SWISSQUOTE

WEEKLY MARKET OUTLOOK

25 - 31 May 2015

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

Greece Is Nearing The Cross Roads

The EU leader summit which centered around the Greek bailout negotiations, concluded with no visible progress. There had been rumors of a short term bailout solution which so far has not materialized. Meanwhile with Greece's liquidity conditions worsening, the barrier between Athens and Brussels remains significant. The primary issue of reforms has yet to be fine-tuned, however the ideological divide is caused by Brussel's belief that Athens is unwilling or incapable of implement economic reforms.

The safe money is betting that the Greece government will cave first due to heavy shift in popular sentiment towards finding a political compromise and staying within the EMU. The Syriza's strategy would then need to get validation of a new pro EU mandate (likely accompanied with heavy reform compromise from the EU) through reshuffling of government radical members, a direct referendum or snap elections. If this is the eventual outcome, it would be considered a masterstroke in political gamesmanship. Yet we are skeptical since the reform measures proposed by hardliners in Frankford, Madrid, Dublin and Lisbon are still economically unpalatable and would therefore force Greece into an unending cycle of financial servitude.

However, while politicians negotiate, the conditions in Greece worsen. The economic situation is deteriorating (despite temporary improvements in trade balance) and ECBs ELA funding has accelerated as deposits are withdrawn. Payments which are due to the IMF of €1.6bn in June and €3.5bn on July 20th to the ECB, will be hard to manage of cash strapped Greece. It's unlikely that any solution can be managed by the end of June, so we must consider that some payments will be missed. The least disruptive would be on domestic payments (pensions, civil servants etc), next would be a default on IMF loans. This would be a geopolitical stain on Europe's reputation, as some of the world's poorest would be seen as funding Europe's extravagant life style.

Finally, a default to the ECB would be devastating. Greece's banking system is being propped up by emergency lending cash. While the lending rules of the ELA are gray, a missed payment would surely be the foundation for the tightening of lending requirements. From there we would see a sudden implementation for Greece capital controls and the release of the drachmas 2.0.

FX Markets

RBA's Easing Bias

The publication of the RBA's minutes from the May meeting shows that the Bank left the door wide open to further monetary policy easing. The minutes contrast with the less dovish statement accompanying the rate cut. At that time, the rate cut had only a temporary effect on the Aussie as it was broadly expected and therefore already priced in by traders. In addition, the lack of clarity from the RBA is confirmed by the minutes as it shows that the members clearly retained an easing bias while markets participants expected no further rate cut, interpreting the move to refrain from providing guidance as a sign that the cash rate reached a bottom. "Members agreed that, the statement communicating the decision would not contain any guidance on the future path of monetary policy", the minutes said.

On the housing market front, the minutes revealed that the rate cut could feed imbalances in the housing market. However, the members noted that housing price growth was strong in Sydney and Melbourne but subdued or even negative in the rest of the country. The RBA declared that "The Bank would continue to work with other regulators to assess and contain the risks arising from the housing market". The recent disappointing data from China will definitely not help improving the Australian economic conditions. As a reminder, China' industrial production for April came in below expectation at 6.2%y/y (6.3% exp, 6.4% prior) while latest data indicates that China's house prices declined further.

AUD/USD moved lower since April 14 and we expect the Aussie to depreciate further in the medium-term as the RBA's easing bias, together with the upcoming rebound in the US economy will weigh on the pair. However, data showed that the US economy may take longer than anticipated to accelerate, allowing the Aussie to move higher in the short-term.

