WEEKLY MARKET OUTLOOK

26 October - 1 November 2015

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WEEKLY MARKET OUTLOOK - An Overview

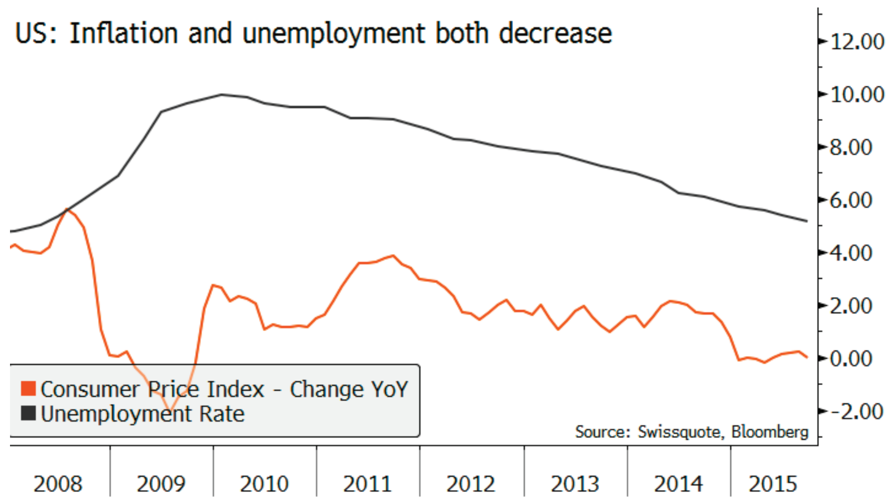
Economics

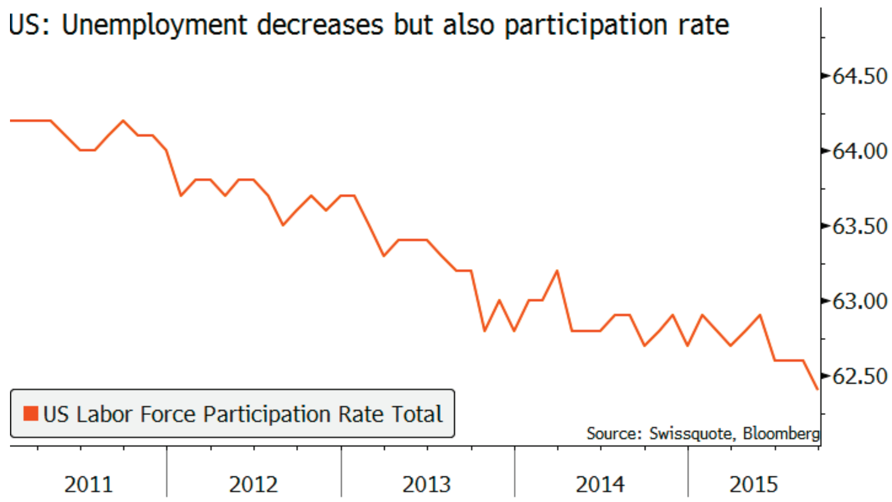
Fed: Hawkish vs Dovish

The power struggle between the Fed's dovish and hawkish members continues. Lael Brainard, dovish, and Jeffrey Lacker (Hawkwish) have spoken last week. It has been said that major divergence is first and foremost an ideological divergence. The hawkish members are strong believers of the Phillips curve, which states that there is an inverse relationship between inflation and unemployment. Better jobs data should provide inflation as there will be more competition for jobs, which would push wages higher and therefore consumption higher.

On the dovish side, there is the belief that the Phillips curve does not truly reflect reality and that there should be an additional “reserve army” of workers, which is not accounted for in the official data. Indeed, these workers gave up seeking unemployment since they lost their jobs. Therefore doves maintain the idea that job conditions are not sufficient for judging the inflation outlook. Nevertheless, these workers should flow back in the jobs market once economic conditions improve and for the time being no reserve army are coming back in. NFPs have confirmed this fact. Over the past two months NFPs have printed below expectations with a very weak read in September at 142k new jobs, while consensus expected at least 50k more.

From our vantage point, we believe that the jobs data effectively underestimates the true reality of the jobs market but we think that the U.S rate hike does not only depend on some economic concepts but also on Yellen's credibility. The Fed's Chairwoman is a hawkish member and while she still does not see any improvement in U.S. inflation, her credibility is at stake and a small rate hike could happen while conditions are not perfect, we think it would even be an error. This would show that her economic ideology actually prevails over other members and that dissidents remain a small minority.





