SWISSQUOTE

WEEKLY MARKET OUTLOOK

17 - 23 November 2014

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WEEKLY MARKET OUTLOOK - An overview

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FX Markets

Political Drama pushed USDJPY to New Highs

USDJPY surged higher this week despite technical expectations for a period of basing around the 114.00 level. The pairs bullish uptrend has been fueled by speculation around policy and politics. And for all but the most savvy Japanese insider, things have been extremely mystifying and opaque. The two primary issues swirling around are the consumption tax increase and the timing of the call for a general election.

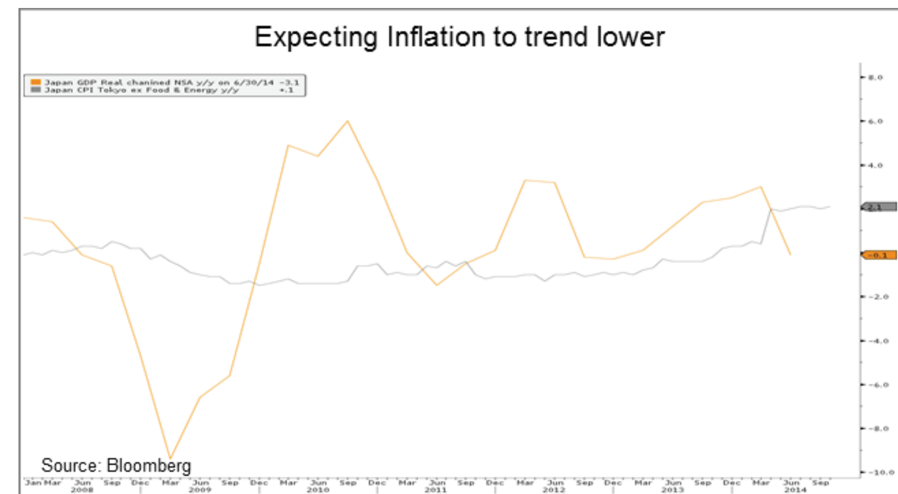
Vat & Snap Elections

By the most recent reports, Prime Minister Shinzo Abe is preparing to postpone the October 2105 VAT hike, conceivably for 18 months, out of apprehension for an already decelerating economy, according to Nikkei. According to senior government officials Abe has reportedly stated that he would be moving toward delaying the tax from 8% to 10% and would decide as soon as next week. So far this is the clearest signal of Abe's policy path we've received. We suspect Abe is waiting to see next week’s (Nov. 16th) GDP report before announcing his decision (despite Cabinet members denial, we are marginally confident the decision has already been made). Should real GDP drop below the 2.0% level, the VAT tax will most likely be delayed. Expectation is growing for a delay which is helping the Nikkei outperform.

On the political front, after (potentially delaying) the consumption tax, Prime Minster Abe the populist will likely take a daring political gamble, halfway through his current term, and call a snap election. The strategy is simple, delaying the unpopular tax will buy him some political capital, enough to increase the LDPs majority in the lower house. However, the strategy carries inherit risk that Abe loses seats and could face calls to step-down.

Weaker JPY as the Drama unfolds

Our expectation on par with this speculation goes like this: real GDP falls to 2.0%, Abe announces the delay of the consumption tax then soon after calls for a snap election. This chain of events should trigger additional JPY selling. As for the USDJPY extensions of bullish moves above 116.10 suggests a broader move to 117.5 (Dec 2007 high) then 124.15 (June 2007 high). The WSJ reported that a Abe insider says USDJPY at 125 would make the PM nervous, but we doubt it would halt his target.



FX Markets

EUR/CHF attractive for a "no" in Swiss Gold Referendum

It has been a heavy week for the EUR/CHF. As the propagandas for the Swiss Gold Referendum gain pace, the leveraged FX flows and put options weigh on the EUR/CHF spot markets. The 1.20 floor is dangerously at target. The BNS did not intervene to cool-off the pressures at the time of writing but the intervention risk is not ruled out depending on how low traders will push the EUR/CHF. The interest rate futures consolidate above par, hinting at the surge in negative rate speculations.

