SWISSQUOTE

WEEKLY MARKET OUTLOOK

23 - 29 March 2015

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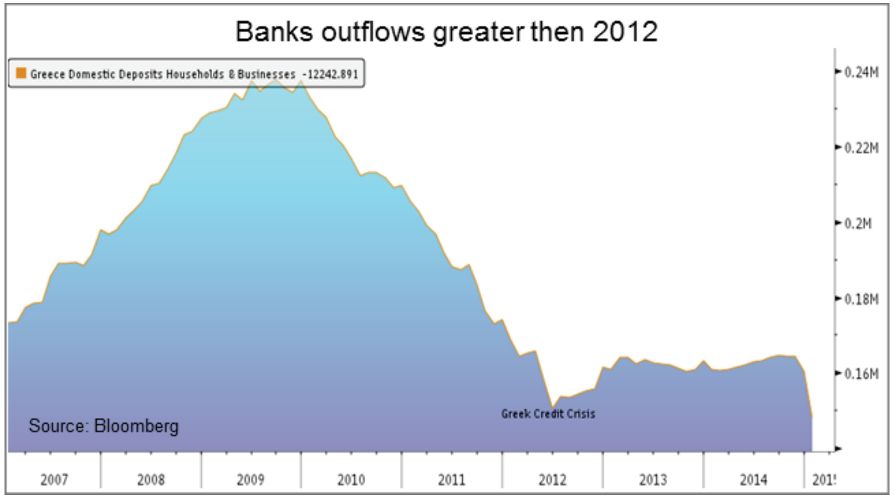
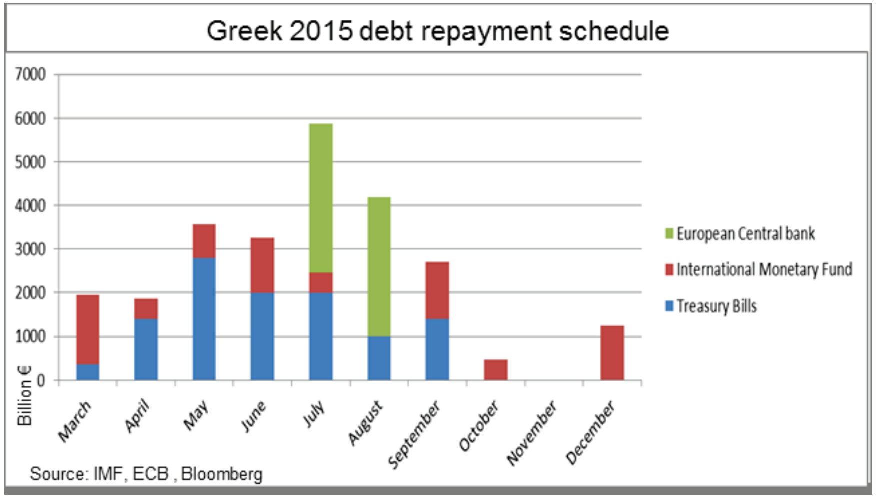
WEEKLY MARKET OUTLOOK - An overview

Economics

Greek drama continues

We remain highly skeptical of the current Greece negotiating strategy; a view echoed by the rise above 22% in Greece 2-year yields. A tactic pushing creditors to the breaking point, only to find last minute reconciliation. All the while, the situation on the ground in Greece is deteriorating rapidly. Tensions reach new highs as Tsipras demands on Europe were unapologetic and Greece has snubbed requests to deliver updates on public finances or reform plans. Yet, after marathon meetings with European leaders, Greece has promised to submit new reform plans in order to secure additional bailout funds to stave off bankruptcy.
Away from the headlines, the situation in Greece is spiraling out of control, with new funds needed urgently to stop an all-out collapse. Perhaps ominously, media outlets are now reporting that the ECB is considering allowing limited Greek banks to buy Greek government debt, only a few days after increasing the ELA by €400m. Growth has marginally improved but significant headwinds remain. The political uncertainty is taking its toll on the financial behavior of participants. Domestic and international investments have all but evaporated. Deposits from banks are being liquidated at an alarming rate (estimated €2-3bn daily), with deposits well below the 2012 lows (prompting rumors of capital controls). Meanwhile tax evasion, which was key to Tsipras' reform measures, continues to plague the cash strapped government (although it has slowed since January substantial €1.048bn shortfall).
Tsipras continues to dance, only at the last moment endorsing the reforms put in place at the Febuary agreement. However, the political backlash which accompanied the pact to reform for cash put the new government in a difficult position. The citizens of Greece elected Syriza not on a reform ticket but to stand strong to creditors. Any significant reform program that gets the German approval is likely to find resistance in the legislature. Pressure is mounting on the domestic front while large debt repayments loom with €1.4bn in June and €3.5bn in July. The time is running out for the Greek government to reach necessary solutions with the IMF, the ECB and the Eurogroup.