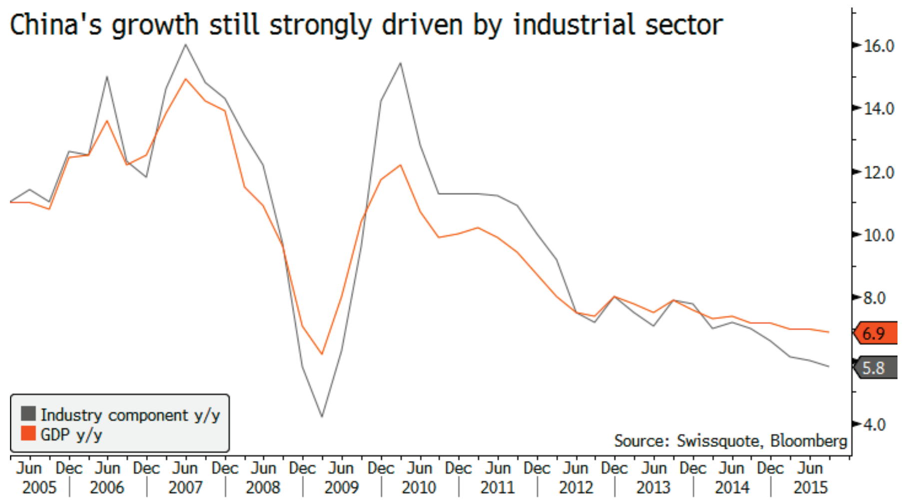
Economics | China To Rise Again

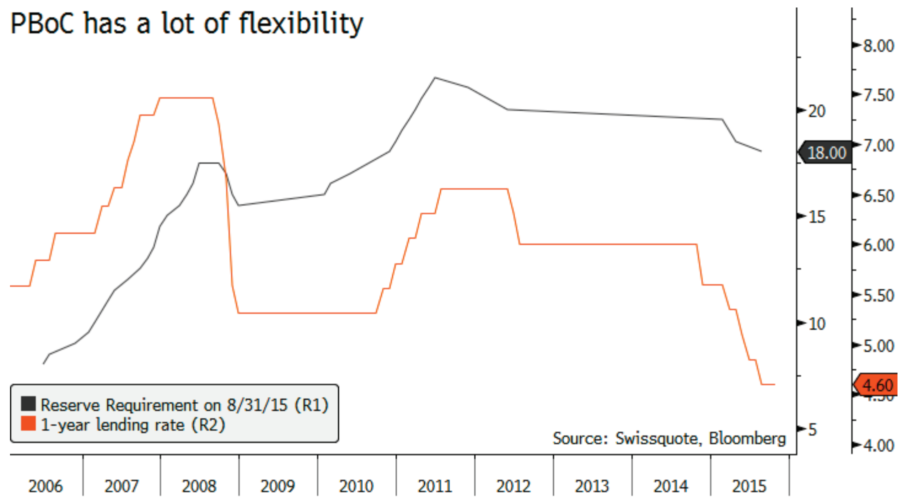
GDP above expectations

China slowed less than expected in the third quarter as the economy can count on a resilient service sector to offset the slowdown of the manufacturing industry. Growth in services accelerated to 8.6% in the third quarter from 8.5% one while, on the other hand, the manufacturing sector decelerated to 5.8% from 6% in the second quarter. All in all, China's third quarter GDP, which printed at 6.9%y/y versus 6.8% consensus, showed that the economy is more resilient than anticipated by the market; in spite of a change in the calculation method, which is aimed at improving accuracy by allowing to better account seasonality and short-term fluctuations.

Optimist on the outlook

As stated above, the industrial sector remains under a lot pressure as the economy continues to adapt to the new normal of slower growth, shifting toward a domestic generated growth from an export driven one. In September, industrial production grew 5.7%y/y, below market's expectations of 6%y/y. Nevertheless, in spite of this mixed data, we think that the worst is over and that China will start to get some colour back as the PBoC continues to act to ensure a soft lending. However, we believe that bad news from the manufacturing sector and the housing market is yet to come as further downward adjustments are necessary to reach equilibrium levels. We anticipate the PBoC to ease further through another cut in the benchmark rates and additional downward adjustments to the reserve requirement ratio (RRR), especially as, unlike most central bank, the PBoC has a lot room to implement further stimulus measure.





Economics

ECB: QE Almost Certain To Be Expanded

ECB on hold

With no surprise, the European Central Bank has maintained its main refinancing rate unchanged at 0.05%. However ECB President Mario Draghi has announced at last week's conference that he is prepared to cut interest rates in the Eurozone sends the EURUSD back to 1.1100. In addition and as we expected, Draghi is willing to step up the pace of the Eurozone as well as increasing the duration of the easing program which end data was initially set up to September 2016.

