WEEKLY MARKET OUTLOOK

16 - 22 November 2015

DISCLAIMER & DISCLOSURES

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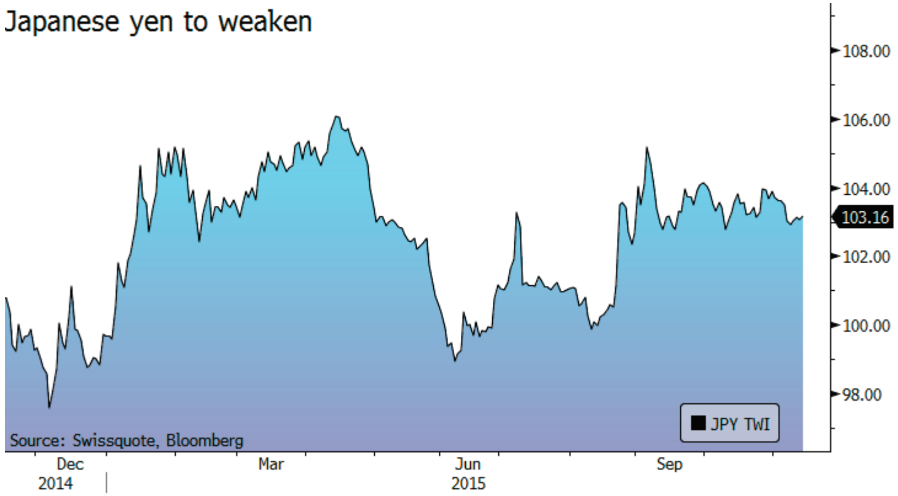
WEEKLY MARKET OUTLOOK - An Overview

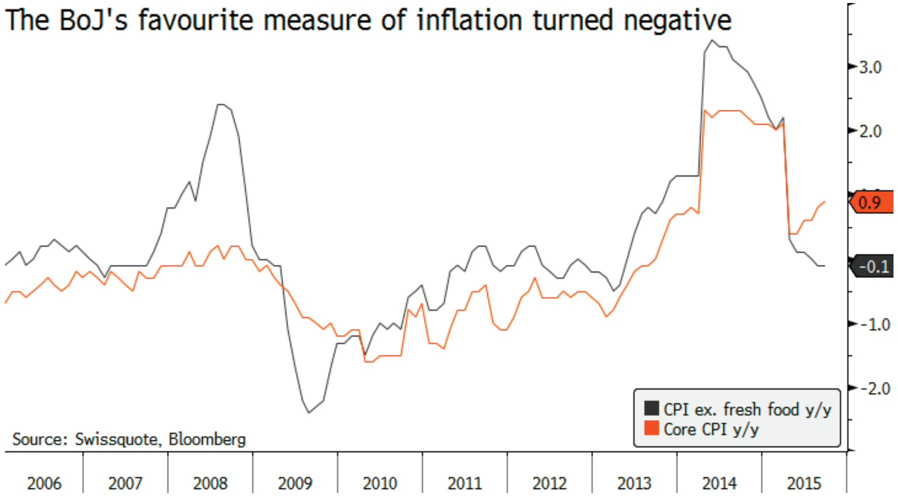
Economics

Japan On The Edge

After a busy week of economic data for Japan, the Cabinet Office will release the gross domestic product data for the third quarter next Monday. Last week data painted a softer picture of the Japanese economy, suggesting that the country is struggling to move onto a pathway of growth and positive inflation. In short, machine tool orders contracted further in October, by 23.1%y/y from a previous drop of 19.1% y/y in September, while machine orders (a proxy for private capital expenditures) continue to recover from April's tax hike. The gauge rose 7.5%m/m in September, beating median forecast of 3.1% and previous month contraction of 5.7%m/m. Separately, PPI surprised to the downside in October by contracting -3.8%m/m versus -3.5% consensus but improving slightly from previous figure of -4%. Finally, industrial production expanded 1.1%m/m in September, improving marginally from the first estimate of 1%.

