SWISSQUOTE

WEEKLY MARKET OUTLOOK

9 - 15 March 2015

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WEEKLY MARKET OUTLOOK - An overview

Economics

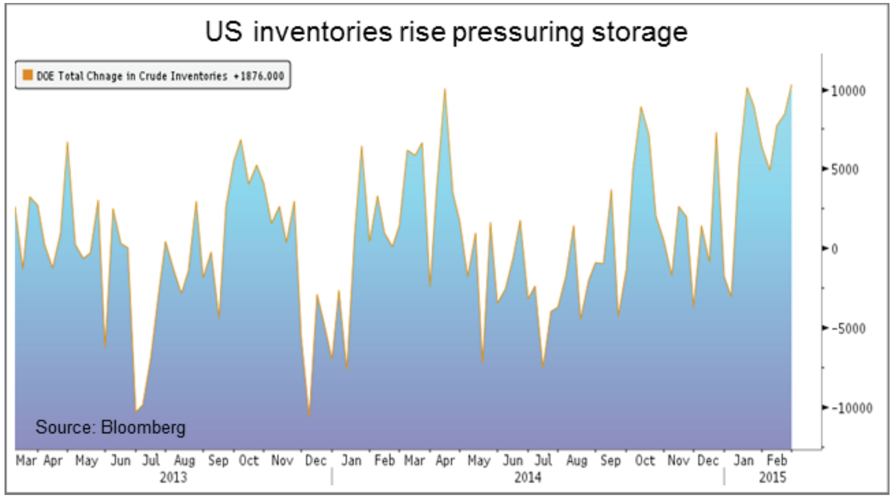
Supply could trigger downside in WTI

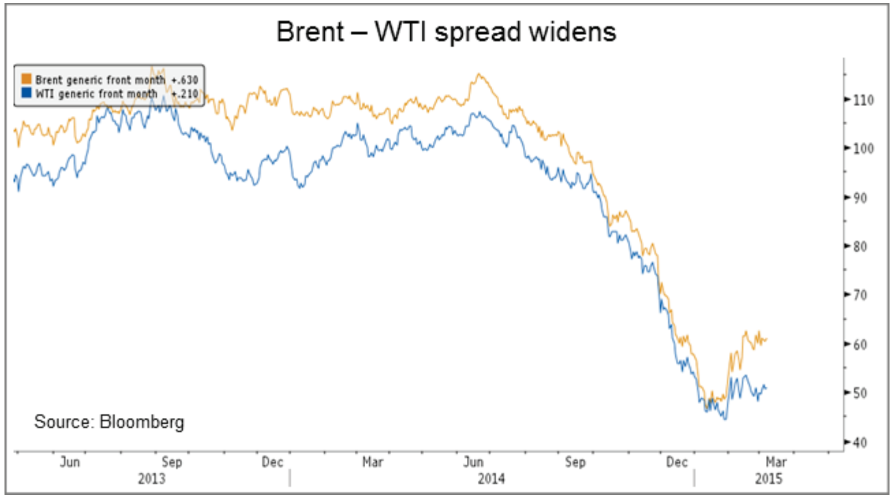
Crude spread remains wide

The spread between brent and WTI remains at around $12 the widest level since January 2014. While soft demand and fears of supply disruption has allowed Brent's price to strengthen, oversupply in the US has kept WTI price subdued. US oil production (mostly in light sweet crude) had risen sharply as output increased to 5,000 barrels to 9.285 barrels a day (verse roughly 8m barrels a day a year ago). US storage data showed a meaningful increase in crude oil inventories above 8.4m barrels to 434.1m. Despite the low price and lack of storage capacity producers have continued to drill. US crude inventories have been increasing by more than one million barrels a day since the start of 2015. According to the DoE US supplies are now at their highest levels in 20 year. The US economic activity has failed to consume the surplus oil which now reached an excess of 1.1m barrels day. The surplus get put into storage. Also, with exports restricted by Federal law, storage space is disappearing. Additional storage tanks are being built at the Crushing facility but at capacity will not be up till mid-year.

Potentially more downside for WTI

The WTI curve has become extreme steep, incentivizing investors to buy crude today and store it until demand/price increases. Which, according to the curves, should increase in value in the near-term. Heading into the US summer driving season and potentially slower production could push prices higher. However, should forward outlook for prices to deteriorate, there is a high probability that oversupply and max-capacity could force inventory dumping. A net effect of lower WTI price and wider brent and WTI spread.