FX Markets — Traders remain cautious as SNB leaves policy unchanged

Removal of EUR/CHF peg weighs on Swiss trade balance, growth and inflation

The SNB maintains the status quo as widely expected. The negative impacts of the franc appreciation post-January 15th is filtering visibly into the economic data. Swiss trade surplus narrowed to 2.47 billion in February (the lowest since September 2010) as exports dropped 2.8% (vs +2.9% a month ago) and imports surged 3.1% /vs -2.2% prev). The weakness in Swiss trade balance should continue as Swiss products become less competitive due to higher franc, while the Eurozone neighbors have hard time stepping out of the economic weakness. The growth and inflation forecasts have been revised down significantly. The Swiss deflation is now expected to ease to -1.0% from 0.2% previous forecast, while the economic growth should decelerate to 0.9% in 2015 verse 3.1% forecasted formerly. Given the weakness in Europe, almost 1% growth is an optimistic forecast. There is increasing probability for the Swiss growth to step in negative territories in the first half of 2015 as the economy needs at least two quarters to absorb and to stabilize post-EUR/CHF peg shock. The recovery from Q3 is subject to downside risks, contingent on the pace of Eurozone’s economic activity pick-up.

Timid correction on the money markets

Post-SNB, the euroswiss futures advanced to 110.92 before easing toward 110.79 (in line with -75bp official rate) with open interest over one and a half times the past 15-days average. The post-SNB money market pricing confirms that the anxiety on more negative rates will remain in the headlines as selling pressures on EUR are not ready to dissipate. Given the global macroeconomic setting, the SNB has room to pull the rates lower in case of emergency. The market should easily absorb 15-25 basis point cut should the EUR risks materialize. (Grexit, Greece insolvability, rising protests against the anti-austerity and the ECB). The SNB is suspected to purchase sizeable amount of EUR to maintain the EUR/CHF within its implicit 1.05/1.10 range. Post-FOMC recovery in EUR will certainly anchor the EUR/USD market within 1.0458/1.0870 (Mar 16th low / Fib 38.2% on Feb-Mar drop) area and allow the SNB to take a breather before fresh turmoil.

FX Markets

BRL faces deeper sell-off on protests, economic data

Political turmoil, higher inflation offset the USD weakness

The political unrest in Brazil kept on pushing the BRL toward fresh 12-year lows verse USD on week to March 20th. The post-FOMC recovery remained limited at 3.1910 as dip-buyers were crowded at levels below 3.20 which becomes a bottom as the political pressures persist. Education minister Comes' resignation adds to political pressures in the country, as the freshly re-elected President Rousseff and the government are under the spotlight for corruption scandal on Petrobras. Proposal on anti-corruption will be presented today, while we see the angry crowds being hardly satisfied on any proposal and stand ready for renewed street protests over the weekend. Traders will certainly be reluctant to hold long-BRL positions over the week-end, hence we should see speculative BRL-longs closing before the weekend and sustain the current BRL weakness.

