SWISSQUOTE

WEEKLY MARKET OUTLOOK

24 - 30 November 2014

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

p3	FX Markets	Draghi sets the stage for quantitative easing - Peter Rosenstreich
p4	FX Markets	Weekly wrap on Swiss franc - Ipek Ozkardeskaya
p5	FX Markets	Risks to BRL recovery - Ipek Ozkardeskaya
p6	FX Markets	Fed and BoE's decisions increasingly data dependent - Luc Luyet
p7	Economics	Japan to focus on growth measures - Luc Luyet
p8	FX Markets	Reduction in NZD short positioning - Luc Luyet
p9	Disclaimer	

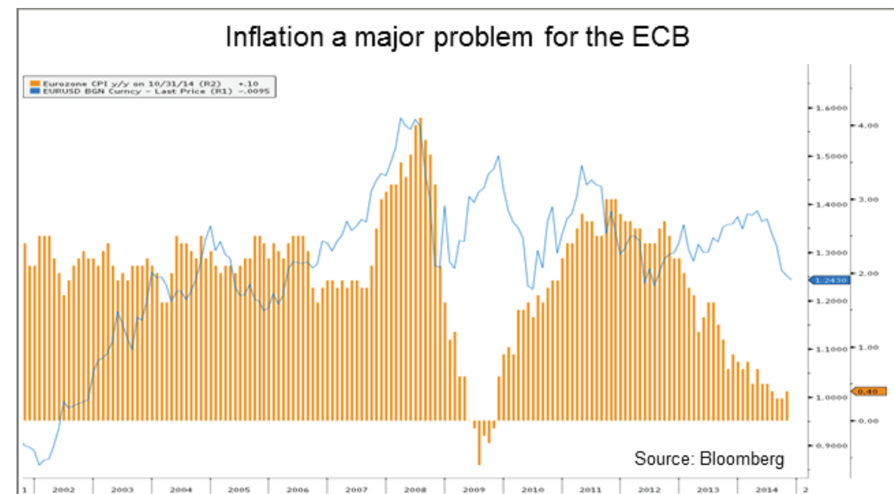
FX Markets

Draghi sets the stage for quantitative easing

Last week Mario Draghi implicitly amplified the dovish rhetoric. Friday's speech by Draghi, titled “Reshaping Europe”, at the 24th European Banking Congress clearly set the ground work for full blown quantitative easing – ie buying of European sovereign debt. “If on its current trajectory our policy is not effective enough to achieve this, or further risks to the inflation outlook materialize, we would step up the pressure and broaden even more the channels through which we intervene,” Mr. Draghi said. He went on to say “We will continue to meet our responsibility—we will do what we must to raise inflation and inflation expectations as fast as possible, as our price stability mandate requires of us.”

Despite comments suggesting that inflation pressures were transitory, due to food and energy prices while short term inflation outlook by some were overly pessimistic, we suspect that deflation is coming to Europe. The annual Eurozone core inflation was 0.4% last month which is far below the ECB target of 2%. It’s clear that the current efforts have not staved off economic weakness. At the most recent ECB press conference, ECB President Draghi openly cited two factors which would trigger the ECB to apply additional measures to expand its balance sheet. First, a weaker inflation outlook and secondly, the inability for prior actions to expand its balance sheet to the target of €1trn. TLTRO take up is expected to be around €40-60bn, not nearly large enough to reach the €1trn required. Draghi did mention that the “purchases of ABS brought encoring creation of credit” but size & depth of alternative asset classes are simply too shallow for the ECB’s massive purchasing needs. This is why despite objections from group and potential legal issues, the ECB is generally understood to eventually also buy sovereign bonds.

The next ECB policy setting meeting is scheduled for December 4th, but the date for the next allotment of TLTRO-funds will be fixed on December 11th, indicating the central bank will delay any action before seeing these figures (potential larger than expected bank take up). We believe by early 2015 these criteria will be met and full blown QE will be started. We anticipate USD and CHF will continue to gain verse EUR.



