WEEKLY MARKET OUTLOOK

1 - 7 June 2015

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WEEKLY MARKET OUTLOOK - An Overview

Economics

G7 Meeting In Dresden

We are going out on a limb here, writing on Friday, but do not anticipate any deal for Greece over the weekend. We have come to accept that the G7 meeting is an opportunity for grandstanding and pushing sovereign objectives rather than building unilateral accords. Therefore we are doubtfully of any innovative breakthroughs on critical stress points this time around. Faltering global growing will top the agenda. With all nations conducting ultra-loose monetary policy pressuring Europe not to “shock” the system by pushing Greek to default, will be a key theme. The US specifically is rumored to be determined to pressure Europe to lower the threshold on cash-for-reforms. Clearly US policy makers are concerned that a crisis in Europe (despite markets confidence of limited contagion) would damage the global recovery and drive investors back into the safe-haven USD trade. With exports in key trading regions already sagging, a strong USD will only extended “transitory” economic weakness reported in Q1 2015.

Yet with the US's focus on growth and Greek crisis, this might provide an opportunity for China to slip in their agenda. Clearly China wants the yuan to play a larger part in international finance and assume a position that reflects their growing influence. In a robust move, which suggests that the US influence in the G7 is waning, the IMF revised its assessment of the valuation of CNY to "no longer undervalued" after stating it was "undervalued by 5-10%" in 2013. For China, a trophy of success would be to have the yuan included in the basket of currencies which makes up the IMF's Special Drawing Rights (SDR), up for review this fall. There has been a clear shift in the US influence as European nations signed up to include China-led development bank despite the US admonitions. Suggesting that despite the US's (and Japan's) demand for currency liberalization, G7 nations pandering for privilege in China, are likely to pressure the IMF to include China-led development bank despite the US admonitions. That is not to say that adding the yuan is only part of a popularity contest, as China has made clear advancements to allow yuan to be “freely usable”, however, strong support from G7 would allow the IMF to provide a pass for “still too strong” external position and time to enact reforms to "reduce excess savings and achieve sustained external balance" and adopt a flexible exchange rate.

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From Greece To The US

Even though uncertainties surrounding the Greek deal caught all the attention last week, causing confusion as traders shifted expectations from one extreme to another, we think that market's attention will refocus on the timing and pace of monetary tightening in the US as we expect the economy to gain momentum soon. Latest comments suggest that Fed's officials are being hawkish regarding the first rate hike, increasing the odds of gradual tightening starting as soon as this year, supported by the latest CPI figures as Core CPI came in at 0.3%m/m versus 0.2% expected. Janet Yellen, reiterated its optimism about the near-term momentum of the US recovery in spite of a Q2 GDP revised lower to -0.7%q/q from 0.2% while markets expected a revision at -0.9%. Final revision is due on June 24. Federal Reserve's Chairwomen declared that "A number of economic headwinds have slowed the recovery, and to some extent they continue to influence the outlook". Adding that "If the economy continues to improve as I expect, I think it will be appropriate at some point this year to take the initial step to raise the federal funds rate target and begin the process of normalising monetary policy". However, the Chairwomen tempered her remarks by adding "the headwinds facing our economy have not fully abated, and, as such, I expect that continued growth in employment and output will be moderate over the remainder of the year and beyond".

Mrs Yellen also made an interesting point about the job market as she acknowledged that even if unemployment rate "has come down to levels that many economists believe is sustainable in the long run without generating inflation", current statistics don't fully capture "the extent of slack in the labour market". Indeed, to be classified as unemployed, people must report to actively seek work, if not they are excluded from the statistics. As a reminder, U-6 (measure including long-term unemployed and the involuntary part-time categories) reached 10.8% last April, two times the more popular U-3 measure (5.4% of total workforce for April).

The situation is therefore not that bright in the labour market and we believe that Fed's officials will take this information into account when determining the timing of the first rate hike. However, most market participants, in our opinion, are more focus on inflation data and economic indicators, awaiting the first set of consecutive good news to resume the dollar rally.

