SWISSQUOTE

WEEKLY REPORT

13 - 19 October 2014

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Economics — Australia's housing market puzzle

Event-full week in Australia

It has been a data-full week for AUD-trading. On Tuesday policy meeting, the RBA maintained its overnight cash rate target unchanged at 2.50%, stating that the drop in the Aussie is still insufficient to boost the economic recovery. In his speech, RBA Governor Stevens voiced his discomfort regarding the unbalanced growth in lending for housing assets and mortgage markets, despite a moderate overall growth. Data on Friday confirmed Stevens' fears. The home loans fell 0.9% in month to August; the owner-occupier loans (desired ones) dropped 2.0%, but the investment lending contracted only by a tiny 0.1%. Although the AUD traded ranged following the absence of detail regarding RBA tools to cool off the housing market, the expectations for macro-prudential measures should temper the AUD weakness in coming months.

Australia's jobs and housing market: a sizeable paradoxe

The Australian housing paradox remains an important puzzle. As the mining industry slows, the Australian policymakers' efforts to shift the labor force from the mining to construction require an attractive housing market. While on the other hand the unbalanced growth in home loans threatens the stability of economic recovery. The introduction of macro prudential measures are needed to cool off the unbalanced growth in the home lending and mortgages markets; yet may have a negative impact on the underlying labor market. The RBA action needs a quality fine-tuning to avoid macro-damages. Investors still wait (and need) to hear more on RBA solutions.

Regarding the labor market, above-mentioned structural shifts introduce important swings in seasonal patterns, thus contaminate the employment reports. This week, the Bureau of Statistics revised down the surprise surge in August employment from 121K (seasonally adjusted) to 32.1K (non-seasonally adjusted). The September data showed 29'700 jobs lost (nsa), due to 51'300 drop in part-time jobs. The full-time jobs increased by 21'600. The seasonally adjusted data will be published from October. Traders need stability to re-start trading on jobs data.

FX Markets

BRL volatilities escalate on run-off polls

Run-off polls favor Neves victory

The President Dilma Rousseff obtained 41% of votes on the first round of elections on October 5th. Marina Silva, the pro-market candidate and Rousseff's main challenger, disappointed with 21% of votes. Aécio Neves achieved a spectacular 34% and will face Rousseff on October 26th runoff. The BRL post-election rally triggered important volatilities through the week to October 10th. USD/BRL gap-opened the week at 2.3689 (vs. Friday Oct 3rd close at 2.4584) and traded in the wide range between 2.3601/2.4328.

The volatilities in BRL escalated on political scenarios and run-off poll results. As Brazilian election talks hint at a tight competition between Dilma Rousseff and her challenger Aécio Neves, the first Brazil runoff poll printed 49% of participants in favor of Neves vs. 41% for Rousseff. The USD/BRL 1-month implied vol spiked above 23% and the BRL jitters are expected to continue / increase walking into October 26th run-off.

