Weekly Market Outlook: January 16th – 20th

Trump's inauguration, ECB & BoC policy meetings, key data in focus

Next week's market movers

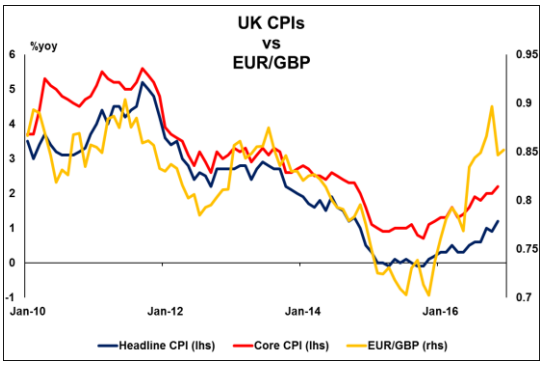
- In the US, the inauguration of Donald Trump as the 45th US President is likely to be the epicenter of market attention.
- In Eurozone, the ECB will probably keep its policy unchanged, having extended the duration of the QE program at the latest meeting.
- We expect the Bank of Canada to keep its easing powder dry as well, amid mixed economic data and elevated oil prices.
- We also get key economic data from the UK, the US, New Zealand, China, and Canada.

On Monday, we have no major events or indicators on the economic agenda. Markets will remain closed in the US for Martin Luther King Jr. Day.

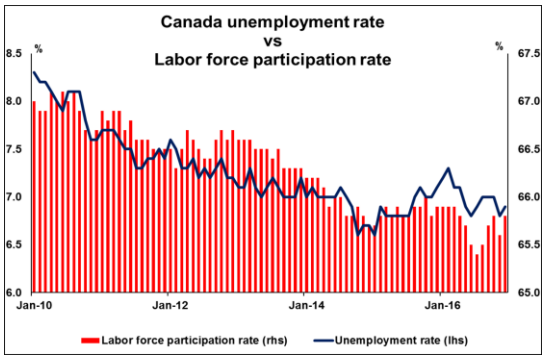
World leaders and key officials will gather in Davos, Switzerland, for the 2017 World Economic Forum, though the actual event won't kick off until Tuesday.

On Tuesday, market participants will shift their attention to the UK, where PM Theresa May will give a speech on "Brexit". Even though many of the discussion topics have not been made clear yet, given all the recent political pressure on the PM to clarify her negotiating strategy and objectives, we think that investors will be scanning her comments for indications of a "soft" or "hard" Brexit. The latest remarks from May were that her top priorities are gaining control of immigration and lawmaking, and that retaining full access to the single market may hold secondary importance. Similar signals in this speech are likely to bring the pound under renewed selling interest, as market participants are likely to discount a higher probability for a "hard Brexit". If on the other hand she delivers more moderate comments and perhaps repeats that she wants a transitory period after Brexit so that businesses are affected less, we could see sterling rebound.

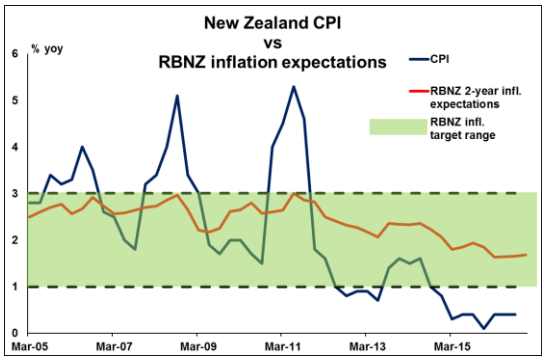
As for the UK economic data, the CPI for December is likely to catch the attention of GBP traders. Both the headline and core CPI rates are expected to have risen further. The forecast is supported by the services PMI for the month, which indicated that inflationary pressures remained substantial, with prices charged rising at the strongest pace since 2011. Regardless, further acceleration in inflationary pressures is unlikely to be any surprise to the BoE, as the Bank already expects the CPI rate to rise to the 2% target by the middle of the year, mainly due to sterling's post-referendum collapse.



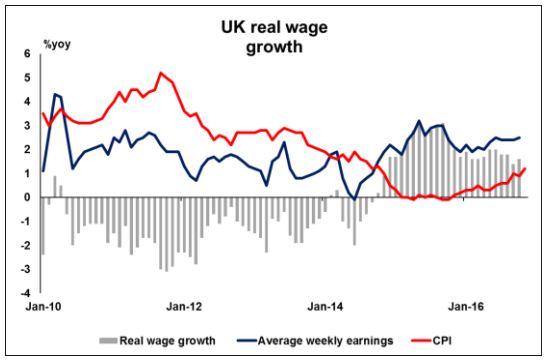
On Wednesday, the first Bank of Canada policy decision of the year will take center stage. The forecast is for the Bank to keep its policy unchanged. Surprises in economic data have been the story in Canada ever since the BoC's latest meeting in December. Even though the nation's core CPI rate slipped unexpectedly in November, the labor market surprisingly tightened in December, with the labor force participation rate rising notably. Bearing these in mind, and that Governor Poloz indicated in relatively recent comments that it would take an economic shock for the Bank to ease again, we share the view that the BoC is likely to take the sidelines and we expect the Bank to maintain its overall neutral bias. The fact that oil prices have remained elevated following the OPEC consensus supports further the case for no action by the BoC, considering that oil is Canada's biggest export by far.