On the inflation front, even if latest data showed signs of improvement, we don't think it will be enough to allow the Fed to increase the target rate before the end of summer. Moreover, the Fed doesn't want to increase rate too soon and will more likely let the US economy accelerates a little bit faster before making the first move. We therefore do not expect a rate hike before September at the earliest.

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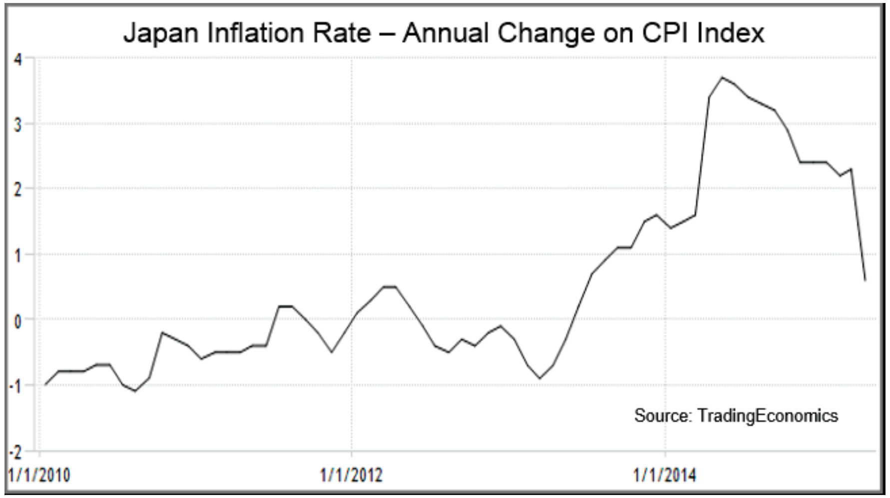
BoJ's Minutes Target Inflation



After The Bank of Japan's minutes of its April policy board meeting have been released last Tuesday. Major statement was that the QQE (Quantitative and Qualitative Easing) will continue until the 2% inflation is stable. The price stability is really an important concern for the central Bank. For this reason the BoJ has decided to take a breath and to delay the 2% inflation target until the first year of 2016. However, some members think the new target is also too optimistic and more largely, members' opinions remain divergent.

It also has been added that "Private consumption lacks momentum". Nonetheless incomes are improving and should push consumption higher and therefore create inflation. In this regard, the Retail Sales m/m for April rebounded at 0.4% after a disappointing prior print at -1.9% in March. Estimate was of 1.1%. Sales tax hike initiated by the Prime Minister Shinzo Abe last year triggered a deeper crisis, weakening global consumption. Yet, another hike has been postponed to 2017. Cancelling this future sales hike, that is fully part of the "Abenomics", would have certainly given the signal that this fiscal policy was inefficient.

We anticipate inflation to rise as the low oil price effect is diminishing and the current debase of the yen will give positive traction to the inflation. In addition "The yen could appreciate if Japan-s economy grows in the next two years as the BoJ has been predicting" said Governor Kuroda. We remain however skeptical on a sustainable Japan recovery. After all those massive quantitative easing, even the BoJ is admitting its concerns about suffering losses on the bonds they acquired to stimulate the economy. Potential losses can be huge.

Economics | Brazil's Institutions In The Spotlight

Next week will be a busy one as the Copom will announce monetary decision on Wednesday while on the data front, May's Manufacturing PMI and Trade Balance are due Monday; April's industrial production on Tuesday while May's Services PMI will be released on Wednesday.

Last Friday, Brazil's Q1 GDP surprised the market on the upside as it came in at -1.6%y/y versus -1.8% expected. Data indicate that the Brazilian economy declined 0.2%q/q from the previous quarter after having shrunk -0.2% in Q4 2014 (the last time we saw a positive figure was in Q1 2014) and we anticipate that it won't be the last contraction of the year. Growth is expected to make its big comeback in the middle of 2016. At the moment, Brazil is therefore in a tough spot. However recent key austerity bills have been approved last week as the Senate accepted measures that reduce pensions and labour benefits, which will help to reduce the government's high debt level. It will therefore help to balance budget while restoring confidence in President Dilma Rousseff's government. Brazil's nominal budget surplus for April came in better-than-expected at 11.2bn reais versus 5bn expected, however Brazil's net debt increased to 33.8% of GDP from 33.1%.