Brazilian CPI accelerates to 6.75% in September

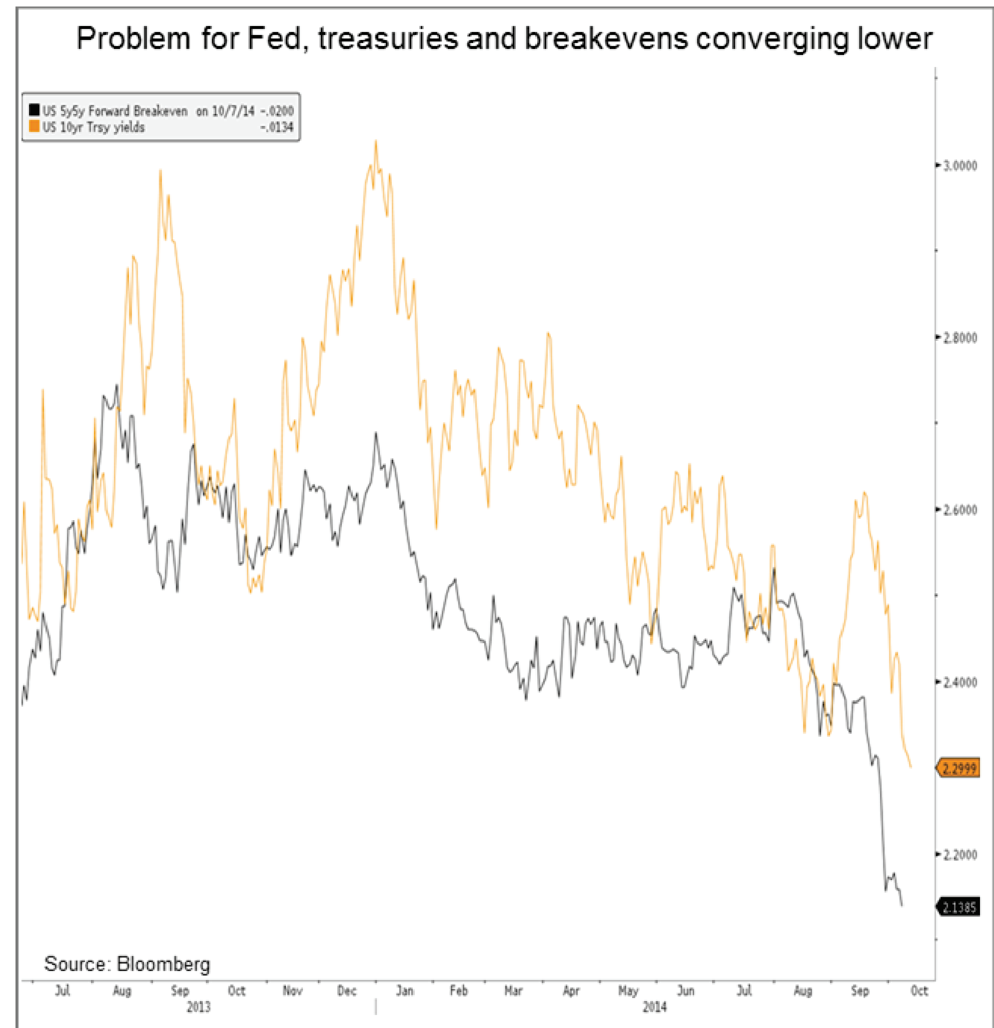
While traders are mostly concentrated on the presidential elections, the macroeconomic data attracted little attention in week to October 10th. Yet the inflation print is rather alarming and is worth comment given that, as soon as the election euphoria is over, the FX adjustments should mostly depend on economic data. In this respect, we ring the alarm bell on deterioration in Brazilian economy. The Brazilian inflation accelerated to 6.75% on year to September, beating the consensus at 6.65% y/y. The quickening inflation is worrying especially as the consumer prices are now accelerating above the BCB's target band (4.5% y/y, +/-2%) while the GDP growth turns negative (-0.6% q/q in 2Q) and the current account balance deteriorates. Moving forward, the increase in Fed-related volatilities, the presumed USD strength as Fed approaches policy normalization, the expected capital outflows from the EM and the BRL sensitivity to UST and USD should further weigh on the BRL. Is another Selic rate hike underway despite alarming growth? The answer is due on October 29th.

Economics

Don't get fooled by any short-term USD weakness

The combination of the recent USD sell-off and Fed's reference to the greenback in the FOMC minutes suggests that the pace of appreciation should slow. However, the USD mid and long-term trend should remain bullish. Here are a few reason why.

Clearly, currency prices are playing a bigger part in policy decision and now the Fed has entered the area generally reserved for EM central banks. Yet although the USD appreciation is considered sharp, by most measures the currency is not overvalued. While USD is now within the policy debate it's unlikely that the Fed will act in order to manage further appreciation.
The dominate driver of USD strength has been its performance against the Euro. The expectations for policy divergence remains intact. Last week as both the ECB Draghi and Nowotny reinforced the view that current measures could be enlarged irrespective of effect on their already bloated balance sheet. In addition, recent weak economic data out of Germany indicates that Eurozone conditions are deteriorating, demanding a strategy now.
Finally, withstanding short-term volatility and knee-jerk uncertainty over the Fed strategy, committee member are on track to lift rates mid-2015. When you remove the hype there are three considerations: inflation, growth and financial market stability. Inflation will remain a headache for the Fed with strong US and falling inflation expectations, but with wage growth grinding higher and unemployment dropping, disinflation is unlikely. The growth side could cool moderately but remains in a strong position. In our view the biggest x-factor is the reaction of the removal of QE by the financial markets. US treasury yields have been uncharacteristically stable considering impending hikes. We suspect that the actions by the BoJ and specifically the ECB will keep the bond market rallies contained, lessening the probability for financial market distortion and allowing the fed to tighten very slowly.



