SWISSQUOTE

WEEKLY MARKET OUTLOOK

3 - 9 November 2014

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Swissquote Bank SA | Ch. de la Crétaux 33, CP 319 | CH-1196 Gland | Switzerland
Tel +41 22 999 94 11 | Fax +41 22 999 94 12 | forex.analysis@swissquote.ch | www.swissquote.com/fx

WEEKLY MARKET OUTLOOK - An overview

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Economics

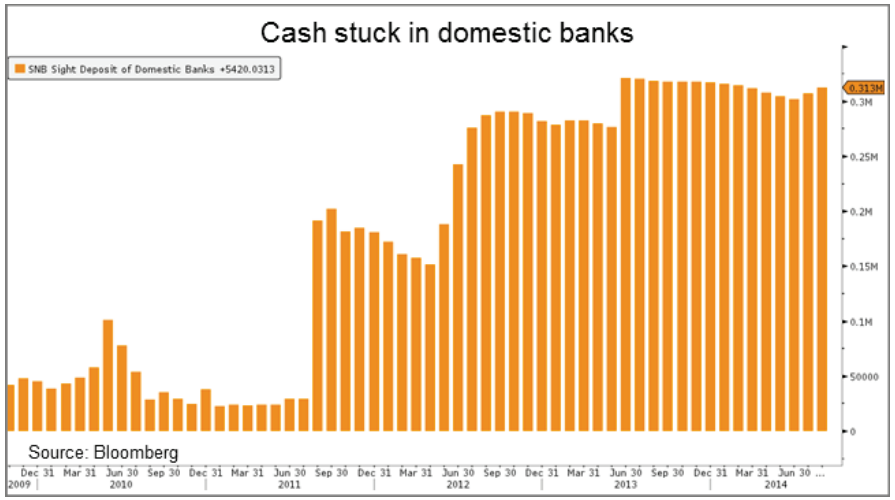
Getting tricky for the SNB

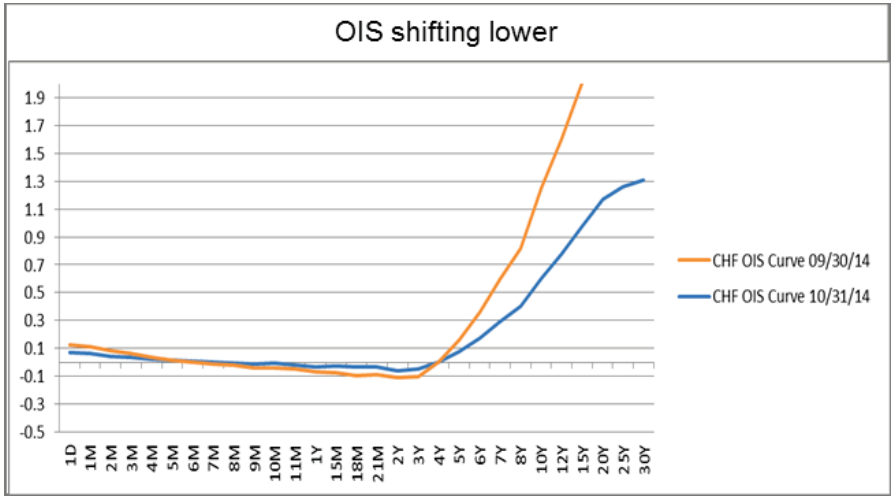
EURCHF on a collision course with EURCHF "floor"

EURCHF continues to grind lower, increasing the speculation that it's only a matter of time till the SNB will have to step-up and defend the EURCHF "floor". On the fundamental front, given the erosion in European economic data it's increasingly likely that the ECB will engage in some type of policy that will debase the EUR (potentially expanding the banks' balance sheet by as much as €1 trillion). The recovery of Swiss KoF leading indicator to 99.8 from 99.1 indicates that pace of economic cooling remains mild. Finally, despite the FOMC ending QE, guidance indicates that the zero interest rate policy would remain "for a considerable time", meaning the upward moment in USD should taper. Overall, it's unlikely that strength in USD will outweigh weakness in the EUR hence creating demand pressure on the CHF (pushing EURCHF to 1.20).

