SWISSQUOTE

WEEKLY MARKET OUTLOOK

30 March - 5 April 2015

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WEEKLY MARKET OUTLOOK - An overview

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Economics

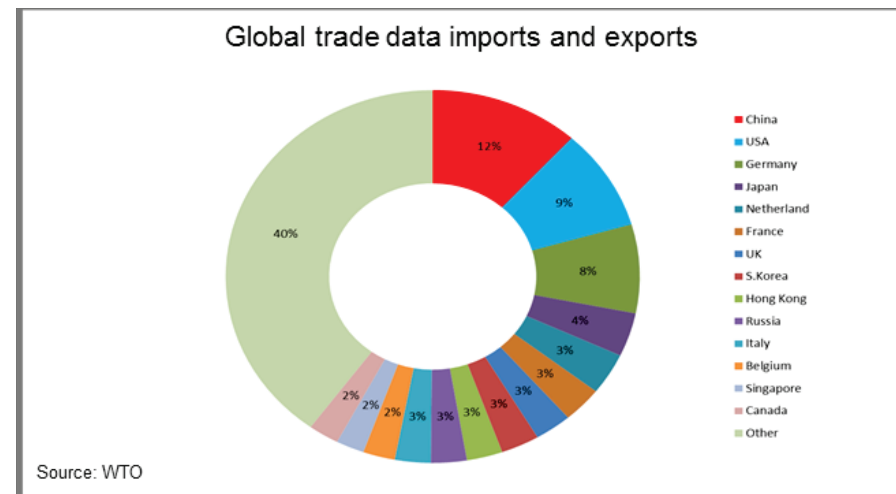
CNY moves closer to inclusion in SDR

In a sharp reversal, the Chinese yuan has erased nearly all of the 2015 loses verse the greenback. Part of this change in direction was due to shift in expectations for the Fed's first rate hike (broader natural USD sell-off). However, this move has also been driven by significant PBoC FX intervention, suggesting a larger policy committed. At the same time, People's Bank of China Governor Zhou Xiaochuan has been vocal, indicating that the Chinese government's aim is to internationalize the yuan. There is a real push to rebrand yuan in the image of a stable, non-EM correlated asset which could be freely traded.

Potentially, not coincidentally, the IMF is reviewing Special Drawing Rights (SDR) and China hopes that the yuan can be included into the fund reserve currency basket. The composition of the SDR basket (USD, EUR, JPY and GBP) is reviewed every five years and reports indicate that yuan narrowly missed the cut in 2010. The IMF criteria for inclusion outlines freely usable currencies which are "widely used to make payments for international transactions and is widely traded in the principal exchange markets." In the last five years, growth in yuan trading volume and usage in international trades has skyrocketed. However, the deliberation around "freely usable" is the barrier. The primary requirement that the yuan is "freely" convertible, has not been meet. Despite strong efforts to internationalize the yuan, it is far from "freely" convertible. While China has reached other milestones such as percentage of global trade and yuan trading volume, the simple fact that investors can't make a sizable bet in China will stop inclusion.

However, this is very much a political decision. Since there are no hard rules for SDR inclusion, there is a critical discretionary aspect with demands a majority vote on the IMF council for any change. This discretionary feature injects a high level of uncertainty into the outcome. We understand the reason to say "no" but there are compelling reasons for the G20 led by the USA to say "yes". China is clearly on the rise and increasingly demanding a role on the global stage. This might be viewed by the US as a way to get China to fast track financial liberalization, while at the same time integrates China into a leadership role with heavy reliance on G20 partners. Inclusion in the SDR and greater role in the IMF might lessen the commitment to China's Asian infrastructure Investment Banks (which is a concern to the US).

In the short term with China's economic fundamentals weak and the US edging towards a rate hike, the yuan still faces downside pressures. But PBoC proactive interventionist stance on CNY and aggressive stimulus plus expectations for end of year growth recovery makes us anticipate CNY strength. Should China move forward with internalization as we have heard from Xiaochuan, we expect a strong pent-up demand for yuan (less concerned about capital exodus).



FX Markets

Safe haven demand sends EUR/CHF below 1.05

EUR/CHF trades below 1.05 first time since Feb 12th

On the week to March 27th, EUR/CHF traded below what the market has accepted as the SNB's 1.05/1.10 implicit band, despite sustained buying interest in the majority of EUR-crosses over a major part of the week. EUR/CHF bottomed down to 1.04222; the break below 1.05 threshold triggered some stress on the euroswiss futures, which topped to 100.890 for the first time since the SNB refrained to cut rates on March 19th scheduled meeting. EUR/CHF made numerous attempts above 1.05 through the rest of the week with suspicions that the SNB might be back in the game while tensions due to Greek uncertainties and Saudi Arabia's air strikes in Yemen reinforced the appetite in franc.