All in all, Japan is struggling to convince investors that its economy is wealthy and that it remains a good investment on the medium to long-term - GDP is expected to shrink further in the third quarter by 0.1%q/q after a contraction of 0.3%y/y in the June quarter. Until now, the yen has been able to hold ground against most currencies, thanks to Governor Kuroda who is providing continuous support to the Japanese currency through overly optimistic comments. However, we believe that this situation cannot last much longer and the BoJ will have to increase the size of its quantitative and qualitative easing programs in the coming months. The central bank has already revised its inflation forecast, postponing its 2% inflation target date by six months - to between October 2016 and March 2017. From our standpoint, it is just a matter of time before the Japanese yen starts weakening again, especially against the US dollar, as the monetary policy divergence will accentuate the yen's debasement. Everybody is waiting on the Fed, the BoJ is no exception.





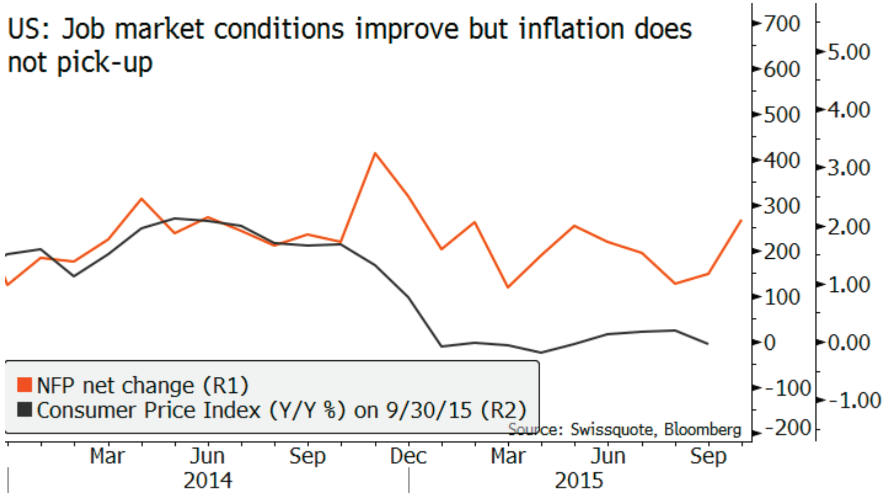
Economics

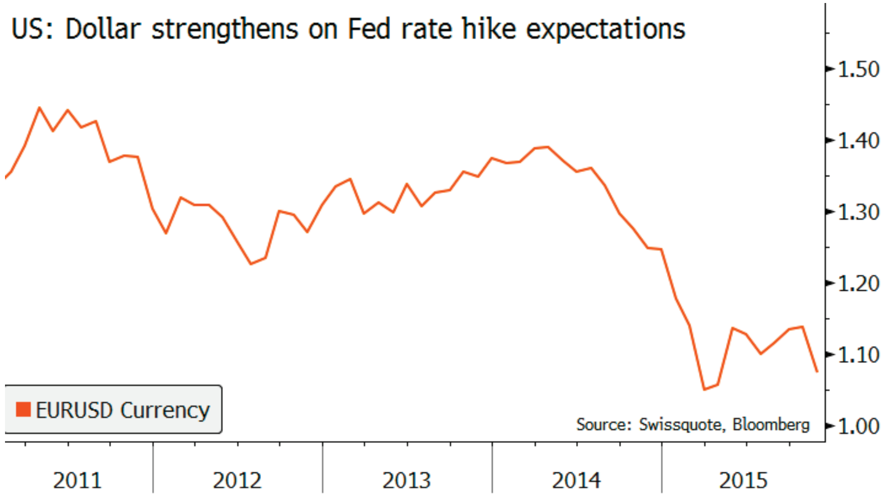
U.S: December's Expectations Are Now Back

Last Friday's jobs report printed at an astonishing 271k, a significant surprise given the market expected 185k. The dollar strengthened strongly as markets had priced in a weak read, similar to previous NFP's data in September. Better jobs data is definitely what the Fed is looking for as it would drive up inflation figures as stated in the Phillips curve theory. Nonetheless, the Fed is expressing that the level of inflation is too low for a rate hike to happen. Plus, the Fed is in a wait-and-see mode, hoping at each CPI data release that the inflation would pick-up towards the target of 2%. Yet, the inflation has not picked up for now, despite the unemployment rate is holding around 5%. As a result, markets really appreciated the unexpected high NFP. The probability for a rate hike in December has jumped to almost 68% according to Bloomberg.

