FP FINANCIAL PARTNERS

Weekly Digest

Week ending **31 January 2016**

Surprise, surprise. From ZIRP to NIRP

Friday saw a long overdue arrival to the topsy turvy world of negative interest rates as Japan belatedly crashed their own party. Their place at this table - and arguably at the head of it - has been laid for many years now as the Japanese economy has grappled with deflation for decades and data out last week showed that the Bank of Japan (BoJ) was not winning the battle to reach, and maintain, a 2% inflation target. Since briefly hitting that target in 2014, inflation has ebbed away as it has in most advanced economies and, for an energy importer on the scale of Japan, the fall in crude prices only exacerbates the deflationary effects. So having previous been in the ZIRP (Zero Interest Rate Policy) camp, they now join the curious but growing club of NIRP (Negative Interest Rate Policy) countries by imposing a levy on new commercial bank deposits in an effort to spur lending and spending. Never mind the metaphorical arrows, this feels like a new bow altogether, albeit one they should have drawn many years ago and ahead of their European counterparts.

Whilst Japan is certainly a long way from Europe, its policies now echo those of our neighbours. This is important in the context of trade, competitiveness and 'currency wars'; a term used to describe the beggar-thy-neighbour policy of weakening one's own domestic currency to make exports more competitive, import inflation and reduce real interest rates to stimulate the economy. The added bonus of achieving positive inflation for the Japanese is that it reduces the nominal value of their national debt, by far the highest of the developed world economies. Few central bankers will admit openly to this being a primary policy objective but certainly one outcome of a negative interest rate policy would be a weak currency as interest rate differentials reduce the attractiveness of the domestic currency.

One need only look to the weaker than expected fourth quarter US GDP numbers released last week to see the impact a strong currency can have on economic growth. Despite the US being a largely consumer-led economy and less dependent on exports to overall growth than say Germany, its manufacturing economy is now contracting at the fastest rate since the depths of the financial crisis and with the trade weighted dollar some 8% higher than a year ago (and ~20% over 18 months) exporters face a currency translation headwind that is unlikely to disappear anytime soon should the US Federal Reserve (Fed) hike again this year, let alone the three times they project. For context, the sterling equivalent trade weighted exchange rate is broadly flat over the same timeframe, although the currency's precipitous decline over the last 6 months masks its volatility.

The more immediate effects of NIRP can be seen in the ensuing sharp moves in rates and asset prices. In the hours following the BoJ's announcement on Friday the yen weakened over 2%, the 10-year government bond yield as good as halved and the Nikkei index ended the day nearly 3% higher with the shares of exporters ripping higher as those of domestic banks came under pressure. The ripple effect flowed through to other markets and gave a fillip to equities in what has been the toughest January for risk assets since the height of the financial crisis. Clear policy communication remains vitally important, as ill-judged or hastily conceived policy responses can do more harm than good (look at China's attempts to placate markets since the summer). What marked this policy change out, however, was the fact that few people saw it coming. It was a surprise. As market commentators pore over last week's Federal Open Market Committee (FOMC) statement for additions and deletions to the wording, and the European Central Bank (ECB) readily primes us (again) to expect 'no limits' to their package of stimulus measures going forward, surprise has morphed into expectation. What the BoJ did show us on Friday is that true policy surprise will still have a profound effect, perhaps more so than measured steps to the same goal (they should know). Japan appears to have played the Fed and the ECB at their own game. The question is, will Mario up his?

Source: Bloomberg. Returns in US dollars unless otherwise stated.

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The **Marketplace**

- Bank of Japan introduces negative interest rates
- Fed relatively dovish
- US GDP growth disappoints investors
- Chinese manufacturing data signals continued contraction
- Oil rises to above $35 a barrel

Market **Focus**

Global

- The Bank of Japan unexpectedly took its benchmark interest rate into negative territory (down 0.20 percentage points to -0.1%). This helped bolster equity markets, while the yen depreciated by 1.9% against the US dollar. At the time of writing the 10-year Japanese Government Bond is yielding 0.04%.
- Fixed income yields fell around the world last week, with Japanese government bonds adding 1.0% (as yields fell) in yen terms and US Treasuries rising by 0.7%. Global investment grade bonds rose by 0.4%.

US

- The US Federal Reserve struck a somewhat dovish tone at their Federal Open Market Committee (FOMC) meeting, with the earlier statement that the they were "reasonably confident that inflation will rise over the medium term" being dropped from the post-FOMC statement. Markets had expected more, however, against a backdrop of market volatility.
- US GDP grew by 0.7% on a seasonally adjusted basis in the fourth quarter of 2015, compared to economists' expectations of +0.8%. The weaker than expected print has sparked concerns that demand in the world's largest economy may be waning.