FX Markets

USD/JPY and EUR/USD are expected to consolidate

Recent FX trends likely to take a breather

The recent steep price actions in EUR/USD and USD/JPY have made Fed officials and Japanese top executives more vocal on the negative effects of a too sharp move in their respective currencies. Coupled with the overextended moves in EUR/USD and in USD/JPY and the elevated IMM net short positions in EUR and JPY, a consolidation phase is likely in the coming weeks. However, these consolidations are not expected to derail the underlying trend. As a result, further long-term weakness in EUR/USD and strength in USD/JPY are expected, though at a more gradual pace.

USD/JPY has weakened near its major resistance at 110.66

An additional obstacle for an immediate rise in USD/JPY comes from the long-term resistance at 110.66 (August 2008), which also roughly coincides with the psychological threshold at 110. To assess the downside risk of a countertrend move, let's look at Fibonacci retracements from the May-October rise. The 38.2% retracement is at 106.55, which is close to the key support at 106.81 highlighted in our last report, represents the first attractive entry point. The 50% retracement at 105.46, which coincides with the previous high at 105.44 (02/01/2014 high), is the second attractive entry point. A deeper decline is unlikely given the high positive correlation between the Nikkei 225 and USD/JPY and the fact that there are clear incentives for Mr Abe to support the stock market.

EUR/USD has seen some pick-up in buying interest

EUR/USD has bounced recently after having reached the 1.2500 threshold. The strong resistance at 1.2995 is unlikely to be broken, especially as the ECB is deploying measures to expand its balance sheet and the negative prospects from the Catalonia referendum on 9 November. As a result, the resistance at 1.2901 (23/09/2014 high) could even succeed in capping any strength in EUR/USD in the coming weeks.

Stock Markets

Stock markets are getting increasingly fragile

Stock markets are getting more fragile

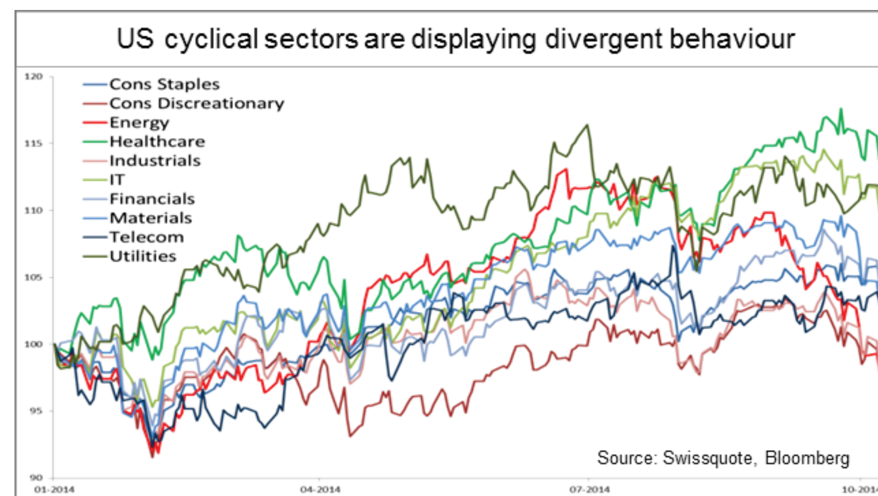
True to its reputation of being the worst month for US equities, September ended with a negative monthly performance and aggravated worries about selectivity in the stock market. Even if the S&P 500, representing US large cap, does not show any significant bearish reversal pattern, we are more concerned by the break of the support at 1356 (01/08/2014 low) in the S&P 400 Midcap. Indeed, a four-month double-top formation is in place, which does not bode well for the performance of US stocks that are smaller than large cap. Furthermore, European indices like the STOXX Europe 600 and the DAX are dangerously close to validate multi-months bearish reversal patterns.

