SWISSQUOTE

WEEKLY MARKET OUTLOOK

15 - 21 June 2015

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WEEKLY MARKET OUTLOOK - An Overview

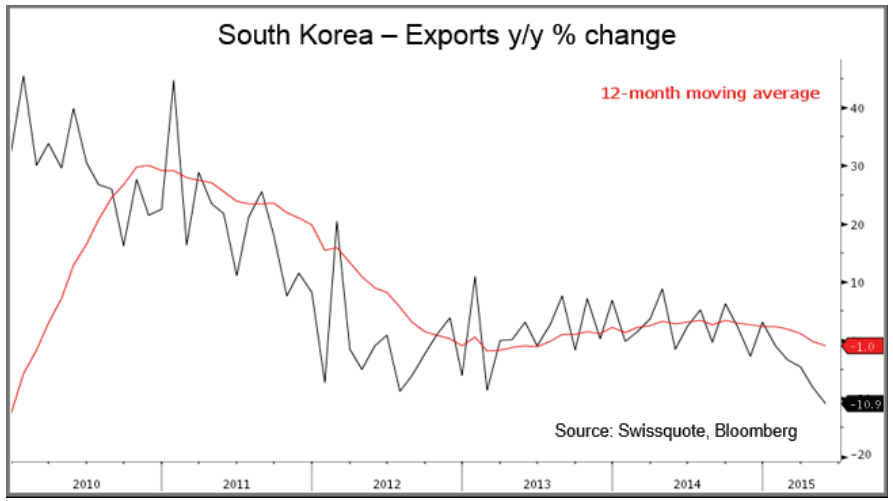
FX Markets

Regional Currency Wars Heat Up In Asia

In a retaliatory strike against the regional currency strength, the Bank of Korea cut its benchmark policy rate by 25bp to 1.5% (consensus to keep rates unchanged). The rate decisions was not unanimous according to Governor Lee. In the aftermath of the MERS outbreak, which has slowed business activity to a greater extent than expected, consumer confidence has now fallen, and steady export deterioration, signifying the outlook for growth is depressed. Overall the accompanying statement was dovish indicating that the "the downside risks to the domestic growth path forecast in April have expanded".

However, the primary rationale for the proactive cut was the persistently weak data from the export market. The BoK lowered its view on exports stating that "trend of decline in exports has accelerated". KRW has been on a 3 year bullish rally against its regional competitor JPY as Abenomics steals growth via competitive devaluation. Data for May exports indicates significant contraction of 10.9%. With exports collapsing the government has re-iterated the need for a weak KRW and concern over neighbors competitive devaluations. Moving forward, while the decision will ultimately be data depended, we suspect that further easing measures will be announced to defend the KRW weakness. That said, we anticipate other Asia regional exports nations to react with counter measures.

Yet, the Bank of Korea easing will be restricted by growing household debt. Cheap credit is fueling the rapid expansion in household debt, which has been troublesome in Koreas past (series of credit bust). While delinquencies have remained low as credit has been going wealthy households. But steady rate cuts has decrease in consumer spending as household look to reduce debt. Clearly, the BoK will also take household debt into consideration in formulating policy.



Economics

RBNZ Cut Its Official Cash Rate

Earlier this week, The Reserve Bank of New Zealand released the monetary policy accompanying its interest rate decision. The report gave us detailed information about the current state of the Kiwi economy. Here is a quick overview of the factors that led the RBNZ to lower its official cash rate by 25bps to 3.25%.

After having decreased constantly from 7.2% in Q3 2012 to 5.5% in Q3 2015, unemployment rate is on the rise again, reaching 5.8% in the first quarter of 2015. This increase can be explained by a higher labour force participation which rose to a record high of 69.6% in the first quarter of 2015 as strong employment growth is prompting people to look for a job. In the first quarter, labour force increased by 73k people with half of it coming from strong net immigration. Net immigration growth rate has remained above 1% for the last four quarters. However, unemployment rate is projected to fall to around 5%, leading to some increase in wage pressures. Moreover, lower oil prices and a stronger NZD in the first quarter added pressure on inflation, with headline CPI falling below 1%y/y in the winter month.

All those factors – long-term growth in employment, strong net immigration, durable wage growth and lower interest rate environment – increase the pressure on the housing market, pushing property prices higher. Just in April, national housing average median price (including Auckland) jumped 7%y/y in May or 1.1% on a month-over- basis, with a more substantial increase in Auckland where the average median price increased by more than 20%y/y. However the alarming situation of the housing market didn't prevent the Reserve Bank of New Zealand to reduce the Official Cash Rate by 25bps to 3.25% last week against the backdrop of growth concerns and low inflationary pressures.

