WEEKLY MARKET OUTLOOK

21 - 27 September 2015

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WEEKLY MARKET OUTLOOK - An Overview

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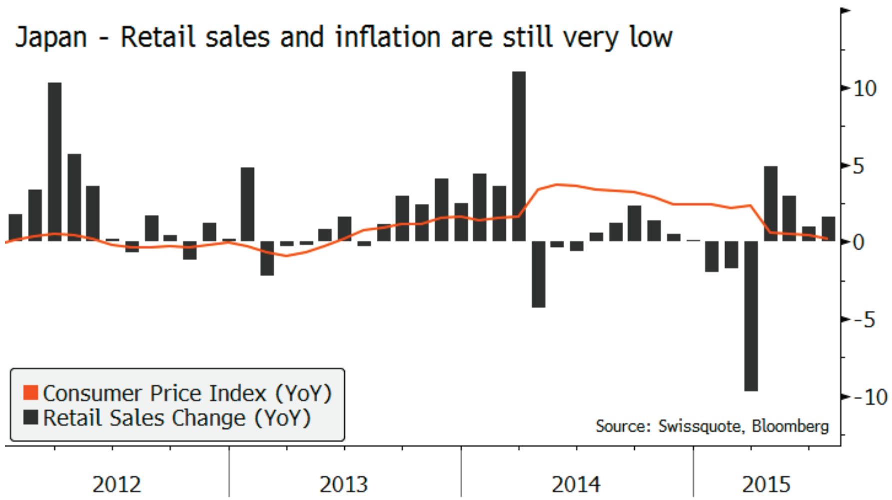
Economics

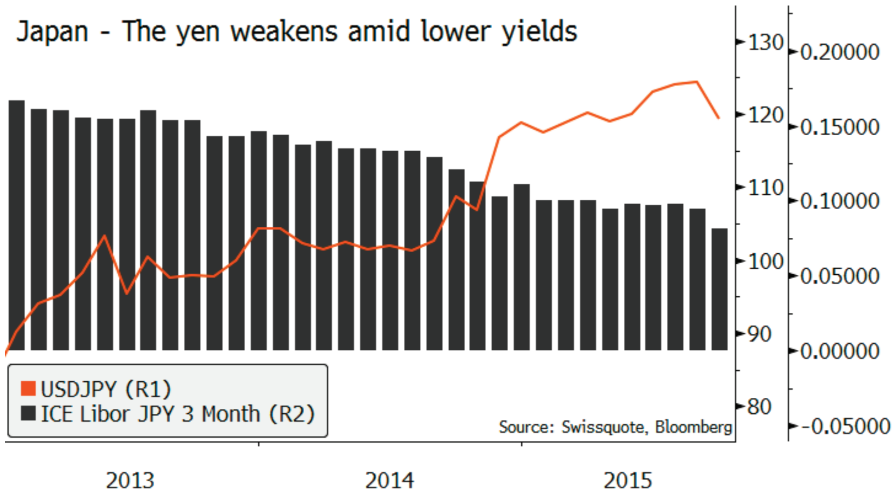
Bank Of Japan Maintains Current Monetary Stimulus

Annualized Japan Q2 GDP shrank at -1.2% y/y despite huge stimulus provided by the "Abenomics" of Prime Minister Shinzo Abe. At the Bank of Japan meeting that was held last week, it has been voted at an 8-1 vote to maintain current stimulus for boosting the economy. Hence, the increase of the monetary base will remain at the annual pace of 80 trillion yen. Later last week, BoJ Governor Haruhiko Kuroda held a speech in which he declared that the central bank will make necessary policy adjustments if needed. Nonetheless, he provided further no clue to the market that the BoJ will ease monetary policy further in the near term.

In our opinion, we consider that there are clear evidences for the BoJ to do it. Indeed, consumer spending is still at a low level and the inflation gauge is at zero. Besides, the 2% inflation target seems unreachable in the current economic conditions. We remember that Kuroda has declared that there is a possibility that the BoJ may lower the inflation forecast. He added that this would be due to the drop in oil prices. However, we think that oil price is the not the main factor in the success of the Japan recovery but it is rather clear that current policies, the "Abenomics", are failing to provide sufficient results. Lingering low oil price is only a compounding factor.

On October 30, the Bank of Japan will release its economic and inflation outlook. It is very likely that the Bank of Japan will add more stimulus. Lawmaker Kozo Yamamoto said the monetary base should be expanded by 10 trillion yen. We now wonder where Japan will stop. The massive debt-to-GDP ratio of more than 230% which makes Japan's debt unsustainable does not prevent the Bank of Japan to keep on applying the same policy. How long will investors remain confident in the Bank of Japan's ability and in the "Abenomics" to stabilize the economy? We remain bearish on the JPY.