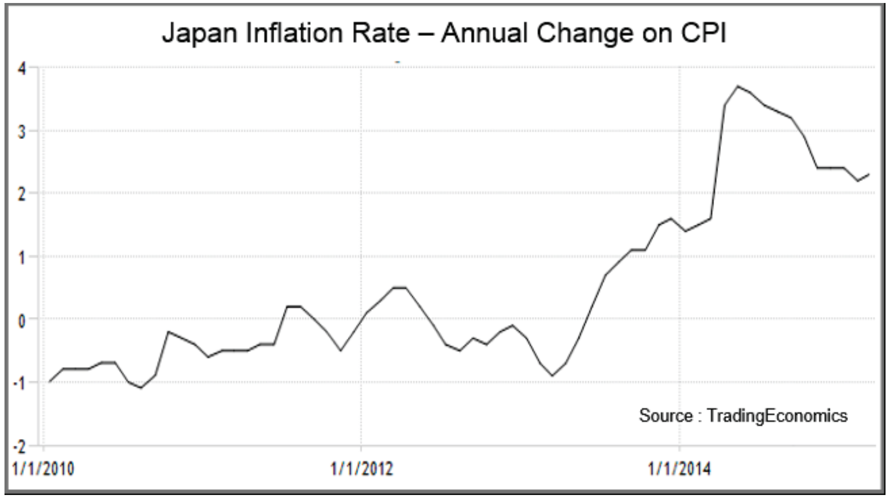
Economics

Japan Is Fighting For Momentum

After more than two years of “Abenomics” which consists of a massive monetary policy easing and fiscal stimulus, Japan's GDP growth printed last week at 0.6%q/q well above consensus at 0.4%. Other economic indicators such as GDP Business Spending came in at 0.4% while analysts were looking for 0.2%. Last but not least, Japan All Industry Activity fell 1.3% m/m in March, first drop in the last thirteen months. We do not forget that last year's sales tax hike, from 5% to 8% after disastrous IMF advice, had a massive impact on the economy. Private consumption took such a dive that Abe postponed next sales tax hike for 2017.

Japan's economy is at stake and the recovery seems light, in comparison with the means used to meet targets. The pressure to achieve high GDP is extremely important to maintain a little more hope on reducing the deficit. Even inflation data, come in at 3.4%y/y and nonetheless below median forecasts of 3.6% y/y, are struggling again countries' wages. Indeed those wages have remained flat for several years. Because of weaker yen, imported goods were more expensive for Japanese. On the other side, the depreciated yen increased the cost of raw materials. Big local companies like Panasonic decided to repatriate production back home even if Japanese cannot afford those homemade goods that remain in warehouses which set to be problematic in the mid-term.

Nonetheless, it seems that Japan has gained positive traction by reducing deflation. USD/JPY is now trading between 119.83 and 122.00. JPY depreciated as markets are still concerned by growth sustainability and high debt-to-GDP ratio. Also, the yen weakness is partly attributable to the recent dollar rally.



Economics

Turkey Struggles With Credibility Issues

The struggle for the Turkish central bank to stay independent from government intervention continued this week. In a decision that was widely anticipated, the central bank left its one-week repo rate at 7.50% while overnight lending rate stayed at 10.75%. Option to not rise rates to fight inflation but potentially angry the president (in the positive side they were not forced to further ease). The policy statement reiterated recent month's language that it's current monetary policy plus prudent fiscal and macro-prudential policies are working to restrain inflation but the uncertainty in global markets, depreciating lira and volatile energy and food prices "makes it necessary to maintain the cautious stance in monetary policy." Perhaps the key point was the spotlight on FX volatility stating"recently elevated volatility in the exchange rates has limited the improvement in the core inflation, as stated in the Inflation Report." This suggest that the CBRT will take action should the TRY depreciate too quickly.

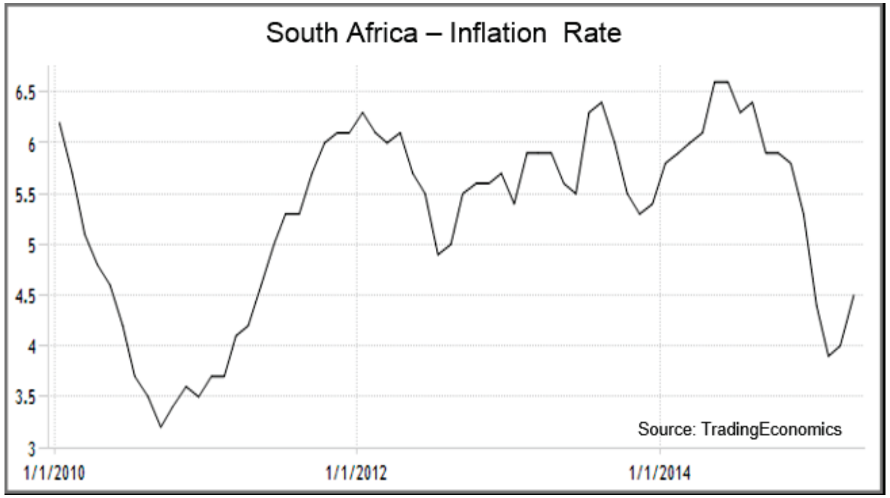
There is a clear divergence between inflation and growth data which is causing significant tension between the central banks and the government. Inflation continues to trend higher while growth sags, Turkey's consumer price inflation rates climbed to 7.91% in April up from 7.61% in March, above the central bank's 5.0% target. Meanwhile the economic slowdown accelerates as current account deficit rose as exports collapsed, leaving business and consumer confidence weak and unemployment is at a five year high.

President Erdogan this year has been tangled in an extremely public spat with Turkish central bank governor Erdem Basci over the direction of policy rates. Despite inflation worries Erdogan's has pressured the central bank to cut interest rates to revised flagging growth. This public meddling has sparked concern over the credibility of monetary policy.

