SWISSQUOTE

WEEKLY MARKET OUTLOOK

14 - 20 September 2015

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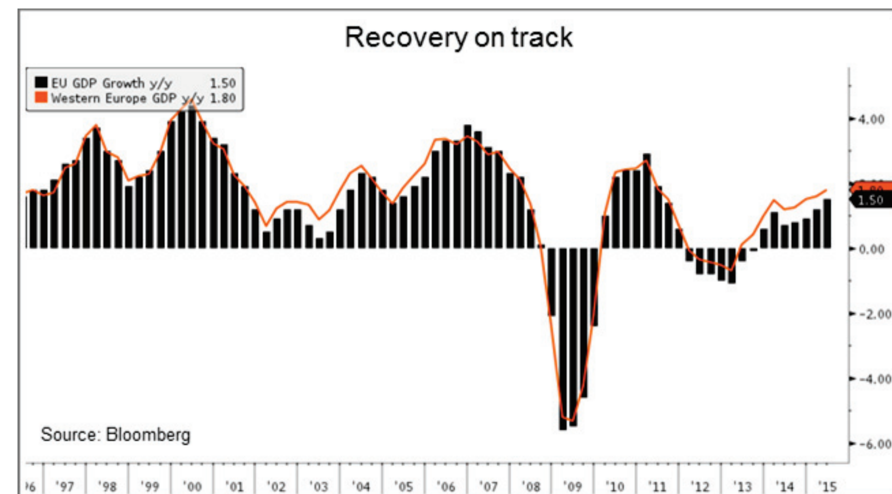
Economics

Mild Growth But Dark Clouds Looming

The ECB recently warned that "the recovery in activity in the euro area is expected to continue, albeit at a somewhat weaker pace than earlier expected, and this is reflected in some downward revisions to the growth outlook." So when the EU final estimate for Q2 GDP was revised up slightly to 0.4% q/q (from 0.3%) showing a moderate decrease from Q1, it was widely expected. The weak read should be seen as a positive since given the softness in some peripheral nations, growth could been lower. Yet overall, there is scant evidence the recovery is stalling as EZ composite PMI increased to 54.3 from 54.3. This improvement indicates that GDP growth in 2015 and 2016 GDP (1.4% and 1.6% respectively) forecasts should be revised higher.

The underlying data was encouraging. The decent pace of growth, improving labor market and lower oil prices should allow consumer spending to continue to develop. In addition, government expenditures due to the unfolding humanitarian crisis should also give demand a bump offsetting recent slowdown in government spending. With political ambiguity around Greece (elections September 20th) lingering, investment remains a source of uncertainty. A big improvement in growth was seen from net trade, driven by strong exports, which clearly benefited from the EUR depreciation. Correspondingly, imports decreased as well. For Europe's recovery to continue the Euro will need to remain weak. The EU is failing to produce inflation and output gap remains, indicates that there are disinflation forces which the ECB will need to address. The ECB has pledged to prolong its asset purchase program which prompt Euro selling. However, monetary easing has a diminishing effect on currency depreciation especially verbal communication rather then actual buying. Finally given the slowdown in China and spillover into EU exports (1.3% of EU GDP, but a 2.4% of German GDP) there are downside risks to Europe growth outlook.