FX Markets
Weekly wrap on Swiss franc

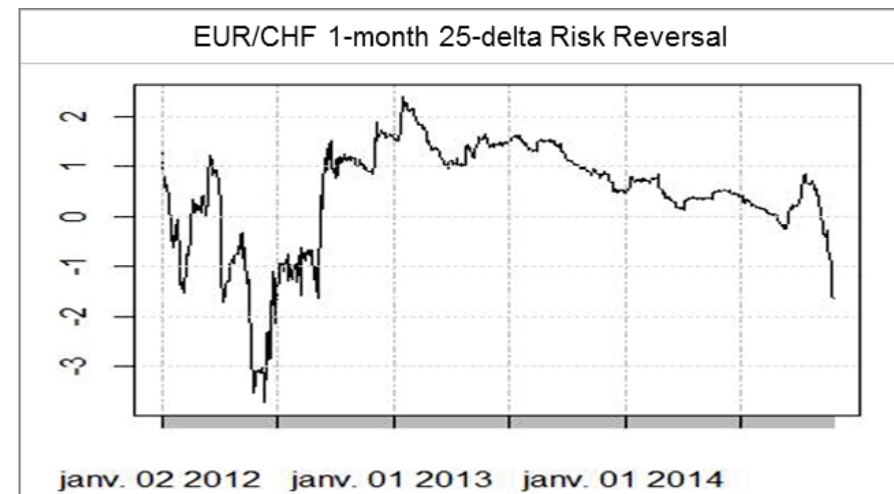
Did the SNB intervened on week to Nov 21st?

EUR/CHF spent the first half of the week between 1.2010/1.2020 range, before we started seeing unusual activity in EUR/CHF. The daily upticks started injecting some noise from Nov 19th, followed by a suspect rally amid ECB President Draghi said the ECB may consider broader asset purchases if needed, in his speech at the European Banking Congress (Nov 21st). All these jitters hardly looked market-driven. EUR/CHF perhaps saw some external support this week. The weekly sight deposit figures due on Monday should give more clarity on the issue. A significant lift in sight deposits should confirm SNB activity.

SNB has room to defend 1.20 floor

The 1-month 25-delta EUR/CHF risk reversals dipped further down on the week to November 21st, confirming the strong disequilibrium in favor of put options. We see growing mispricing in the EUR/CHF derivatives with short-term maturities as we believe that technically there is no reason for the SNB to let the market destroy its floor; not this soon.

On November 30th, the Swiss population will decide whether the SNB should bring up its gold reserves to a minimum 20%, physically preserved in Switzerland and unsellable. The SNB currently holds 8% of its assets in gold and bringing the reserves to 20% is certainly a sizeable operation, yet is not a direct risk to EUR/CHF's 1.20 floor. This is why we believe that the shorter-term bets against the floor are nothing but noise and see opportunity in taking advantage from the mispricing via topside OTM calls. Indeed, the SNB can technically continue stirring its own balance sheet to counter the undesired franc appreciation as long as the ECB expands its own balance sheet. The SNB will have less flexibility to decide on its portfolio allocation, and certainly will face higher cost, yet technically the operation is possible. If however the ECB decides to move on with the QE, it would then become too risky for the SNB to follow. The potential divergence between the ECB and the SNB would then place the 1.20 floor at severe risk.



