SWISSQUOTE

WEEKLY MARKET OUTLOOK

22 - 28 June 2015

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WEEKLY MARKET OUTLOOK - An Overview

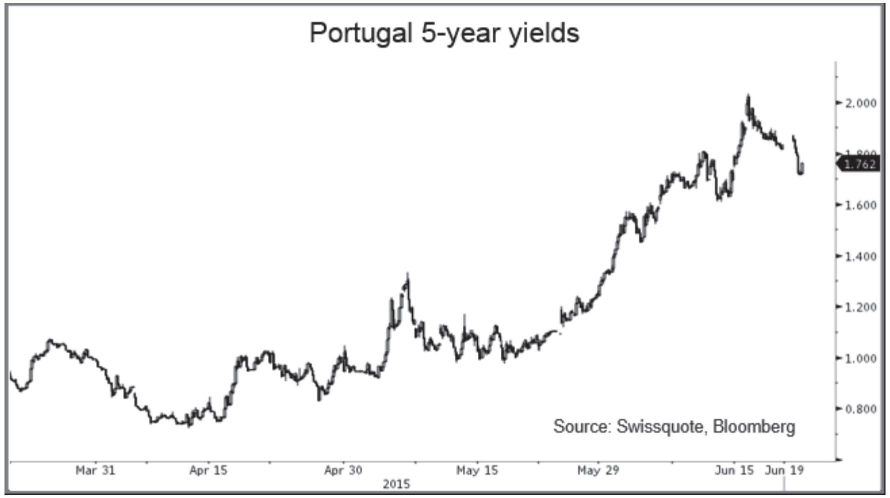
Economics

European Contagion

FX markets have been worryingly unalarmed over the lack of agreement between Brussels and Athens. However, peripheral Eurozone sovereign bond yields have been sold-off aggressively. Meanwhile peripheral over German, yield spread has widened significantly. Perhaps once again fixed income is acting like the "canary in the coal mine." Since October 2014, peripheral bond yields have enjoyed the benefits of the ECB's massive €1.1 trillion bond buying program. Yield starved investors piled into anything, contracting historically risky nations yields to bizarrely low levels.

Two key factors have been driving the recovery in yields. First is that the economic data in Europe continues to perform. Annual inflation rose to 0.3% in April after five months of deflation. While still well below the ECB's target level of 2.0%, the return of price pressures are a positive sign that QE is working and it is potentially indicating that the ECB will not have to follow the Fed and BoJ pattern of endless balance sheet expansion (i.e. ending QE in September 2016 as proposed). The second factor is the clear risk of a Greek default and/or "Grexit". While clearly we have come to this point many times during the Greek crisis, the general political rhetoric has been toned down a bit, with new flows of positive progress to balance the negative news. However, this time the language is extremely destructive. The probability of a Greek default (either IMF, ECB and/or public liabilities) has increase significantly and rates are adjusting accordingly.

That said, the recent bond yield rise and volatility have prompted concern outside Greece. Years of QE have constrained global yields as investors and central banks crowded each other out. In turn, yields, equities and commodities have become highly correlated with one another. A rapid unwind in rates could lead to sudden contagion on other markets.