As the corruption scandal gains momentum on streets, the risk of a potential sovereign rate cut worries those who have money invested in BRL-denominated assets. The five-year credit default swaps rose to 6-year highs (306.340 bp). A downgrade on BRL rating would speed up the current capital outflow from Brazilian assets, increase selling pressures on the Real and therefore accelerate the uptrend in inflation. As expected, the IPCA-15 (extended national consumer price index collected in between 15th of each month) printed 1.24% increase on month to March 15th, thus pushing the annual inflation to 7.90%, levels last seen in 2005. As the government restriction on prices are being removed, the inflationary pressures in Brazil should remain tight despite globally lower oil prices (as the depreciation in Real offsets the fall in the oil market). The hiking consumer prices is expected to lead to additional Selic rate hike on April 29th policy meeting. This means that stronger inflation read will revive BCB-hawks and trigger short-term BRL correction on better carry appetite. Fundamentally however, the risk investors should prefer to reallocate funds to alternative risky assets that offer lower rate spread yet for better visibility. It is also important to remember that lower rating restrict the collateral value of BRL and BRL-denominated assets, therefore indirectly impacts a portfolio's total return. This is why, higher return does not always justify increased allocation.

Data-full week ahead in Brazil: time to face the reality

The BRL will step into a data-full week: foreign direct investment, current account balance, unemployment and 4Q GDP will give direction to traders through the week ahead. Little improvement in current account deficit, foreign investors' reluctance to boost activity amid Petrobras scandals and mounting anger against President Rousseff and the government, combined to fragile fiscal conditions, place the Brazilian economy at the edge of stagflation. Next week data will give a quantified summary of the economic situation and determine whether further BRL depreciation is justified.

The broad-based EUR weakness had little impact verse the BRL. EUR/BRL extends gains above 3.50 no matter how tight the EUR returns have become. The EUR/BRL is being overly purchased in our view: efforts to escape the political turmoil in Brazil do no longer justify the reverse carry flows towards the EUR, where the eco-political situation is hardly better. The oversold BRL verse GBP, CHF and the negative positioning in speculative futures (-8550 contracts as of March 10th) signal there is potential for decent short-covering. However there is little probability of this happening over the next week.

Economics

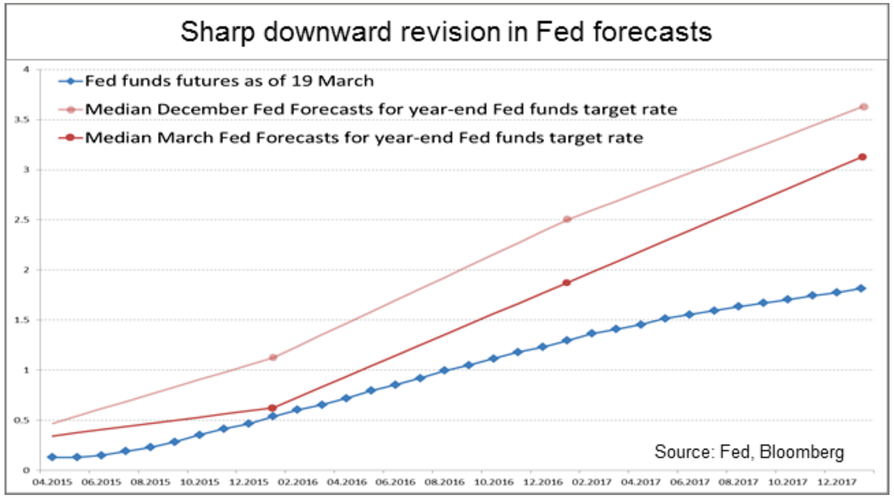
The Fed has raised the bar for a June hike

Significant downward revisions in Fed's economic projections

As expected, the March FOMC statement has removed the "patient" forward guidance, indicating that the Fed could start raising rates in the next couple of meetings. However, the numerous downward revisions in the Fed's economic projections, notably the longer-run normal unemployment rate and the near-term inflation outlook, strongly hint at a later hike than June. Indeed, by pushing the longer-run unemployment rate lower (from 5.2%-5.5% to 5.0% to 5.2%), the Fed has increased the requirements to fulfil in order to raise rates. Furthermore, Fed chair Yellen also mentioned the recent appreciation of the US dollar as a restraining factor, through declining import prices, on inflation. It seems therefore likely that the Fed wants to avoid a too steep USD appreciation.

