SWISSQUOTE

WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

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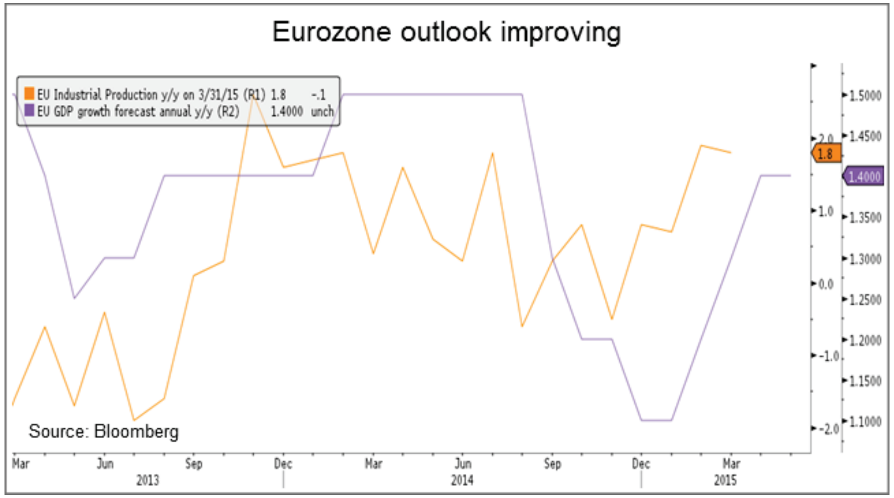
Economics | Verbal Intervention

Draghi commits to QE

Its has been a painful few weeks for our short EURUSD call. After a brief pullback EURUSD reversed the decline and surged to 1.1445 highs, accentuating a broad-based USD sell-off. The weakness in USD has been the result of soft US economic data which has not shown the post-winter weather economic recovery which many had predicted. US advanced retail sales were flat against 0.2% expected and industrial production contracted 0.3%. While robust labor markets felt less so, as JOLTS Job opening increased to 4994 verse 5133 prior read. The disappointing US data has further detached the monetary policy divergence story from the markets psyche. Persistent EURUSD strength appears to be worrying ECB President Mario Draghi. A devalued EUR has been a key driver to Europe's economic revival. Eurozone data continued to improve this week as industrial production y/y rose 1.8% and GDP growth came in at 1.0%. Expectations for inflation, market based indicators have also been moving higher. With well broadcasted, timely comment, Draghi reinforced the banks continued confidence in their aggressive bond buying program. He went on to stress that the QE program would be implemented in full, which implies that asset purchases would continue through September 2016.

We suspect that this was a direct effort to minimize the markets demand for Euro above highlighting Europe's recovery story or stimulating risk taking. With interest rates stabilizing/stalled (specifically German and US yields), Draghi's comments could prove to be a reflection point for EUR strength. Remember Draghi's 2012 timely pledge to do “whatever it takes” to save the euro. Now all we need is for this week's US data heavy schedule (durable goods, new & pending home sales, consumer confidence, GDP and PCE) to show a glimmer of hope that Q1's feebleness was actually transitory.

Yet should US data continue to stumble on we could still see a weaker EUR. There is evidence that a disagreement is emerging in the ECB over the handling of Greece. In the German newspaper, Handelsblatt ECB member Weidmann was vocal in expressing his concern over Greece's usage of ELA to keep domestic banks liquid. Should US data improve and Greek uncertainty linger, we would look for opportunities to reload short EURUSD positions.



