SWISSQUOTE

WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An overview

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Economics — No Currency War, Really?

Officially, there is no currency war

The more policy officials attempt to discredit discussions over a currency war, the more we should pay attention. Central bank policy is the primary determinate of FX pricing. The head of the International Monetary Fund (IMF) Christine Lagarde recently rejected the concept of neo protectionism (since it seems currency war terminology is not PC) by stating "There's been lots of talk of currency wars, and we have not seen any such thing as a currency war. We've heard currency worries, not currency wars." Yet judging by the actions of policy makers globally, managing the exchange rates have now become the primary tool for economic recovery policy. Having failed to make the necessary structural changes that might have pulled them out of depressionary economic conditions, central bankers have turned to the quick fix of currency price manipulation. When faced with sub optimal growth and weak inflation dynamics, a weak currency can provide export growth, import inflation, and provide a broader economic pick up as busy companies create jobs and increase wages.

A change of language

The current currency war has its roots in the 2009 G20 meeting where the theory of global rebalancing was launched. The concept suggests that countries with excess current account surplus through exports should shift towards consumption growth, while nations with deficits through consumption should shift economy towards export growth. The problem was that no one indicated how this transition should take place. Without the key structural changes, were results can be unpredictable, competitive devaluation provides a simple solution. According to the "premium parity puzzle" theory, a currency with higher interest rate expectations will appreciate versus that of a currency with lower interest rate expectations. Interestingly, still in the throw of the financial crisis central bankers were already using tools that weakened their currency, they only had to find other instruments to restrain interest rate expectations. Since then we have seen broad based quantitative easing and even negative interest rates. Countries have shown that they would be willing to cut rates prematurely (officially concerned over deflationary threats) then allow currency appreciation.

While global rebalancing has taken on a negative connotation, the concept remains strong. Lagarde has just changed the language. "There has to be fiscal consolidation and it has to be at the right pace and it has got to be country-specific. It often has to go hand in hand with monetary policy, and we've seen quite accommodative monetary policy in order to support and help fiscal consolidation" Lagarde stated.

This current phase of global currency wars was never about formal proclamations or grand gestures, but more fought as a guerrilla war. The US Treasury Departments Semi-Annual Report to Congress on International Economic and Exchange Rate Policies, warned Europe against relying too much on exports driven growth. This comment is a clear indication that currency wars are still raging. US policy makers are now worried that the strength of the USD will derail its economic recovery and are taking strategic (yet subtle) actions. Competitive devaluation was use extremely successfully to revitalize the US economy as rounds of QE kept USD artificially weak (remember EURUSD at 1.5144). Now that the tables are turned, with the ECB unleashing QE, debasing the EUR and stealing export growth, we expect this unobtrusive struggle to begin to heat up as the Fed heads towards its first interest rate hike in September and USD continues its bullish drive. Ironically, the next victim in the nonexistent currency war could be the US economy.