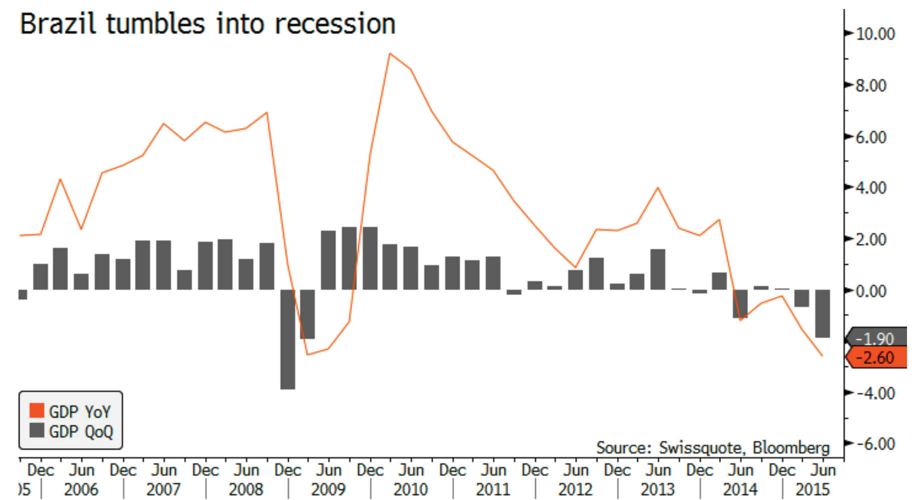
Economics

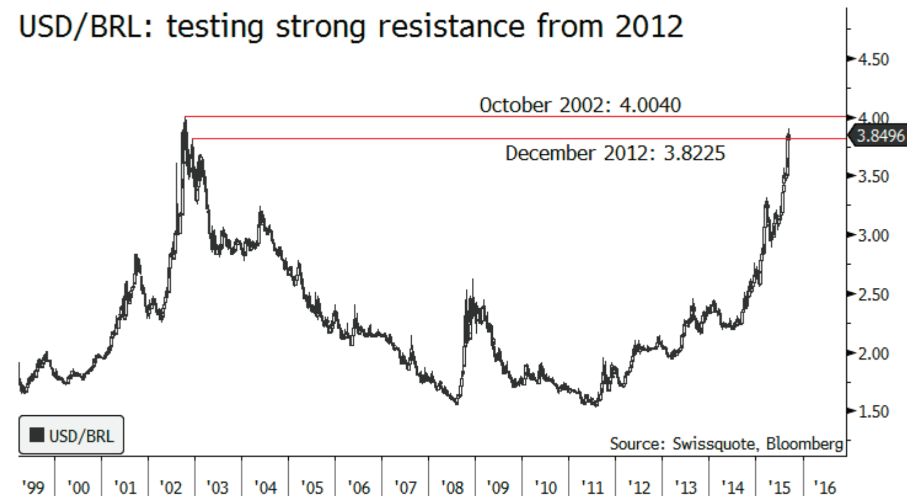
Brazil Downgraded To Junk Status

Only 6 weeks after lowering Brazil's investment grade outlook to negative, Standard & Poor's cut Brazil's credit rating to BB+ from BBB- as the government keeps readjusting its fiscal target. We anticipated a downgrade of Brazil's sovereign debt but the timing surprises us. Moody's just downgraded Brazil's rating by one notch to Baa3 from Baa2 on August 11th, while S&P put it on negative outlook on July 28th. However, we believe there is a solid, fundamental rationale behind the aggressive downgrade. Over the last few weeks, the political and economic situation has deteriorated faster than anticipated. Dilma Rousseff's ruling coalition is falling apart while the Congress is undeniably sidestepping the cutting of expenses, watering down measures devised by Joachim Levy.

On a more positive note, the downgrade may act as an electroshock for Brazilian politicians. Major reform overhauls are needed to set the Brazilian economy on the road to growth; politicians cannot turn a blind eye forever as concrete actions are needed to address the fiscal budget. Therefore, now may be the right time to start considering Joachim Levy's proposals before it is too late.

Looking at the big picture, we think that there is a real concern about the broad EM space. This aggressive downgrade will only highlight weakness in Brazil and have investors revaluate risk in other EM nations. The anticipated sell-off in Brazil will certainly spread to other Latin American countries. However, the story is only marginally focused on Brazil's collapse but rather broader macro themes such as weak commodity prices, threat of a China lead global economic slowdown and destabilizing effect of strong USD in EM nations. Events in Brazil plus these macro themes will emphasise the markets growing anxious of another EM meltdown.





