WEEKLY MARKET OUTLOOK

12 - 18 October 2015

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WEEKLY MARKET OUTLOOK - An Overview

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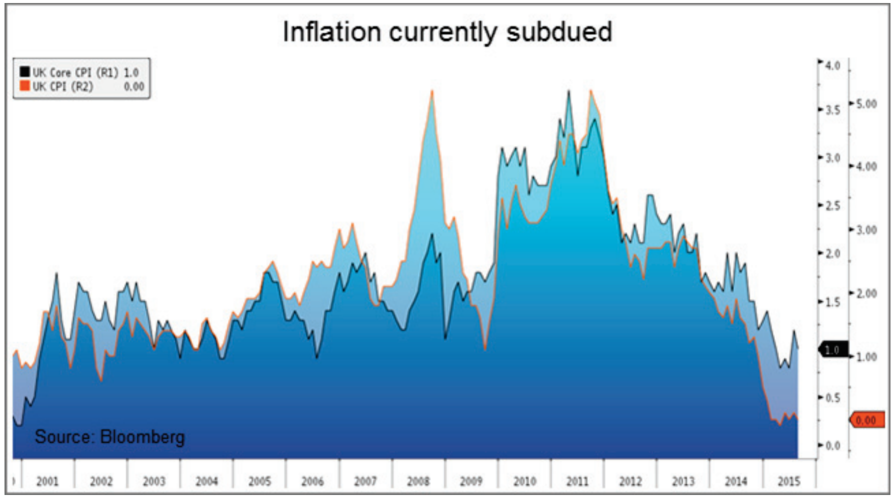
Economics

BoE Rate Expectations Too Far Out

Last week the Bank of England's MPC voted 8-1 in favor of no change in interest rates or adjustments to target asset purchases. With the next Inflation Report only a month away, it's was unlikely that the minutes would provide real clarity. Dissimilarly, the Fed and the BoE minutes painted a more balanced view although slightly dovish. Members provided an even view, stuck between robust UK economy and concerns that global activity would be weaker than anticipated. BoE MPC member Ian McCafferty, the lone dissenter, indicated that in his view domestic inflationary pressures were building, while "domestic cost pressures were likely to come to outweigh the dampening influence of the appreciation of sterling".

Market expectations for a BoE hike feels excessively bearish in late 2016. A view which has been essentially driven by a larger trend of overdone downside risks to growth. This view has proliferated despite BoE claims that global worries will not halt the banks current strategy. Governor Carney stated that the "exact timing of a Fed move was not decisive for timing" of any rate hike but "we will determine the timing for the start of the process of monetary policy normalisation consistent with UK". With UK economy moving forward at a reasonable pace (balanced by strong industrial production but weak PMI service data) and tight labor markets already generating wage growth we should see steady transmission into inflation. In addition, the weaker GBP should ease BoE members concerns over importing deflation. We remain constructive on the GBP in the current environment, anticipating that incoming information will pull in expectations for a rate hike. On the data front, CPI and labor statistics will be significant. GBPUSD bullish momentum should continue after clearing 200d MA at 1.5330. Traders immediate focus will be on 1.5367 (09/23/2015 high) before uptrend extension to 1.5659 (09/18/2015 reaction high).



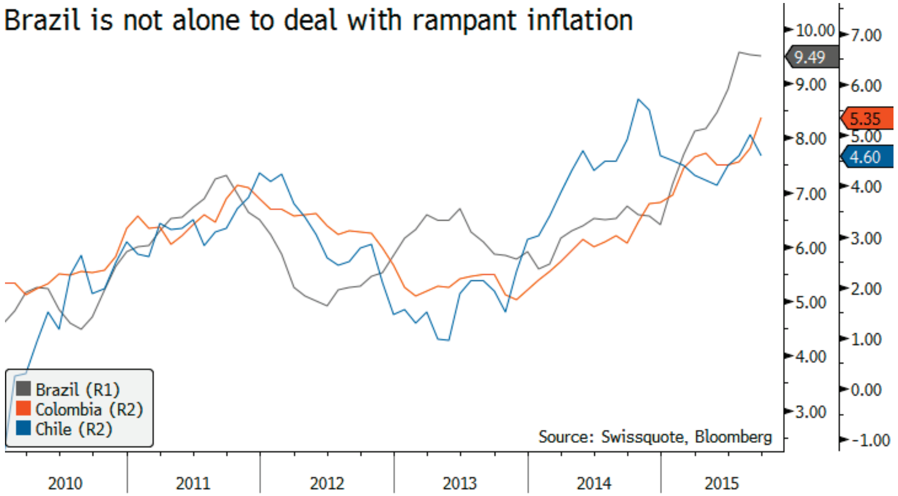
Economics | Latin America: Inflationary Pressures Remain High