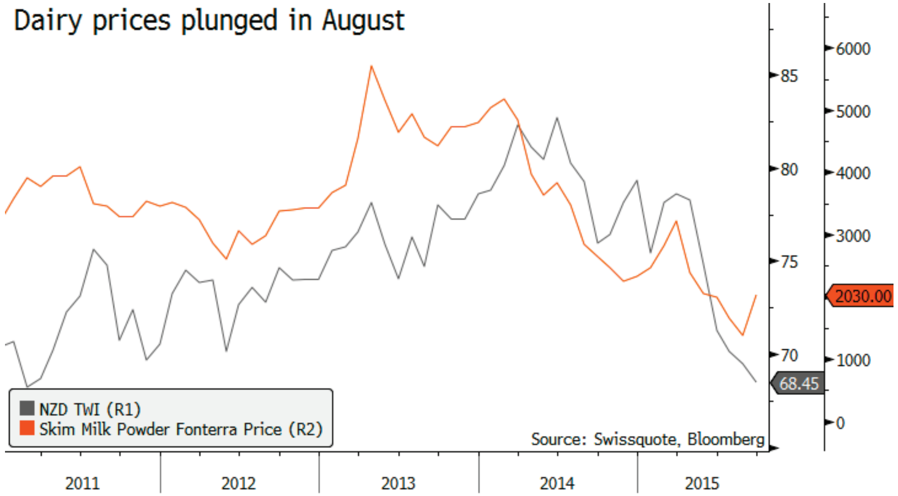
FX Markets

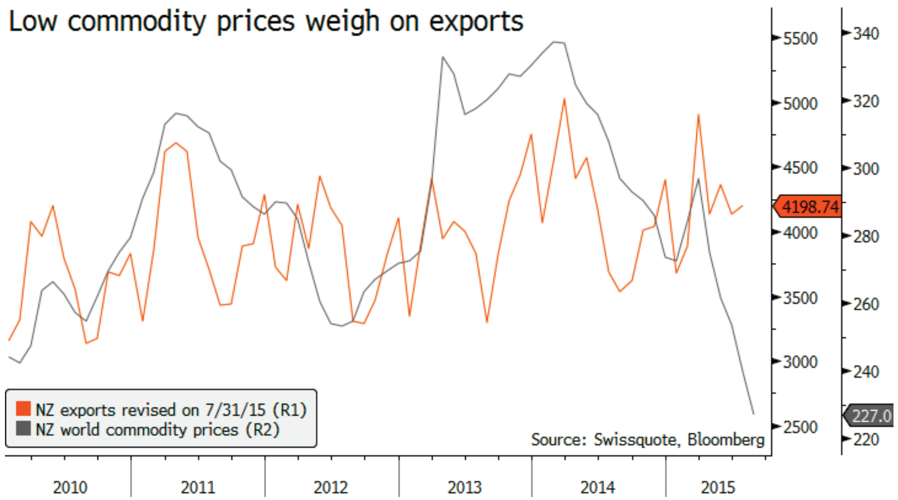
NZD Remains Weak And Vulnerable

New Zealand's Q2 GDP came in on the soft side last Thursday just a week after the RBNZ cut the OCR by 25bps to 2.75% in an attempt to boost growth. The Kiwi economy expanded by only 0.4%q/q (seasonally adjusted) while market participants were looking for an expansion of 0.6% q/q; however it is still better than the previous quarter during which the economy grew 0.2%. Data showed that agricultural production increased 3% after contracting 2.3% in the first quarter. The mining industry grew 2.5% - after a contraction of 7.8% in the March quarter - as extraction in oil and gas increased. Exports were badly hit, particularly due to low dairy prices, and contracted 1.1%. However, it seems that there is light at the end of tunnel as dairy prices have begun to recover since mid-August. In addition, the country can also count on strong growth in the tourism sector as a cheaper currency makes New Zealand more attractive to tourists.

Overall, we see that the market underestimates the impact of low commodity prices and a weak global demand on the Kiwi economy. A weaker New Zealand dollar will definitely help the country to address those issues. However, we believe that the RBNZ will rather wait, firstly, to get more data before moving on with another rate cut as the economy still needs to digest the last cut and to adapt to a low commodity prices environment.

Accordingly, we expect trade deficit (due next Thursday) to have widened further - for the third straight month - in August as exports suffer from weak global demand and tumbling dairy prices. All in all, we anticipate the Kiwi to continue depreciating over the coming weeks as the recent rally in NZD/USD, due to the Fed inaction, will likely be short-lived.





