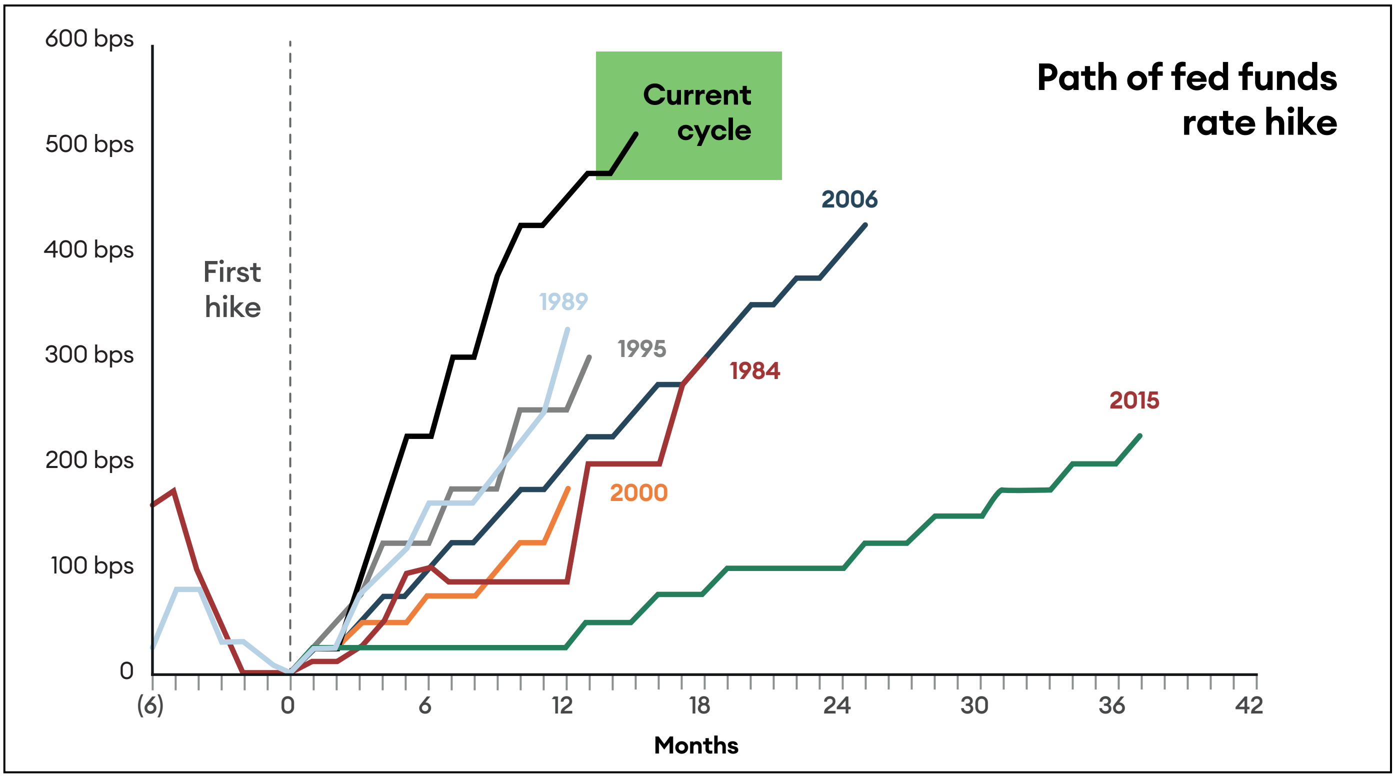
Hawkish debate in FOMC: The minutes to the 3rd of May Federal Open Market Committee (FOMC) pointed to a debate between several members unhappy with the 'unacceptably slow' progress on inflation and those who believed more policy firming may not be required. The hawkish undertone re-ignited speculations of another rate hike in the upcoming meeting of 13-14 June where this divide among the members may still play out an uncertain outcome.

Markets repricing the rates outlook: Given the strong set of data released in May (inflation, purchasing managers index, non-farms payroll) along with the hawkish FOMC minutes and statements from a number of Fed governors, the market implied odds of rate hikes in the June and July meetings shot up to 77% and 25% respectively during the month. However, right now the market ascribes a 70% probability of a pause in rates. At the same time, the market has significantly repriced the outlook for rate cuts. Just a month ago they were looking at a first rate cut coming in September with nearly 100 bps (1%) of cuts by the January FOMC meeting, whereas now the market is just about pricing one cut by January.

70%
Probability of a pause in June

Inflation looks more stubborn: Despite aggressive rate hikes, the sharpest in the last four decades (see chart), progress on the inflation front remains slow. Even though inflation across the US, Eurozone and the UK continues to come off, core inflation is turning out to be more stubborn. Headline inflation is easing due to the base effect of high energy cost last year, but core inflation is sticky due to a very strong labor market.