In the meantime, San Francisco Fed President John Williams said in a speech that was held a week ago that a rate hike should be the next appropriate step. He also said something that appears more alarming as it shows that the Fed may have lost control of the situation "I see [the situation] as more of a warning, a red flag, that there's something going on here that isn't in the models, that we maybe don't understand as well as we think".

However, according to him, another set of good data would be sufficient to meet the Fed's forecast and bring an end to the zero interest-rate policy in place since the end of 2008. Yet, Williams also confirmed its concern about the current low inflation. In addition, the global outlook remains uncertain, in particular global growth that is likely to have a deeper impact in the United States economy. In other words, we consider that U.S growth is still vulnerable. Meanwhile, the dollar has soared on new Fed expectations and the euro is now holding below 1.0800 dollar. We think that a rate hike is largely overestimated and expect a retracement towards 1.0900.

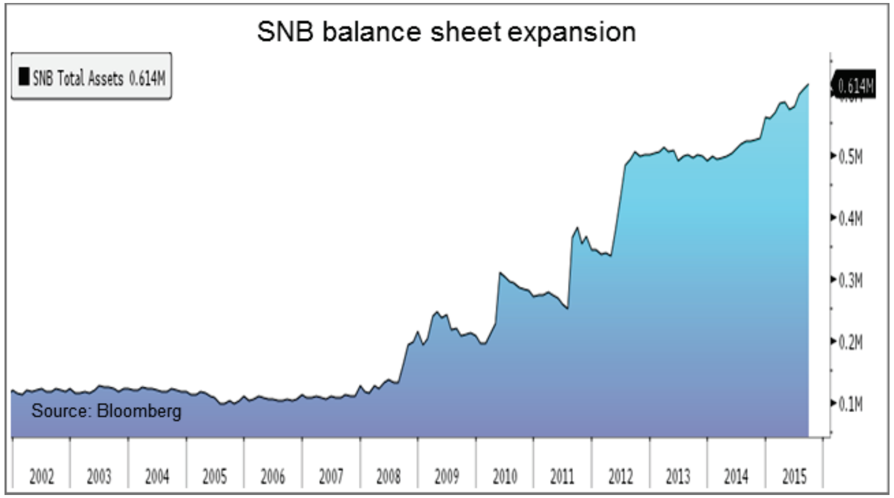


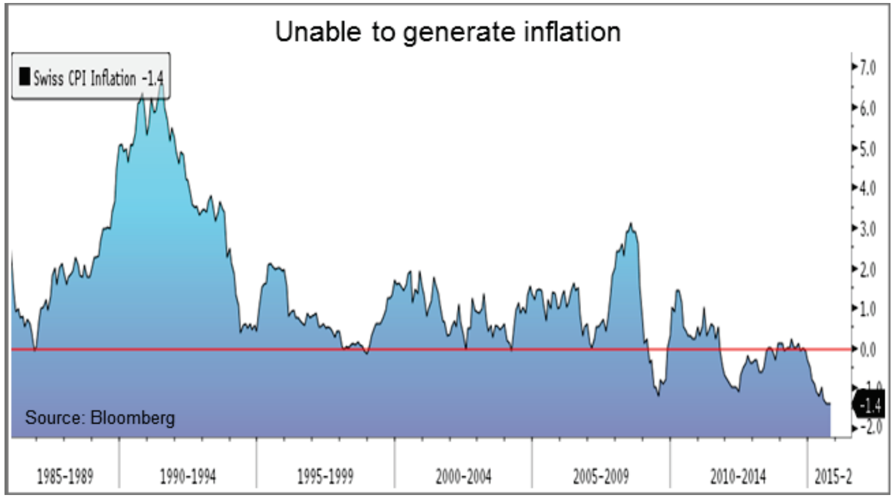


Economics

SNB Stands Ready To Act

FX markets are not really helping the Swiss national bank's problem with an overvalued CHF. While the CHF depreciates against the USD it has gained against the EUR. However, for the SNB it's the CHF position vis-a-vis the EUR which matters most. Finding itself entrenched amid current Swiss economic conditions which are broadly deteriorating and deflations, the SNB needs the CHF in a competitive position with its largest trading partner. Recent marginal improvements in data were driven by CHF deprecation which has now reversed. ECB President Mario Draghi's dovish comments clearly signal that December will at least open the discussion for QE expansion. However, actually actions are highly probable. We anticipate not only lengthened asset purchases but further cuts to the deposit rate. Lower interest rates in Europe will have a direct effect on capital flows into Switzerland. In September, the SNB held off acting, leaving sight deposits rate lower boundary