Economics

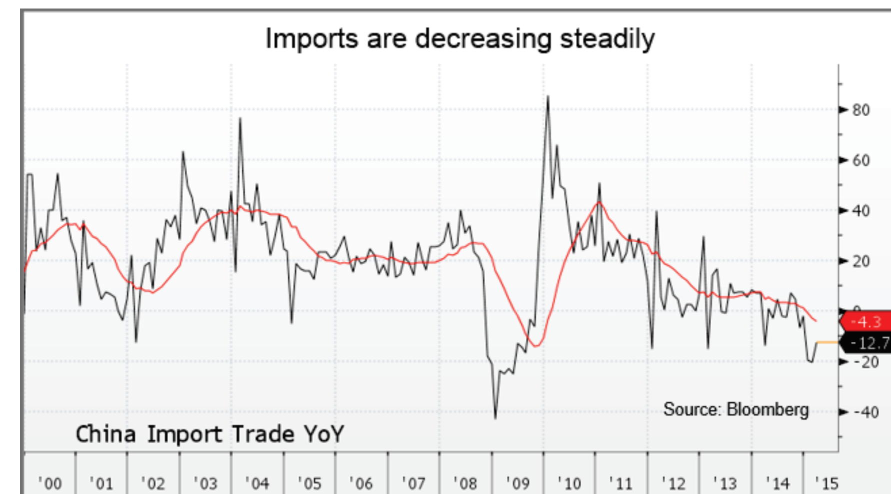
China's Economy Normalization

China economy is slowing down

Not only the US economy is showing signs of slowdown this year as the second biggest economy is also showing weakness. The Chinese economy grew only 7% during the first quarter, the lowest read since Q2 2009 while exports decreased by -15%y/y in March verse 12% consensus (previous read was revised from 48.3%y/y to -3.2%) and imports came in at -12.7%y/y in March verse -10% expected. All in all, trade balance was released at $3.08bn while analysts were looking for $40.1bn. Industrial production rose 5.6%y/y in March verse 7% expected. More importantly, industrial production has declined substantially since 2010, reaching its lowest level since November 2008 (!).

PBoC to soften the impact

However, a slowdown of the Chinese economy seems inevitable as the country is willing to reorganize its economy toward a domestic generated growth in order to limit its dependence to developed countries' economies and is therefore ready to expand at a slower pace. Policy makers are aiming to soften the impacts of a contained economic expansion on the job market and overall financial stability. In addition, inflation is subdued as China's CPI for March was released at 1.4%y/y far from the 3% annual target. There is therefore some room for further monetary policy easing. The PBoC already lowered its benchmarks last February by cutting the one-year lending rate by 25bps to 5.35% and the one-year deposit rate by 25bps to 2.5% (prior cut happened last November). However, we expect further rates cuts in the coming months as well as some adjustments of the reserve requirement ratio (currently at 19.50%, last cut by 50bps in February) as Beijing announced policy makers will act to support the economy if unemployment increases or wages tighten. Currencies of countries highly sensitive to the Chinese economy should consequently benefit from further monetary policy easing from the PBoC.



FX Markets

Can Greece Spoil The Party ?

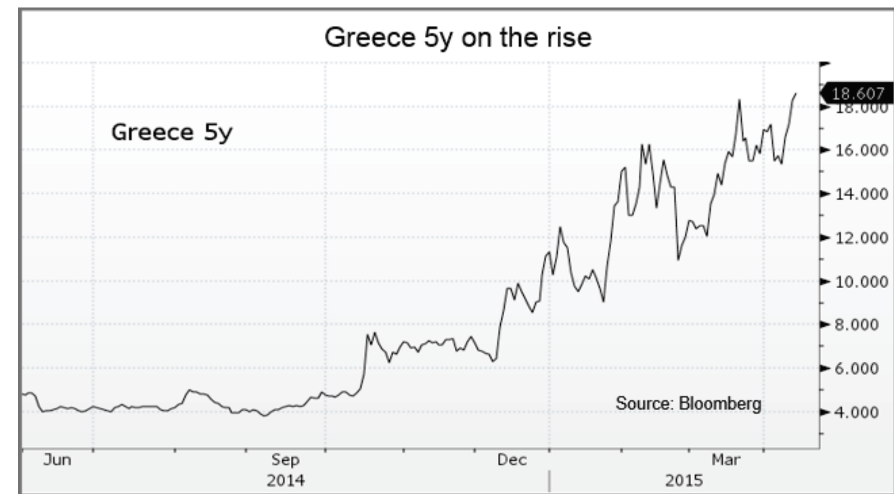
EU economy starts to pick up

Back in March, the ECB implemented its homemade QE and started buying 60bn euro worth sovereign debt per month. The program was initially scheduled to last until September 2016, or longer if needed. When the news has been made public on January 22, EUR/USD quickly lost 2.6% and since then the single currency retreated further to a minimum of 1.0458, down almost 10% in less than 3 months. Looking at the big picture, the euro depreciated more than 18% since the Fed confirmed cessation of buying bonds last October after injection of $4.5tn over five years. After more than one month, the effects are becoming visible on the Eurozone economy as a weaker euro allows companies to price their good and services more competitively while increasing bond prices allows investors to access better borrowing terms. The stock market rallied by almost 15 % (Euro Stoxx 600) since January 22 while 5-years Euro bonds lost 23bps and are currently into negative ground, around -0.16% as of April 17. At country level, German 5-year yield moves around -0.16%, the French one is roughly flat (-0.010%) while the Greek 5y is at 18.62%, a level last seen in 2011.

