WEEKLY MARKET OUTLOOK

8 - 14 December 2014

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

DISCLAIMER & DISCLOSURES

WEEKLY MARKET OUTLOOK - An overview

Economics

Wages poised for acceleration

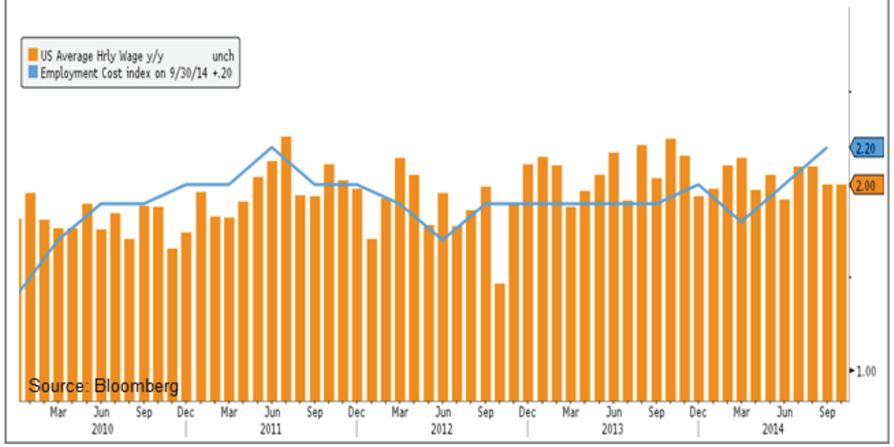
The US recovery continues to pick up speed indicating that the Fed should be preparing the raise interest rates. Yet, so far the lack for recovery in wages has suppressed many of the Fed members optimism. To the Fed, increasing wages will signal that the consumer is actually participating in the current expansion and are healthy enough to withstand tighter policy. Currently wage growth is stuck around 2.1%, well below pre-crisis peak of 3.5%, but trend is now gently trending higher. The current round of peripheral data indicates that wages should start to catch-up to other accelerating employment indicators. New claims for unemployment insurance dropped to 297,000 last week, services PMI rose to a nine-year high at 59.3 and the unemployment rate fell to 5.8%.

But there are leading indicators which also tell an interesting story. The Bureau of Labor Statistics' September job openings and labor survey has a job "quit rate" which has hit the highest level in six years. A clear signal that workers feel more confident in better opportunities and higher wages at other jobs. The Employment Cost Index a wide-ranging gauge of wage and benefit expenditures, has increased to 0.7% from 0.3% in the first quarter. And finally the participation rate now increased to 62.80 from 62.7 as more worker are enticed back into the work force due to better job prospects.

Stanley Fischer, the Fed vice-chairman, stated commenting on the probability that wages should begin to quicken, "I think that has a significant chance of being about to happen," he said. Then he makes the clear connecting between labor and Fed tightening cycle stating "If the labor market continues to strengthen, and if we see some signs of inflation beginning to increase, then the natural thing is to get interest rates up." The next Fed FOMC meeting is Dec 16-17th where we expect a majority of policy makers to expect that higher rates will occur in 2015.

Job "Quit Rate" on the rise

Higher costs will drive wage increase



Economics

USD/JPY clears 120 resistance

Moody's downgrade Japan's rating

Moody's cut Japan's rating to A1 with stable outlook. As the Abenomics fail to achieve its fiscal targets and the delay in structural reforms weigh on the economic recovery, the successful first arrow (massive monetary stimulus) only pushes the country toward a deadlock. PM Abe's government does not hold its promise before the BoJ, which is to proceed with fiscal reforms meanwhile the BoJ injects massive liquidity by buying its debt. The delay in the second round of sales tax hike formerly scheduled in 2015 may cost big to Abenomics, as postponed fiscal consolidation raises tensions between Kuroda and Abe. BoJ Governor Kuroda said that the impact of tax delay on inflation and growth is "the responsibility of the government", not the BoJ's. The discomfort between leaders is becoming an issue.

The BoJ has become the main creditor of government debt since Q1 and continues buying heavy amounts of Japanese bonds (8-10 trillion Yen per month), deepening the government's public debt, cited among the world's largest debt load. If now the rating companies start raising doubts on nation's solvability, the higher risk premium on Japan's debt, combined to weaker Yen may seriously injure the trust in Abenomics. On the other hand, a higher inflation yet moderate wage growth, is certainly not a healthy long-term combination to redress Japan on its feet. According to the latest data, the labor cash earnings grew at the unexpectedly slower pace of 0.5% on year to October (vs. 0.8% exp. & last). One thing is sure: Japan needs fresh air.