Domestic Savers holding CHF

While safe-haven flows have eased according to SNB data, the CHF remains in uncomfortable high demand. With strong domestic demand keeping the CHF elevated vs EUR, the SNB will have a difficult time protecting EURCHF floor with any other tool except direct FX intervention. Negative interest rates, the most likely second response to any threat against the minimal exchange rate, becomes politically difficult when directed against domestic savers and when not targeted at foreign speculators. Changing domestic investor's liquidity choice is a significantly problematic proposition. Particularly when global yields provide little natural incentive to lure investors out of the relative safety of CHF. In addition, we don't know in the context of global low yields how effective driven rates negative would actually be, but perhaps would only drive domestic investors into an already white hot real estate market. Options available to the SNB are becoming scarcer and the reality of a collision between the market and the SNB is growing. Watch for EURCHF to head lower.

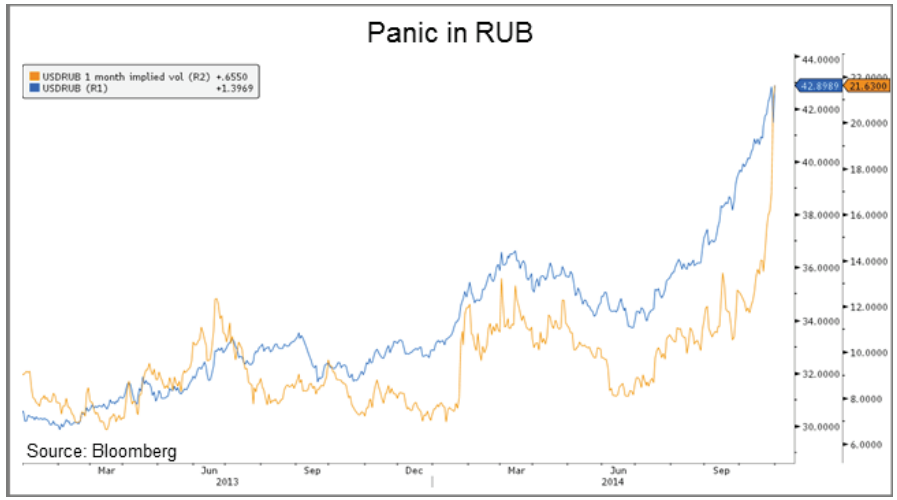


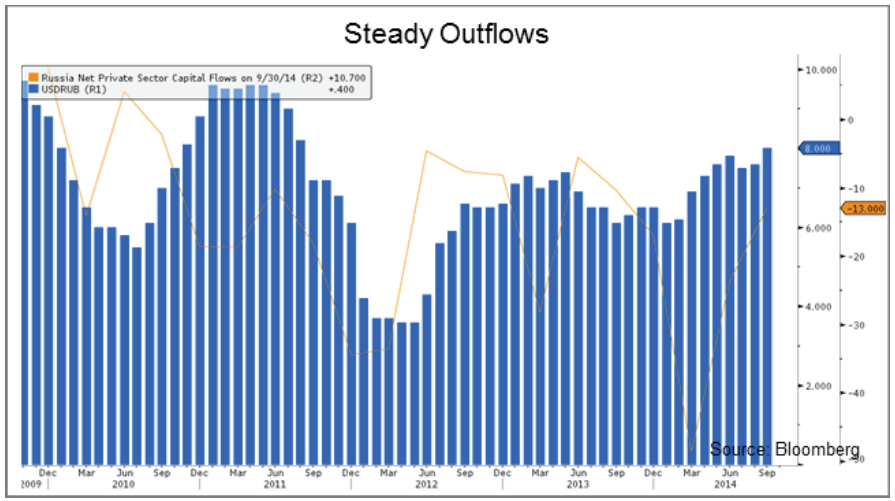


Economics

Hike unlikely to stop RBL fall

Volatility has been increasing in the RUB, but went recently ballistic. Since September, RUB has lost nearly 29% vs USD (13% vs CBR basket). The aggressive RUB depreciation is the primary reason for the monetary policy tightening. In a somewhat surprise move (we had anticipated 75-100bp) the Central Bank of Russia hiked its policy rate by 150bp to 9.50%. Anything smaller was unlikely to halt the current flight from RUB, help stabilize the financial instability taking place and provide credibility in the CBR ability to target inflation. Outside of the rate adjustment, there was plenty of market speculation that the CBR possibly could give up intervention mechanism completely and thereby letting the RUB freely float. Yet despite market concerns there was no adjustment to FX policy. For the last 3 months, RUB has consistently reached the upper-bound of the CBR non-verbal band which has force the CBR to raise the upper after intervene with $350mn before