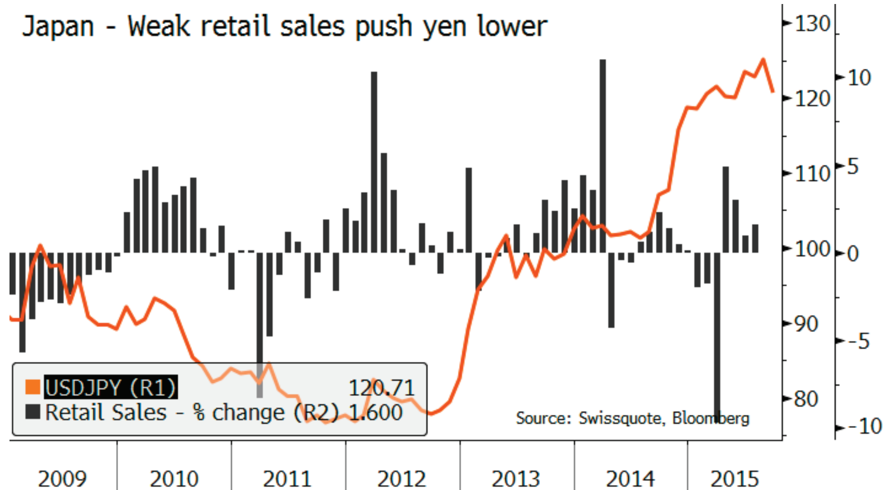
Economics

Shinzo Abe Committed To Cut Corporate Tax

In an event that was held last week in Tokyo, Japan's Prime Minister Shinzo Abe declared that the effective corporate tax rate of about 35% will be cut by next year by at least 3.3%. Abe stated that he is willing "to go beyond that if possible". Indeed the "Abenomics" is not living up to expectations. Consumer spending are very low and the country is struggling for exiting a period of 20 years of deflation. We think that Abe is now grasping at other ways to stimulate the Japanese economy as the "Abenomics" are failing to provide sufficient results. Last Tuesday, the final read of the second quarter GDP came in at -0.3% quarter-on-quarter, improving by 0.1% from the first print. Furthermore the annualized GDP deflator diminished at 1.5% from the first read at 1.6%. Prices are still increasing but it seems at a slower pace.

We consider that the Japan's economic strength is a serious concern. Despite all measures provided by the "Abenomics" - in particular the money waterfall -, there is no current pickup in inflation. The Bank of Japan's inflation target of 2% is still quite distant while the CPI struggles to hold above 0%y/y. BoJ's Governor Kuroda remains confident and Central Bank officials maintained their view that the pace of asset purchases will not be increased. However an economist survey is showing that a third of the respondents see the Bank of Japan expanding monetary stimulus in October.

We remain bullish on the USDJPY. Over the past few weeks, the yen has strengthened on markets pricing in a later rate hike. Nonetheless, Shinzo Abe has not many arrows left. There is no clear path of recovery. 122 seems a decent target.