The US Non-Farm Payroll data released for the month of May had conflicting signals: on the one hand the economy added 339,000 jobs, much higher than expected for the 14th-straight month but on the other hand, the unemployment rate ticked higher to 3.7% and wage growth moderated. The Labor market remains red-hit but is probably showing early signs of cooling. At the same time, Q1 GDP and personal consumption have been revised upwards and the forward looking services PMI (purchasing managers index) has shot up further into the expansionary territory indicating strong demand. Overall, the economy is holding on surprisingly well despite sharp rate hikes and hence a rapid decline in inflation towards the target of 2% is not yet on the horizon.



Source: FactSet, Goldman Sachs Global Investment Research As of May 2023

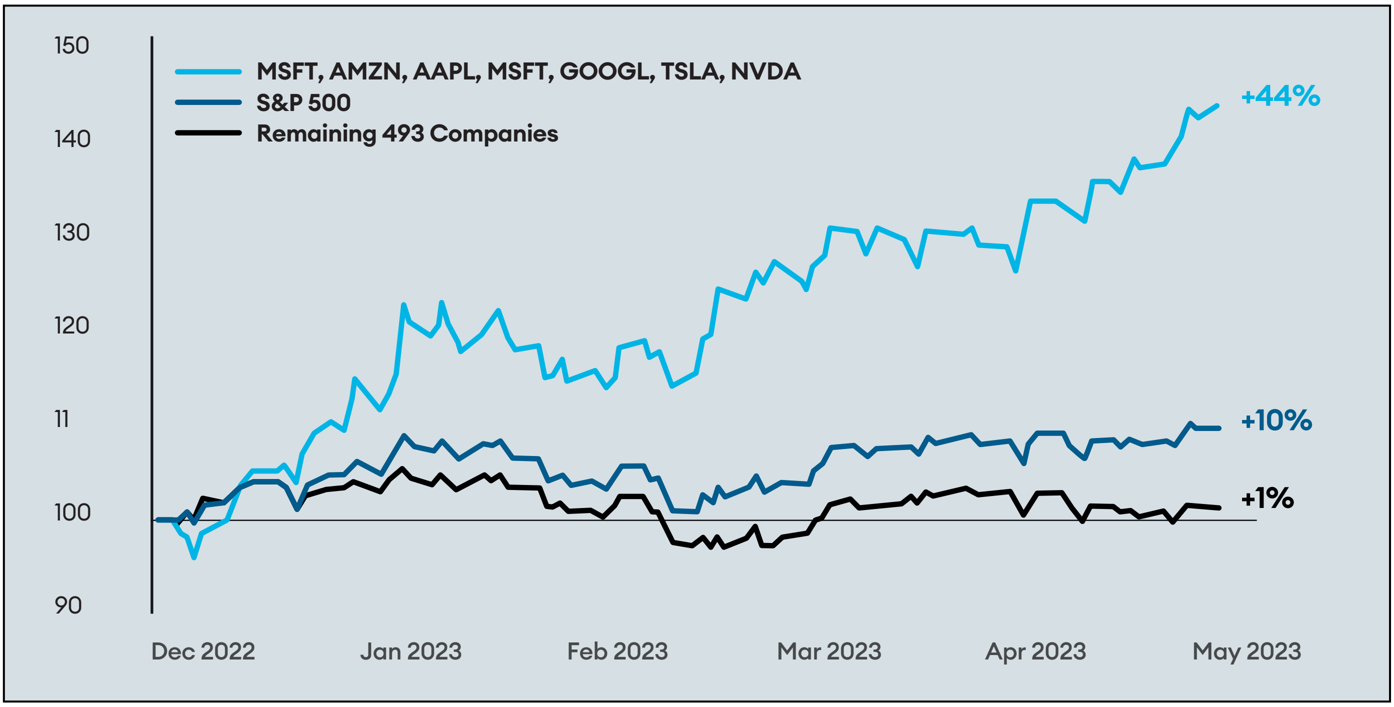
US Debt Ceiling Debate: ***Much ado about nothing***

The debate about raising the US debt limit beyond the current $31.4 trillion hogged the limelight through the month of May with many actually worried about a default by the US Treasury. The debt ceiling is a self-imposed limit that the Congress had introduced in 1917 to ensure a healthy debate on government borrowings. Currently, the US runs an annual deficit of $1 trillion and hence raising more debt is merely procedural. However, it does lead to extensive political wrangling between the Democrats and the Republicans in every such instance. Over the last 100 years, the ceiling has been raised under the watch of both the parties but deals are always cobbled together at the eleventh hour with much political brouhaha. The same episode was replayed this time and finally, at the eleventh hour, both houses of the Congress approved suspending the ceiling till January 2025 when the next president takes over. The deal imposes certain caps on spending but kept the massive spending under the Inflation Reduction Act intact. While this was going on, both equity and bond markets ignored the political drama and the US dollar continued to strengthen (despite the supposed risk of default!).