FX Markets

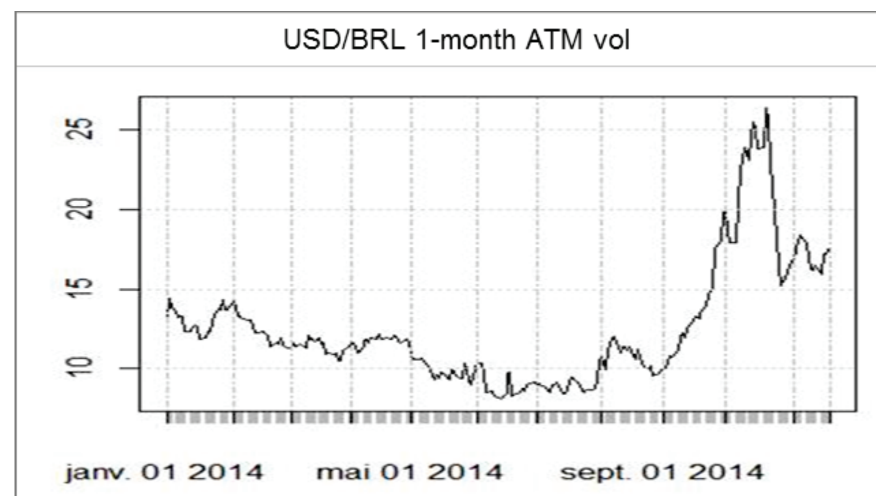
Risks to BRL recovery

Inflation eases to 6.42% in mid-November

Brazil inflation accelerated at the softer pace of 0.38% in mid-November print, pulling the yearly inflation down to 6.42%. The good news is that the inflation managed to step in BCB's 4.5% (+/-2%) target band mid-November, led by weaker energy prices which certainly had a softening impact on all sub-groups. The transportation costs increased 0.20% on month to mid-November down from 0.45% in September, since the slide in global oil prices accelerated; the communication costs fell 0.21% m/m. Less comforting news is that the government-conducted rise in fuel prices (on Nov 7th) is probably not fully reflected in mid-month figures and may push the inflation back above the target range by the end of the month. In addition, the FX volatilities certainly give little comfort to the BCB, expected to proceed with additional 25 basis points rise in Selic rate at December 3rd meeting. The central bank "won't be complacent about inflation" said BCB's director of economic policy Carlos Hamilton in a speech given on November 18th. The top-range inflation will likely be on BCB's menu at next meeting, while speculations on 50 bps hike should range sideways until 3Q GDP release due next week (Nov 28th). According to market estimates, the GDP grew 0.1% in third quarter following two quarters of contraction.

Uncertainties on Rousseff's new finance team persist

After hitting 2.6287 on November 14th, USD/BRL entered the short-term bearish consolidation zone this week. The volatilities increased however, warning that despite recovery the stress should stay in the headlines before the nomination of Brazil's new economic team. We see optimism on Rousseff's candidate list for Ministry of Finance. According to a government official, Nelson Barbosa (former Dep. FinMin), Alexandre Tombini (Central Bank Governor) and Joaquim Levy (former Treasury Secretary) are among considered names, while Henrique Meirelles (former Central Bank head) and Luiz Carlos Trabuco (Bradesco CEO) are not on that list. The information is unofficial and the political risks may abruptly halt BRL recovery.