FX Markets

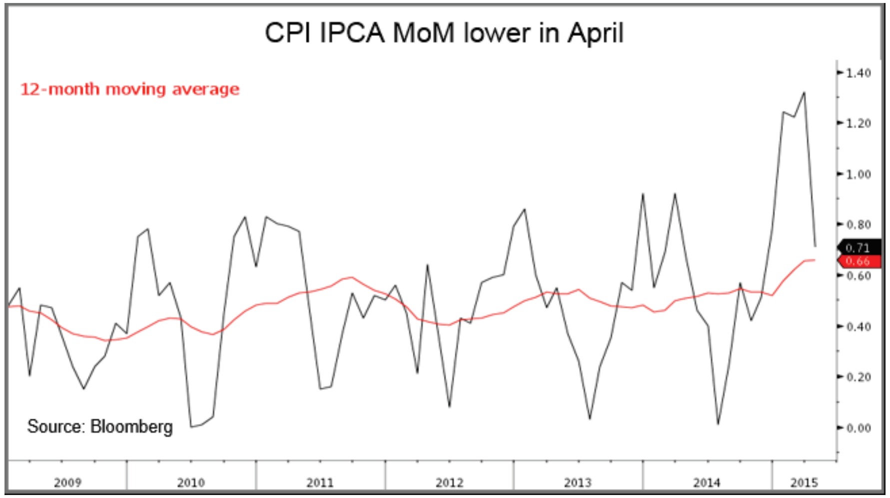
Brazilian Economy Under Pressure

Stronger BRL despite weak economic data

The Brazilian real outperformed the USD as traders are becoming impatient about the lack of US economic recovery. Earlier this week, US retail sales came in flat while analysts were looking for an increase of 0.2% m/m. April's PPI was released at -0.4%m/m versus +0.1% expected. For the last few weeks, all signs point toward a slower economic recovery in the US and, as a consequence, a dollar being dragged lower as traders delay the first Fed rate hike. Further south, the IMF released Brazil Country Report earlier this week. The report stated that the country is "in a tough spot" and that "economic activity is expected to contract in the near-term". However, the IMF forecasts growth over the medium term but warns that it will be highly dependent on the implementation of reforms aiming at improving the country's financial situation and controlling inflation in order to restore lost credibility. A weaker dollar will therefore help the BCB to keep inflation lower. On the data front, Brazil March retail sales contracted by -0.9%m/m versus -0.4% expected, adding to the disappointment, industrial production released last week printed at -3.5% y/y against -3% expected while Brazil IPCA came in at 0.71%m/m versus 0.75%, the lowest level since November 2014.

The BCB to increase the Selic rate

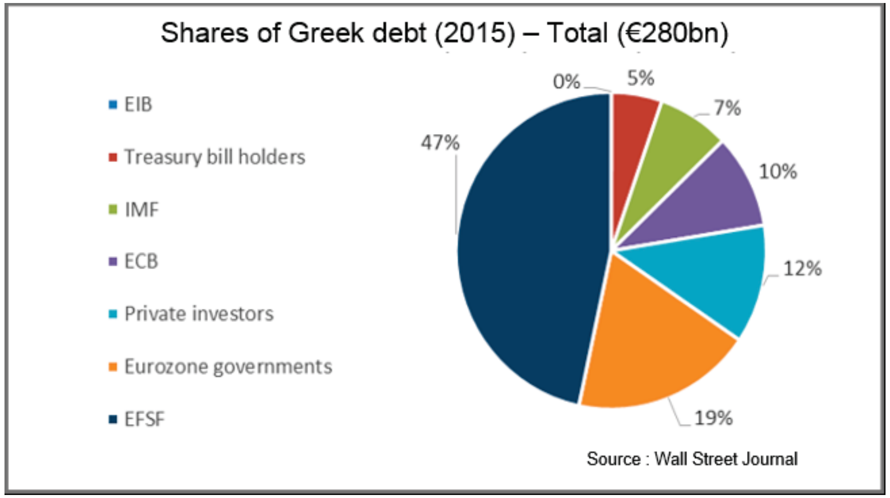
We anticipate the BCB will keep tightening monetary policy by rising the Selic target rate at the next policy meeting (June 2 and 3). The latest data indicates that a 25bps hike is likely. The current IPCA read indicates a slight deceleration in elevated inflation while recent downside surprise on the economic front points toward a more severe economic contraction. The balanced data will enable the Brazilian central bank to increase rate by 25bps to 13.50%, allowing economic activity to breath without hurting its inflation fighting credibility.



Economics

Greece's debt concerns continue

As the Greek saga is going on, we are still wondering if Greece will ever have the ability to pay off its debt. Let's recall that Greece has a total debt around $320 Billion. In order to fulfill repayment, the terms of the bailout indicates the necessity for Greece to achieve a massive 4.5% surplus of the GDP each year. In other words, after interest payments are paid off, tax receipts must be above national income by 4.5%. Only Germany is expected to obtain this year a 2% surplus. We anticipate fiscal revenues to be increased to meet this objective.