China

- China's manufacturing Purchasing Managers' Index (PMI) disappointed investors as trading resumes this week, registering 49.4 versus consensus forecasts of 49.6. This is the index's lowest print in three years, and marks a fall from the 49.7 print seen in December (a number below 50 indicates a contraction in activity).

Commodities

- Brent crude added 8.0% last week to take the global benchmark to above thirty once more. At the time of writing Brent is trading at circa $35 a barrel. Rumours that OPEC may start cutting production seem to have fuelled the rally, although this rumour was later dispelled. The general boost to sentiment that was generated by dovish central banks also helped push the price higher.

Alex Harvey, CFA & Scott Gordon

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Week ending **31 January 2016**

Asset Class/Region	Currency	Currency returns			
		Week ending 29 Jan. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.8%	-5.0%	-5.0%	-2.6%
United Kingdom	GBP	3.2%	-2.4%	-2.4%	-7.9%
Continental Europe	EUR	0.9%	-6.5%	-6.5%	-4.3%
Japan	JPY	4.2%	-7.4%	-7.4%	3.3%
Asia Pacific (ex Japan)	USD	2.9%	-7.8%	-7.8%	-18.0%
Australia	AUD	1.8%	-5.5%	-5.5%	-5.8%
Global	USD	1.7%	-6.0%	-6.0%	-6.0%
Emerging Market Equities					
Emerging Europe	USD	7.1%	-2.9%	-2.9%	-15.1%
Emerging Asia	USD	3.0%	-7.3%	-7.3%	-18.9%
Emerging Latin America	USD	7.6%	-4.6%	-4.6%	-32.4%
BRICs	USD	3.4%	-10.0%	-10.0%	-24.3%
MENA countries	USD	6.4%	-11.3%	-11.3%	-25.5%
South Africa	USD	10.8%	-3.7%	-3.7%	-31.9%
India	USD	1.5%	-7.1%	-7.1%	-22.0%
Global emerging markets	USD	4.5%	-6.5%	-6.5%	-21.8%
Bonds					
US Treasuries	USD	0.7%	2.2%	2.2%	0.6%
US Treasuries (inflation protected)	USD	1.3%	1.5%	1.5%	-2.8%
US Corporate (investment grade)	USD	0.4%	0.4%	0.4%	-2.8%
US High Yield	USD	1.1%	-1.6%	-1.6%	-6.6%
UK Gilts	GBP	1.6%	3.9%	3.9%	0.4%
UK Corporate (investment grade)	GBP	0.9%	1.2%	1.2%	-2.2%
Euro Government Bonds	EUR	1.1%	2.0%	2.0%	1.6%
Euro Corporate (investment grade)	EUR	0.8%	0.6%	0.6%	-0.7%
Euro High Yield	EUR	0.8%	-1.2%	-1.2%	-1.2%
Japanese Government	JPY	1.0%	1.5%	1.5%	2.8%
Australian Government	AUD	0.5%	1.4%	1.4%	2.0%
Global Government Bonds	USD	0.4%	1.5%	1.5%	-1.2%
Global Bonds	USD	0.4%	1.1%	1.1%	-1.6%
Global Convertible Bonds	USD	0.3%	-4.5%	-4.5%	-4.1%
Emerging Market Bonds	USD	1.3%	0.6%	0.6%	1.9%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 29 Jan. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	0.8%	-3.4%	-3.4%	-10.2%
Australian Property Securities	AUD	1.9%	1.0%	1.0%	2.2%
Asia Property Securities	USD	5.1%	-8.4%	-8.4%	-9.2%
Global Property Securities	USD	2.3%	-5.1%	-5.1%	-9.9%
Currencies					
Euro	USD	0.3%	-0.2%	-0.2%	-4.3%
UK Pound Sterling	USD	-0.2%	-3.3%	-3.3%	-5.5%
Japanese Yen	USD	-1.9%	-0.7%	-0.7%	-2.3%
Australian Dollar	USD	1.2%	-2.8%	-2.8%	-8.7%
South African Rand	USD	3.6%	-2.6%	-2.6%	-27.3%
Swiss Franc	USD	-0.6%	-2.0%	-2.0%	-9.7%
Chinese Yuan	USD	0.1%	-1.2%	-1.2%	-4.9%
Commodities & Alternatives					
Commodities	USD	3.1%	-3.9%	-3.9%	-22.8%
Agricultural Commodities	USD	-0.3%	-1.6%	-1.6%	-10.3%
Oil	USD	8.0%	-6.8%	-6.8%	-29.3%
Gold	USD	1.8%	5.3%	5.3%	-11.1%
Hedge funds	USD	-0.5%	-3.4%	-3.4%	-6.6%

* Estimate

Source: Bloomberg

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