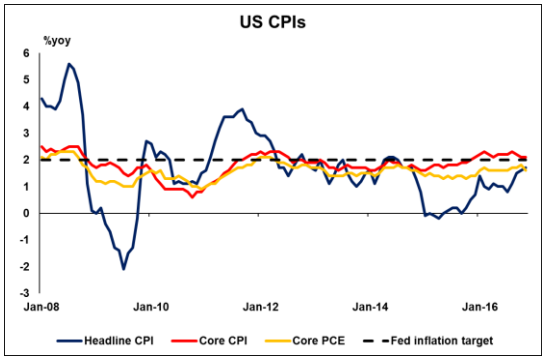
As for the economic indicators, during the Asian morning, we will get New Zealand's CPI data for Q4, though no forecast is available yet. We hold the view that the CPI rate may have risen from +0.4% yoy in Q3, supported by a rapidly tightening labor market, as well as the RBNZ's three rate cuts throughout 2016. What's more, since early November, NZD/USD has been in a declining mode, which may have pushed up imported inflation as well, supporting the case for a higher CPI rate.



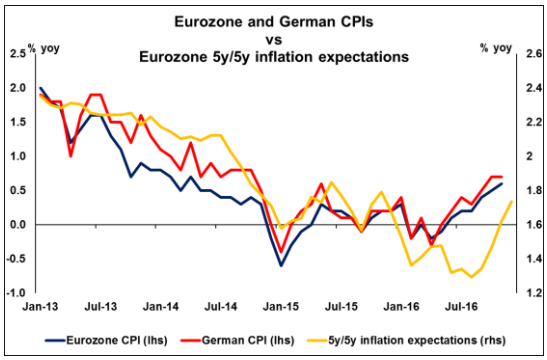
From the UK, we get employment data for November. Without any forecast available, we expect the unemployment rate to have held steady, with risks skewed to the downside, and average hourly earnings to have accelerated somewhat. Our view derives from the UK services PMI for November, which indicated the fastest employment growth since April, as well as further increases in labor costs. Looking ahead, we think that UK inflation and wage growth will be closely followed by market participants. A strong case can be made that consumers' real income growth is likely to be squeezed by rapidly rising inflation, due to sterling's post-referendum collapse. This could be a factor that weighs on aggregate demand in the UK, and thus, economic growth. Not only does rising inflation suggest slower increases in real incomes for consumers, it may also have significant impact on the BoE's rate path. The Bank has signaled multiple times that there are limits to the extent that above-target inflation can be tolerated, implying that excessive overshooting of the 2% target may force the Bank to tighten policy in order to curb inflation



In the US, December's CPI data are due for release. As with most of the other indicators this week, there is no forecast presently available. Given that the nation's ISM manufacturing and non-manufacturing PMIs both showed that prices accelerated in December, we expect the CPI to follow suit. Something like that could be another piece of data that enters the basket in support of 3 Fed rate hikes in 2017. However, as things currently stand, we maintain the view that the FOMC may deliver 2, not 3 hikes this year. We believe that the combination of a more dovish Committee this year in terms of voting rights, as well as the officials' concerns with regards to excessive USD strength may be factors that deter the FOMC from implementing the 3 hikes it penciled-in at the December meeting.

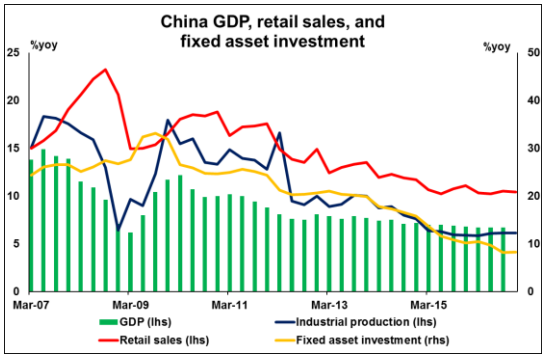


On Thursday, the ECB will announce its policy decision, followed by a press conference from President Draghi. At its latest gathering, the Governing Council extended the minimum duration of its asset purchase program until December, though at a reduced pace of EUR 60bn per month from EUR 80bn previously. Although this was initially interpreted as QE tapering, the Governing Council indicated that it's willing to increase the program in terms of size and/or duration if the outlook becomes less favorable, reassuring market participants that this is not tapering, but simply a "less for longer" decision. Given that the Bank took these actions only last month, and that in the meantime data showed Eurozone's CPI accelerated notably in December, we do not expect any action from the officials at this gathering. We think that the focus will fall on how they view the outlook for inflation following the latest surge in the headline CPI rate, which reached its highest level since 2013. However, given that the core rate rose only marginally, we do not expect this improvement to prove a game-changer for ECB policy. We believe that absent signs of a notable pick-up in underlying inflationary pressures, the ECB is likely to maintain its dovish policy stance intact for the time being.