adjusting the non-intervention band by RUB0.05. According to external analysis this would suggest that the CBR has already interview to the tune of $24bn in October alone. Clearly this is an unsustainable rate. However, given the near panic like RUB trading currently, a sudden move towards a free-float would have only exacerbate the current flight from RUB. We see the lack of announcement today as a delay tactic. Postponement would see the improvement in current account due to winter fuel export revenue and avoid the colliding with external debt repayments allowing a more stable transition.
There seems to be two key reasons why RUB continues be deprecate. First is the weakness in oil prices which is the backbone of the Russian economy and second is the private sectors attempt to build up a reserve of FX ahead of Q4 debt repayments. And this is occurring with a backdrop of an unresolved situation in Ukraine and corresponding western sanctions. Overall we don't see either of these situations getting resolved near term. Therefore this large rate hike is unlikely to curb inflation and steady exodus from RUB. The overall tone of the MPC statement indicates that they stand ready to raise rate further should inflation outlook worsen (or RUB sell-off continued). We suspect we have not seen the end of either





FX Markets

Range-bound EUR/TRY profits to carry traders

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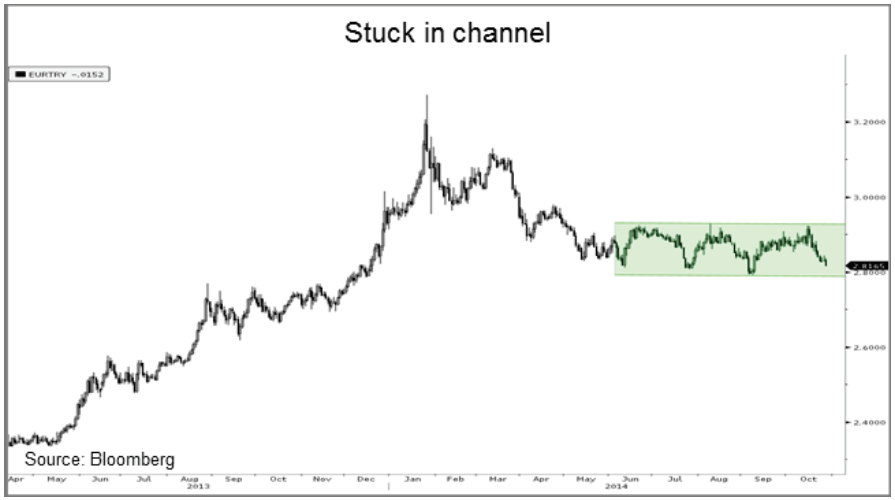
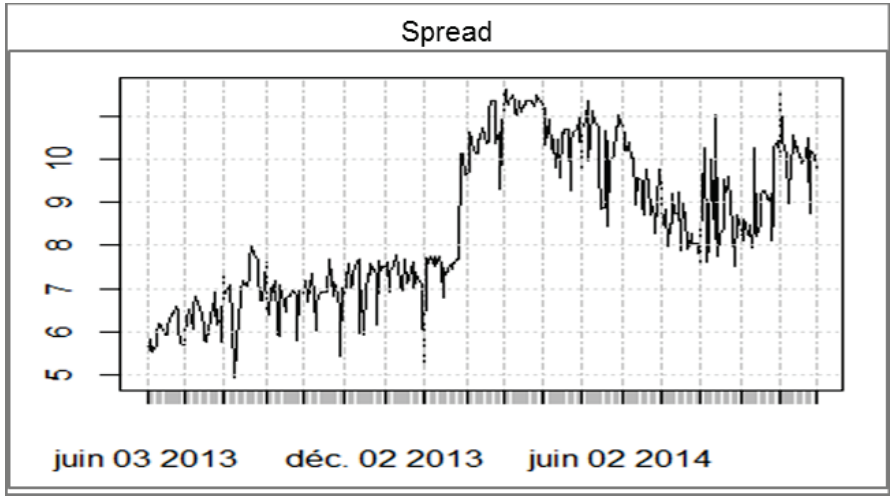
The EUR/TRY hit the record high on January 27th following a market revolt against the so-judged unconventional and inadequate monetary policy. After an emergency meeting, the Turkey Central Bank proceeded with significant rate action on January 29th and pulled the one-week repo rate from 4.50% to 10.00%, and shifted the overnight borrowing / lending corridor from 3.50% / 7.75% to 8.00% / 12%. Combined to the introduction of massive easing from the ECB (TLTRO, ABS & covered bond purchases and negative deposit rates), EUR/TRY stabilized at 2.80-2.93 band since June 2014. The EUR/TRY tested 2.80 bids on September as the ECB cut the deposit rate for the second time to -0.20%.