As the EUR/CHF fails to move sustainably back in the 1.05/1.10 band, we see two possible scenarios moving forward. First, the SNB's struggle to prevent the franc from appreciating will surge tensions on the Swiss rate markets by increasing the probability of an emergency rate cut. In this context, the SNB's implicit commitment to keep EUR/CHF within 1.05/1.10 will revive the market appetite to challenge the SNB and keep the EUR/CHF more close to 1.05 bottom rather than to 1.10 ceiling. With the EUR correction underway and the political discontent regarding the negative rate environment, we however see no immediate need to add more pressure on banks and pension funds. And the easing pressures on the euroswiss futures support this view. This reasoning bring us to the second alternative where, the SNB will take advantage of its post-January 15th vague communication and implicit target strategy and let the EUR/CHF fade at acceptable pace toward the parity and hope that the upside pressures verse the US dollar would not take long so to counterbalance the overall franc strength.

We closely monitor the rate markets in order to keep track of any tension that would signal a potential, unscheduled SNB intervention. 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).

The broad franc appreciation pulled USD/CHF down to one-month lows. With the Fed walking toward policy normalization (even if the normalization should happen softer than formerly expected), the counter-forces in the US dollar should however curb gains in the franc and challenge the bearish USD/CHF move pre-200-dma (currently at 0.9423).

Economics | Volatile week in Brazil

S&P affirmed Brazil's investment grade rating

The selling pressures in BRL curtailed amid the S&P affirmed Brazil's investment grade rating (BBB- lowest investment grade) at the beginning of the week to March 27th. The expectations that Rousseff should continue pushing for tighter fiscal discipline at the second term of her mandate prevented a potential deterioration on Petrobras scandal. Petrobras outlook has been revised down to negative from stable BBB-. This is an important relief for the real, first because it dissipated the mounting risks of a sovereign downgrade to non-investment level. Second and most important, the only risk of downgrade has been enough to lead to mid-long term adjustment on investment portfolios, which was clearly going against the BRL over the past three weeks. This is because the lower collateral value of non-investment grade asset pushes investors to fly toward investment grade assets, as to leverage their holdings and enhance their portfolio returns. The stable S&P outlook has been a fresh breath in BRL on the week to March 27th.
We believe it will take some more effort and couple of concrete steps for Rousseff to gain back investors' confidence and bring the money back to Brazil. The BRL relief is therefore seen as temporary. The National Monetary Council pulled the long-term interest rate target 50 basis points higher to 6% despite the deepening economic slowdown. The high volatilities however continue deteriorating the risk-to-reward ratio of short-term long carry positions and should build stronger support at 3.00/10 area.

Stagflation risks

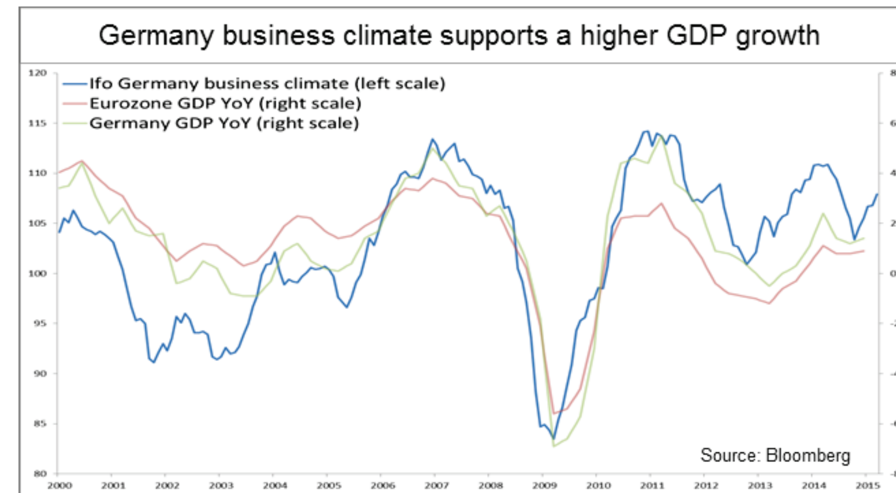
The BCB published its quarterly inflation outlook on March 26th and stated that the inflation is expected to rise to 7.9% in 2015 if the Selic rates is kept unchanged at 12.75%. The consumer prices are expected to head down toward 4.9% in 2016, in line with the BCB's inflation target band (4.5% +/-2%). The bank warned that the inflationary pressures in the short-term will remain, mostly due to removal of restriction on prices and the meaningful BRL depreciation. The unemployment climbed significantly from 5.3% to 5.9% in February. We judge central bank's forecasts too optimistic given the current economic outlook and expect further rise in Selic rate as Brazil's macroeconomic data rings the alarm bell on stagflation risks.