Economics

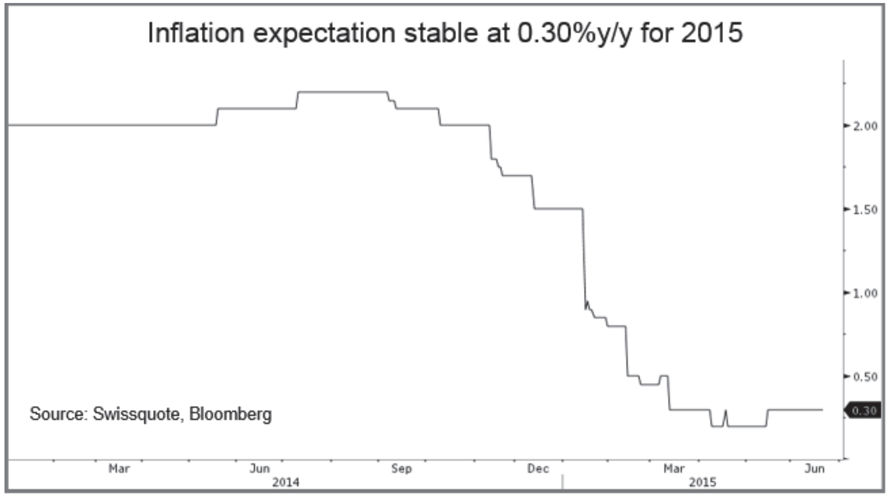
June FOMC Meeting: A Dovish Tone

Yellen more dovish than expected

On Wednesday, the Federal Open Market Committee maintained the federal funds rate's target range between 0% and 0.25%. Most market participants suggested that the statement and the press conference pointed toward a lift-off later in 2015. However, most FOMC members lowered their projections for the federal fund rates for 2015, 2016 and 2017, the dots-plot showed. Janet Yellen, Fed chairwoman, declared that the Committee wants to see further improvements in the labour market and to feel reasonably confident that inflation will reach the 2% target over the medium term before starting to increase the federal funds rate. The Committee maintained its Core PCE inflation projection to between 1.3% and 1.4% for 2015 but increased its forecast for 2016 to between 1.6% and 1.09%. On the unemployment front, the members increased their projections to between 5.2% and 5.3% in 2015 from between 5% and 5.2% in March. The Fed also lowered its GDP growth forecast to between 1.8% and 2% compared to between 2.3% and 2.7% in March. In addition, last CPI figures released on Thursday indicate that inflation did not pick up as fast as anticipated by the market. May CPI figures printed at 0.4%m/m versus 0.5% expected while Core CPI came in at 0.1%m/m – the smallest increase this year - versus 0.2% median forecast.

Future is still uncertain

Considering all the above revisions and the overall dovish tone of the press conference, we believe that a September rate hike is not guarantee yet as the Fed maintained that any change of the monetary policy will remain data dependent, saying that "the Committee will determine the timing of the initial increase in the federal funds rate on a meeting-by-meeting basis, depending on its assessment of incoming economic information and its implications for the economic outlook". It is clear that policy makers want to see further improvements in the economy before starting to raise rates as it could derail the ongoing recovery. We therefore cannot rule out that the Fed may start the tightening cycle from a later date.



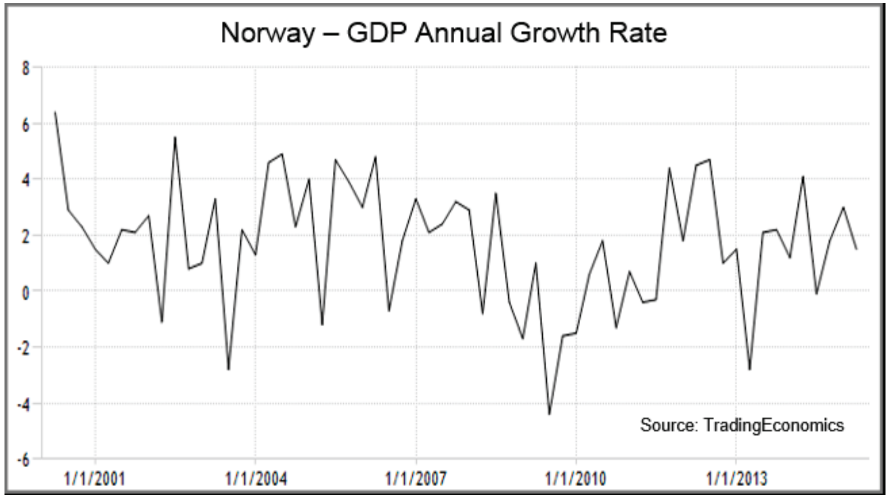
Economics

Norges Bank Struggles Against Housing Prices

As broadly expected, Norges Bank cut the deposit rate by 25bps to 1% as the country is facing weaker growth, sluggish economic outlook and below target inflation level (May CPI at 2.1%y/y and target at 2.5%). A month ago, Norges Bank kept its rates on hold. We assumed that policymakers' officials were gaining time for gathering more data. Meanwhile, Manufacturing PMI, Industrial Production decreased in May. Furthermore, the Q1 GDP growth figure came in at a disappointing 0.2% while prior GDP growth figure for Q4 2014 was 0.9%. As we expected the economy is still suffering from low oil prices and the likelihood for a cut rate had increased. Governor Olsen declared that as long as the Brent will stay below $70 a barrel the Norwegian economy will be at stake. For the time being, the oil surge has been temporary and oil prices remain clearly on the $60-level a barrel and therefore it is likely that further rate cut will happen.