Higher interest rate spread

Given the rate differential, the short-term long-EUR/TRY strategies have undoubtedly become interesting. The spread on overnight deposit rates is significantly advantageous for EUR/TRY carries. However the EUR/TRY long positions carry important FX risk: carry strategists should be aware of the high carry unwind risk in EUR/TRY positions. The high yielding EUR/TRY holdings are only recommended for risk-lovers. The 1-month EUR/TRY implied volatility (computed on 1-month ATM options) has ranged from 10-15% over the past year. This picture includes Turkey's political, geopolitical and macroeconomic risks. And the above-mentioned risks persist.





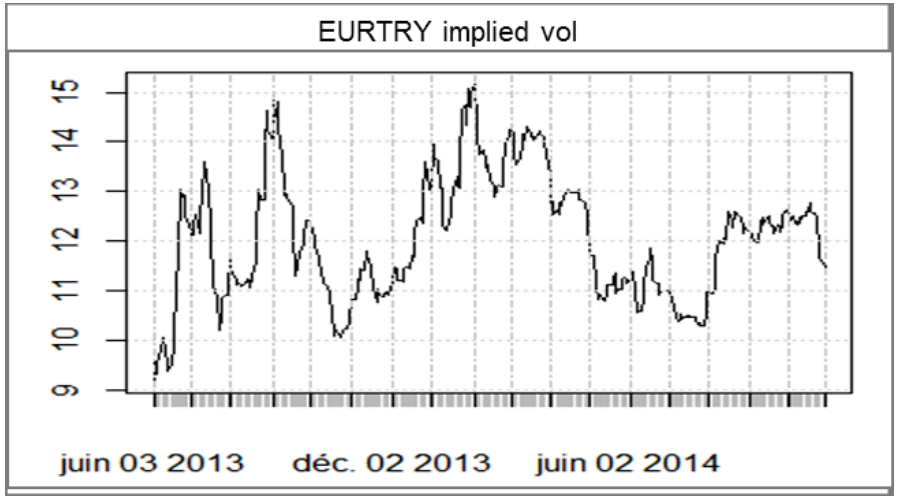
FX Markets

EUR/TRY: The key risk is the carry unwind

Short-run versus Long-run

In the short-run, the international capital flows and technical indicators should be actively monitored to detect the periods of carry unwind. Over the past six months, the mean-reverting behavior of EUR/TRY has been profitable for TRY holders. Trend and momentum indicators remain marginally bearish as EUR sentiment remains globally negative. We keep our short-term bearish view as long as the 200-dma (currently at 2.9218) holds. Option barriers are placed below 2.85 for the month ahead.

In the longer-run however, the TRY is subject to large set of risks (political, geopolitical and macroeconomic risks). A breakout above the 2.93 range top should signal a mid-run bullish reversal pattern, in which case the rate spread will be insufficient to cover the FX risk and EUR/TRY long positions should be closed.