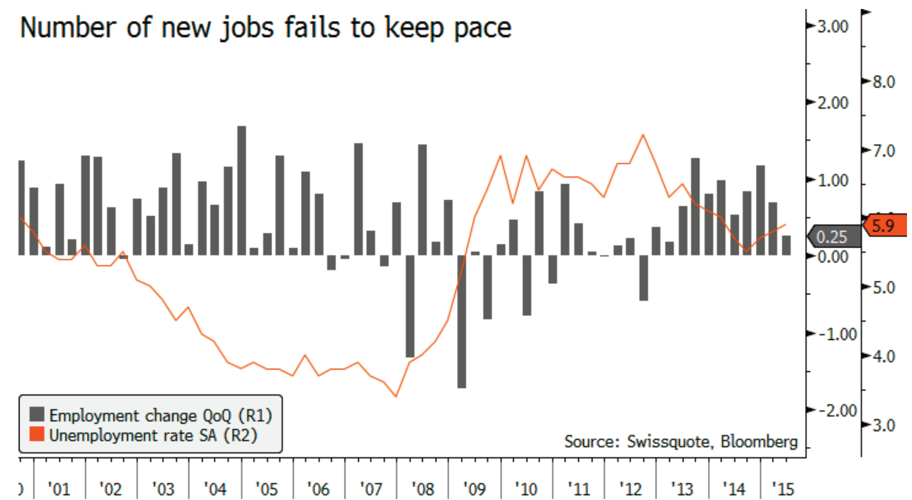


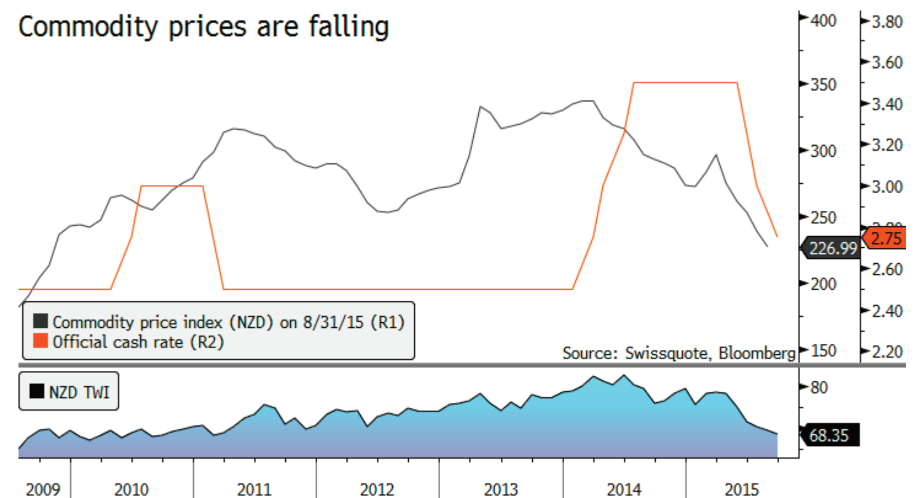
Economics

RBNZ Cut OCR And Signaled Further Easing

As expected, the Reserve Bank of New Zealand eased its monetary policy for the third time since the beginning of the year. The RBNZ cut the OCR by 25bps to 2.75% and left the door wide open for further easing. In its September's Monetary Policy Statement, the Central Bank revised downward its growth projection to around 2% from 3% in its June statement, arguing that "the economy is adjusting to the sharp decline in export prices, and the consequent fall in the exchange rate". On a more positive note, Graeme Wheeler noted that growth was supported by "robust tourism, strong net immigration, the large pipeline of construction activity in Auckland and other regions". Therefore, it will unlikely be the last rate cut in 2015 as the economy feels the pinch of a slowdown in global demand and more specifically from China. In addition, headline inflation is still far from the 2% target. This is due to the fact that the depreciation of the New Zealand dollar has been offset by a collapse in commodity prices. In fact, we believe that the RBNZ will bring the OCR even lower than 2.75% in an attempt to weaken the kiwi further, especially since the effect of such rate cuts on the housing market will be mitigated by modifications to the Loan to Value Ratio restriction rule (LVRs) and to the minimum deposit threshold for investors in Auckland.

As a result, the New Zealand dollar dropped 2.30% against the US dollar and is now trading around $0.6280. We were already bearish on the NZD and this dovish statement has only reinforced our view that the RBNZ wants to see a weaker Kiwi. Furthermore, we believe the recent rebound in NZD/USD will be short-lived and that the kiwi will continue to move lower against the greenback once traders start to price in the upcoming rate cuts.



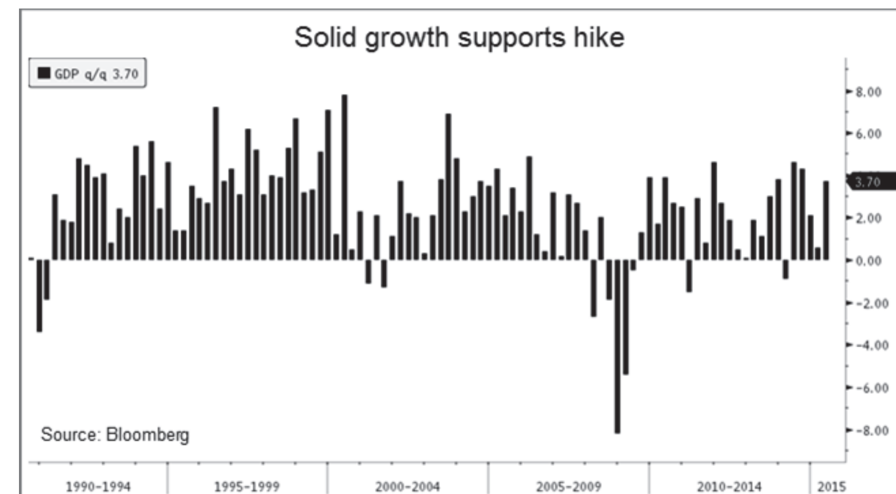


Economics

It's Finally Here: The September FOMC

The FOMC 16-17th policy meeting has entrenched itself as the primary driver of FX pricing. Yet the unwinnable debate continues to revolve around a September or December rate hike. Today's University of Michigan consumer sentiment ease marginally to 85.7 from 91.9, yet spillover of results into the broader policy discussion should be limited. With no silver bullet scheduled between now and Thursday, and with the debate widely seen as balanced, USD directional moves should be restricted.