USD/JPY clears 120, volatile week ahead

USD/JPY finally broke 120-resistance; Tokyo closed the week on green note. However, the profit takings and corrective shorts will likely be challenging on the upside before December 14th snap elections. Once the volatilities around 120 ease, we expect sustainable advance, traders already shift targets to 130s.

Economics

Draghi forces the QE dissenters off the game

This is just a temporary disappointment

The ECB maintained the status quo at December 4th meeting. Those speculating for a QE announcement have been disappointed. This is essentially what caused the EUR-rally while Draghi spoke yesterday. However it is worth noting that the accompanying statement was very dovish, although not sufficiently to satisfy EUR-bears' appetite. Mario Draghi did not refrain from talking about a potential QE, vowing to proceed with additional stimulus by the first quarter of 2015, if need is still there. Besides, the ECB is already expanding its balance sheet by TLTROs, covered bonds and ABS purchases. Since the ECB announced the private debt purchases in October, 17.801 billion euro worth of covered bonds and 368 million euro worth of ABS have been added to ECB balance sheet. The second round of TLTRO is due in December. Yet given the sizeable disappointment in September (82.60 billion euro lent), we do not expect a game-changer outcome on December action. Released today, the 3Q GDP read came in line with expectations, the gross fixed capital formation decelerated at the faster pace of 0.3% (vs -0.2% exp.), government spending and household consumption improved slightly in the third quarter. While the ECB press conference was slightly less dovish than anticipated, all clues point at the launch of government bond purchases. Draghi's straightforward comment that he did not need a unanimous decision to activate policy was a clear shot at the QE dissenters and cleared the primary obstacle to moving forward. This is why we maintain our expectations for QE announcement by the first quarter of next year.

EUR/USD rebounded from a fresh 2-year low of 1.2280 to 1.2456 post-Draghi whereas the narrower Spanish/German 10-year yield told a more realistic story. EUR/USD's failure to close the ECB-day above the 1.2435/50 (MACD pivot / 21-dma) confirms the negative sentiment in EUR/USD. The futures markets continue trading very close to theoretical value (cross currency basis close to zero), so that we can clearly tell traders watch closely divergences in the central bank policies. Therefore, any positive surprise from the US has the power to wipe out bullish attempts on EUR/USD and set the tone back on downside.

Christmas comes early for the SNB

Clearly, if anyone was happy with the outcome of the last ECB meeting of this year, it was the Swiss National Bank. Since the ECB did not announce full blown quantitative easing, immediate weakness in the Euro has been avoided and pressure on the EURCHF floor delayed. However, telling by today price action any reprieve will be short lived. Interestingly, the SNB data released today indicates that any FX intervention by the SNB has been less than expected through November. The SNB's foreign currency reserves increased from 460.4 billion to 462.4 billion francs (vs. 465.5bn exp.), quiet low given the high pressures on the 1.20 floor before the Swiss Gold Referendum. Fortunately, the SNB credibility remains solid after the "no" vote of November 30th, enticing speculators to go long EUR/CHF with hope of catching a quick FX intervention below 1.2020 levels. This makes the SNB cost for defending the "floor" low, the correlation between EUR/USD and EUR/CHF is back to negative territories (-10%). Although the ECB's QE will force the SNB to defend the floor at a significant higher cost starting from next quarter, for right now Christmas has come early for the SNB.

FX Markets

Rising expectations for a RBA's rates cut

Weak Q3 GDP opens the way for a potential RBA's rate cut

The Reserve Bank of Australia (RBA) is not in a hurry to raise rates, as can be seen by the repeated forward guidance of steady rates in the statement following its December monetary policy meeting. The weak Q3 Australian real GDP release is unlikely to make the RBA hastier about raising rates and could even prompt the central bank to cut rates to stimulate the Australian economy.

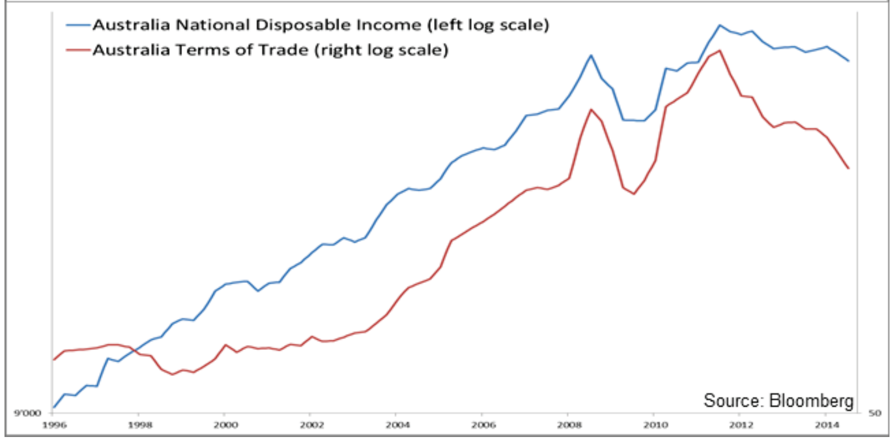
Australia is facing national income recession