The collection of votes has already started, the results will be published on November 30th. All seven political parties stand sharply against the initiative, except the UDC – Union Démocratique du Centre – which indeed came up with the idea that the SNB should keep 20% of its reserves in physical gold. As we move on, news reveal that UDC's central committee is also in the "no camp" (35 no votes vs. 34) while in the Parliament, less than 50% of UDC representatives are in favor of a "yes" vote. This situation is nothing new for the UDC, the party is regularly subject to divergent opinions regarding economic subjects. Although the UDC pretends to be the Central Democratic Union, the party is rather known for its right-tendency opinions and most often attacked on its extreme right purposes. However, the paradox in the heart of the UDC is an important signal for the Swiss voter: even the instigators of the project are not sure that this is the right direction to go. For the UDC President Toni Brunner, the differing opinions are nothing else than a sign of healthy democracy. He insists that the proportion of "no" voters in UDC remains small.

Originator Committee play on national feelings

The UDC supporters at the origin of the initiative base their propaganda on heavy nationalist arguments. "Following the massive pressures exercised by Americans, we have all of a sudden declared that 1550 tons of our reserves were excessive" argue instigators, and liquidated this quantity at "miserable" price. "This should never happen again. Gold is not a Monopoly currency at disposal of politicians and bankers. The product of past generations hard work belongs to the population." The originators also express their disapproval to hold foreign debt as "investment". These holdings are said to be "not real values".
In opposition, the government and a clear majority of Swiss Parliament's both chambers base their arguments on solid economic analysis. The SNB is mandated to ensure the price and financial stability and is successfully fulfilling its goals. The commitment to stock 20% of the SNB's assets in physical gold will squeeze the Bank's capacity to fulfill its mandate and may reduce its credibility. Federal Council adds that two thirds of SNB benefits are distributed to cantons, one third to the Confederation, and warns that the nation's income would also be harmed by the introduction of such constraint.

It is time to play it clever!

The tensions in Switzerland have been mounting over the past weeks due to unexpectedly balanced election polls on the Gold Referendum. However we believe that the rational will finally win over the Swiss gold debate. In our opinion, the markets have gone well beyond themselves. EUR/CHF edges the oversold conditions (RSI at 30%), the 1-month implied volatility advanced to 4.45%, highest levels over more than a year. The 1-month (25-delta) EUR/CHF risk reversals became quite negative as demand for put options increased overly. The rational calls for action. Given our biased view in favor of a "no" outcome, we believe that there is opportunity in the topside OTM calls. On the spot markets, EUR/CHF is seen at optimal entry levels for long EUR/CHF positions.

FX Markets

Improving macro-metrics favors the lira

Turkish current account deficit narrows, EUR/TRY weakens

Turkey printed 2.22 billion dollar deficit in September verse -2.60bn expected and -2.77bn last. A solid combination of internal and external factors push Turkish CAD lower since early 2014. The lower, yet less volatile lira, and fading domestic demand in one hand, the slide in energy and commodity prices on the other hand act certainly in favor of Turkey's balance of payments. In addition, the recent dovish shift in G10 monetary policy stance played in favor of short-term financing as concerns on geopolitical tensions eased over the past months.

The attractive macro environment pulled EUR/TRY to 11-month low of 2.7564 on October 31st. The further slide in oil prices and the fresh BoJ stimulus should bring further improvement to Turkey-metrics before the year end. The 3-month cross currency basis develops in favor of TRY verse EUR. This picture tells that the FX risks are being offset by attractive spread differential. Despite prevailing geopolitical risks, a further decline in TRY volatilities should keep the appetite in short-term TRY holdings. The 1-month implied volatility declines to 8.16% versus an 12-month average of 10.38%. We look to benefit from rate advantage as long as volatilities decline and the 200-dma (2.9037) holds.

Central Bank verdict on November 20th

This being said, the overall situation is a real temptation to ease the monetary policy for the Central Bank of Turkey. The MPC will meet on November 20th and is widely expected to keep its rates unchanged. However we see opportunity for surprise rate decision. In our view, besides the favorable global macro conditions, the down-trending core inflation (ex-energy, food and alcoholic and non-alcoholic beverages and gold) increase the probability for a 25 basis point cut in benchmark repo rate to 8.0%. The overnight corridor is expected to remain unchanged at 7.50%/11.25%.