Stock Markets

Stock market weakness seen as temporary

European growth outlook is improving

The recent release of the Germany's Ifo index surprised on the upside, indicating increasing optimism among German companies on the back of a decline in oil prices, a weaker euro and the lack of fiscal tightening. This positive sentiment is also confirmed by the rise in Eurozone PMIs. Coupled with signs that the flow of lending to the private sector continue to improve, economic data signal that the recovery is gaining traction and therefore point for a positive growth outlook in 2015. However, it has to be said that significant risks could derail some of this optimism. Indeed, although not our base scenario, the crises in Greece and Ukraine could damage the Eurozone growth outlook, should the situations significantly worsen (Grexit and further round of sanctions).



Prices behaviour does not call for the end of the underlying uptrend

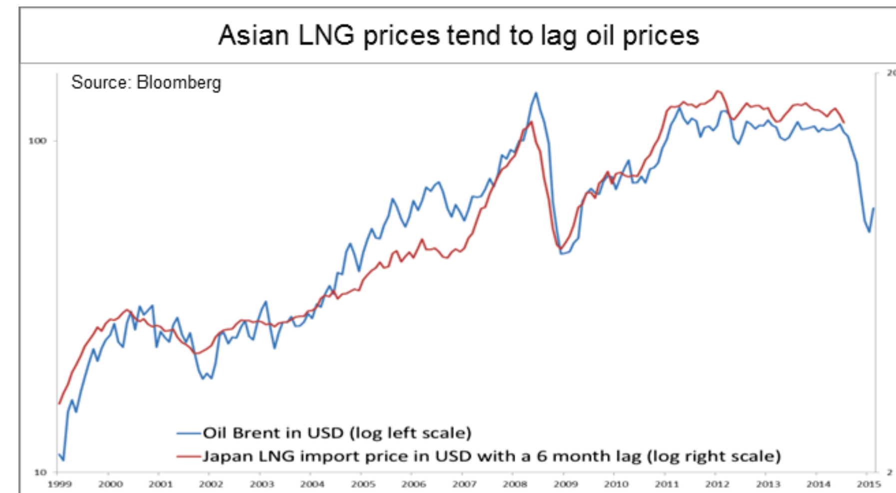
The improving European outlook and the ECB liquidity injections have supported higher stock market prices, as highlighted by the numerous price breakouts in stock indices. From a technical analysis standpoint, the breadth of these breakouts (from a regional, sectorial or size standpoint) indicates a broad-based rally and therefore an internally strong market. As a result, the recent price weakness is likely to be temporary instead of a reversal of the underlying bullish trend. Besides, looking at the STOXX Europe 600, a price correction near the major resistance area between 401 and 408 (2000 and 2007 peaks) is not so surprising, especially given the recent sharp rise. Given the lack of any significant bearish reversal pattern, it is difficult to assess the downside risk. Nevertheless, the breadth of the market suggests that a decline bigger than 10% is unlikely, which implies that the support at 364 (02/02/2015 low) should hold. Intermediate supports can be found at 387 (04/03/2015 low) and 374 (17/02/2015 low).

FX Markets

Tough times likely ahead for the Australian economy

Australia's terms of trade likely to decline further

The persistent prices decline in Australia's top two exports, iron ore and coal, is likely to weigh on the terms of trade. Besides, the expected sharp decline in liquefied natural gas (LNG) is unlikely to improve this outlook. Furthermore, while increasing exports volumes, especially to China, have supported higher GDP growth in the last few years, the recent data coming from China suggest that a cyclical peak in export volumes has likely been made. This development should significantly deteriorate the economic outlook of Australia. Indeed, GDP growth is likely to decline along net exports, potentially forcing the RBA to revise its growth outlook. Furthermore, the tax revenues from exporters' income are also expected to decrease, which should hurt the government budget. Overall, the likely ongoing deterioration in Australia's terms of trade, the weakening growth outlook and the negative effect on budget suggest that the recent rise in AUD/USD is likely in its final stage.