Lowering rates increase inflationary pressures that will add up to the overheated real estate market. Indeed, property prices increased tripled since the mid-1990s and grew by 7.5% in the last 12 months. Last Wednesday, the Norway's Finance minister Siv Jensen held a conference on strategy for housing market. It has been decided to boost supply by allowing the construction of less costly houses in order to cool down the market. In addition, the minister threatens the bank to introduce new measures in case lending activities are not dampered. Thus, she proposed tighter lending rules.

The Bank also left the door wide open for further monetary policy easing. We therefore expect another rate cut later this year, most probably after the summer. USD/NOK jumped from 7.60 to 7.70 with 7.85 as the next target.



Economics — SNB: Alone Against All

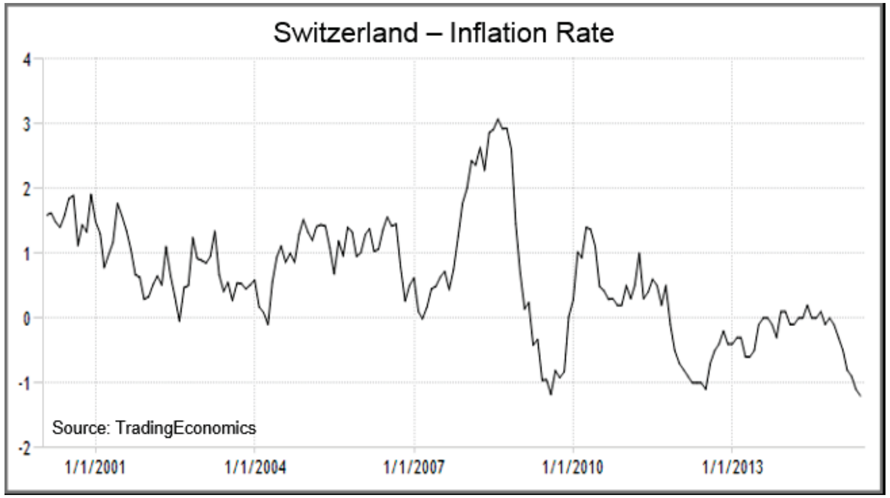
Swiss economy expected to contract further

Swiss policymakers have celebrated thus far the resiliency of the economy to absorb the shock of 15% EURCHF devaluation. However there is mounting evidence that mid-and-longer term consequences are slowing filtering thought the system. The SNB believes this is merely a soft patch driven by the sudden revaluation. Yet, incoming data clearly indicate that the strong CHF against the euro is placing a significant lasting drag on Switzerland's recovery. We believe that Switzerland should be bracing for a deeper negative economic impact from the strength of the franc. In its June forecast, the Swiss government statistics office (SECO) anticipated further economic deceleration to 0.8% in 2015, from the 0.9% expected in March. Meanwhile GDP growth in 2016 has been revised downwards to 1.6% from 1.8% previously. The SECO stated that "Foreign trade is expected to have a negative impact on growth in Switzerland throughout 2015 as a whole. In light of the steady, albeit weak, economic recovery in Europe and the continued positive expansion of domestic demand in Switzerland." Worryingly, this is an optimistic view on domestic demand as retails sales have only just recovery from a sharp decline and inflation pressures remain weak. We are not confidence that demand will remain strong, as consumers look across the borders for additional value. The Swiss economy remains "vulnerable" to FX volatility and with the situation in Greece intensifying, we would expected further capital inflow into Switzerland.