Nominal GDP, which gives a better idea of taxation revenues than real GDP, fell by 0.1% (the first fall since 2009), weighting on national income. Indeed, growth mostly came from mining exports. Sadly, given the decline in commodity prices, the terms of trade, which measures the difference in value between exports and imports, continues to decline. As a result, there is less income stemming from exports despite GDP growth and as the increased supply should continue to weigh on commodity prices, the terms of trade is likely to decline further. A weaker Australian dollar would help the non-mining economy and could lift consumer spending, which was disappointing in Q3. However, the bar for a rate cut remains elevated as the central bank is eagerly looking to curb demand in the housing market and would be at odd with its current forward guidance of "steady rates". Furthermore, the monetary stimulus in China and Japan could also lift the Australian growth outlook.

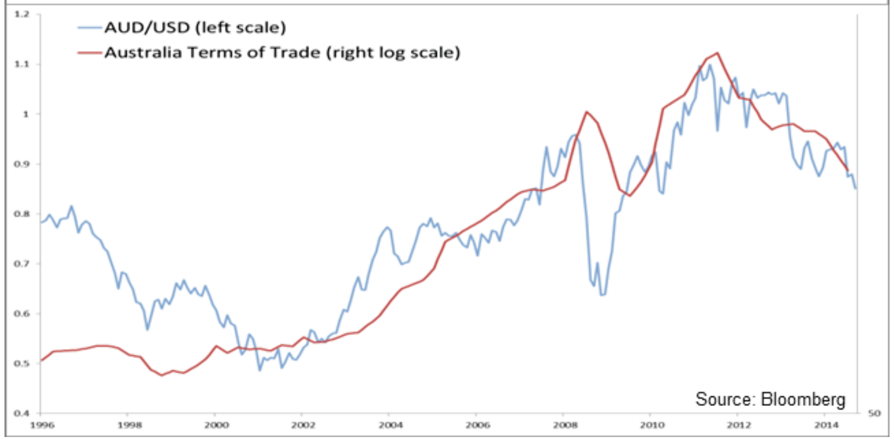
AUD/USD expected to decline further

Rates cut or not, the decline in the terms of trade is expected to drive AUD/USD lower. However, should the market sees further signs pointing to a RBA's rates cut, the anticipated decline towards the support 0.8067 (25/05/2010) could occur quite quickly.

Decline in terms of trade weighs on national income



Declining terms of trade calls for lower AUD/USD



FX market

GBP likely to be supported by short-term tailwinds

UK keeps a neutral fiscal stance ahead of 2015 elections

The economic forecasts presented by Chancellor Osborne during the UK Autumn Statement highlight potential large spending cuts for the year beyond 2015 in order to reduce the structural deficit. Indeed, for the next two years, UK's overall budget deficit should further increase despite a current fairly robust growth environment. In the short-term (meaning until May 2015 UK election), the neutral fiscal stance coupled with small stimulus (like the stamp duty reforms) are likely to boost the short-term growth outlook.

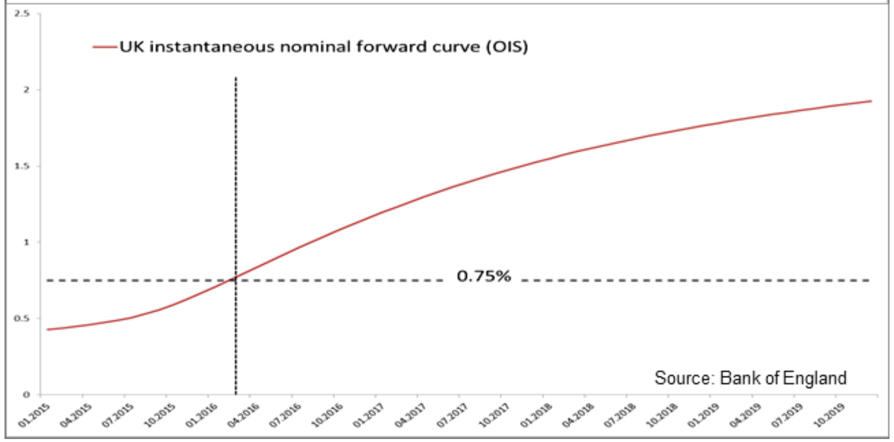
The BoE is facing a difficult situation

With the UK government in charge of reducing the imbalances in public finance and the Bank of England responsible to support UK growth outlook, the current neutral fiscal stance could favour a sooner than expected rate hike (currently expected by the market early in 2016). This view is also supported by the recent strong PMIs data, which points at further strong growth in the months ahead. However, growth in 2015 is likely to get hurt by political uncertainties and the potential renewed fiscal austerity, calling for an accommodative BoE. As a result, even if the British pound could be attractive in the next few months, the outlook is far less obvious in the longer term.