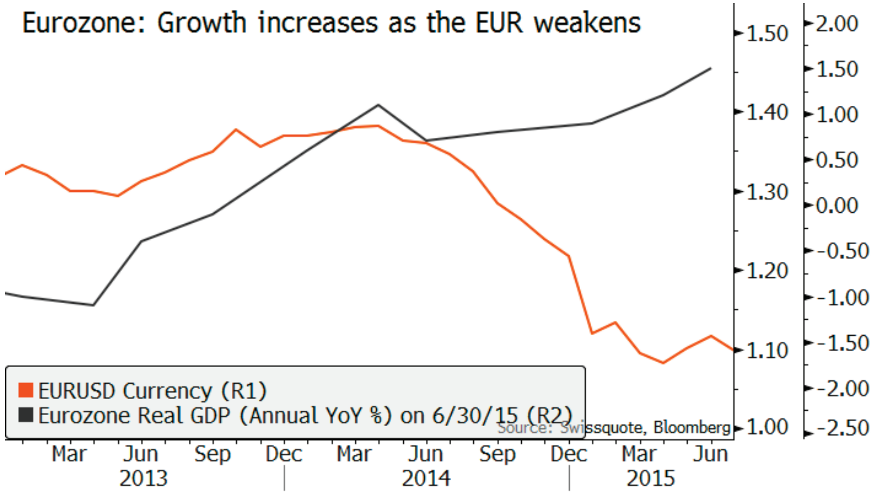
Draghi is concerned about the slowdown in emerging markets, in particular China, and he added that downside risks for the Eurozone's inflation and growth are rising. Next economic data will be closely regarded and official announcement will be made at the next meeting in December. At this moment the QE will be reassessed and very likely expanded. For the time being €60bn are injected to the market. It could go up to €80bn.

Bearish view on the EUR-complex

We remain bearish on the EURUSD. QE is so efficient that it needs to be increased and made longer. Another currency, EURCHF, is pushed downside and we believe that the SNB will be forced to react. Switzerland is finding back its safe haven status because of mounting uncertainties in the Eurozone. Only equity markets are rising. The era of cheap money is just at its beginning and money will keep on flowing in stocks markets.

SNB to react

We believe that the SNB are poised to react in the event that the Swissie strengthens lower than 1.0700 CHF for one euro. As the EURCHF is pushed downside, the Swiss central bank now finds itself in a difficult situation. For the time being, the SNB still has some time to react as the ECB will only officially announce its adjustments to its QE programme at its December meeting. A new peg is a definite possibility. The SNB has a massive battle ahead against the backdrop of a massive ECB QE and mounting European uncertainties that are bringing capital back to safe haven Switzerland. A peg could be a good compromise as rates are already too low level.



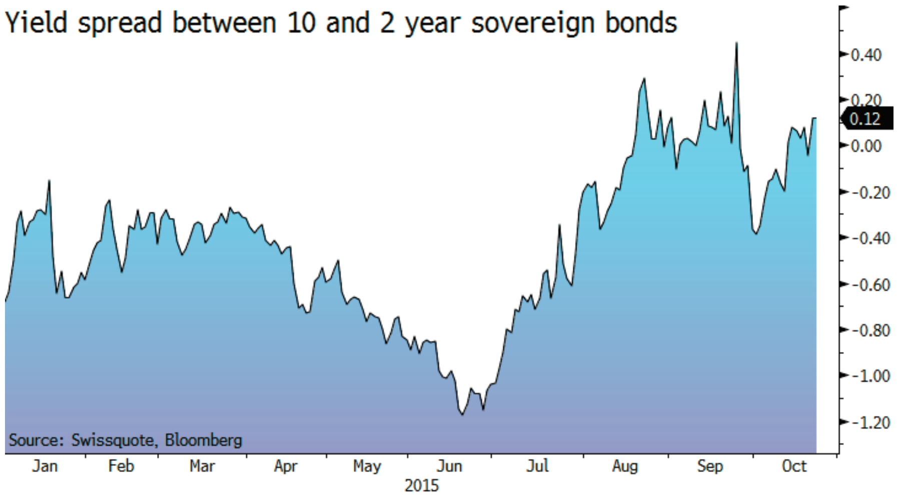
Economics | Brazil: Stuck In The Mud

Not out of the wood yet

Global investors should not get to comfortable as the recent correction looks like profit taking rather than a structural led reversal. With the political gridlock and expectations for additional downgrades from rating agencies BRL downside looks attractive. The situation in Brazil keeps worsening: inflation expectations for 2015 and 2016 are still unanchored and continue to rise steadily. According to the latest BCB survey, inflation should reach 9.46% by year end and 5.87% by the end of 2016. The mid-month inflation report released last week showed that consumer prices rose 9.77%y/y since mid-September, compared to an increase of 9.57% in the previous reporting period. We anticipate that inflation will remain unanchored as long as the country didn't address its political crisis.

Focus on politics

However, in regard to Copom decisions rate last Thurday, the markets are discounting the inflation data to focus on the political gridlock. Unfortunately, the political crisis appears unlikely to improve anytime soon. Asides from the fact that the Congress is avoiding the cutting of expenses, impeachment threats had materialised. A request to open impeachment was submitted to the lower house's president, Eduardo Cunha, on Wednesday. The market is now wondering whether Mr. Cunha is willing to accept the request, which would lock the country into an extended period of political gridlock, pushing Brazil deeper into recession. The BRL is therefore doomed to remain under selling pressures as the prospect of a positive outcome vanishes once again. Moreover, we believe that the little help stemming from the ECB's dovish comments will likely be short-lived.



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