The Fed stated that the conditions for the first rate hike after a 9-year hiatus, is predominantly dependent upon labor markets and inflation expectations. With unemployment falling to 5.1% and job creation steady over 200k (slight dip in August 173k read), most would argue that full employment has been achieved. However, the Feds preferred measure of inflation, PCE y/y, continues to weaken, sliding to 1.2% in July. Evidently, inflation is well off the Feds 2% target, supporting the case to hold rates. In addition, weakness in China and fall in oil prices increase disinflationary risks. Fed fund futures are pointing to a December hike but undoubtedly September remains a solid probability. Potentially, the principal deciding factor will be the unquantifiable affect Chinese volatility and impact on global growth will have on Fed members reasoning. FX traders should avoid the Fed "timing" hype and just play the range in EURUSD. With no clear indication on timing, EURUSD will bounce around the current range. Range resistance at 1.1365 should cap upside, while 1.1087 base should provide support.



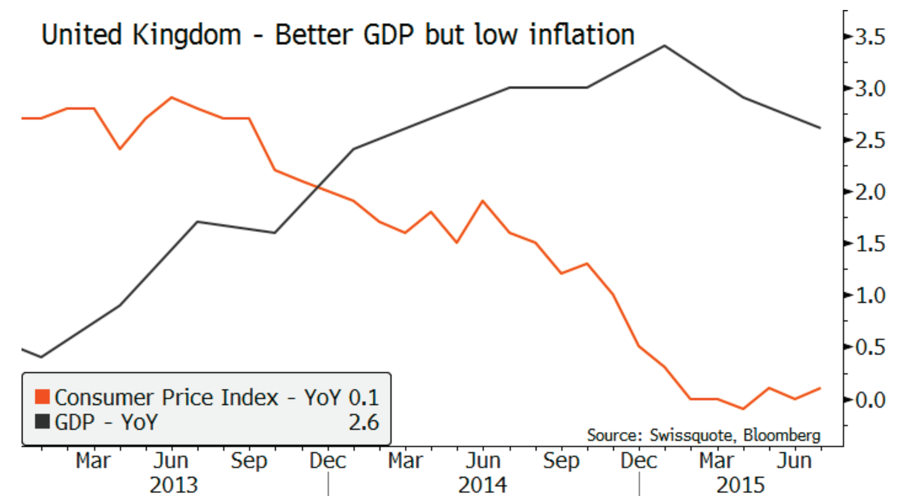
Economics

Bank Of England Appears To Be Dovish

The Bank of England has decided to leave its rate unchanged last week. Policymakers were not only considering domestic conditions but also global conditions. Markets are currently driven by the next U.S. Fed rate hike, the China's turmoil and lingering low oil prices.

At the last BoE meeting that was held in early August, only one member voted "yes" for a rate hike. This time and as we expected the panel voted exactly the same at 8-1 to keep the key interest at 0.5%. We considered that there was no reason for others members to vote in favour of a rate move. Nonetheless it is important to say that UK domestic conditions support a tightening policy. Only inflation remains at concern, it printed at 0.1% year-on-year in August. On the other side, retail sales stands currently at 4.2% y/y despite a minor setback in August. GDP is also on its way up with a read at 0.7% for Q2.

We think that what is really weighing on the minds of BoE members is that the global growth and productivity remain low. The WTI is holding below $50 a barrel on fears of China's slowdown and on the current OPEC oversupply. It is likely that the current negative outlook impacted the decision to increase rates as UK may suffer from a slower global economy. The BoE minutes stated that there is continued upside risks to inflation relative to the target and that the current global turmoil has not altered the outlook for the U.K. economy. Nonetheless as there is no inflation, we consider the BoE minutes as more dovish. Therefore we think that the Bank of England will sit tight and wait for more supportive domestic data before making any move. The BoE rate hike is not for now and this reality provides some positive traction to the single currency.



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