SWISSQUOTE

WEEKLY MARKET OUTLOOK

8 - 14 June 2015

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WEEKLY MARKET OUTLOOK - An Overview

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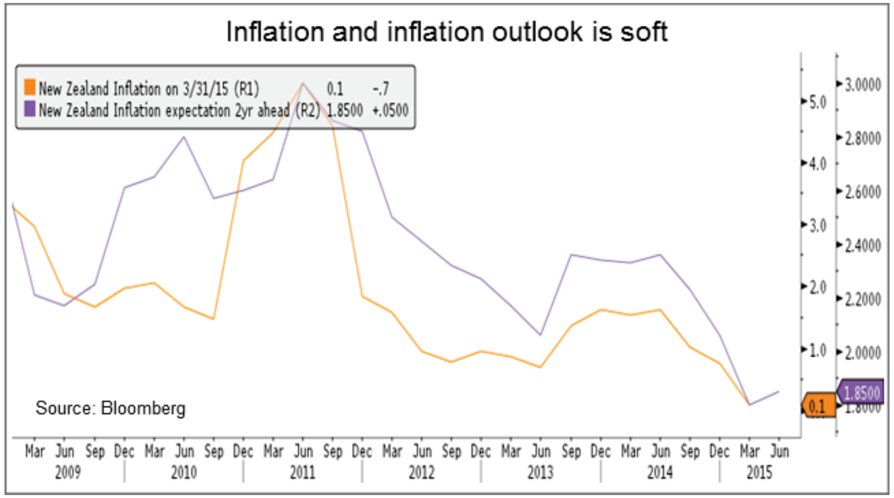
FX Markets

Fundamentals Support AUDNZD Bullish Break

The AUDNZD cross has completed a bull flag pattern indicating further upside potential. Plus given the underlying fundamentals we suspect that further bullish momentum should be anticipated. While Australia's economic condition is weak, on a relative value basis it should outpace New Zealand. Expectations for next week's RBNZ rate decision is relatively balanced between no change and 25bp cut in the official cash rate. At the April meeting the RBNZ indicated if "demand weakens, and wage and price-setting outcomes settle at levels lower than is consistent with the inflation target", we could expected lower interest rates. Since then demand has been clearly decelerating as commodity prices weaken and regional exports slowed further. Merchandise exports dropped to 4.17bn as trade deficit rose to -2624m. Headline inflation rate has dropped to new all-time lows at 0.1% y/y (significantly below the RBNZ target rate) on low oil prices.

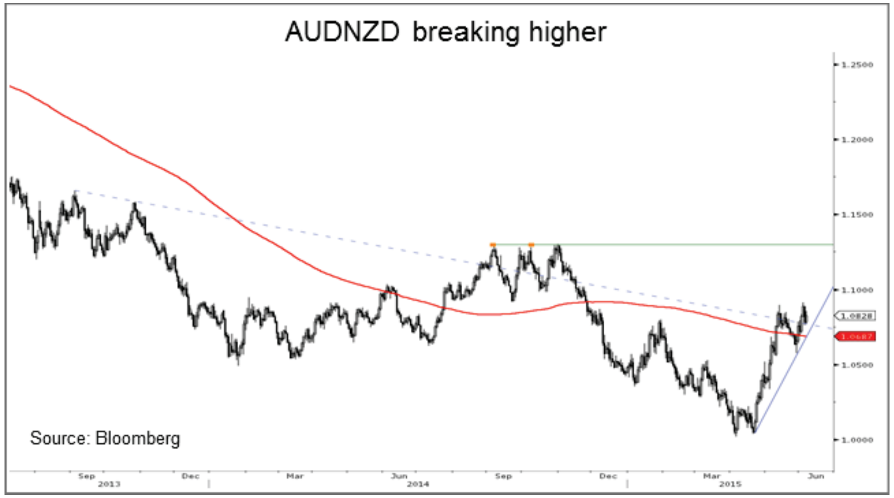
Worried over housing market bubbles

Yet there are some economic bright spots which will keep the RBNZ on the sidelines for now. The consumer remains healthy as retails sales rose 2.7% and unemployment rate remains low (despite slight disappointed uptick to 5.8%). However, the housing markets continues to accelerate to the RBNZs discomfort. House prices y/y rose 8.3% in April after drifting lower in much of 2014. We expect that the RBNZ will delay any action until new tighter lending restriction are in place to discourage developing asset bubble. Overall, there will be still room for easing even if the central bank hold this time around. Traders should expected a weaker NZD and higher AUDNZD moving forward.