Commodities

A technical take on precious metals

Long-term technical structures call for further weakness

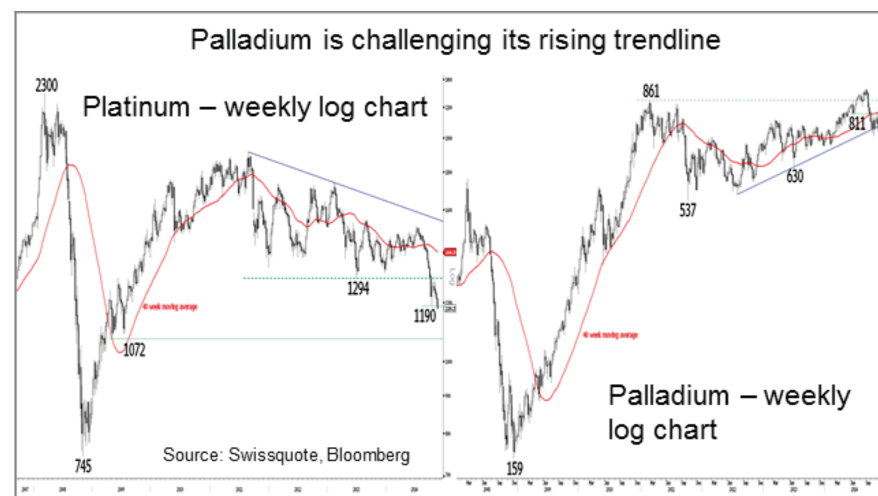
Looking at long-term price configurations of precious metals, three (gold, silver, platinum) out of four have validated multi-months distributive patterns since September. The duration of these bearish patterns and the implied downside risks suggest that a bottom in this commodity segment has likely not been made yet. Palladium has also declined sharply since September but the long-term succession of higher lows remains intact, as can be seen by the rising trendline. However, a break of the resistance at $811 is needed to alleviate concerns of an upcoming second leg lower.

Gold likely to decline towards $1045

The bearish breakout at $1181 in gold has validated a 16-month declining triangle formation, calling for a decline towards the key support area between $1045 (05/02/2010 low) and $1027 (29/10/2009 low). In the shorter term, the recent rebound has thus far been unimpressive. As a result, the resistance at $1194 (given by the 50% retracement from the October high at $1255) is likely to curb any prices appreciation.

Monitor the short-term price action of Platinum

The short-term technical configuration of Platinum is worth monitoring as prices are challenging the key support at $1190 (06/10/2014 low). A decisive break lower would confirm the downside risk at $1072 implied by the recent validation of its multi-months distributive pattern. It would also not bode well for the short-term performance of gold and silver.



FX Markets

The BoE unlikely to welcome any Sterling appreciation

Short-term inflation outlook downgraded by the BoE

The long-term outlooks published in the November quarterly inflation report (QIR) were not significantly different than the ones made in the August report. However, the wording signalled a clear dovish tone. Indeed, Mr Carney has acknowledged market expectations that a rate hike was unlikely before next summer and that the tightening cycle will be very gradual. Combined with a downgrade in the short-term inflation outlook (highlighted by a more likely than not drop below 1% in the next six months) and the disinflationary cost of sterling's appreciation (substracting 0.75% point from CPI inflation over the past year according to the BoE), the conclusions are clearly putting a ceiling on any significant GBP appreciation. Looking at the timing of the first rate hike, although it is true that it remains data-dependent, more positive surprises on wages will be needed to push the BoE towards a more hawkish stance.

The technical structure favours further GBP weakness

Looking at GBP/USD, prices continue to drift lower. The technical structure favours further weakness towards the support at 1.5423 (14/08/2013 low) at the minimum. The resistance at 1.6184 (21/10/2014 high) is not expected to be broken in the coming months, which should also be the case for the resistance at 1.6038 (30/10/2014 high).