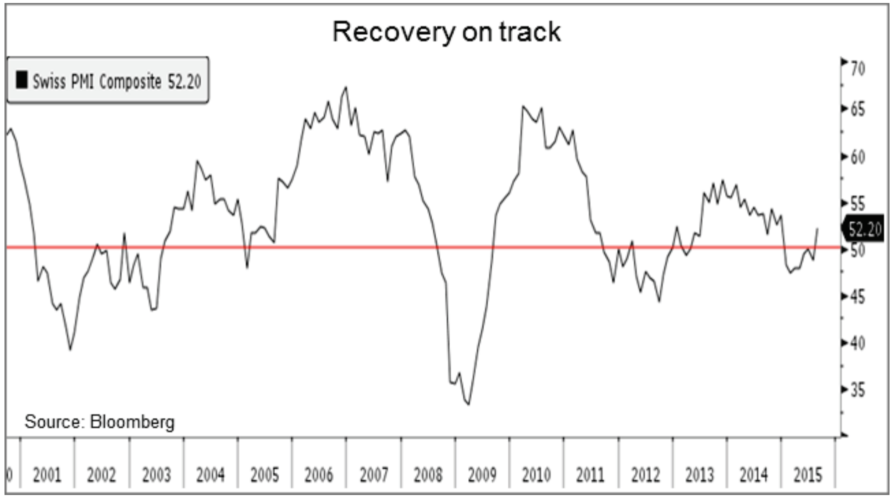
Economics

SNB Watching ECB

The SNB monetary policy assessment of 17th September was rather a dull affair but provided further confirmation that the CHF should weaken further. As expected the SNB held 3-month Libor target rate at -0.25 to -1.25%. The interest rate on sight deposits with the SNB remains at –0.75%. According to the SNB, the Swiss franc is “significantly overvalued, despite a slight depreciation” and “remains active in the foreign exchange market as necessary.” Basically, the SNB has toed the company line. Inflation was decreased 0.2% points to –1.2%; due primarily to a fall in oil, while growth has picked up slightly, yet the environment remains challenging for many companies due to CHF appreciation.

Perhaps the most interesting aspect of the monetary policy assessment was the sentence: “negative interest rates in Switzerland and the SNB’s willingness to intervene as required in the foreign exchange market ma ke investments in Swiss francs less attractive; both of these factors serve to ease the pressure on the franc”. This clearly gives an official blessing to FX traders to sell CHF. In addition by reminding the markets of negative interest rates it potentially indicates that should CHF remain overvalued, further cuts in rates can be expected. Yet the SNB remain aware that there are risks with CHF weakness, suggesting that “economic developments in China” and “turbulence in the international financial markets” could impact monetary global policy. We suspect that the SNB is overly optimism on its growth forecast (just dodged recession) and underestimates the structural changes sparked by the perpetually strong CHF. We remain vigilant for potential ECB action on interest rates and a preemptive response by the SNB.

The lack of further policy action sparked a relief rally in CHF. We anticipate a reversal of this knee-jerk reaction and further weakness in the CHF. Despite solid current account surplus and large gold reverses, traders no longer see the CHF as the primary safe haven trade of choice but rather the funding currency of choice.



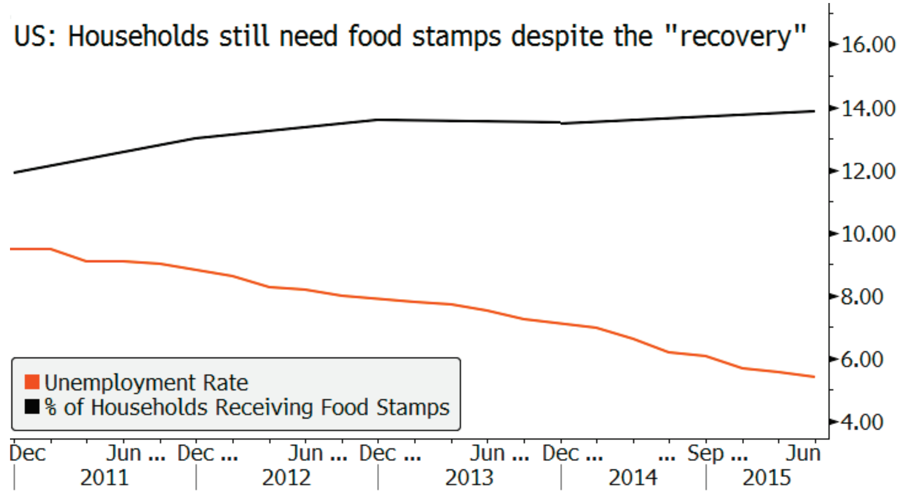
Economics

Fed Holds Off On A Rate Hike

The FOMC decided to leave its rates unchanged at 0%-0.25%. Fed Chairwoman Janet Yellen stated that despite the improvement in the labour market, the Fed is still concerned by the fact that inflation sits well-below the longer-run objective of 2%. She added that lingering weak oil prices and lower import prices added downside pressure to inflation. It was also said that the Federal Reserve will be willing to increase rates once there is (even) further improvement in the labour market and more evidence that inflation will reach the 2% target. Indeed, part-time employment is elevated in the U.S and the wage growth remains subdued.

