# WEEKLY MARKET OUTLOOK

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# WEEKLY MARKET OUTLOOK - An overview

# FX Markets

# The SNB shifts toward more risky fixed income assets

**EUR/CHF tops at 1.05**

EUR/CHF's spike above 1.05 at Swiss open fueled speculations that the SNB might be behind the move. The money markets show limited reaction, we see no particular stress on euroswiss interest rate futures. As EUR/CHF tops, real money names and business owners will increasingly be tempted to sell EUR verse CHF on futures and derivatives markets to set FX hedges vis-à-vis the risky EUR. Therefore we expect choppy upside at 1.05/1.10 area.

The impact of EUR/CHF debasing is heavily felt in Swiss everyday life. The grocery shops, supermarkets, furniture, clothing shops give sensibly high discounts in order to prevent clients from buying across borders. This being said, the labor market is now under important contraction pressures. In the canton of Geneva, the negotiations for 50% unemployment are already on the wire. We expect significant price adjustment in the real market over the months ahead, which in turn should cool-off buying pressure in franc.

**SNB increase allocation in riskier fixed income assets**

Official data shows SNB's EUR reserves increased from 45% to 46% as of end-4Q; A-rated fixed income assets rose significantly from 3% to 10%, verse AA-rated FI holdings (down from 29% to 22%). The SNB will likely expand its risk tolerance in order to compensate losses due to further EUR weakness. We would not be surprised to see the SNB shifting from EUR holdings to non-EUR, higher yielding fixed income assets to diversify its portfolio risk now that there is no more constraint on the EUR/CHF.

USD/CHF advanced to test 200-dma (0.9288) on week to January 30th. Trend and momentum indicators suggest that post-SNB correction is coming to an end as the pair steps into bullish consolidation zone. For the week close above 0.9141 (Fibonacci 61.8% on January 15th drop), we see further upside potential toward 0.9551 (Fib 74.6%). The 25-delta risk reversals are still negative across the curve, yet should normalize above the zeroline given the Fed's diverging outlook from its G10 peers.

## FX Markets

## Turkey should not rush to an "emergency" cut

**Turkish Central Bank may announce rate cut on Feb 4th if CPI falls more than a percentage point**

The disappointed political faces amid 50 basis point cut on the benchmark repo rate at January 20th MPC meeting, are certainly a weigh on Turkish Central Bank's shoulders. The Bank seemingly prepares field for further rate cut as the official inflation expectations are lowered from 6.1% to 5.5%, while the 2015 CPI is now expected to get aligned with CBT's 5% target.

This is how the CBT Governor Basci brought the brilliant idea of a potential policy gathering on February 4th, post-CPI read (Feb 3rd). For more market diplomacy, Governor Basci added that the exceptional meeting is equally contingent on the Fed expectations in favor of a delay in rate normalization and on the high volatilities in EUR. "If the fall in the inflation rate is bigger than a percentage point, then there may be need to make an evaluation" before February 24th scheduled MPC meeting. "It's long time until Feb 24."

**Markets reject additional rate cut**

Since mid-2014, the highly-energy-dependent Turkey's headline CPI eased from 9.66% to 8.17% on year to December - alongside with the oil market's above 50% drop - steadily pulling the core CPI (ex food and energy) down from 9.75% to 8.73% y/y. This is certainly a lucky hand for the government and the monetary policy committee as obviously nobody expected such debasement in the oil market to miraculously halt the overheating inflation before it stepped above 10% in the first half of 2014. On a side note, we also remind that the policymakers were looking for alternative ways to compute inflation to ease upside tensions artificially (!) One thing is crystal clear, as soon as the oil effect is over, the Turkey will have to face its idiosyncratic fundamentals, which in our view are not favorable for easing, and even less for an emergency action.

Given that Turkish bonds trade at yields equaling negative real returns at the moment, we are below the inflation breakeven even if a concrete CPI print confirms disinflation (on Feb 3rd). The 2, 5 and 10 year government bond yields are below 7%. Even with a full percentage point drop in inflation, the rate cut will hardly be justified in real terms and should be perceived as mispricing given the knee-jerk TRY-negative reaction to Basci's speech on January 27th. In addition, Turkish investments are subject to political risks before mid-2015 elections, which should bring the market to reject a zero-real-return /zero-risk-premium framework sooner than later! Therefore any surprise action carries potential to push USD/TRY to fresh record highs.