Inflation and inflation outlook is soft

Source: Bloomberg



AUDNZD breaking higher

Source: Bloomberg

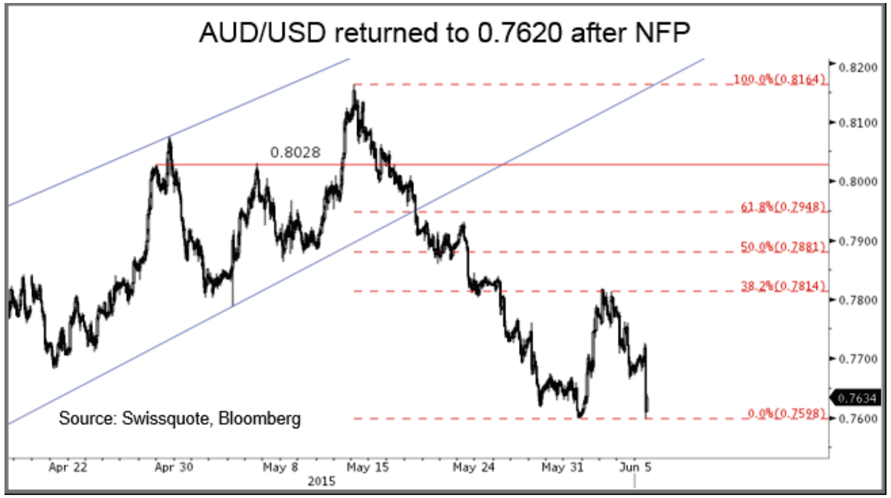
Australia's Economy Is Still Weak

Mixed data

The Australian economy expanded 0.9% in the first quarter compared to Q4 2014. Despite the fact the figure printed above markets' expectations, we do believe that the picture is not as bright as depicted by those numbers. Indeed, domestic demand printed flat while consumption contracted -1.2% (sa) during the first three months according to the data released by the Australian Bureau of Statistics. The positive figure is therefore mainly due to net export (export rose 5% while import were up 3.1% s.a.), which proves that competitive devaluation definitely helps. In addition. total capital formation, used to proxy total investment, declined by -3.2% (sa) over the winter months. More recent data from the retail side showed that the economic situation in April didn't improve much as retail sales surprised markets on the downside for the second month in a row, printing flat versus 0.3%m/m expected (prior read revised downward to 0.2%m/m from 0.3%).

Further rate cut?

All in all, those data confirm our bearish AUD/USD view, increasing the odds of further rate cuts by the Reserve Bank of Australia. On a slight note of caution, if growth do not pick up significantly in the US, it may not resume the dollar rally and allow the Aussie to strengthen against the greenback, forcing the RBA to act to keep the AUD weak – in the last statement, Glenn Stevens maintained that "Further depreciation seems both likely and necessary, particularly given the significant declines in key commodity prices". However, the recent better-than-expected NFP figures from the US allowed the Aussie to reach our 0.76 target, however good news have to keep flowing from the US in order to allow AUD/USD to move lower.



AUD/USD returned to 0.7620 after NFP

Source: Swissquote, Bloomberg

Economics

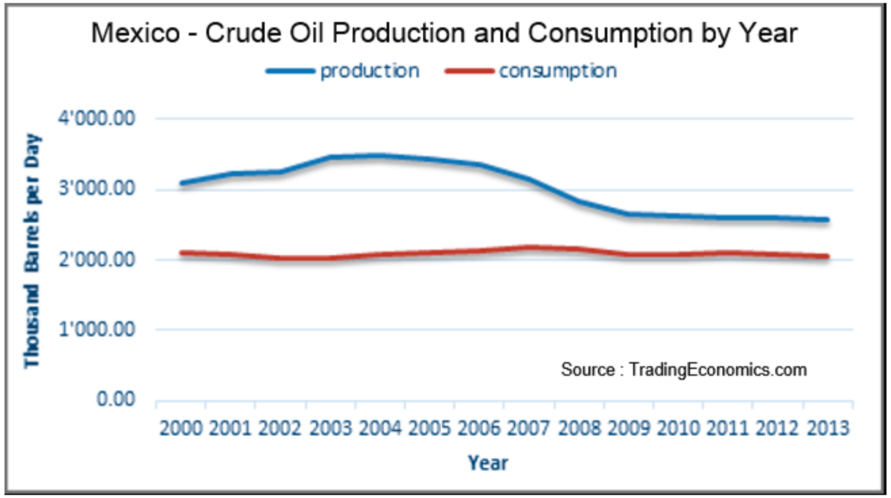
Mexico: Investors Wanted

Mexico is one the wealthiest country in terms of oil resources and natural gas in the world. It is ranked 18th in terms of reserves. Yet, Mexico energy markets remains a state property through Petroleos Mexicanos (Pemex). No other private companies are allowed to drill Mexican oil until new reforms will take place. Indeed, due to rigidity, Pemex has been unable to increase production, the revenues are steadily decreasing. In addition, infrastructure are antiquated and create more and more midstream issues which makes the oil transportation even more difficult.