Clouds on the horizon

However, the Greece situation is giving a headache to EU officials. Standard & Poor's cut Greece's credit rating from B- to CCC+ with a negative outlook. The rating agency added that economic growth looked highly uncertain and that Greece needs deep economic reforms. In addition, rumor is spreading that Greece asked to delay its next debt payment to the IMF. The Greek 5y yield increased steadily over the last 8 months as investors a possible default of the Greek government while the German one went the opposite way to negative territory. Italian and Spanish 5y yields are also higher as investors pursue their flight to safety.

Surprisingly, the market is not pricing the effect of a Greek exit on Germany while the latter has an exposure of €92bn (or 3.2% of GDP) to Greece.

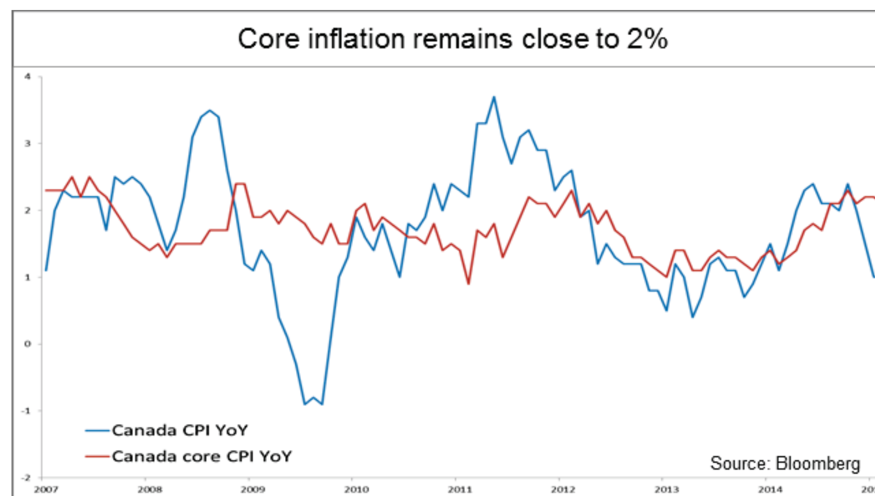


FX Markets

Medium-term Phase Of Strength Likely Underway For CAD

The BoC is looking through the oil price shock on growth

As expected, the Bank of Canada (BoC) left its overnight rate unchanged at 0.75%. However, the central bank changed its economic outlook following its revision of the impact of the oil price shock on domestic growth. The BoC now expects a more front-loaded effects than in January but not larger. As a result, these negative effects on growth should dissipate in the second half of the year. Consequently, the Q1 growth forecast has been lowered but the subsequent growth outlook has been revised higher. More importantly, the inflation outlook has also been upgraded starting from Q2. Overall, the BoC is pleased with the current monetary policy despite the short-term negative oil effect while the central bank expects positive economic surprises in the second half of the year. Coupled with the threats on financial stability linked to the elevated household debt levels, the odds to see further easing this year have significantly decreased.



USD/CAD has broken its key support at 1.2352

Looking at the price behaviour, the break of the key support at 1.2352 has validated a multi-month bearish reversal pattern. As a result, the technical configuration confirms a medium-term phase of weakness for USD/CAD. The implied downside risk from the previous distribution phase is given by 1.1905, which is near the 38.2% retracement of the rise that started in July 2014. Another key support can be found at 1.1731 (06/01/2015 low, see also the 50% retracement).