FX Markets

ECB starts buying €60bn sovereign debt on March 9th

Optimistic economic forecasts failed to revive EUR-bulls

The ECB maintained the status quo at March meeting. At his monthly press conference in Nicosia, the ECB President Draghi's press conference triggered short-term volatility in the FX markets. EUR/USD first spiked to 1.1114 as Draghi said the borrowing conditions improved significantly - thanks to positive impacts of bond buying program - and the benefits from measures are being transmitted to the real economy. While the inflation is expected to remain in negative territories for couple of months ahead, the stimulus significantly "damped second round oil effects" and halted the decline in inflation expectations according to Draghi. The ECB staff predict the Euro-zone inflation back to 0% (vs. 0.7%) in 2015, with the real GDP expected to accelerate to 1.5% (vs. 1.0%). The optimistic tone revived a short-lived rebound in EUR/USD yet levels above 1.11 quickly became good price for fresh shorts.

What didn't please the EUR-trader?

First, the ECB will start buying 60 billion euro worth sovereign debt per month from Monday March 9th until September 2016… and longer if needed. Concretely, the ECB pledges to extend the QE program until the inflation is comfortably on path to 2% target. The open-ended QE means that the total size of asset purchases may exceed 1.14 trillion euro and this is no positive news for the EUR. Although the inflation expectations suggest there would be no need to extend the sovereign purchases (CPI to pick-up to 0% in 2015, 1.5% in 2016 and 1.8% in 2017!), the uncertainty over the economic forecasts failed to convince traders.
Second and worse, the ECB will buy negative yielding debt. Although the purchases exclude papers yielding lower than the deposit rate, this flexibility will most probably shift demand to longer maturity bonds and distort the duration of bond portfolios.

"ECB is the central bank of Greece"

Finally, the doubts vis-à-vis the Greek bailout crisis keep the EUR markets quite tense. President Draghi said the Greek banks are in good shape and it is important to keep them healthy. The "ECB is the central bank of Greece" said Draghi as the 100 billion euros lent to Greece stands for 68% of country's GDP. The ECB is ready to consider reinstating the waiver for Greek bonds' eligibility as collateral, however certain conditions should be met.
Greece needs to repay 6.5 billion euros of debt and interest in three weeks ahead, if not another default will certainly be a massive damage to country's credit rating and will automatically leave Greece out of the QE program. On Monday, the Finance Minister Varoufakis will meet his EZ counterparts to seek solution to unlock funds. Draghi highlighted that Eurogroup decisions are important to "an enormous extent" to the ECB. "If there is an agreement, our background changes completely and we would be in much better place to take favorable decisions for Greece", he added.

FX Markets | RBI's rate cut increase pressures on the CBT

RBI surprisingly cuts the benchmark repo rate

To everybody's astonishment, the RBI lowered the benchmark repo rate by 25 basis points to 7.50% via surprise action in an effort to "compensate the delay in fiscal consolidation" and to comply with PM Modi's budget announcement (!) While the new budget was rather expected to displease the RBI and keep the bank on hold at least until April 7th scheduled policy meeting, the surprise rate cut was all but expected! To summarize quickly, the PM Modi announced four days ago to include the funding of infrastructure to his first full-year budget and did little to decrease subsidies, meaning that his government is not afraid of widening the deficit to fuel growth. In this picture, the higher government spending and softer fiscal consolidation is upright against the central bank's price stability mandate (government and the CB agreed to fix the target at 4% +/-2%). There is the surprise effect! While the India's inflation is ranked third among the leading Asian economies (with January CPI at 5.11% y/y), nobody would have expected Rajan to get positioned in the easy-money camp. Apparently, the low energy environment justifies temporary policy deviations both on fiscal and monetary legs. Now that the RBI made its growth-supportive stance explicit, markets do no longer rule out additional rate action at April 7th meeting. The RBI action is now good to strengthen support at 61.7664, Fibonacci 61.8% retracement on May-Dec'14 rise.