# FX Markets
## The Fed keeps its rate guidance

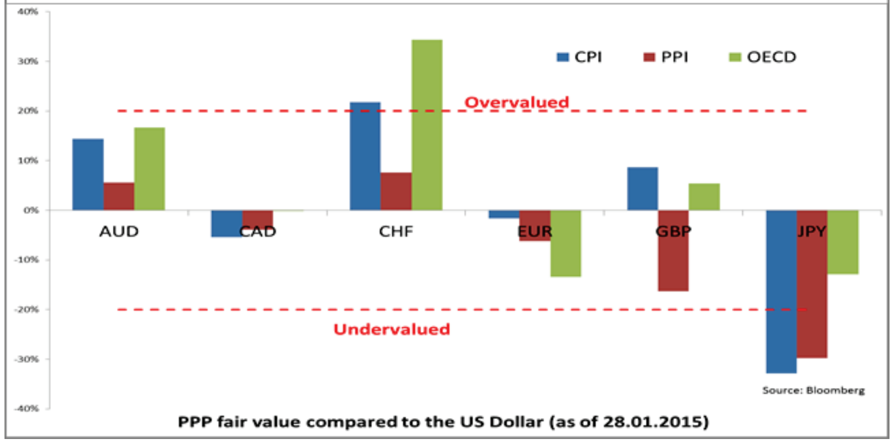
### Patiently moving towards rates normalisation

The January FOMC meeting statement was broadly unchanged compared to December. On the hawkish side, the Fed dropped any reference to a "considerable time", improved its assessment on the domestic economy and on the labour market, did not seem concern about the further weakness in headline inflation and did not mention the recent weak capex orders. On the dovish side, the Fed added "international developments" on factors that could affect the timing of the tightening cycle. While the Fed is likely to view the ECB's QE and the other recent monetary stimuli as a significant factor to reduce the risks of further weak global demand, it also increasingly supports a stronger US dollar. Overall, as the Fed is more focused on the health of the labour market, a June hike remains the most likely scenario. However, the timing remains heavily data dependent. For the time being, the potential positive spillover of the central banks' easing policies on global demand and the net positive impact of the lower oil price outweigh negative effects on domestic growth and inflation from a stronger dollar.

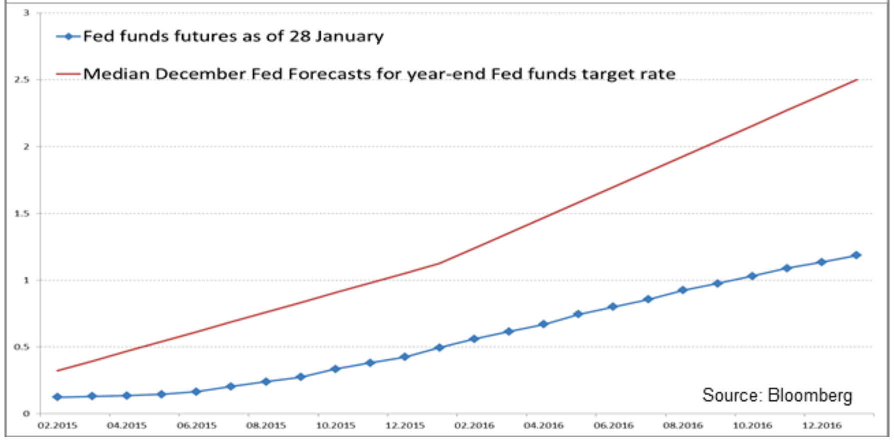
### The US dollar is far from overvalued

Although the recent rise in the value of the greenback has been impressive, valuation are far from overvalued. Indeed, looking at some fundamental measures like PPP, long-term valuations do not suggest any significant exaggeration in the value of the US dollar. However, given that the ECB's QE and part of the Greek uncertainties are behind us, most of these Euro negative factors are now discounted. As a remaining big driver for Euro weakness is the timing of the Fed's tightening cycle, which remains very uncertain, the appreciation of the US dollar is likely to slow in the near-term. However, if our June scenario is correct and given the more dovish stance from the markets, we continue to favour a medium-term bullish view on the US dollar index. Any decline near 91.0 should be seen as a very attractive entry point.

USD is far from being significantly overvalued




Market expectations significantly more dovish than the Fed's



## FX Markets

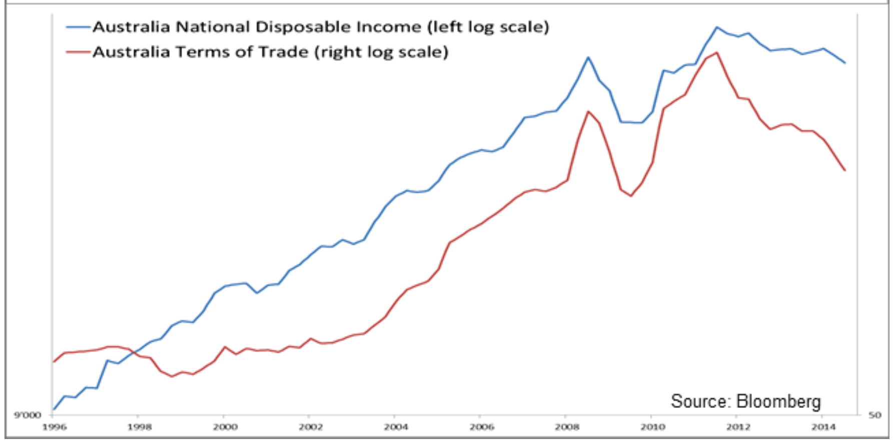
## RBA's rate cut is getting nearer

**Q4 Australian inflation unlikely to significantly cheer the RBA**
The stronger-than-expected Q4 core CPI is unlikely to change significantly the bleak outlook of the Reserve Bank of Australia on the domestic economy. Indeed, the rapid decline in its terms of trade is expected to continue given the dim energy price outlook. Coupled with weak demand in China and Europe, export earnings should weigh on the economy through weaker income growth and favour weaker capex in the the next months. Furthermore, the global decline in yields linked to the ECB's QE announcement is increasing the attractiveness of the relative high yields associated with Australian assets, supporting a higher Australian dollar.