MARKET OUTLOOK

Interest rate outlook — a long pause: As mentioned in the 'Economic Update' section, the US economy is holding on surprisingly well despite sharp rate hikes. A rapid decline in inflation towards the Fed's target of 2% is not yet on the horizon. The Fed has telegraphed two messages very clearly: first, that the real impact of its aggressive rate hikes will unfold gradually over the coming months and secondly, easing rates too early can be perilous, as history has shown. Given this, we believe the Fed is most likely to pause and stay put for the rest of the year even if the economy faces a technical recession in the coming quarters. The outlook for rate cuts become even more uncertain given the next presidential elections in November 2024. Normally the Fed would not like to be seen influencing political campaigns by moving rates closer to the elections.

Equity markets: US equity investors are drawing comfort from: a) that the Fed is most likely done with raising rates and b) the Q1 earnings season has been surprisingly robust (78% of the companies beat earnings estimates and 67% beat revenue estimates) despite headwinds of extremely sharp rate hikes. The most rate sensitive segment of the equity markets i.e. mega cap technology stocks that were hammered hard in 2022 are the top performers this year. The tech heavy Nasdaq index is up a whopping 32% year-to-date primarily driven by a handful of mega-cap tech stocks (see chart next page) after plummeting 33% last year. Investors are showing confidence in stocks like Microsoft, Alphabet, Meta, Amazon, Apple and Nvidia to deliver superior growth especially after they have cut cost by laying off a large number of employees. The star performer of the month was the specialty chip designer Nvidia that jumped 36%, riding the widespread interest in artificial intelligence applications that the company specializes in, without much competition. We believe equity markets, especially the technology stocks, have discounted a lot of positive news already. During the rest of the year they are likely to hold their performance but unlikely to repeat the performance of the first 5 months. A gradual allocation at the index level should be continued for capturing long term performance.



Source: GS Global Investment Research and GS Asset Management

A generational buying opportunity in fixed income: Income oriented investors like pension funds, endowments and private clients looking to allocate towards their core portfolios have had a tough time for more than a decade-and-a-half, when rates were zero-bound. Now, thanks to the actions of central banks, these investors can earn high returns without taking much risks. At the beginning of 2022, investment grade bonds were yielding close to 2% per annum whereas today the same are yielding 5% to 6% per annum. We do not expect the USD rates to go significantly higher from the current levels and hence the prevailing yields represent a generational buying opportunity in bonds even if the rates remain on pause for some time. We believe income-oriented investors should take advantage and lock up returns for the longest possible duration with high quality names.

MARKET DATA

Global Equities	Last price	YTD 2023
MSCI World	2800.56	7.60%
Dow Jones Ind.	32908.27	-0.72%
S&P 500	4179.83	8.86%
NASDAQ COMP	12935.29	23.50%
EUROSTOXX 600	451.76	6.32%
FTSE 100	7446.14	-0.08%
India Nifty50	18534.4	2.37%
Nikkei 225	31078.27	19.10%
Shanghai Comp	3204.56	3.73%

Currencies	Last price	2023 Chng
Dollar Index	104.22	0.68%
Euro	1.0686	-0.18%
GBP	1.2437	2.93%
JPY	139.24	-5.83%
CHF	0.9105	1.54%
AUD	0.6491	-4.73%
CNH	7.1217	-2.80%
INR	82.72	0.01%
SGD	1.3526	-0.97%

Regional Equities	Last price	2023 Chng
Dubai DFM	3567	7.20%
Abu Dhabi ADX	9484	-7.88%
Saudi Tadawul	11,014.00	5.11%

Commodities	Last	2023 Chng
WTI Crude	67.88	-15.42%
Brent Crude	72.4	-15.73%
Nat Gas	2.26	-49.47%
Gold	1965.67	7.77%
Silver	23.52	-1.78%
Copper	365.55	-4.07%
Corn	594	-12.40%

Market Data as of 31 May 2023

CBD INVESTMENT SOLUTIONS

CBD offers a range of solutions that can help you manage wealth for short-term or long-term objectives:

ASSET CLASS	SOLUTIONS
FIXED INCOME	• A large range of regional and international bonds, perpetuals and sukuks • Top-rated global and regional mutual funds investing in bonds and sukuks and distributing regular income • Both Sharia-compliant and conventional fixed income solutions are available
EQUITIES	• International equity and ETF trading on CBD's award-winning mobile app CBD Investr • Trading in UAE equities with CBD Financial Services mobile app or with brokers
MULTI-ASSET	• Income distributing mutual funds, from leading fund managers in the world, investing in equities and fixed income
SYSTEMATIC INVESTMENT PLAN	• Invest regularly in globally diversified and actively managed portfolios on CBD's award-winning mobile app CBD Investr
ALTERNATIVES	• Mutual funds investing in US senior secured loans delivering regular income

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