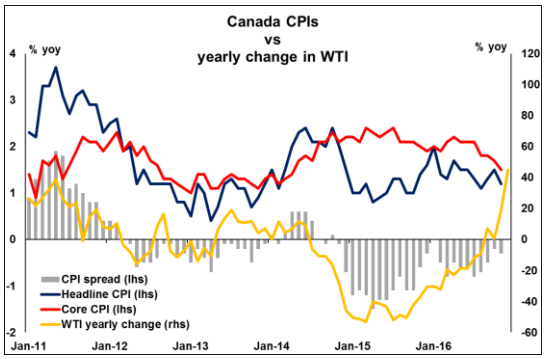
On Friday, all eyes will be turned to the US for the inauguration of Donald Trump as the 45th President. His latest press conference on Wednesday was somewhat disappointing, as he revealed nothing new regarding his upcoming fiscal or regulatory policies, something that led to a notable correction lower in USD. Given this lack of clarity, we expect investors to be on the lookout for any comments on these two key subjects once again. A confirmation that he plans to follow through with his pre-election rhetoric and push massive fiscal stimulus through Congress, as well as easing regulatory burdens, could reignite the post-election USD rally. On the other hand, if he avoids these crucial topics once again, or if his stance towards them seems less confident than pre-election, the latest pullback in USD could continue, as investors become increasingly impatient regarding the absence of details on the nation's fiscal direction. Our view is that at some point he will have to discuss these hot topics and we see the inauguration as the ideal occasion. Even if he does not dig into details, such as the size and composition of any fiscal package, we consider it likely that we get some comments on these economic issues, though the tone he delivers them in will probably be vital for the dollar's near-term performance.

As for the economic data, during the Asian morning, China's GDP for Q4 is due out. We also get the nation's industrial production, fixed asset investment and retail sales, all for December. Both retail sales and industrial production are forecast to have slowed somewhat in yearly terms, while fixed asset investment is expected to have risen at the same pace as previously. As for GDP, no forecast is available yet. Our own view is that GDP growth may have remained unchanged at +6.7% yoy with risks skewed to the downside. Our reasoning is based on the nation's trade data for the quarter, where imports rebounded on average to enter the positive territory, while exports remained within the negative area. This may have weighed on net exports and thereby, GDP growth.

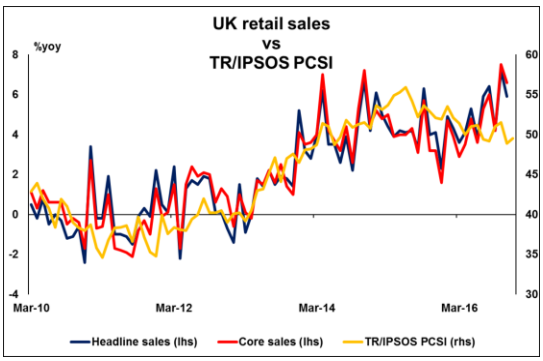


Looking ahead, we believe that China's GDP growth could slow further this year. Economic growth has been highly supported by fiscal stimulus in recent years, something that has led to a surge in the country's debt-to-GDP ratio. As a result of this, Bloomberg recently reported that high level Chinese officials such as President Xi Jinping, have instructed the Communist Party that meeting the nation's GDP growth objective of 6.5% - 7.0% is not mandatory, if doing so creates too much risk. Thus, we believe that gradually, the Chinese government is likely to wind down its fiscal stimulus, something that may lead to somewhat slower growth.

From Canada, we get CPI data for December. In the absence of a forecast, we expect both the headline and the core CPI rates to have risen, a rebound from November. We base our view on the nation's manufacturing PMI for the month, which showed that output charge inflation reached its fastest pace since May 2014. Coming on top of the nation's employment figures for the month, which overshot expectations and improved significantly, we believe that a potential rebound in the CPI rates is likely to be another piece of evidence supporting no policy action by the BoC in the foreseeable future.



From the UK, we get retail sales for December and the forecast is for the yearly figure to have accelerated, though the monthly print is expected to have slowed. The yearly forecast is supported by consumer sentiment indicators, such as the TR/IPSOS and the Gfk indices, which showed increased optimism in the month. At the same time, the BRC (British Retail Consortium) retail sales for December accelerated in yearly terms, which enhances the case for a yearly acceleration even further.



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