Greece has confirmed last Monday the payment of an installment of €750m to the IMF which adds up for a May total installment of around €2bn. Last Friday Greece had also to reimburse €1.4bn to Treasury bill holders. Within the next two months, Greece has to reimburse in total 14 ml including IMF repayments that account for 2bn. We do not forget that also most of the Greek debt is owed to the European Financial Stability, debt with rates up to 1.5% with payments taking place in 2022 to 2050.

We think that it is highly likely that Greece will manage to fully reimburse the IMF. However, we think that Greece will be unable to pay its debt to the other creditors. Shall we add that Greece has to pays also pensions and public wages. This is mainly the reason why Greece is expecting to receive a further €7.2bn of bailout by the end of June. We remain negative on the EURUSD on Greek uncertainty and further monetary policy divergence as it brings downwards pressure to the pair. Recent unwind of USD long provides a good entry point to reload short EURUSD positions.

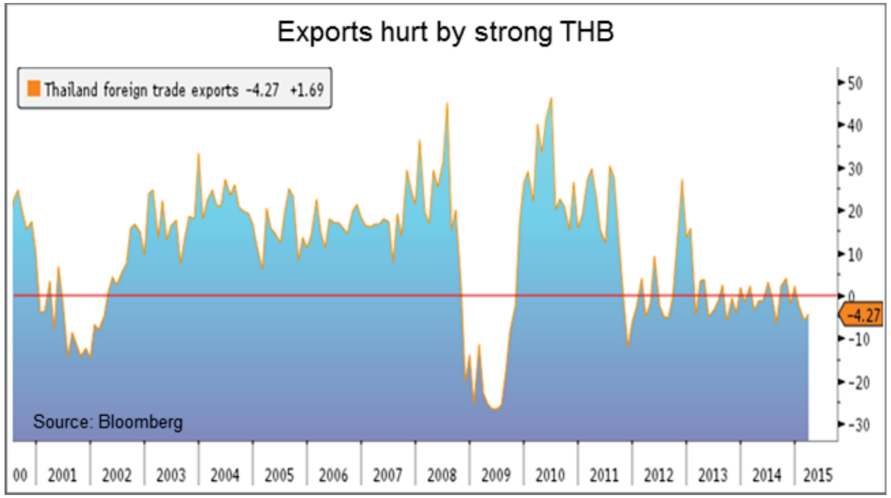
FX Markets

Bank of Thailand fights back

The Thai baht (THB) fell to a five year low verse the USD as Thai policymakers increased their initiative to weaken the currency. USDTHB surged to 33.89 helped by broad USD selling. Regional currency war is alive and well in Asia. Regional indirect competitive devaluation is not happening as a rapid fire pace as seen in the past and therefore is getting missed by the market. On April 29th the central bank unexpectedly cut its main interest rate by 25bp to 1.5% (second cut in two months). In addition the government relaxed capital control the next day which allowed citizens to hold foreign currency and acquire international assets. The coordinated move was clearly geared at destroying demand for THB.

Growth in Thailand remains weak with outlook worrying. Slowing demand from China and western trading partners are putting a strain on trade balance. Meanwhile private investment and consumption were also very downbeat, even given the government's increase spending and its public broadcast of billion dollar infrastructure development projects. The THB has been stronger verse all regional currency and quickly loosing export competitiveness. With decelerating economy and a government not ready or unable to make the critical structural adjustments, a weaker THB is an easy way to steal export growth from its neighbors. Exports which are primary input to economic growth contracted -4.3% for March. Spillover from a recovery in exports should positively affect all areas of the Thai economy, including inflation. In addition, a weaker THB should directly help stimulate domestic demand by attracting additional tourists, while incentivizing locals to buy domestic made good and services.