FX Markets

Riksbank interest rate at 0% for the first time in history

The Riksbank cut the interest rate by 25 basis points, from 0.25% to 0.00% (vs 15 bp cut expected) in an effort to temper the deflationary fears due to moderate Euro-zone growth and ultra-lose ECB policy. In post-decision communiqué, Riksbank said "[…] the economic activity is continuing to improve. But the inflation is too low. The Executive Board of the Riksbank has therefore decided that monetary policy needs to be even more expansive for inflation to rise towards the target of 2%." The Riksbank will not raise rates until the inflation clearly picks-up according to official statement; the Swedish policy makers think it "appropriate to slowly begin raising the repo rate in the middle of 2016". The aggressive rate action sent USD/SEK above the 7.3285 resistance (2012 high), the pair rallied to 7.36 in a single move. The move will likely find ground at 7.30+ against USD. We target an advance towards 7.52s – 2010's symmetrical shoulders top – walking into 2015.

EUR/SEK rallied to 9.3483 for the first time since July 3rd. Weaker EUR convictions capped the rally pre-9.40 resistance. The RSI advanced to 68%, the 30-day upper Bollinger band (9.2743) has been significantly left behind. Nearing the overbought conditions, we see a cool-off in upside attempts. The key resistances are placed at 9.3887 (July 3rd high), 9.3979 (2011 high), 9.4275/84 (Q4, 2010 resistance). On the longer-run, we believe that the determination of Riksbank to counter the ultra-lose ECB policies should determine the preference versus the euro. The 3-month cross currency basis fades towards zero, suggesting a bigger focus on interest rate differential. In this context, the ECB's unconventional tools (ABS, covered bond purchases, TLTROs) will no wonder keep the upside challenging for the EUR/SEK.

Economics

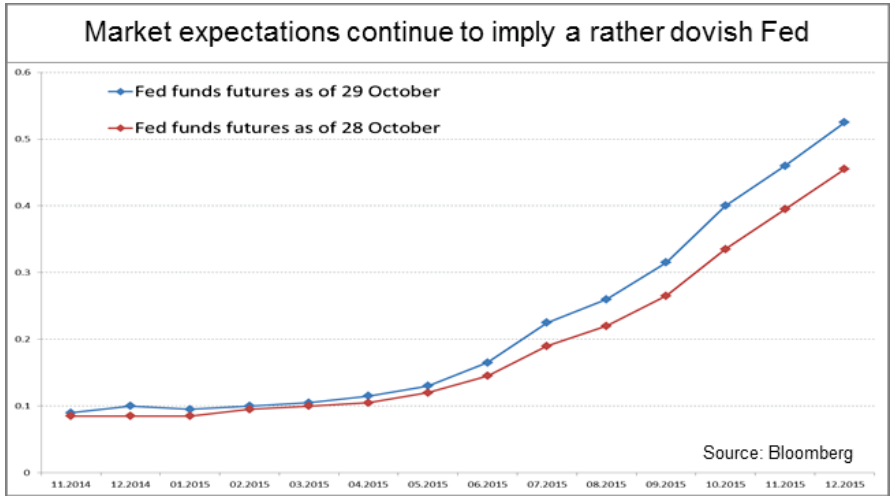
The QE3 is dead, long live the US dollar

The Fed acknowledges the improving labour market

As previously announced by the Fed, the open-ended quantitative easing (QE3) launched in September 2012 has been fully tapered in October. More surprising was the tone of the Fed statement, which leaned on the hawkish side despite the recent concerns on the global growth outlook. Indeed, the US growth expectations have been slightly improved, as fiscal policy is not mentioned as a potential drag anymore, and the description of the US labour market was upgraded, as the "underutilisation of labour resources is gradually diminishing". On the inflation side, the outlook was not downgraded, despite the negative effects notably stemming from lower energy prices, as the Fed continues to perceive a diminishing likelihood for inflation to run below 2% since early 2014. Overall, even if this more positive statement can also be seen as a justification to end QE, it nonetheless signals that the Fed clearly acknowledges the improving job market.