Segmentations also visible in sectors

Looking at YTD performance of US sectors, we can see different market behaviours. The leading pack is composed of IT, health care (biotechs) and utilities. The first two sectors have outperformed thanks to their superior growth prospects. However, the lagging pack is composed of consumer discretionary, industrials and energy. The fact that cyclical sectors (which tend to do well when the economy is growing) like consumer discretionary and industrials are not participating confirms the selectivity issues that are plaguing the market.

Seasonality at the rescue?

Despite worsening technical configurations, a robust US growth outlook and the fact that Eurozone and Japan are under heavy medications should offer some support to stock markets. Furthermore, US stock market seasonality is getting more positive in October (the "bear killer"), November and December (the last two months are the most bullish two-month period in US market). However, any year-end rally could be short-lived unless some broad improvements in participation occur rapidly.



FX Markets

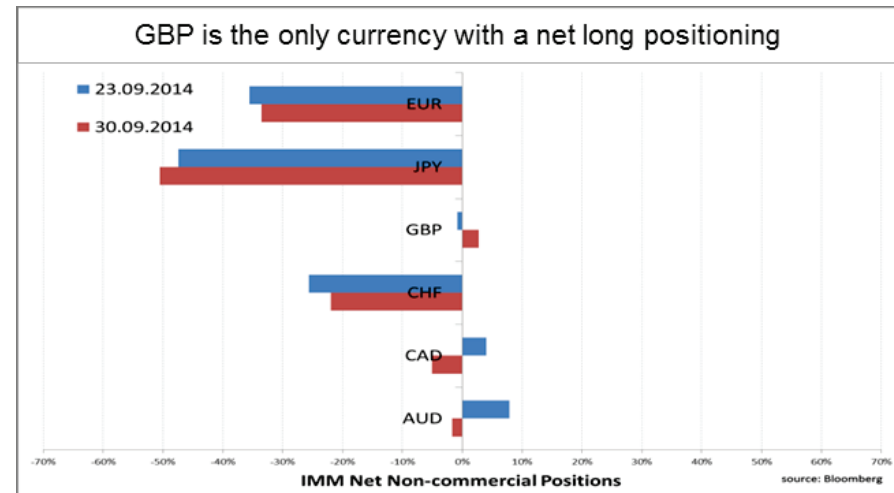
Positioning favours USD consolidation

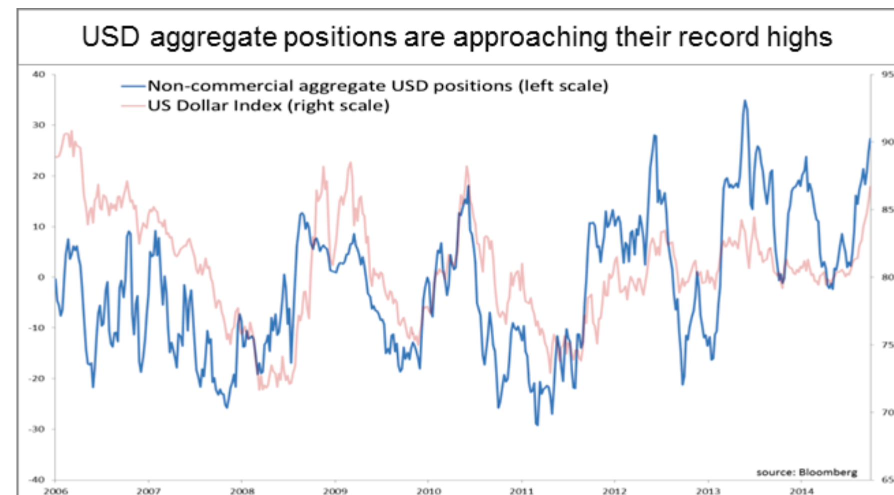
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 30 September 2014.

With the exception of the British pound, all currencies have net short positions against the US dollar. The resulting effect is that aggregate USD positions are getting closer to their highest levels (seen in May 2013). However, with the recent disappointments in term of dovish stance from the Mr Draghi and Mr Kuroda, a consolidation phase in the US dollar is getting increasingly likely.

Concerning commodity currencies, as net long positions in Australian and Canadian dollars have been wiped out, any further weakness in these currencies will be not be supported by long AUD or CAD unwinding. As a result, it is worth monitoring the strong support at 0.8660 (24/01/2014 low) in AUD/USD and the strong resistance at 1.1279 (20/03/2014 high) in USD/CAD.





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