Short-term setback for USD but long-term outlook unchanged

The resulting effects can be seen in the downwards revisions in the median of the Fed funds rates forecasts: from 1.125% to 0.625% for the end of 2015, from 2.50% to 1.875% for end of 2016 and from 3.625% to 3.125% for the end of 2017. Despite the probable later rate hike, the Fed has not adjusted the pace of the next rates hikes higher. In the light of these changes, USD weakness was likely. However, the amplitude has likely been magnified by the elevated long USD positions (see page 8). We suspect that the Fed is overly cautious on the US economic outlook, as small changes in the growth and inflation outlook have resulted in big changes in the Fed funds forecasts. Indeed, we continue to expect further improvements in the labour market which should translate into higher wages growth, while the weakness in housing sector was partly explained by adverse weather. As a result, although a September rate seems now the most likely scenario, the new rate path signaled by Fed forecasts leave room for USD positive surprises. Overall, the post-FOMC USD weakness should not change the underlying uptrend, continuing to favour a sell on rallies strategy.

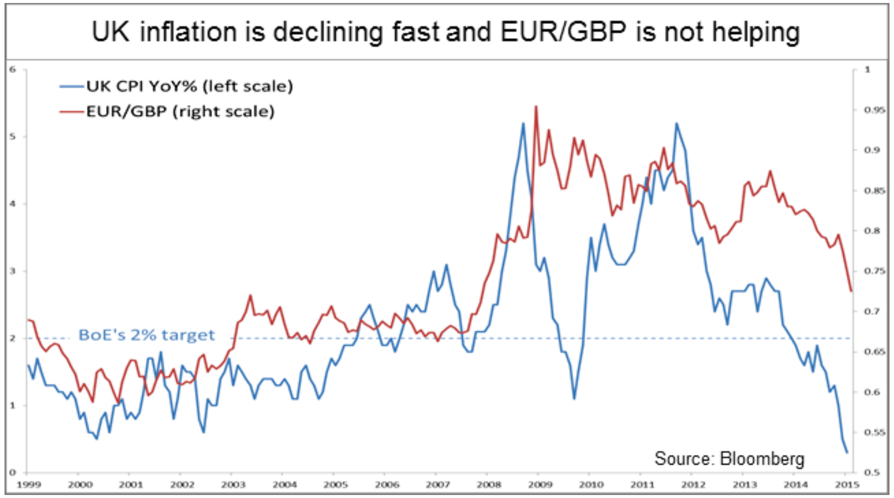


FX Markets

The BoE is getting vocal about sterling's strength

Dark clouds on British pound

While the uncertainties linked to the upcoming UK general elections should likely weigh on the GBP, the recent comments from members of the Bank of England hint that further GBP appreciation would be a threat to the inflation outlook. Indeed, on 12 March in a speech to a business audience, BoE governor Mark Carney stated that "it may be appropriate to take into account persistent external deflationary forces arising from the combination of continued foreign low inflation and the protracted effects of sterling's strength" on UK CPI. Furthermore, persistent GBP strength is unlikely to help reducing the large UK current account deficit. Although British companies are especially hurt by recent FX moves as they tend to import raw materials denominated in dollar and sell their product to the Eurozone, Martin Wheale also warned on 11 March on the risks caused by a rising exchanged rate.



Limited options for BoE to curb GBP inflows

Part of the reasons behind GBP strength since the start of the year come from portfolio allocations: as most central banks in Europe have pushed rates into negative territory, the divergence in relative monetary policy have supported inflows into GBP. While cutting rates or expanding QE seem extreme responses, the Bank of England is left with the option to push back rates hikes expectations. Given the influence of EUR/GBP in UK's inflation outlook, the central bank is likely to postpone any early rate hike and even wait for the end of the ECB's QE in order to limit the attractiveness of the British pound. Overall, the evolution of the British pound should now be more influenced by the weak UK inflation outlook than by the robust growth data. As a result, we see further downside for the sterling: GBP/USD is expected to decline towards its strong support at 1.4231 (May 2010 low), while EUR/GBP is likely to consolidate above the 0.7000 support area with resistances at 0.7455 (12/02/2015 high) and 0.7592 (03/02/2015 high).