Nevertheless, the RBNZ does not sit idly by and takes measures to address the growing market risk in Auckland. The Bank proposed changes to LVR (loan-value-ratio) policy earlier in May, with potential entry force in October this year. The new policy requires residential property investors using bank loans for Auckland area to have a deposit of at least 30%. The second change concerns an increase of the existing "speed limit" for high LVR borrowing (i.e. borrowers with less than 20% deposit) outside of Auckland from 10% to 15% of the dollar value of banks' new residential mortgage lending. Finally, the 10% speed limit will still apply for high-LVR loans to owners-occupiers in Auckland. The underlying purpose of those changes is to reduce the imbalance between Auckland and the rest of the country and also to improve the resilience of the banking system to a potential burst of the real estate bubble.

Despite the Reserve Bank's appeal directed to banks to observe the "spirit" of the restriction and to not seek high-LVR investor lending in Auckland, we suspect that investors will pursue high-LVR loans over the summer before the new regulation comes into effect. We therefore expect the housing market to strengthen further before we start seeing the effects of the new regulations. All in all, it will soften the Reserve Bank's penchant – to a certain extent - to cut rate quickly despite its strong dovish bias.

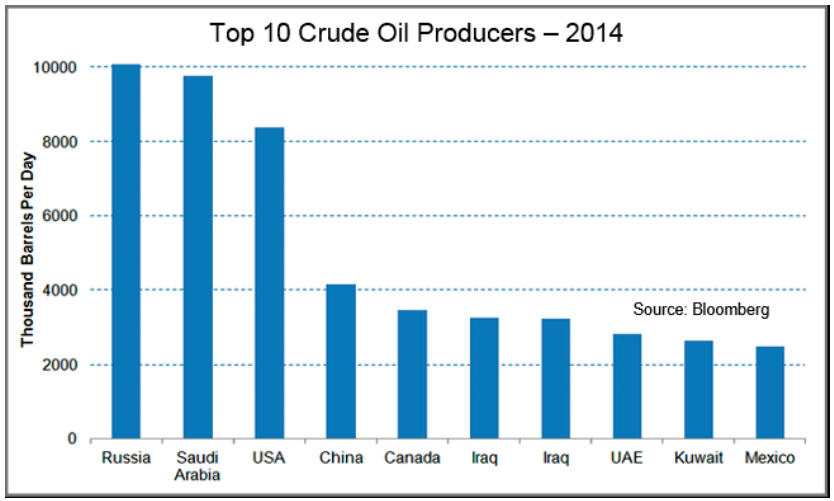
Economics

OPEC Defends Its Market Share

Following the OPEC summit that was held in Vienna last Friday, it has been decided to keep production level unchanged (despite concern of oversupply by some members). OPEC production quota remains at a level of 30 million barrels a day against a backdrop of declining oil demand over the last year. It seems that OPEC is still engaged in a strategy to defend its market share of 40% of the world's oil supply. Hence, maintaining its production at a higher level puts pressure on the booming US shale oil, who have higher production costs. The strategy is based on an assumption that a high production cost will slowdown US drilling. There is mounting evidence that the low price strategy is actually working as a number of US drilling rigs has declined by around 1% in the past week. Over the past year, it is more that 50% of US drilling rigs that have been closed.

The OPEC also emphasized that it is necessary to maintain such a level in a context of global economic recovery as the oversupply is expected to ease as demands will increase. "Market stability has to be everyone's concern" added OPEC.

Following the OPEC meeting, Iran has reiterated that it will return the market. For the time being, Iran is still under embargo. However, by June 30th, we expect an agreement between Teheran and six countries (China, France, Germany, US, UK and Russia). In case of nuclear deals that would lift the sanctions, Teheran has pledged to export more oil despite falling prices. Yet, Iran brought to light the tenuous balance between OPEC's members to maintain production output while oil price is decreasing. As a result, oil price has been pushed downside and we target the Brent to reach $60 a barrel on the medium-term.



Economics

Brazilian Economy Remains Under Pressure

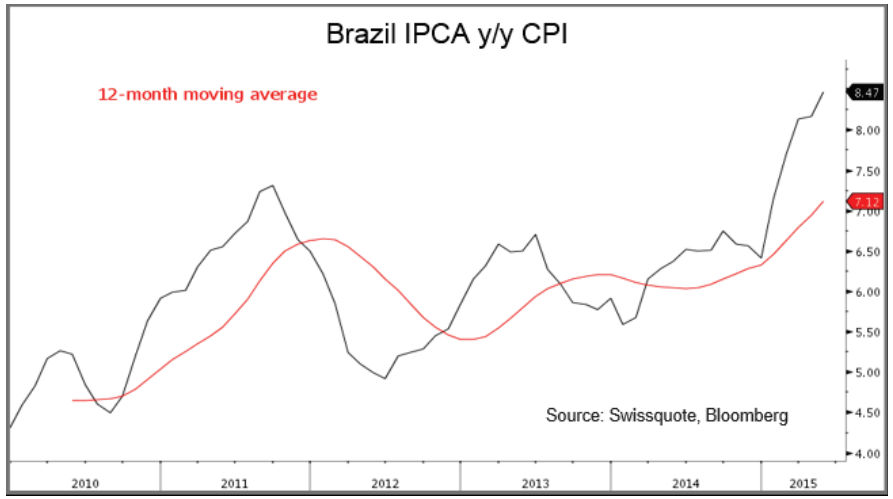
On Tuesday last week, Dilma Rousseff announced an infrastructure investment plan of BRL198bn. The new concessions will be auctioned to private investors and are related to investments in seaports, airports, roads and railways. The main purpose of this package is to revitalise the Brazilian economy by building new infrastructures but also by renovating outdated ones that weigh on the productivity and the efficiency of the world's seventh biggest economy.