Turkish lira falls to all-time low verse USD

If the USD/TRY hit fresh all-time-high (2.6281) in week to March 6th, the move had no wonder something to do with the RBI action. On top of faster-than-expected core CPI fall in December (perfect excuse to fuel President Erdogan and government's call for lower TRY rates), the RBI's dovish move reinforced fears that the CBT can only see its refusal-margin collapse! This being said, we see the risk of political pressures increasing as Turkey's economic situation remains gloomy three months before the the general elections. The front-end of Turkey's sovereign curve remains strongly inverted with the back end of the curve shifting higher as the country risk spills over longer maturities. The FX and money markets therefore are clearly positioned against additional rate action from the CBT, although President Erdogan points CBT Governor Basci as responsible for the economic slowdown! The 3-month cross currency basis hints at decreasing interest in TRY verse USD.

Economics

Weaker JPY unlikely to improve Japan's growth outlook

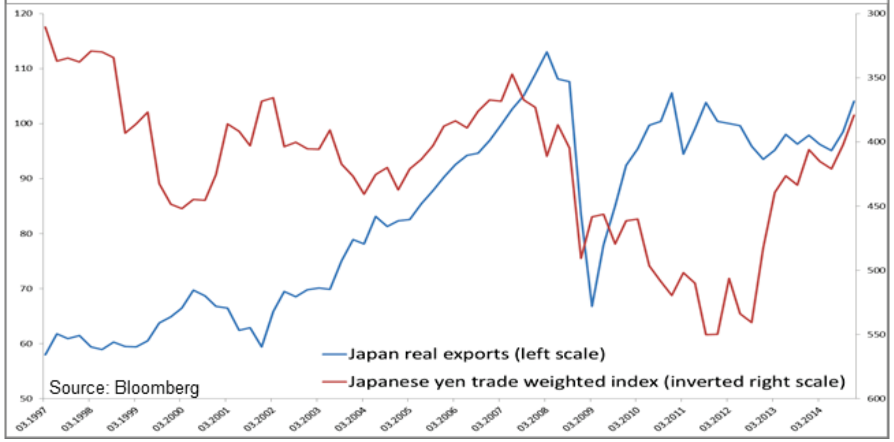
No virtuous cycle in Japan yet

One of the main objectives of Abenomics has been to create a virtuous cycle by boosting corporate earnings, especially exporters through a weaker yen, in order to increase wages, which in turn will lead to an increase in household spending, supporting further improvements in corporate profits. In the process, growth would strengthen, inflation would move towards its 2% target (eroding households saving) while government tax receipts would increase thanks to a higher VAT tax. Sadly, for the time being, the Japanese economic situation remains far away from this rosy picture. Indeed, while large cap Japanese export companies have gained, they have preferred to increase their savings instead of investing to gain market shares. In the meantime, the yen weakness has penalised the working class (notably through higher imported food prices) and importers.

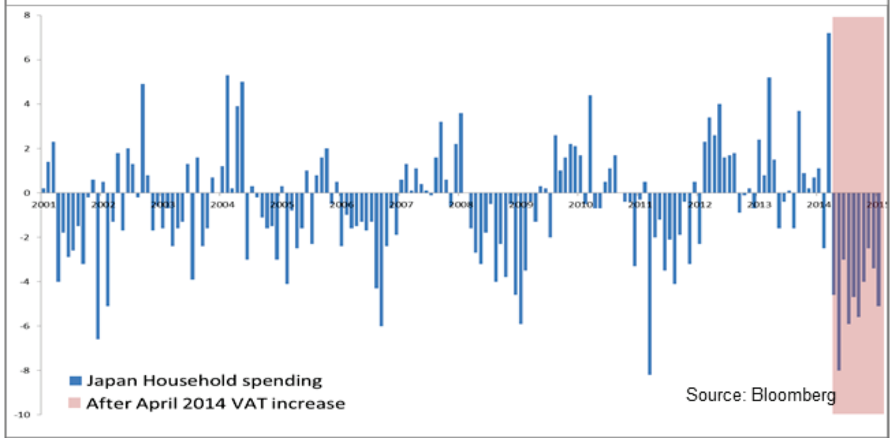
Japan's growth needs to strengthen ahead of fiscal consolidation

Overall, the Bank of Japan's monetary policy has thus far not been very successful. Indeed, inflation and inflation expectations are not high enough to curb domestic savings while the weak yen has only been positive for exporters. With fiscal consolidations set to increase as 2020 is getting nearer, Japan has not a lot of time to significantly improve its growth outlook. As a weaker yen is unlikely to significantly strengthen the Japanese economy, we could see a shift towards other policies. A strategy based on improving wages outlook could lift household spending and favour corporate investments (to respond to the resulting increased sales outlook). Furthermore, higher wages would be more effective in lifting inflation than a weaker yen. As a result, the current wage negotiations ("shuntô") are critical to assess Japan's capability to reignite a virtuous cycle.