In 1994, Mexico, aware of those critical issues entered into the North American Free Trade Agreement in order to boost investment and therefore growth. Investments has marginally supported oil and gas production. Yet, it appeared that those investments have not been entirely sufficient to reverse the decrease of oil production over the last ten years.

While demand for oil remains high, exports have decreased and therefore Mexico had to import even more natural gas from the United States in order to support, ironically, all the oil and electricity production. The market reality is now pushing Mexico to liberalizing its energy markets, in particular infrastructure investments are highly requested.

The energy markets is a key sector for Mexico. Alongside the significant investments, Banxico is also willing to lend a helping hand by utilizing monetary policy tools. For the time being, its policy rate remains unchanged at 3.00%, keeping policy accommodating. The stable inflation inflation below 3% leaves room for further easing as growth has been volatile this past years. it is also important to add that Mexico will not leave inflation going up if FED pushes rates higher. Indeed, we think that Banxico will copy United State rate policy to maintain this balance. The Central Bank is for now on a patient stance.



Source : TradingEconomics.com

Economics

BCB Fights For Credibility

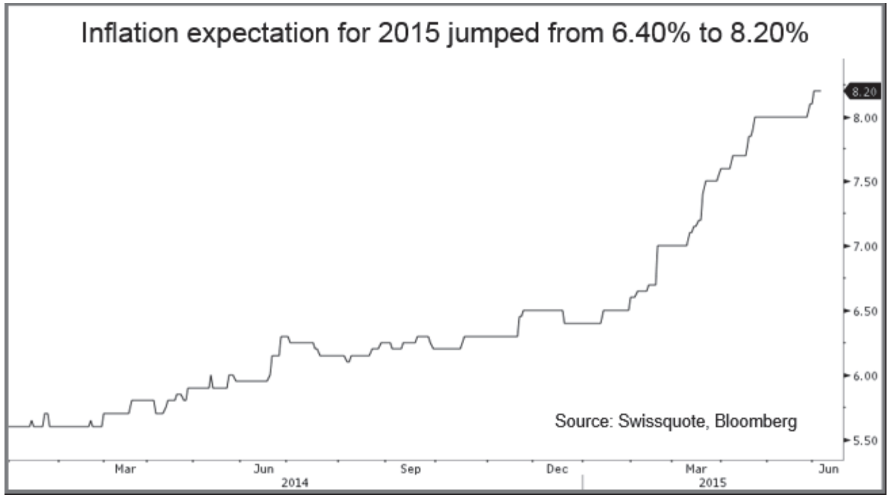
Last week, USD/BRL ground lower, falling to 3.1041 last Wednesday, as austerity measures made their way through the Congress. In addition, a few economic indicators surprise on the upside with May's Trade Balance printing at $2761mn versus $2400mn. The increase was driven by stronger exports (+$1.6bn) and slightly weaker import (-$0.7bn) supported by the effect of a weak BRL. Low oil prices and a slowing economy has helped to boost trade balance surplus. April's Industrial production contracted "only" -1.2% m/m (s.a.) while economists expected a contraction of -1.4%. On the other hand, Markit PMIs contracted in every sector (manufacturing at 45.9 verse 46 previous month, composite at 42.9 verse 44.2 and services at 52.5 verse 44.6). All in all, the Brazilian economy is not out of the wood yet and successive rate hikes from the BCB do not help to relieve the pressure on the economy but we may have seen the bottom.