Most Latin American countries are dealing with high inflation levels while local central banks are struggling to curb inflation expectations toward desired levels. Brazil is not the only country seeing accelerating inflation. Colombia is also facing higher inflation levels as the economy adjusts to new external conditions and a substantially weaker peso. Inflation rose 4.74% in August and 5.35% in September - well above the central bank's target of 3%, +/- 1%. In Chile, headline CPI printed at 4.6%y/y in September, also above the central bank's target of 3%, plus or minus 1%. Despite lower expectations for September (4.9%y/y), the BCC is expected to increase the overnight rate at its monthly meeting on October 15th, which will bring the benchmark rate to 3.25%, up 25bps.

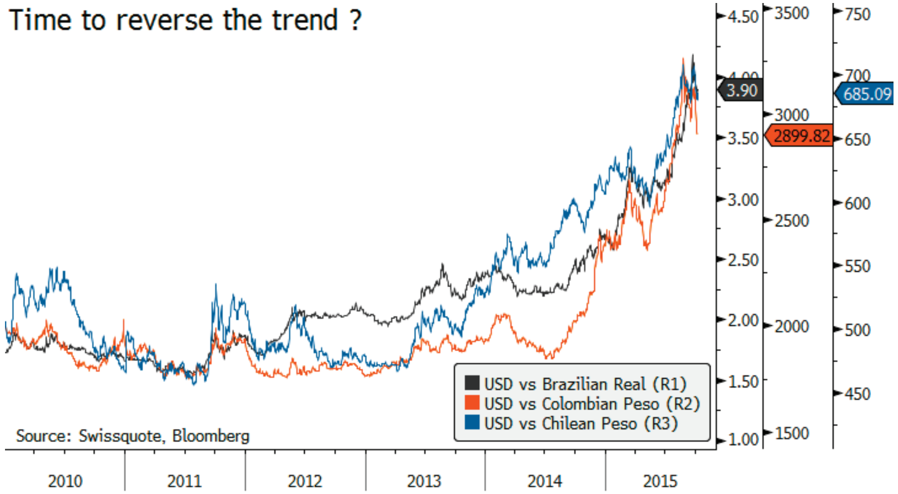
In Brazil, the central bank is wrestling with rampant inflation and struggling to anchor inflation expectations against the backdrop of deteriorating political conditions. IPCA inflation was released last Wednesday and came in above median forecast, printing at 0.54%m/m, above median forecast of 0.52% and previous reading of 0.22%. On a year-over-year basis, the market was anticipating IPCA to have edged down to 9.48% from 9.53% in the previous month, September's figure was released slightly higher at 9.49%.

So far the BCB has been unable to bring inflation expectations back to the 4.5% target for 2016. In fact, according to the latest survey, economists expect inflation to reach 5.94% by then. Even if the BCB seemed determined to maintain the Selic at 14.25% for an extended period of time, we believe that the central bank may be forced to increase its benchmark rate. For now, inflationary risks remain to the upside against the backdrop of a potential US Fed rate hike and considering Brazil's own internal issues including the current political gridlock and fiscal chaos.

Brazil is not alone to deal with rampant inflation



Time to reverse the trend ?