Muted increase in exports compared to decline in yen



Consumer spending has still not recovered from VAT increase



FX Markets

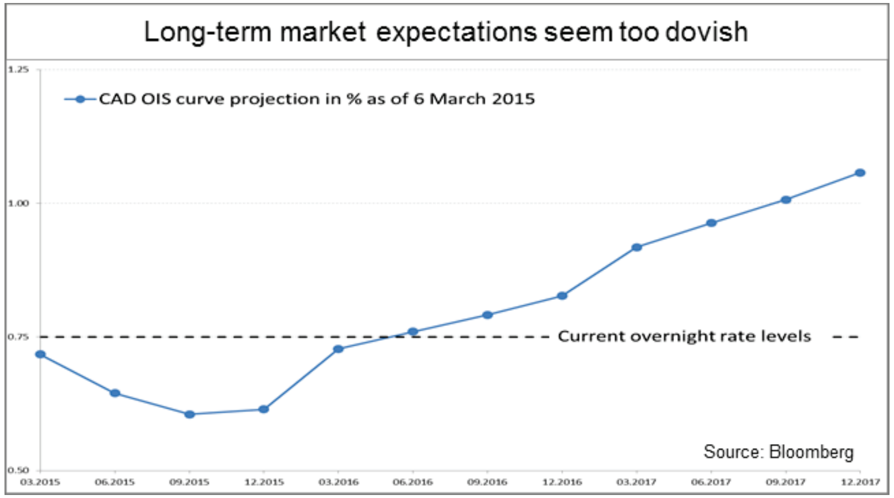
BoC's Governor Poloz hints at a more hawkish policy

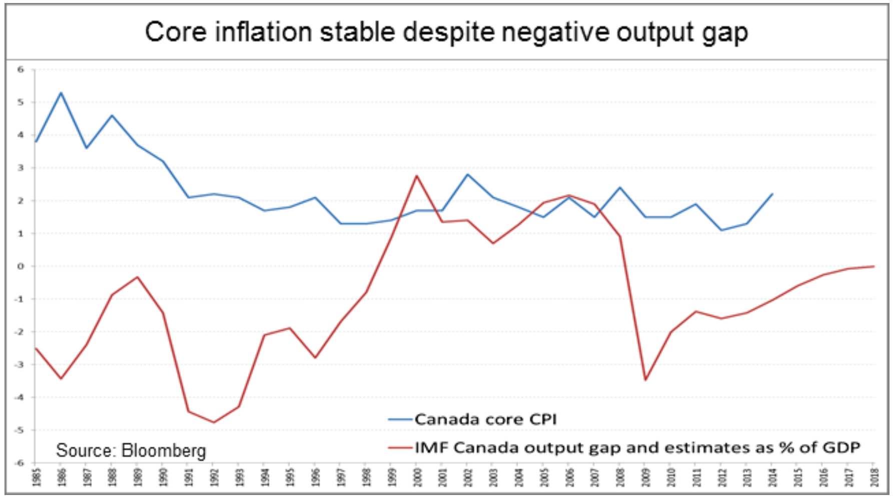
Bank of Canada seems reluctant to cut further

The Bank of Canada (BoC) left the overnight rate unchanged at 0.75%, suggesting that further "insurance" was unnecessary given the improving growth outlook and stabilising oil prices. The BoC's statement did reflect a more positive outlook compared to January and, coupled with Mr Poloz's speech on 24 February, suggest a potential shift towards a more hawkish stance. Indeed, it seems that the insurance given by a rate cut is getting increasingly costly given the household debt imbalances. So while there was a tacit agreement from the central bank monetary stimuli for a reduction of savings to support growth, it seems that Mr. Poloz is getting increasingly willing to push for pro-saving incentives. It has to be said that with more than 150% household debt to disposable income, a housing market collapse would have severe and long-lasting effects on the Canadian economy.