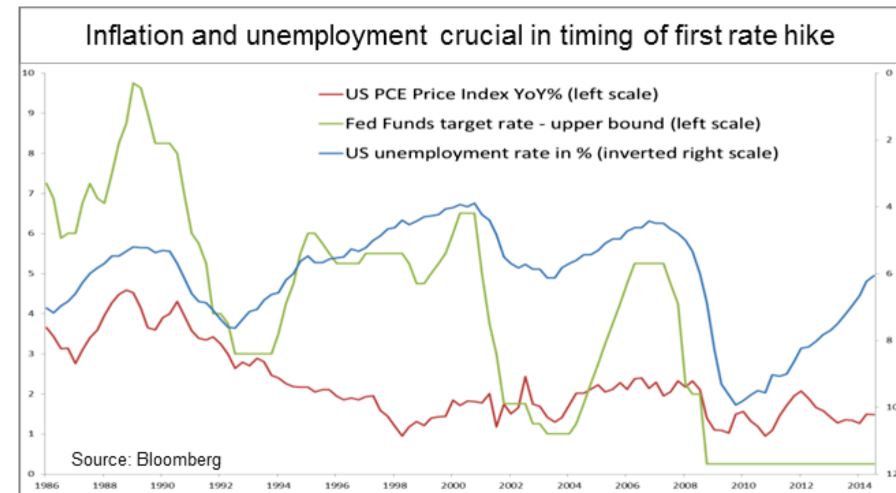


FX Markets

Fed and BoE's decisions increasingly data dependent

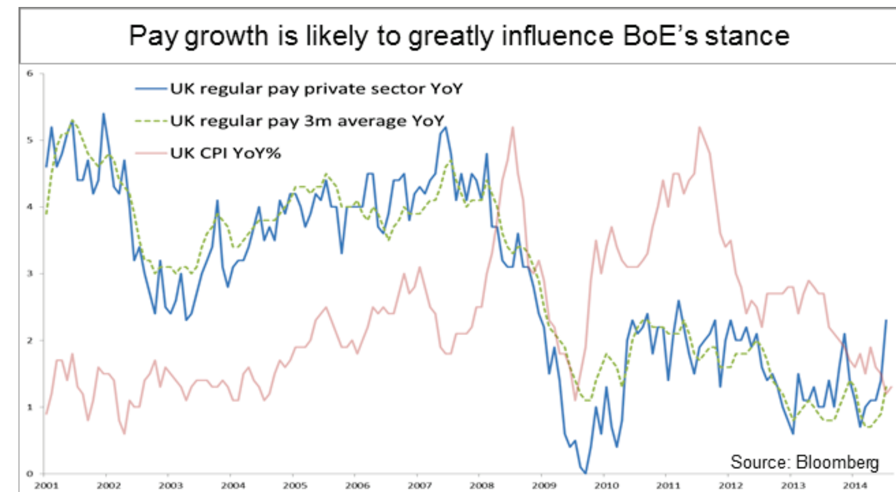
Mind the Fed's dual mandate not the Fed's wording

The FOMC minutes highlighted the struggle within the committee on how to communicate its policy intentions without causing turbulences in financial markets. Indeed, as the start of its tightening cycle is getting nearer, the Fed wants to clarify that the timing will greatly depend on incoming economic data, which is not conveyed in the "considerable time" statement. However, the Fed is also afraid that removing this statement could be wrongly perceived as a significant shift in its policy stance. As a result, instead of focusing too much on the Fed's wording, it seems more important to monitor on the inflation outlook and the health of the labour market. The improvements in the latter was the key factor to end the Fed's asset purchases and is likely to play the greater role in determining when to raise rates. In that respect a June 2015 hike is a reasonable assumption in our view.



A more balanced Bank of England

The BoE minutes showed, as expected, that the vote on rates remained unchanged at 7-2. However, among the seven members in favour of leaving rates at their low levels, there was "a material spread of views on the balance of risks" to the inflation outlook. Indeed, some members see a risk that spare capacity could be eliminated more quickly than anticipated, suggesting that future vote results could vary greatly depending on incoming data. For the time being, the already low levels of the household saving rate coupled with ongoing fiscal consolidation could lead to a weaker private consumption (which currently remains strong as highlighted by the recent strong retail sales), especially if pay growth do not improve significantly. Furthermore, given the current significant risks that inflation fall below 1% (which would force Mr Carney to write an explanatory letter to the Chancellor of the Exchequer), the BoE is in no hurry to raise rates. As a result, it is rather unlikely that a rate hike will occur before the third quarter of 2015.