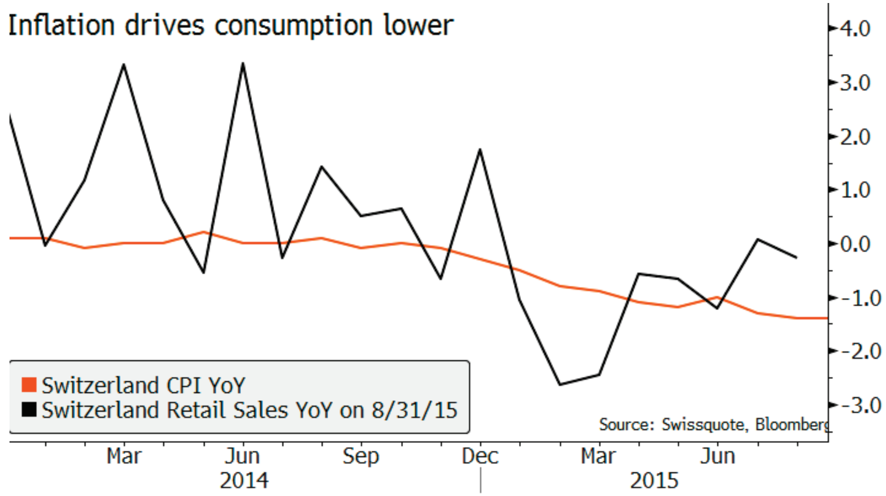
Economics

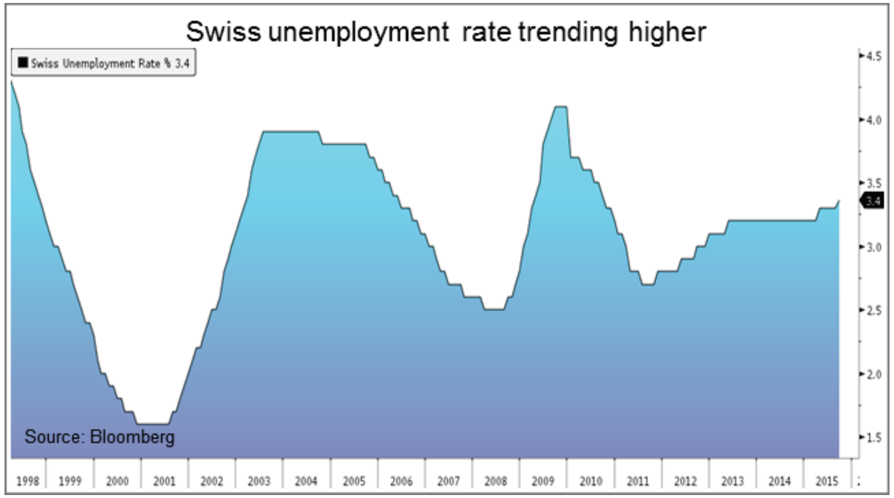
Swiss: Deflation Set To Continue

Times are tough, even in Switzerland. Almost nine months on it is clear that the Swiss economy is still digesting the SNB decision to abandon the EUR floor. Recent data has been coming in mixed; for example August retail sales contracted and purchasing manager's index surprised to the downside in September. Furthermore, the CHF is still seen as overvalued. After disappointing inflation data earlier last week, the seasonal adjustment unemployment rate printed at 3.4% in September from 3.3% a month before. While we cannot consider the labour market to be in danger, the abandoning of the floor, coupled with global turmoil did create some downside pressures for the job market. The Swiss economy is steadily declining and GDP concerns are growing, especially when we realize that the EU accounts for almost two thirds of Swiss exports. Indeed, European growth is still at stake. Nevertheless, the recent EUR surge should provide a boost to the Swiss economy in the coming months, as there are some lags for an economic change to be correctly reflected in the economy.

However, we think it's likely for the EURCHF pair to break the 1.1000 level again. The market is driven by volatility, as global uncertainties remain strong and risk-off sentiment is only set to grow. It's our view that the U.S. Federal Reserve is sending a strongly negative signal by delaying its rate hike U.S. recovery looks unsustainable and traders are starting to price the end of the zero interest-rate policy by 2017. Commodities and safe-haven countries may be targeted in the near future.

Even considering the deceleration of the Swiss economy, it remains a port in the storm. As we anticipated, the weakening of the Swiss Franc, which we have seen over the past 3 months, did not have a major impact on the inflation data that have been released last week. The CPI printed at -1.4% y/y. It is clear that the Swissie remains strong and the downside pressures on the price of imported goods' price won't diminish for the time being.





Economics

Dovish Fed Pushes Back Lift-Off Expectations

Disappointing NFPs

In the wake of a disappointing September US jobs report, market participants finally start to question the Fed's eternal optimism. The last nonfarm payrolls report shows that the US economy created only 142k jobs in September while economists were looking for a reading of 201k. Even worse, the previous figure was downwardly revised to 136k from 173k. It seems now that the Federal Reserve is not only having an inflation issue but also a job market issue - average hourly earnings show that wage pressure was anaemic during the month of September - as it just lost is last hawkish argument. The US economy is losing momentum and appears even more vulnerable to the global environment than anticipated. The Fed is now facing a dilemma: either it decides to save what is left of its credibility and raises rates by year-end, taking the risk to worsen the situation by strengthening the dollar; or FOMC members decide to adjust their views and speeches to the current state of the global and local economy and maintain the federal fund rate close to zero.

A rate hike a December finally ?