With a general election in June for the AK Party, which has built its success on a strong economy, economic uncertainty is an extreme liability. While a tension between the government and central bank has lessened we still believe Erdogan will not allow rates to rise (barring even an extreme such as higher inflation or TRY collapse). With rates unlike to increase in 2015, capital outflows expected to accelerate ahead of expected tightening in US monetary policy and general fear of political influence in monetary affairs, we continue to expect the TRY to weaken.

Economics

SARB Between High Inflation and Low Growth



South-African Reserve Bank (SARB) has announced to keep its repo rate unchanged last Thursday. Since 2013, rates have increased gradually from 5% to 5.75% now. The Reserve Bank is still in front of a dilemma because inflation is rising back towards its 2014 level of around 6% and that GDP growth is set to be low this year. Last Wednesday's CPI figure came in at 4.5% y/y for April vs prior February figure of 3.9% y/y, nonetheless below expectations. "Inflation rate is vulnerable and should breach the reserve bank's target" Governor Kganyago said. The rebound in oil prices had a significant effect on inflation but this low prices effect is now vanishing. Furthermore, dollar rally in the past 6 months made the ZAR much weaker and therefore pushes inflation higher.

In addition of an upside risk for interest rate due to inflation, the South African growth is at stake. Structural problems hampers the South African's economy, including multiple electricity shortages which constrain GDP. In addition, strikes were numerous and brought down business confidence as surveys pointed out. It is worth adding that 2% growth forecast for this year is far below the level required to ease high unemployment. The reserve bank has chosen the status quo by maintaining unchanged its repo rate. On the mid-term, uncertainties will push the central bank to react.

We anticipate SARB to face this dilemma by prioritize its own credibility by achieving, despite low growth, its objectives of maintaining inflation in the target range of 3% to 6%. Therefore it is very likely to see SARB tightening its rate before year-end.

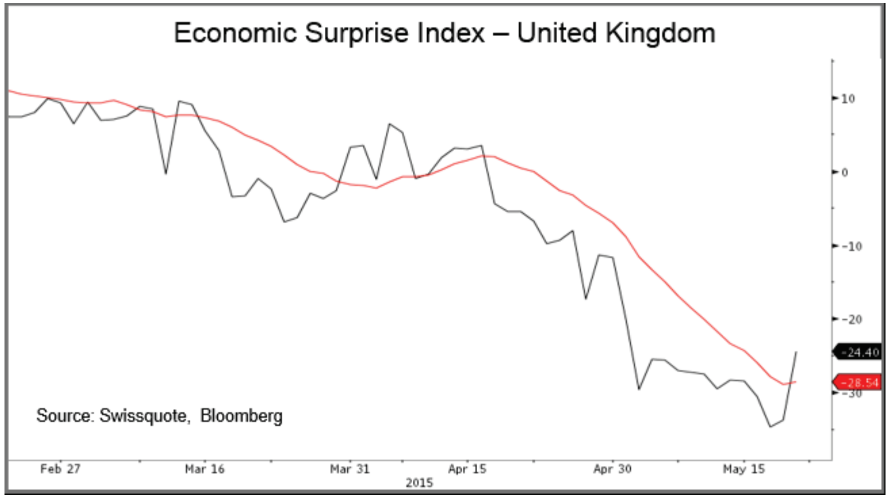
FX Markets

UK Economy Is Gaining Momentum

It is now two weeks that the uncertainty associated with the UK General Election has been removed. The Conservatives victory was cheered by both FX and equity markets, initiating the sterling's rally against the dollar and stopping the sell-off in UK equities. In addition, markets seem determined to leave the EU referendum problem for another time and chose to focus on the US recovery and UK encouraging data.

UK economy on the right path despite low inflation level

GBP/USD is gaining momentum as United Kingdom proved to have better managed winter months than the US. April Retail sales from the world's biggest economy came in way above expectation (1.2%m/m versus 0.2% consensus) on the back of strong March data – industrial production grew 0.7%y/y versus 0.1% consensus and manufacturing production grew 1.1%y/y versus 1% expected. The picture is not all bright however as headwinds arising from upcoming fiscal tightening may jeopardize economic expansion for the years ahead. Moreover, inflation slipped below zero for the first time in 50 years, delaying a potential rate hike from The Bank of England in 2016. While in the US, inflation picked up in April as CPI Ex food and energy surprised on the upside, printing at 1.8%y/y versus 1.7% expected. However, we still think that a rate hike from the Fed in June is highly unlikely.



Monitor closely data from the US

On the other hand, in the light of recent data from the US, it appears that the "temporary factors" have lasted longer than anticipated and are now undermining American's mood (May Philadelphia Fed survey came in at 6.7 versus 8 exp, 7.5 prior read). All in all, we remain GBP/USD bulls and we expect the sterling to stay in its hourly uptrend channel. However, downside risk remains as traders keep a positive dollar bias while waiting for the US economy to take off. Last Friday, the pair consolidated moved closer to the bottom of its uptrend channel after US CPI read.

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