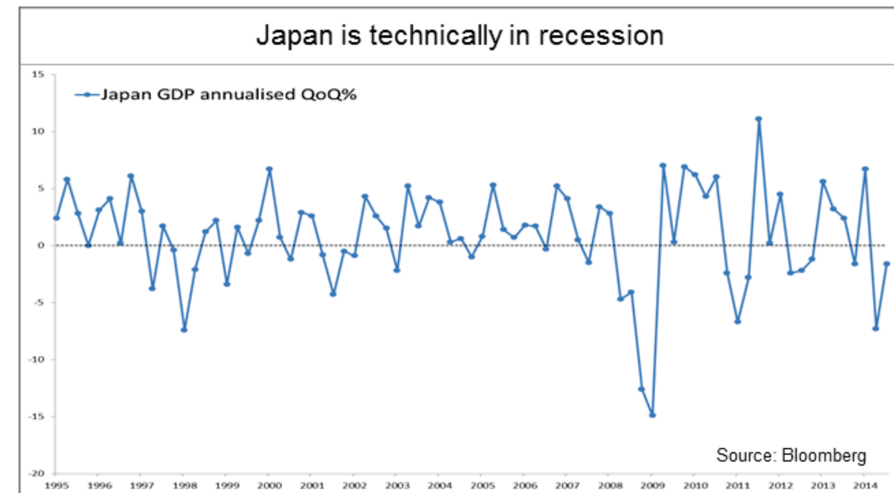


Economics

Japan to focus on growth measures

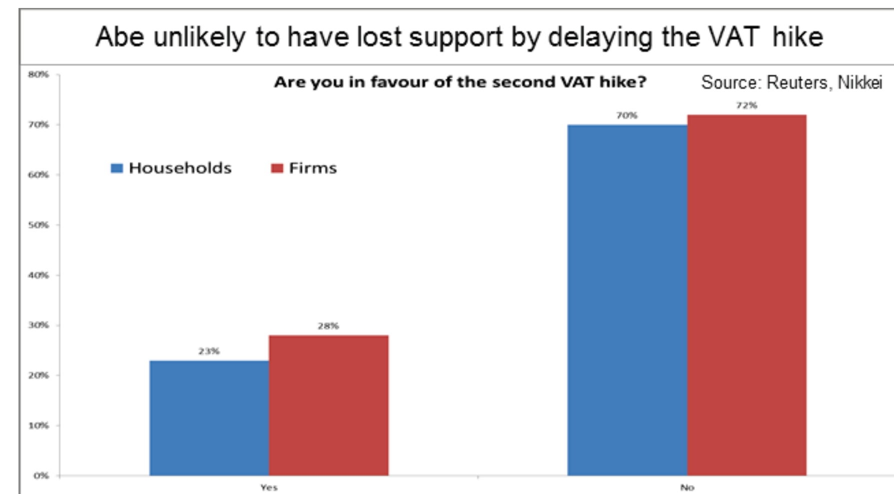
Will the delayed VAT hike weaken the Abenomics?

Mr Abe's decision to delay the VAT hike is unlikely to please Mr Kuroda and the ministry of finance, which are two critical pillars of the Abenomics. However, the preliminary estimate of the third quarter GDP was such a shock that it could ease part of the discontent. It seems to be the case within the Bank of Japan (BoJ), as the recently expanded monetary policy is now backed by a wide majority (8 vs 1 against a previous 5 vs 4). However, further easing remains unlikely given the government's lack of fiscal discipline. Another part of the answer is expected to be given by the upcoming elections to the Lower House. The LDP currently have 295 seats, while its coalition amounts to 326 seats. As a result, the majority (238 seats) is very unlikely to escape Abe's coalition, especially as public ratings strongly favour the LDP over DPJ (37% vs 6%). Nevertheless, a broad LDP victory could dampen resistances among fiscal hawks within the party and give a new legitimacy to pursue Abenomics.



Expect a stronger focus on growth

With the postponing of the VAT hike, Japan is unlikely to face any fiscal headwinds in 2015 and 2016, paving the way for further strength in USD/JPY. On the other hand, the likely positive results from Abe's party to the Lower House elections should lead to new stimulus to lift growth and inflation, favouring a stronger domestic stock market. On the other hand, the delay in the implementation of the VAT hike darkens the fiscal outlook of Japan. Indeed, it is increasingly likely that Japan will have to face significant fiscal drag from 2017 in order to have a chance to restore a primary balance in 2020, as promised by Mr Abe. Coupled with a potential exit strategy from the BoJ, Japan's PM would be well advised to speed up its economic reforms, if voters grant him a fresh mandate, to back up his pledge of fiscal discipline. Indeed, a reason behind the weak growth is that Japan is in a dire need of a strong third arrow to counter-balance the negative effects of its ageing demography.



FX Markets

Reduction in NZD short positioning

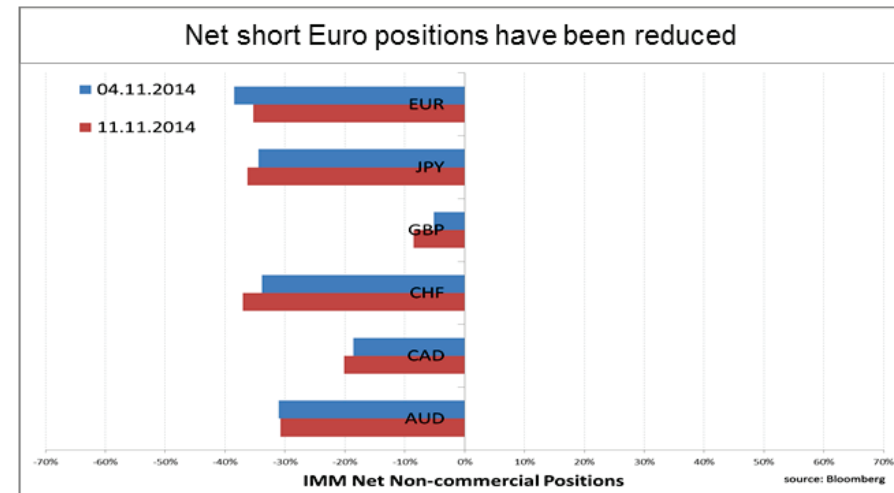
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