We believe that the zero interest-rate policy and quantitative easing approach has proven inefficient. We predicted that no rate hike would happen as data has been coming in mixed and still believe that quantitative easing 4 is not far off. The era of cheap money is not over. Yellen added that even if a rate hike happens, monetary policy will remain accommodative. This really shows how worried the Federal Reserve is concerning the sustainability of the so-called U.S recovery. However, it transpires that Fed members have in fact increased their projections for economic growth this year, which is now expected to hit 2.1% this year and 2.3% in 2016.

The USD-complex has been weakened after the announcement even if the markets had partially priced in a “no hike”. Nonetheless, new expectations will emerge for October and December and strong beliefs around the world’s first economy are still alive and will sustain the dollar at a strong level. At this point, we start questioning the ability of the Fed to succeed in its mandate of stabilizing price and favouring full employment. And we recall that confidence is what makes a central bank reaching its expectations.



FX Markets

IMM Non-Commercial Positioning

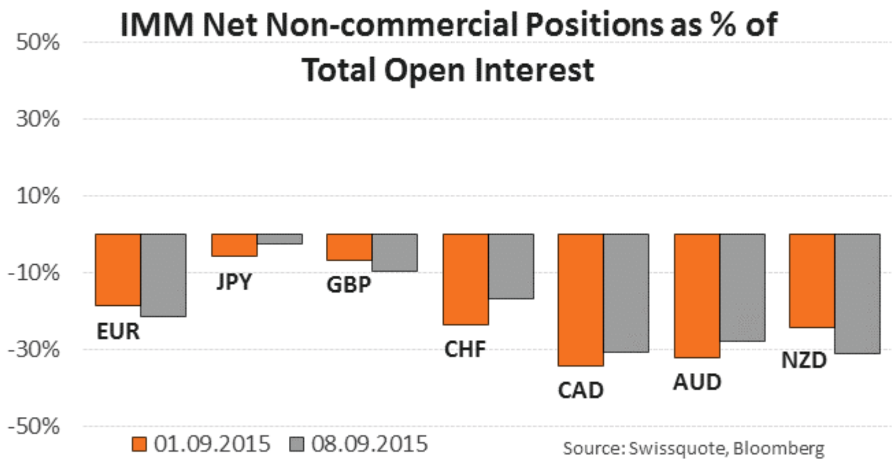
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

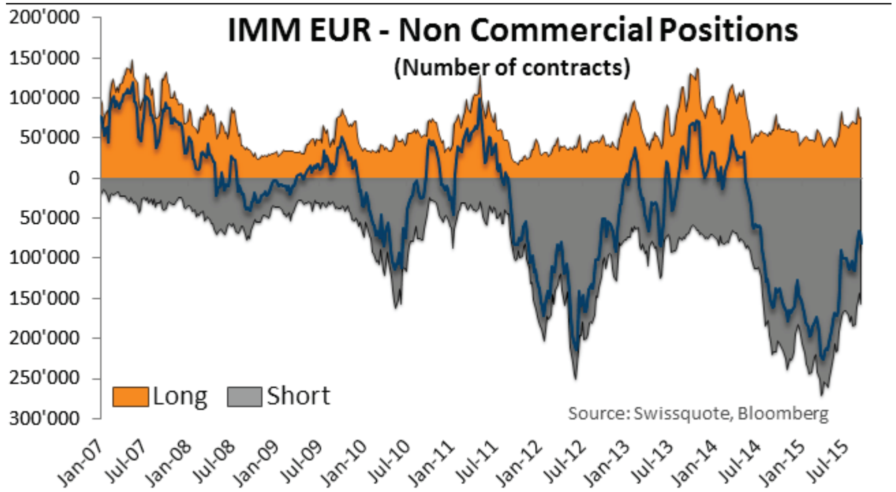
The IMM data covers investors' positions for the week ending September 8th 2015.

Swiss franc short positions have decreased substantially over the 3-previous weeks, reaching 16.85% of total open interest ahead of the SNB and Fed meeting. A decrease of short CHF positions together with a reduction of long USD positions indicated that traders were reluctant to hold strong speculative positions ahead of the two central banks meetings.

EUR short positions decreased substantially since March 2015 and, as time goes by, it seems that the trend is here to last; despite a small up tick in short euro positions during the week ending September 8th.

NZD short positions increased massively as traders speculated about the RBNZ decision to ease further its monetary policy. The central bank did not disappoint them as Governor Wheeler cut the OCR by 25bps to 2.75%. We should therefore see a decrease of short positions in the foreseeable future.





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