Rate hike timing depends on data

The Fed is still ready to wait for a "considerable" time before raising rates, suggesting that a rate hike in the next six months remains unlikely. However, as the Fed has clearly stated that the timing will depend on incoming data, the start of the tightening cycle is surrounded with considerable uncertainties. Given the overall hawkish tone of the Fed's statement, a June 2015 rate hike remains the most likely outcome. However, market expectations continue to lean towards a later hike and remain well below the median expectations of Fed officials, which was at 1.38 in September. As a result, the odds to see a hike sooner than what is expected by the market are likely greater than the odds to see a later hike, which suggests that a long USD position remains attractive in the mid- to long-term time horizon.



FX Markets

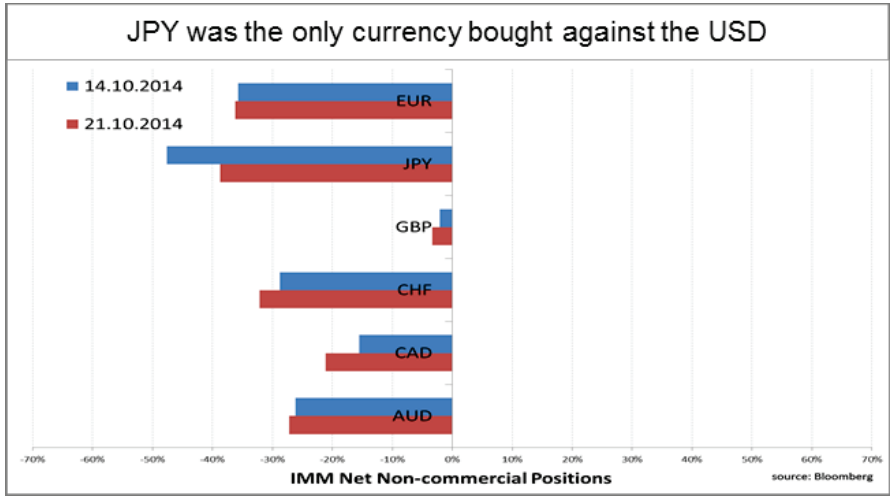
JPY short positions unwound before BoJ easing

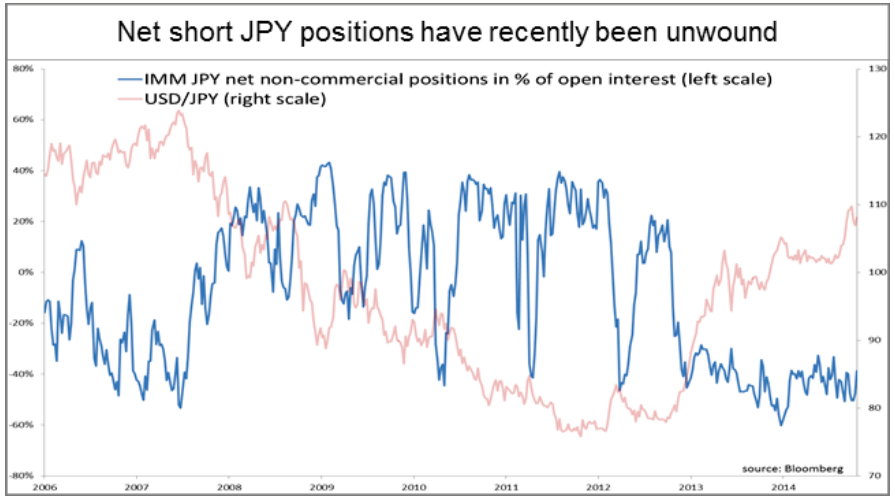
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 21 October 2014.

The buying interest in USD has a bit faded as can notably be seen by the slight increases in net short EUR and AUD positions and the significant decline in net short JPY positions.
Given the additional stimulus launched by the Bank of Japan, the resulting rise in USD/JPY is likely to meet less obstacles from positioning. Concerning EUR/USD, prices remain significantly exposed to any upside volatility, as EUR short positioning has not really eased despite the recent bounce in prices. As a result, further short-term decline in EUR/USD is heavily dependent on ECB monetary actions.

The decline in net AUD positions is slowing. Coupled with the recent successful test of the key support at 0.8660 (24/01/2014 low), an unwinding in net short AUD positions is likely needed before any new sustainable decline in AUD/USD.





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