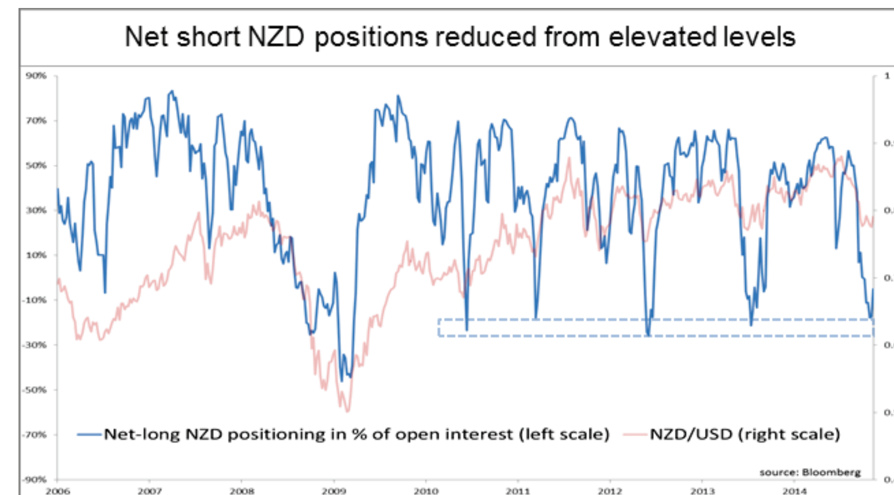
The IMM data covers investors' positions for the week ending 11 November 2014.

Euro net short positions have been reduced. Coupled with oversold conditions in EUR/USD, the obstacles for further sustainable short-term declines are significant. However, the longer term direction is down, so we continue to favour selling any rallies.

There have been some new building of short positions in the Japanese yen following the surprise easing of the Bank of Japan. Given the postponement of the VAT hike and potential new pro-growth stimulus in the pipeline, USD/JPY is likely to continue to grind higher.

Net short positions in New-Zealand dollar have been reduced from elevated levels. Even if NZD/USD is more sensitive to the upside given the large net short NZD positions, the technical structure remains negative as long as prices remain below the key resistance at 0.8052 (04/02/2014 low).





DISCLAIMER

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Swissquote Bank and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions, or regarding the accuracy, completeness or reliability of the information contained herein. This document does not constitute a recommendation to sell and/or buy any financial products and is not to be considered as a solicitation and/or an offer to enter into any transaction. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or in any other kind of investments.

Although every investment involves some degree of risk, the risk of loss trading off-exchange forex contracts can be substantial. Therefore if you are considering trading in this market, you should be aware of the risks associated with this product so you can make an informed decision prior to investing. The material presented here is not to be construed as trading advice or strategy. Swissquote Bank makes a strong effort to use reliable, expansive information, but we make no representation that it is accurate or complete. In addition, we have no obligation to notify you when opinions or data in this material change. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments.

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning Swissquote Bank, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. Swissquote Bank does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are for information purpose only and are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Swissquote Bank as a result of using different assumptions and criteria. Swissquote Bank shall not be bound or liable for any transaction, result, gain or loss, based on this report, in whole or in part.

Research will initiate, update and cease coverage solely at the discretion of Swissquote Bank Strategy Desk. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. Swissquote Bank is under no obligation to update or keep current the information contained herein and not liable for any result, gain or loss, based on this information, in whole or in part.

Swissquote Bank specifically prohibits the redistribution of this material in whole or in part without the written permission of Swissquote Bank and Swissquote Bank accepts no liability whatsoever for the actions of third parties in this respect. © Swissquote Bank 2014. All rights reserved.