BCB increased the selic rate

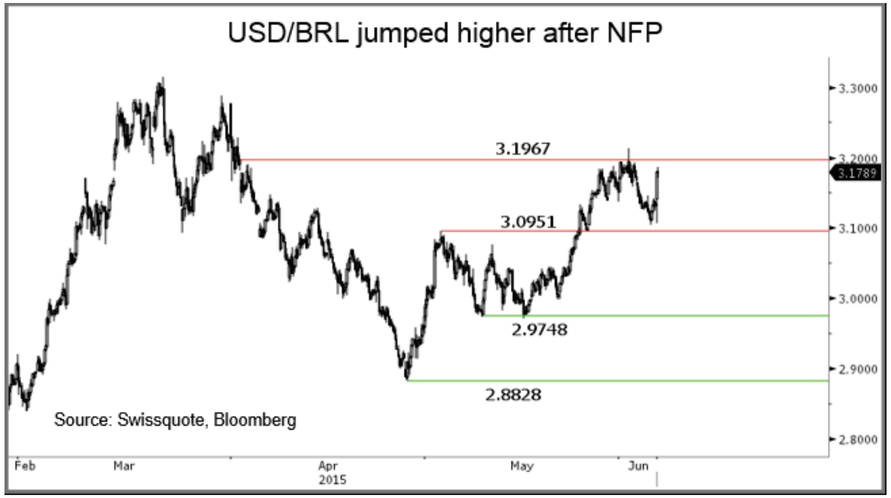
As anticipated by the market and us, the BCB increased the Selic rate by 50bps to 13.75%. The accompanying statement was roughly a copy-past from previous months and we therefore must wait on the release of the minutes' meeting, due on June 11, to get detailed information. Despite improvement in inflation expectation (12-months IPCA anticipation soften to 5.99% from 6.02% while inflation is forecast at 8.26% for 2015), we still expect the BCB to keep raising rate next month to 14% as inflation anticipations for 2016 are still well above the 4.5% target - recent survey by the BCB shows that inflation is expected at 5.5% by the end of next year.

What is next?

Given the need for the BCB restore credibility, we don't think the Copom is done with rate tightening yet, despite the declining economic activity. We therefore expect the Bank to increase one last time to 14% in July and so start cutting rate once the austerity measures start to kick in.


Inflation expectation for 2015 jumped from 6.40% to 8.20%

Source: Swissquote, Bloomberg


USD/BRL jumped higher after NFP

Source: Swissquote, Bloomberg

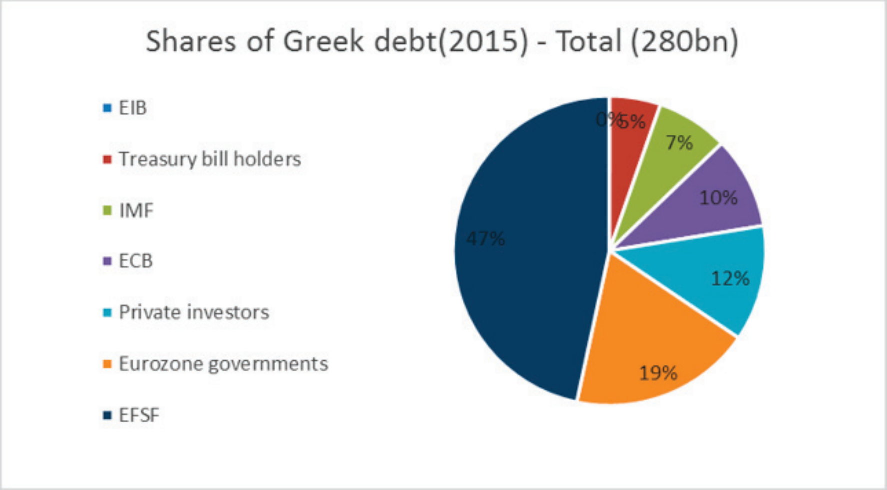
Economics

Greece Delays IMF Payments

Berlin has been host to another emergency summit on the Greek topic which gathered German and French leaders with ECB and IMF chiefs. The talks were focused on unlocking €7.2bn in bailout funds under more austerity conditions (ie cash-for-reforms). Following this last-chance summit, Greece has proposed to its creditors Thursday night a 47-page proposal in which the Greek government declared that compromises have been made. Greece also added pressure by saying it would not fulfil the next IMF payment due this week in case there is no deal by Friday the 5th. However, cleverly Greece decided, under a specific rule, to gather several small payments in a larger one, and thus to delay its installments to the end of June (stating to "chose not to pay".

We do not think that unlocking funds again and again is a sustainable solution over the long run. The truth is that three years ago already Greece should have defaulted even if now creditors are playing the fake “take-it-or-leave- it game”. Greece is currently unable to reimburse the IMF, even at the end of June. It is worth adding that Greece must also pay almost €7bn to the ECB in July and August. Its important to understand that the ECB credibility is at stake (due to massive lending this time around), if Greece actually defaults (again). In our opinion, a Greek default would not necessarily mean an exit from the Eurozone, but will alter considerably the ECB's strategy to support Greek banks.

Greece's officials seem to be gaining time as the current compromises are too demanding. The pressure on Greek pensions and on public domestic wages are now at a climax. Politically, Syriza has been elected under the promise of stopping austerity but agreed nonetheless in reforming pensions and the value added tax system. Euro is on its way out and the sooner the cheaper. ECB, to save its credibility is now disposed of compromising on the 4.5% budget surplus for 2015 and 2016, “1% and 1.5% are now the new target” said Manos Giakoumis, Greece deputy prime minister.



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