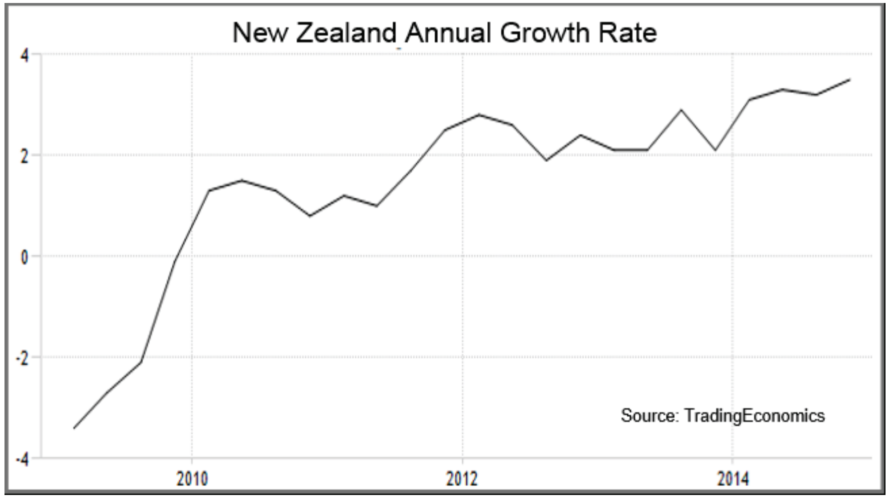
Selic to increase by 50bps

Initially we anticipated the BCB to increase the Selic rate by 25bps to 13.50% at the next policy meeting on June 2 and 3, as data indicated a slight deceleration in elevated inflation while downside surprises on the economic front point toward a more severe economic contraction. However, recent hawkish comments by central bank's deputy-governor Luiz Awazu Pereira indicate that the BCB is committed to maintain the actual pace of tightening, saying that the Copom will continue to remain "vigilant". The wording therefore suggests that a rate hike of 50bps to 13.75% at the next meeting is more likely.

The BRL weakened against the US dollar and tested the resistance at 3.19/20 yesterday before stabilising around 3.16. During the next few days, political factors will keep pressuring the BRL and we therefore expect further weakness in the short-term.

Economics

Concerns On New Zealand Data



Building permits came in last Friday at a disappointing -1.7% m/m with a prior figure of 11%. In the same time the ANZ activity outlook, a survey of business opinion, dropped to a two-year-low. Only 15.7% of respondents expect New Zealand economy to improve. It has to be compared with last month survey with 30.2% of positive opinion. Business confidence is slowing down as economy falls. More specifically, Fonterra - a co-operative owned by New Zealand farmers - has set its payout to an eight-year-low due to the over-supply of dairy product in the world. This will add even more pressure on New Zealand GDP.

New Zealand inflation's expectations for this year fell to 1.62%. Though inflation is still on the Reserve Bank's target band of 1 to 3%. 1.76% was the previous estimate. Outside of this target band, the official cash rate at 3.5% is subject to be lowered. Softer economic data would push the reserve bank to stimulate the economy. Nonetheless, there is still room for the reserve bank to act.

The central bank has also to deal with housing prices that are rising due to low mortgage rates. Some say the bubble is about to burst. Even the country's government admitted housing bubble's fear in Auckland. In average, across the country, prices have increased by roughly 8% since March 2014. By reducing the rates, the risk is to inflame the housing market.

NZD has weakened against the greenback for the last six months and is now trading between 1.4000 and 1.4100. However, recent major moves are mainly due to the US. Yet, confirmation of New Zealand's difficulties will push the pair higher.

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