Looking at EUR/GBP, the break to the upside out of a short-term horizontal range, whose bottom was near the strong support at 0.7755 (23/07/2012 low), favours a phase of strength. The key resistance area between 0.8047 (15/10/2014 high, see also the declining channel) and 0.8066 (10/09/2014 high, see also the the 200-day moving average) is likely to be challenged in the next few weeks.

FX Markets

JPY net short positions continue to be reduced

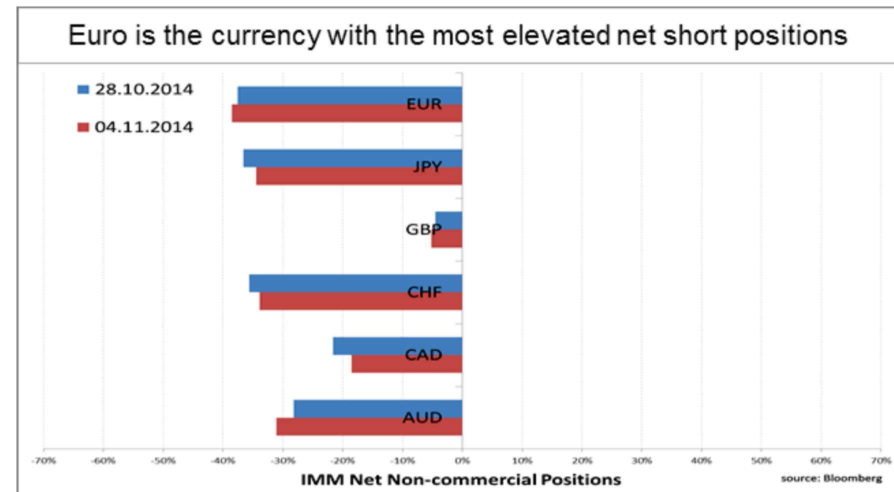
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

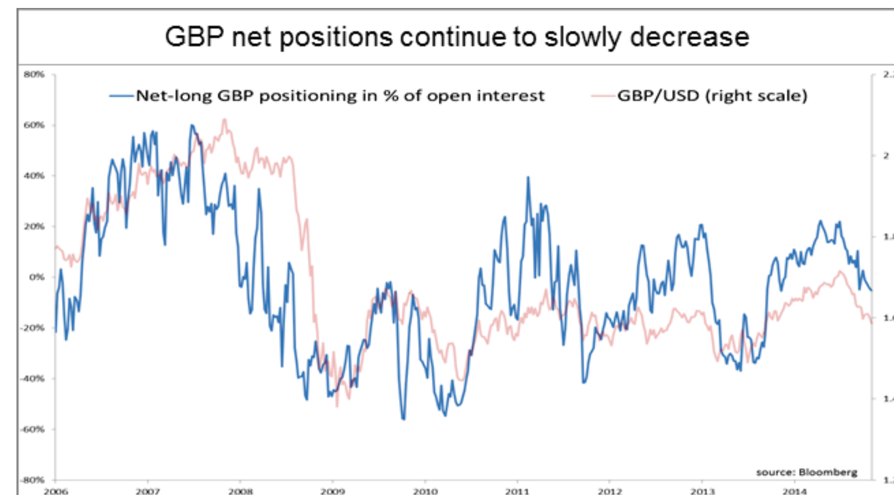
The IMM data covers investors' positions for the week ending 4 November 2014.

Quite surprisingly, the net short JPY positioning kept on being reduced despite the additional stimulus launched by the BoJ on 31 October. Even if the data encompass two trading days prior to the BoJ's announcement, the lack of significant buying interest following this news could indicate that no further easing is expected by the Japanese central bank for the months to come. In any case, the lack of extreme net short JPY positions means less obstacles for a move higher in USD/JPY.

On the other hand, the Euro continues to be sold, making it the most sold currencies against the US dollar. As a result, the obstacles for further short-term weakness in EUR/USD are not receding. However, we continue to favour a medium-term decline towards 1.20 for EUR/USD.

The British pound is the least sold currencies against the US dollar. Given the recent dovish statement by the BoE following the release of its quarterly inflation report, this positioning is unlikely to be supportive for a stronger GBP.





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