Long-term rates market expectations are too dovish

While the BoC is likely to welcome any tailwinds from a weak Canadian dollar in the next months, we suspect the market is underestimating the 24 February long-term hawkish signal. Indeed, a rate hike is only expected by the market at the end of 2017. Furthermore, Canadian core CPI has remained stable above 1% despite a large decline in output gap. Finally, although only due in November 2016, the renewal of the BoC inflation mandate will likely reflect the need to address economic imbalances even if it is at the cost of inflation deviating from its target for an extended period of time. As a result, the bar does not seem that high for the BoC to start its normalisation process, especially if households debt growth is picking up again. Overall, we continue to favour a rise in USD/CAD towards its major resistance at 1.3065 (March 2009 peak) due to a less patient Fed. However, we suspect that further strength should be limited.





FX Markets

Net short AUD positions near record levels

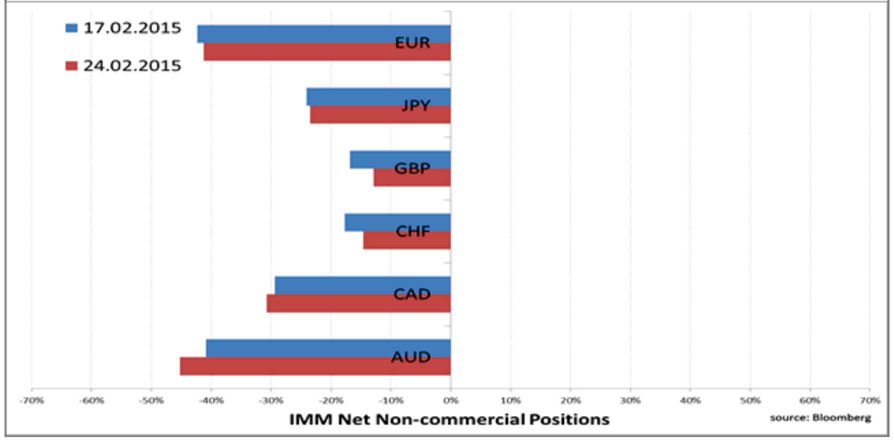
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 24 February 2015.

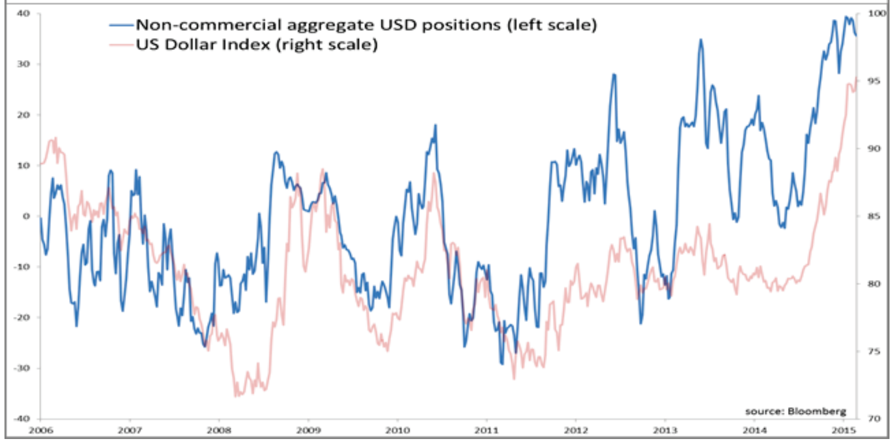
The net short EUR positions have been further reduced. Coupled with reductions in net short positions in JPY, GBP and CHF, the aggregate long USD positions have posted a decline for the third straight week. Although long USD exposure remains at elevated levels, we continue to believe that the market does not discounted a less patient Fed, as can be seen by the recent market reaction to 6 March US job market.

Net short AUD positions have further increase (-45.17%), getting closer to their record levels (-48.17%). Furthermore, the RBA's decision to leave rates unchanged (although hinting at further rates cut) suggests that the central bank is getting less aggressive in driving the Australian dollar lower. As a result, we suspect that the medium-term downside potential in AUD/USD is getting thinner.

Net long AUD positions are getting more extreme



Aggregate long USD positions have been reduced



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