The government already unveiled a concession plan back in 2012 and it wasn't a tremendous success, to say the least, as only 20% of the total BRL210bn had managed to attract private investors' interest. However, Rousseff said that this time the concessions will guarantee fair returns to investors as the Brazilian Development Bank is offering attractive financing conditions to auctions winners. Beside the evident desire of the government to create a more positive environment for private-public investments, in an attempt to end the ongoing recession, the new concession plan is also aiming at balancing the recent negative headlines related to fiscal adjustment measures that cut in labour and social expenditures. The investment package came as a breath of fresh air, even if it will not improve immediately growth perspective given that more than 65% of the investment auction will take place after 2018.

Copom minutes: not the end of rate hikes

Despite this welcoming news, the future is not that bright for Brazil as the ongoing recession will likely suffer from collateral damages resulting from the BCB's fight against inflation.

Inflation pressure remains strong in Brazil despite the BCB's efforts to reduce inflation toward the 4.5% target. Inflation increased alarmingly in May and accelerated to 8.47%y/y, as food and beverage, housing, healthcare and personal expenses pushed the measure above median forecast of 8.30%. The negative headline increased the odds of further monetary policy tightening by the BCB, with another increase of the Selic rate by 50 bps by the end of July (next Copom meeting on July 29). In addition, the hawkish tone of the Copom minutes released yesterday suggests that Brazil is not done with rate hikes yet. The 2.5% BRL's appreciation against the USD on Thursday highlighted the fact that market anticipations are skewed towards further rate tightening. We anticipate that decreasing volatility and the absence of negative headlines about the ongoing fiscal consolidation process will renew traders' interest in the carry embedded in the Brazilian currency, strengthening the BRL against the dollar in the short-term.



Economics

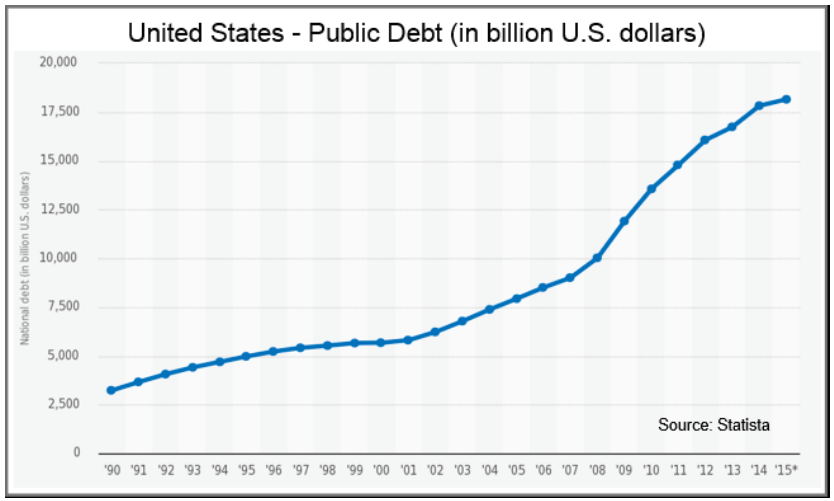
US Struggling On The Recovery Path

Last Monday, US Labor department released its Job Report for April. It included data for jobs opening (JOLTS). The figure printed at 5.3mn. In March, Job Openings decreased to 4.99mn from 5.14mn a month before. The data remain controversial as we question the trustworthiness of figures due to very lowest samples used for the report creation.

Later this week, US retail sales came in better than expected at 1.2% in May m/m, erasing the loss from December to February. It is the third increase in a row. Purchase of new cars pushed up the indicator. In addition, retail sales have printed a 2.7% rise year-on-year. Dollar gained from this data, but it seems that the market is reluctant to reload long dollar position as there are still uncertainties on the recovery. Nonetheless expectations concerning a Fed rate hike in September has been boosted.

Next week, the FOMC will meet. Even if a rate hike is very unlikely to happen, the minutes - due in early July - will be examine carefully to assess the likelihood of a September rate hike. However, there is one major issue of raising rates, it will also increase the annual deficit by a huge amount. Indeed, US has around $18 trillion debt and an increase of just 1% would rise the federal deficit by more than $100 billion. US economy has to be strong enough to make this deficit sustainable over the long haul.

We persist on staying cautious on EURUSD as the pair is mainly driven by Greek talks. The pair remain oriented downwards as long as there is no settled deal between Greece and its creditors. However, any new positive information on that topic will give upside pressure to the currency. We consider that will be a good entry point to reload short EURUSD positions.



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