Recent strength in AUD/USD looks like an oversold rebound

From a technical analysis standpoint, the lack of a sharp sell-off (capitulation) or of a base formation suggests that the recent AUD/USD strength is a countertrend move. The sharp reduction in net AUD short positions (see page 8) is unlikely to offer much support to any further AUD strength. As a result, the resistance area defined by 0.7913 (26/02/2015 high) and 0.8025 (28/01/2015 high) should be hard to break. Downside potentials are likely given by the recent low at 0.7561 (11/03/2015 low) and the psychological level at 0.7000.

FX Markets

Net CHF positions back into positive territory

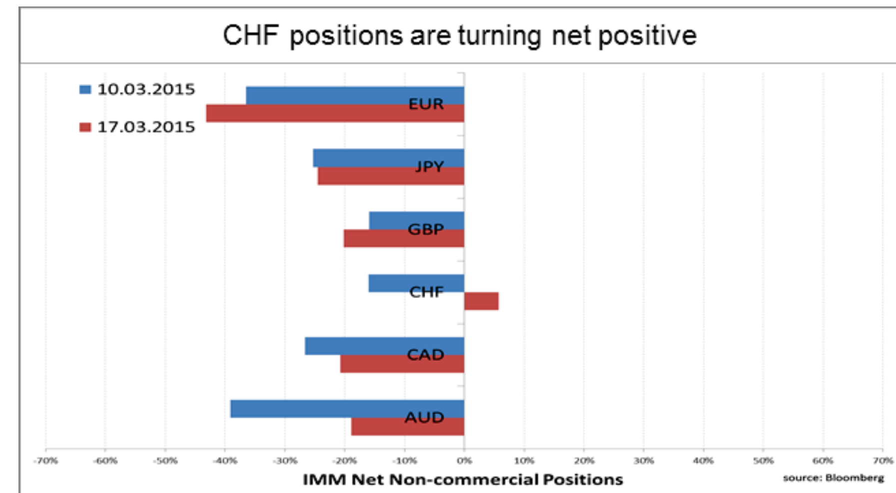
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

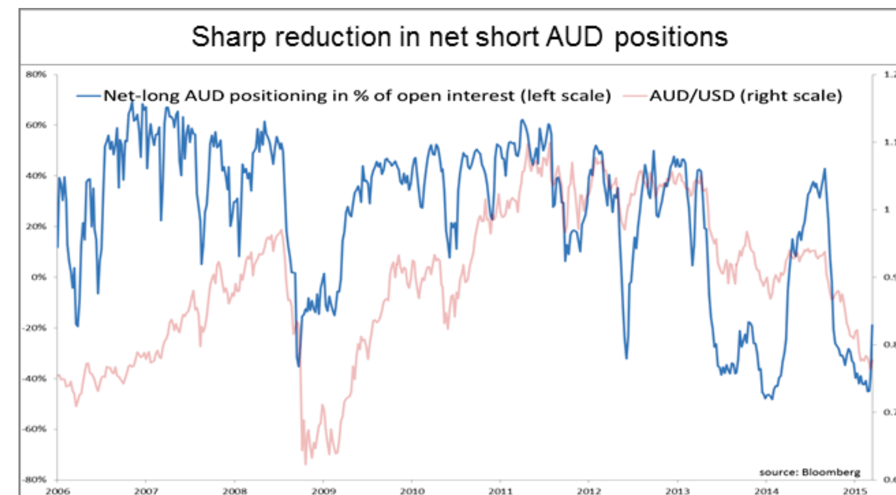
The IMM data covers investors' positions for the week ending 17 March 2015.

Short EUR positions have been increased ahead of the March FOMC meeting. The probable significant short covering following the rather dovish comments from the Fed has likely fueled the rise in EUR/USD. Some clean up in the elevated net short EUR positions should occur before a new leg lower in EUR/USD.

A sharp change in position has occurred in CHF: net CHF positions have moved back into positive territory, as the SNB is seen as rather confident on the ability of its current monetary policy to curb CHF inflows. However, the recent weakness in USD/CHF and EUR/CHF is likely to increase the pressure on the Swiss central bank to be more active either through FX interventions or through lower rates.

The other significant change was made in net short AUD positions. The current levels (-18.86%) suggest that a long AUD/USD is now less attractive from a position standpoint.





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