The market is now pricing a rate hike in March 2016. The likelihood for October fell to 13% while the odds of a lift-off in December dropped to about 30%. However, even if the Fed claims that its monetary policy remains data dependent, the "credibility" argument prevents us to rule out once and for all a rate hike in December. We expect the Fed to move in March. In the short-term, the greenback will remain highly sensitive to Fed members' comments and economic data from the US.

Dovish FOMC minutes

Market participants were expecting that the hawkish speeches delivered by FOMC members in the aftermath of the September meeting would be reflected in the minutes. There is nothing of the sort! The minutes showed that the Committee wasn't even close to tightening its monetary policy in September and was still trying to find some common ground concerning the most appropriate timing to start raising rates. The minutes focus on low inflation and anxiety over global volatility above emphasising strong labor markets (main cusp of hawkish members argument). In clear wording that global risk had taken prominence over domestic factors. The "third" mandate indicates that a hike will only occur when there is stability in global markets. Yet the primary catalyst for volatility is directly related to the Fed's hiking expectation (not Asian growth prospects as some have suggested). In the current environment, the USD upside should be limited against G10, however we could see some significant recovery in the much maligned EM currencies.

FX Markets

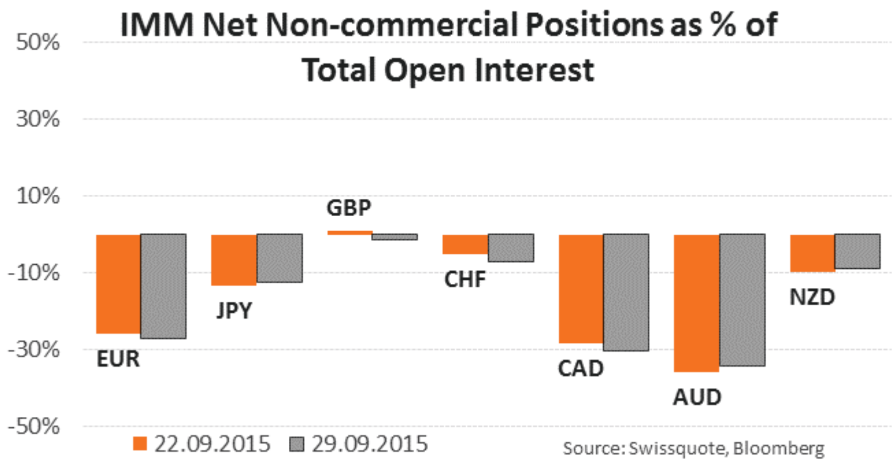
IMM Non-Commercial Positioning

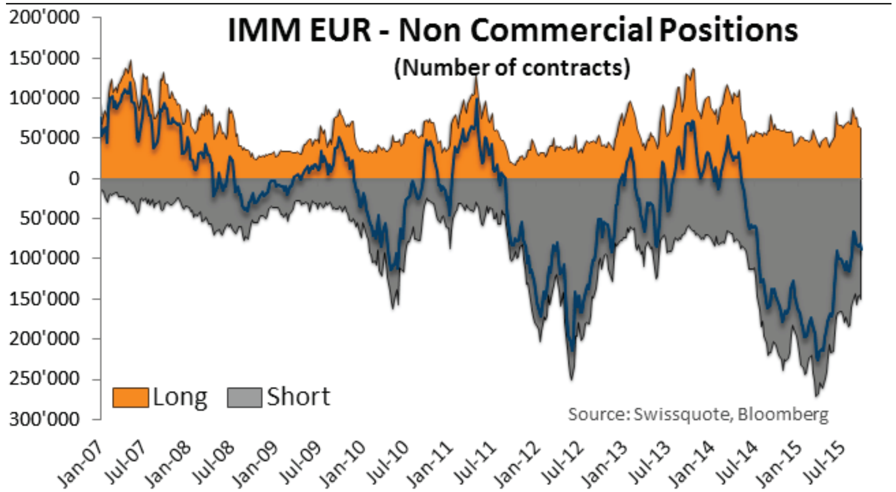
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending September 29th 2015.

Swiss franc net short position has increased last week. It seems that the market is still on hold, switching from the safe haven to the global uncertainties that are also weighing on the Swiss economy. Short EUR increased as well as global European uncertainties remain strong. There are growing concerns that the ECB monetary policy may not be so effective since the Fed constantly delays its first rate hike after almost a decade of a zero interest-rate policy.

The GBP net position is quasi neutral. Markets are pricing in a rate hike for late 2016 or 2017. The AUD position is still strongly short as the Reserve Bank of Australia kept rates on hold at 2%. The outlook for Australia remains negative as lingering weak commodities prices weigh on the Australian economy.





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