SNB left monetary policy unchanged

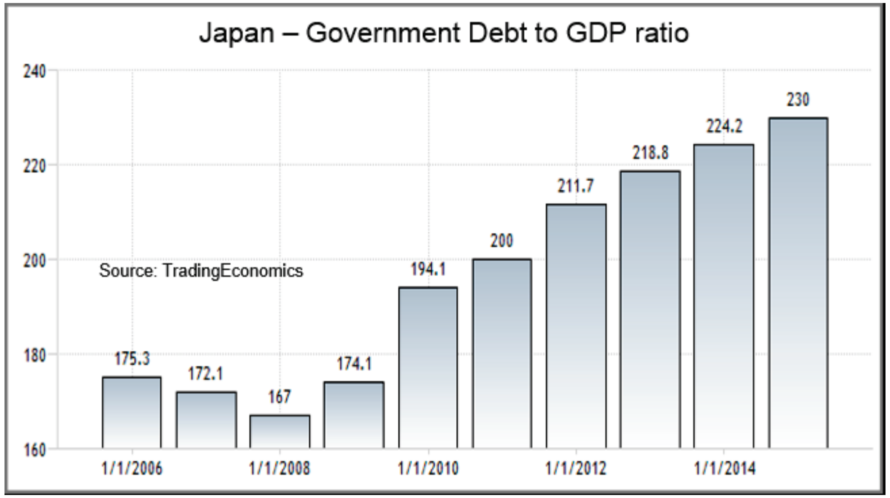
As expected, the SNB held the target band for the 3m LIBOR at -1.25% to -0.25% and the sight deposit steady at -0.75%. With a limited tool box to work with, the SNB will opt to wait for additional evidence that the strong CHF is damaging the Swiss economy. That said, even if the data accelerated downwards, there is very little that the SNB can do.

Lower interest rates will have a limited effect, while FX interventions will only encourage the market to challenge the central banks and generate billions more in losses. We anticipate EURCHF to head back towards 1.0235 support as Greece slides toward default.



Economics

Bank of Japan : Too Much Optimism On Growth



Last week, Bank of Japan Governor Kuroda stated that the yen was very weak. Markets interpreted this controversial speech as an attempt to strengthen the yen or at least to predict its future moves. Therefore the greenback fell below 123 yen for a dollar on those comments. Yesterday, Kuroda explained that he did not make this declaration on purpose nor he was trying to influence the yen exchange rate. Despite those additional comments, the yen remains stronger than it was last week before Governor's speech.

We think that policymakers' officials are unhappy with the yen's collapse over the last few years. The USDJPY reached this month its highest level since 13 years. Obviously, the QQE effect made the yen weaker, which pushed up the exporter's revenues and stock prices amid imports cost went higher. At the moment, Japan's growth is higher than expected, GDP growth came in last week at 3.9% y/y way higher than the estimate at 2.9% y/y. Further monetary easing will continue until the inflation target of 2% is reached. April core inflation is at 0.3% y/y.

Last Friday, the BoJ met and it has been decided to maintain the expansionary monetary policy. The central bank will increase base money at an annual pace of 80 trillion yen. After this decision, Japanese stocks expanded and we anticipate them to grow even higher as long as the central bank increases base money. This will likely increase the already massive debt-to-GDP ratio, the highest in the world, which is expected to rise to 252% by 2020 according to NAB economics. Those figures are far from PM Abe who stated that Japan's growth forecasts for the next five years is set to be 3% y/y which is much higher that what economy had over the last ten years.

FX Market

RBA: Room For Further Rate Cut

AUD still overvalued

Last week, the Reserve Bank of Australia (RBA) released the minutes from its June 2 meeting. The Bank reiterated that the Australian dollar was still overvalued in its opinion and that there is therefore room for further Aussie depreciation. "The exchange rate was close to the lowest levels seen earlier in the year, but members noted that the current level of the exchange rate, particularly on a trade-weighted basis, continued to offer less assistance than would normally be expected in achieving balanced growth in the economy. A further depreciation therefore seemed both likely and necessary, particularly given the significant declines in commodity prices over the past year." minutes said.

However, the RBA noticed that private investments were particularly low in certain non-mining sector like manufacturing where "the rate of investment had been lower than the rate of depreciation in recent years". Confirming our opinion that, despite improving GDP figure (Q1 0.9%q/q seasonally adjusted), the economy is not in a good shape as it relies heavily on exports while domestic demand remains flat and private consumption contracted -1.2% (s.a.) during the first three months of the year. The Bank added that a lower Aussie would definitely have "beneficial effects on some sectors" to the extent that the AUD remains lower for a significant period of time.

Waiting on the US

All in all, we think that another rate cut cannot be ruled out. However, at the moment, we believe the RBA will stay on hold and take the time to assess the development of the economy and the financial market, hoping that good economic data keep flowing from the US - which cannot be considered as granted yet - as it would allow AUD/USD to move lower without the intervention of the RBA.

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