**The RBA still on its way to cut rates**
Given the potential headwinds on the Australian economy, we suspect that the RBA will downgrade its inflation outlook and remove its neutral rate bias during its February meeting. Such revisions would strongly hint for a rate cut in March in order to protect the economic recovery and further weigh on the Australian dollar. However, the RBA could be less patient as mentioned by a close RBA watcher, which had some reliable sources from RBA's senior staff in the past. Even if the RBA has to respect a media "black-out" in the week before policy meeting, AUD/USD made new lows on the news.

**Recent strength in AUD/USD is likely temporary**
Looking at AUD/USD, the recent new lows below the support at 0.7855 ( 26/01/2015 low) confirm an underlying bearish trend in AUD/USD. As a result, we favour further weakness towards the support at 0.7451 (18/05/2015 low). A resistance stands at 0.8136 (22/01/2015 high).

Weaker exports likely to weigh on income growth




No sign of stabilisation in AUD/USD's decline yet

# FX Markets

## AUD has the most elevated net short positioning

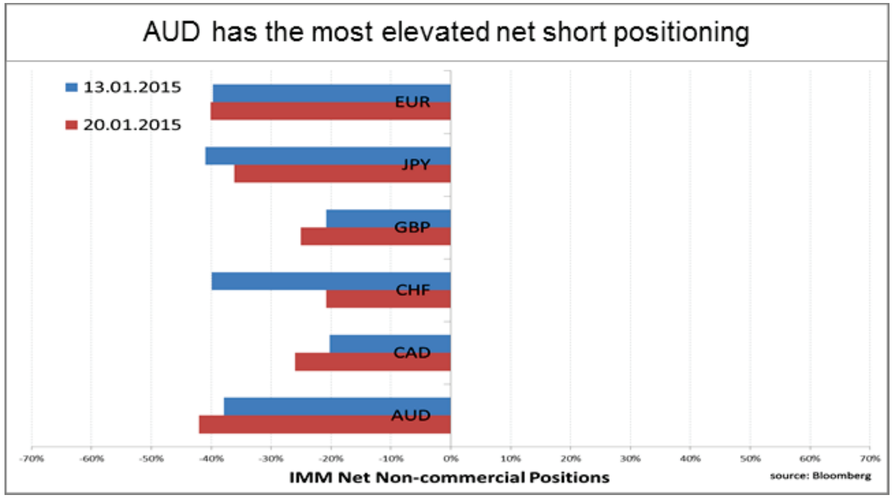
**The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.**

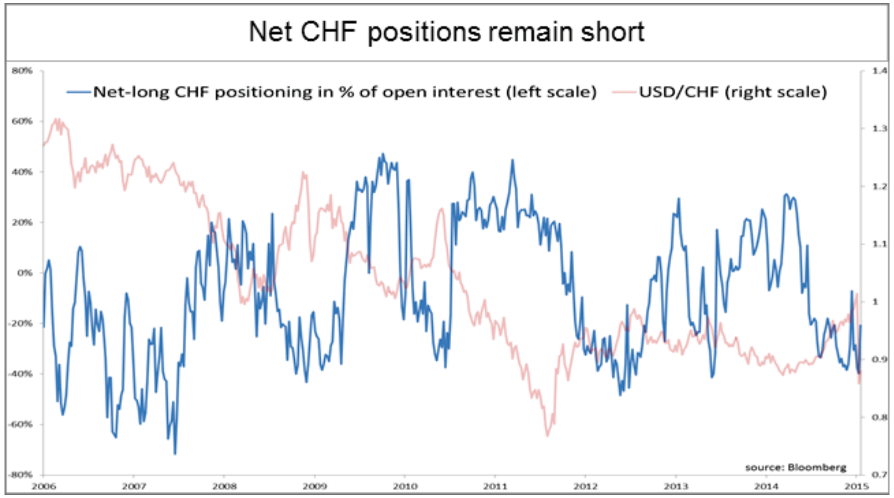
The IMM data covers investors' positions for the week ending 20 January 2015.

Swiss Franc short positions have been sharply reduced (from 39.9% to 20.8%) following the SNB's announcement to drop the minimum floor on EUR/CHF. However, net CHF positions remain short suggesting potential for further short CHF unwinding.

Net short EUR positioning has further increased ahead of the ECB meeting. Even if we continue to favour further long-term decline in EUR/USD, a lot of the short-term negative factors for a weaker Euro have been discounted. Coupled with elevated net short EUR positions, the short-term downside risks seem reduced.

The Canadian dollar net position was not highly short ahead of the surprise cut by the Bank of Canada on 21 January. It therefore favours further rise in short positions. On the other hand, Australian dollar net short positions are elevated, suggesting a potential for a short squeeze should the RBA failed to act or sound dovish at its next monetary policy meeting.



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