FX Markets

EUR/USD rebound fueled by elevated short EUR positions

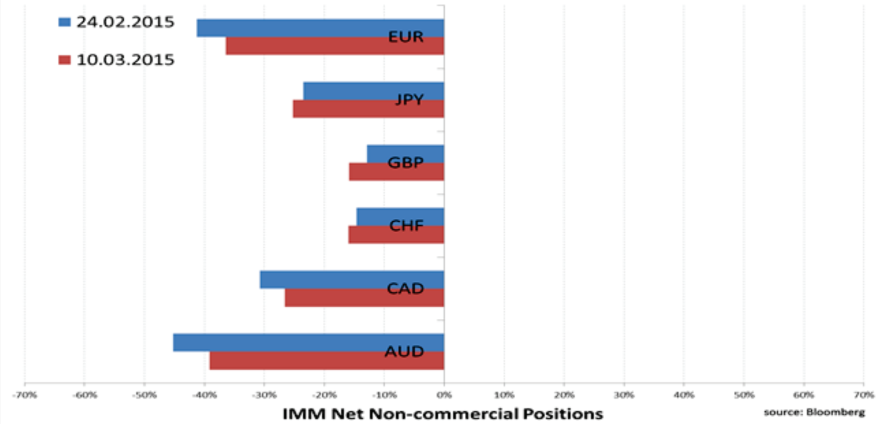
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 10 March 2015.

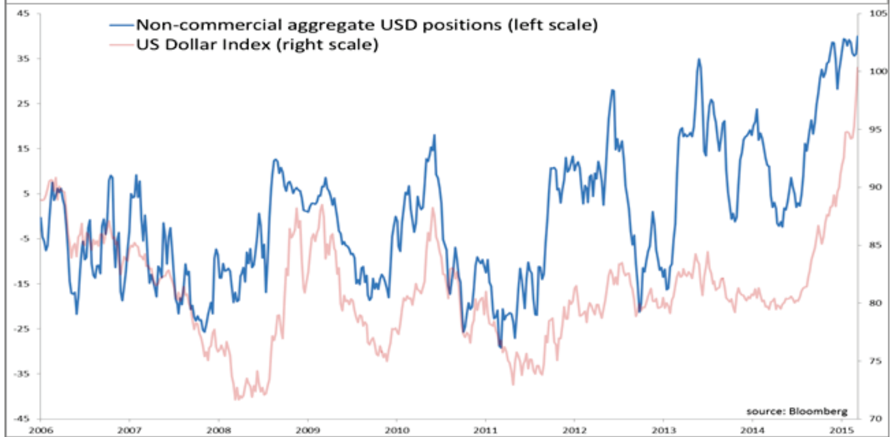
The relative divergences between the significant reductions in short EUR, CAD and AUD short positions and the record high in aggregate USD positions need some explanations. The rationale is that aggregate USD positions do no take into account the open interest, whereas other currencies are divided by it. However, the open interest takes into account commercial positions (i.e. hedges), which stands at elevated level. As a result, the decline of the short positioning in EUR, AUD and CAD is mainly caused by the rise in open interest. Overall, the persistent elevated short EUR positions is likely to fuel any rebound in EUR/USD, as can be seen by the rise following the FOMC meeting. However, it is not expected to alter the underlying bearish trend in EUR/USD.

The recent breakout of the key support at 1.4814 in GBP/USD coupled with moderate short GBP positions do not bode well for the British pound. We expect further GBP weakness in the next few months.

Elevated short EUR and AUD positions have been reduced



Aggregate long USD positions remain at record high



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