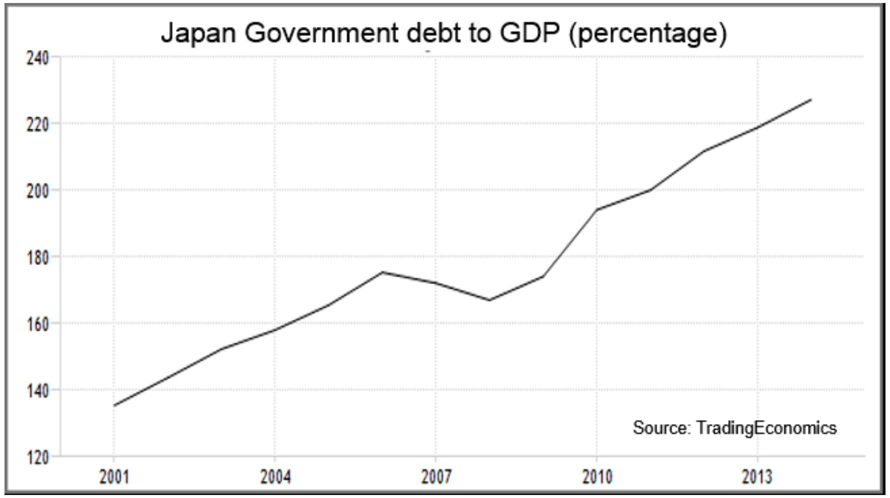
In their recent dovish statement, the BoT clearly mentioned its apprehension over the THB appreciation against trading partners and competitors, without disguising the currency devaluation objective of cut-ting rates and loosing capital controls. Traders should anticipate that the regional race to the bottom to accelerate, with central banks taking proactive easing stance. Interest rates remains the strongest tool which the BoT has to limit the THB strength. So with deflationary spiral looking more likely with three consecutive negative reads, we should anticipate further policy action.



Economics

Japan's Debt Is Still Not Too Big To Fail

Japan has over the past year increased the sales tax from 5% to 8% in an effort to control debt which has a stratospheric ratio debt/GDP -the highest in the world - at 227.2%. Late April, Japan failed to increase again sales tax and has been downgraded by Fitch, the rating agency, to A from A+ over what we decently called debt fears. Let's add that Bank of Japan Governor Kuroda admitted the impact of increasing consumptions taxes had a negative effect on the overall economy directly damaging the household purchasing power. However, we anticipate the BoJ will further increase VAT to push inflationary expectations despite harmful consequences in the Japanese economy. There is not many options now for the BoJ than to play more on fiscal arrow of the Abenomics policy.



Economically speaking, Japan's Q1 GDP grew moderately by 1.6% while inflation target has been set at 2%. Today, Balance of Payments came in better than expected, Yen 2.8 trillion vs Yen 2.0 trillion. Japan's current account surplus is now at the highest in 7 years. The country surplus currently benefits from low crude oil prices pushing down the imports and a very low JPY level spurred the foreign exports. After Fukushima disaster in 2011, Japan relied more on energy imports as nuclear reactors were systematically shut down. So a lower oil prices have benefited the balance of payments so far. Clearly, PM Abe's strategy of deliberately debasing the Yen has worked out well for Japan by pilfering export growth. We anticipate the Nikkei is likely to further benefit from this export driven surplus and maintain equity at a decent level as Japan's concern over deflation is far from being finished.

USDJPY is trading between 119.00 and 120.50. It is likely that a resistance at 120.50 to be targeted.

FX Markets

Waiting For Temporary Factors To Fade Away

Slow thaw?

After a harsh winter and port strike among other temporary factors that have caused the US economy to almost stagnate in the first quarter (Q1 GDP grew by only 0.2%q/q), persuading definitely the Fed to delay the first rate hike, traders are waiting on the first good news to resume the dollar rally. Unfortunately, April's data were disappointing as well, non-farm payrolls came in at 223k versus 228k while previous read was revised down to 85k (!) from 126k. Surprisingly, most analysts called it a "good" news, arguing that the slowdown was indeed temporary and that the figures will support expectations that the Fed is on track to raise interest rates. However, traders didn't buy it as EUR/USD moved sideways at first before continuing to rally as high as 1.1445 last Thursday, on its way to test the key resistance standing at 1.1450 (highs from February). Faking good news is not good enough, markets want to see real improvements and the last Retail Sales read did not help (0%m/m in April verse +0.2% expected).

Growth should accelerate

We still expect the US economy to recover slowly with a significant acceleration in Q3, pulling the dollar up. In the short/mid-term, traders are very impatient to play the upcoming dollar rally. Therefore, the release of several "real" good news in a row will resume the USD appreciation. The release of US economic data continues this week with Housing Starts on Tuesday (1020k exp, 926k prior), MBA Mortgage Applications on Wednesday; Initial Jobless Claims (270k exp, 264k prior), Manufacturing PMI (54.5 exp, 54.1 prior), Existing Homes Sales (5.22m exp, 5.19m prior) and finally inflation figures are due on Friday (0.1%m/m exp, 0.2% prior or -0.2%y/y exp, -0.1% prior). A higher read of inflation data would help the dollar to gain some strength.

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