As the underlying trend in the US dollar is positive, this likely revaluation of the Canadian dollar could be more attractive against other currencies. In that respect EUR/CAD should continue to decline towards its 2012 low, while a key resistance stands at 1.3766 (27/03/2015 low). CAD/SEK also looks interesting as prices are expected to break the resistance at 7.1966 (19/08/2010 high) and move towards its 2010 high at 7.7249. A support can be found at 6.7378 (18/03/2015 low).

FX Markets

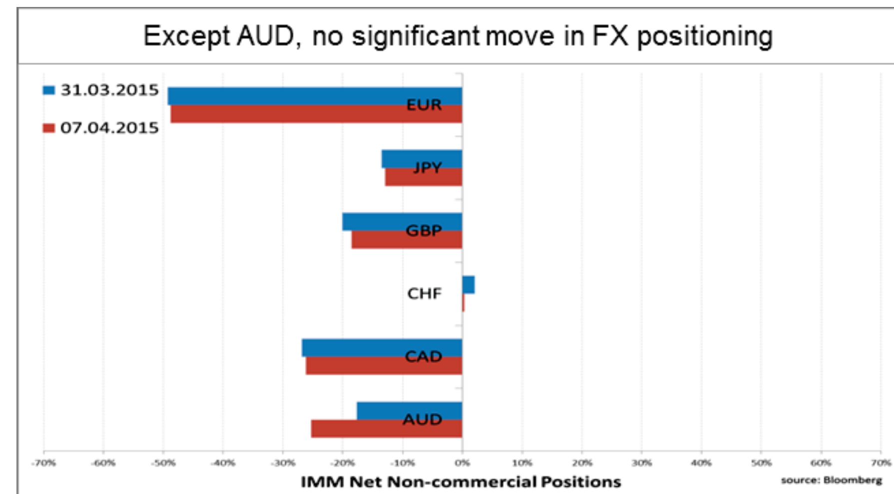
Slight Reduction In Aggregate Long USD Positions

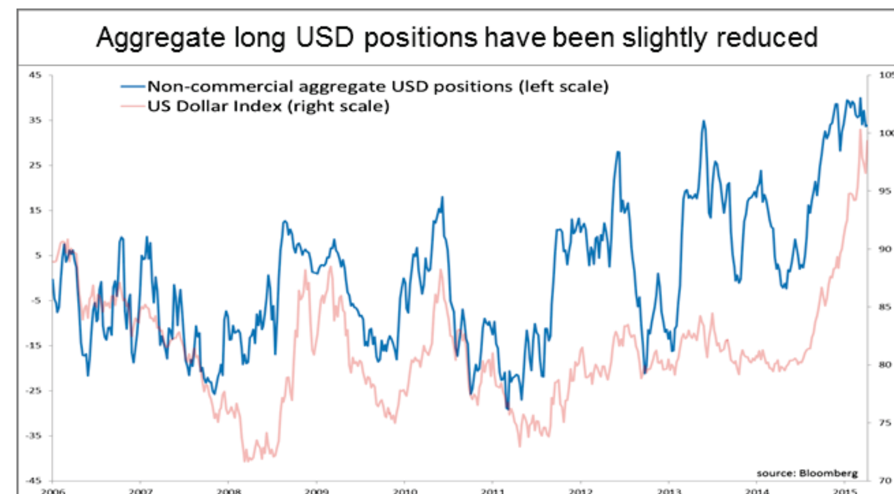
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 7 April 2015.

Changes in FX positioning were rather insignificant. The only exception was the increase in net short AUD positioning. Given the decision of the reserve Bank of Australia to leave rate unchanged on 7 April, it is likely that some of these additional AUD bearish bets may be deceased in the short-term. However, as explained in our last report, a bearish AUD/USD position seems attractive given the expected May cut.

Concerning the other currencies, net short EUR positions have been slightly reduced but remain near their 2012 record levels. On the other hand, net short JPY positions have been slightly decreased. Given the less dovish statement from the Bank of Japan on 8 April, a further reduction in net JPY positions should occur. This should make a long USD/JPY increasingly attractive as the second half of the year is getting closer (as the BoJ is expected to stay on the sidelines until June at the minimum).





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