EUR/GBP consolidation likely to be followed by further decline

Looking at EUR/GBP, prices have moved within a horizontal consolidation between 0.7767 (01/10/2014 high) and 0.8066. Given the positive UK short-term growth outlook and the expected ECB's balance sheet increase early 2015, odds favour a break to the downside out of this range. As a result, any prices close to 0.8000 offers an attractive risk/reward for a short EUR/GBP position.

Market expectations points to 0.75% bank rates by February 2016



The resistance at 0.8066 will be hard to break

FX Markets | US dollar increasingly sensitive to any downside risk

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.

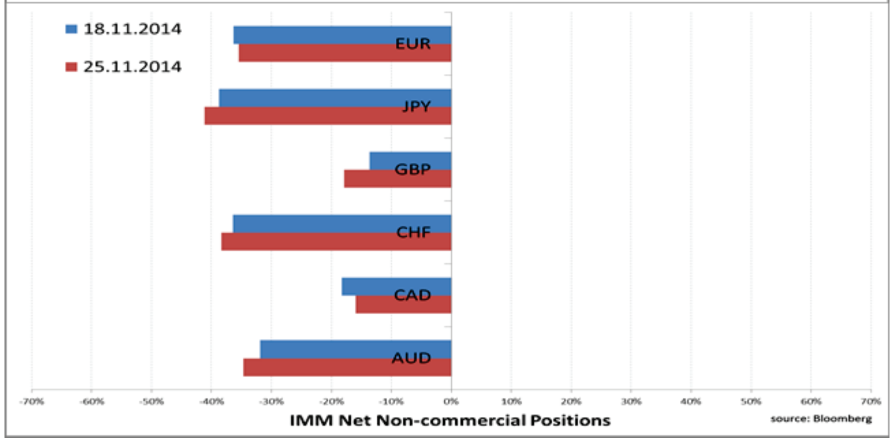
The IMM data covers investors' positions for the week ending 25 November 2014.

With the increase in net short positions in JPY, GBP, CHF and AUD, the aggregate long USD positions continues to post record highs. The resulting effects is that the USD is highly sensitive to any news suggesting some delay in the start of the Fed's tightening cycle.

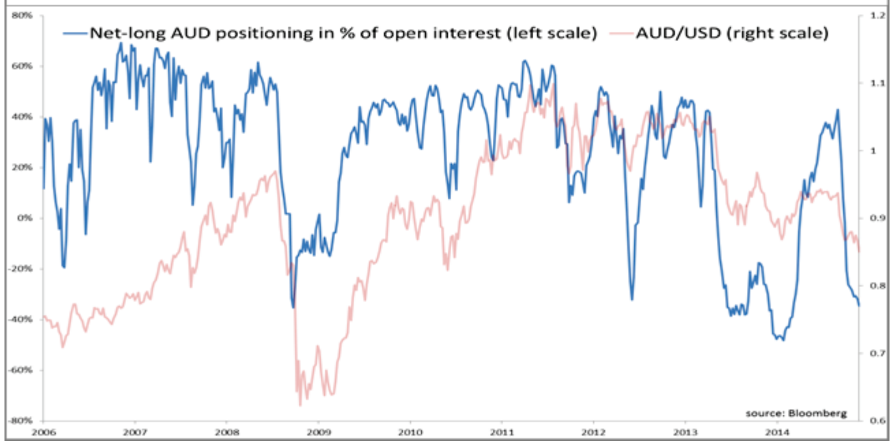
The increase in net short GBP positions has been the most significant change. With a highly volatile timing for the Bank of England first rate hike, increasing bearish sentiment favours a long Sterling position as the currency is getting more sensitive to any positive GBP surprises.

Net short AUD positions are at elevated levels. Even if the long-term technical structure favours further weakness in AUD/USD towards the strong support at 0.8067, chasing the market to the downside is getting increasingly risky from a positioning point of view.

GBP has been significantly shorted



Net short AUD positioning is at elevated levels



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.