at -0.75%, despite dropping the inflation forecast, choosing instead to stand ready to react to the ECB's potential policy actions. The SNB has two primary tools to handle further ECB easing and CHF strength. The banks can further reduce interest rates (first tightening current deposit rates loopholes) and/or direct currency intervention. While the SNB will never fully abandon currency purchases, the likelihood of significant FX intervention remains a low probability as the SNB balance sheet has expanded into unsettling territory. Swiss policy makers have been vocal in recent weeks highlighting the importance of negative interest rates on sight deposit as a policy tool. On November 3, the SNB president mentioned negative interest rates as a primary monetary policy strategy to 'dampen upward pressure on the Swiss franc.' The Swiss economy remains fragile indicating that the SNB will defend the CHF from further overvaluation against the Euro. Given the Bank's track record of inflicting as much damage on CHF longs as possible, heading into December, CHF traders should be wary of potential aggressive action.





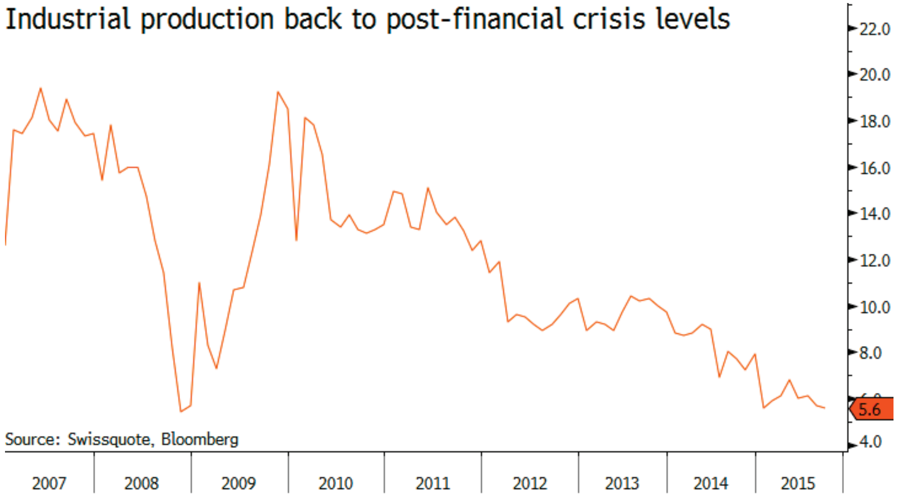
Economics

PBoC: Stimulus' Effect Lag

The Chinese economy is still in troubled waters as the effects of the PBoC's massive stimulus are taking time to translate into the real economy. Last week CPI report showed that inflationary pressures are not picking up yet as they printed at 1.3%y/y versus 1.5% consensus and 1.6% previous reading, signaling that there is some room for further monetary easing from the Chinese central bank; especially considering the fact that the PBoC has an inflation target of 4%.

Data released last week suggest that the bottom has not been reached yet. Industrial production continued to slide in October, for the third month in a row, and rose 5.6%, while economists were looking for an expansion of 5.8%. However, retail sales came in slightly above expectations, printing at 11%y/y versus 10.9% median forecast. Consumption appeared to be impressively resilient as it remained strong even during the summer turmoil. As China wants to reduce its dependence on western demand, it needs a stronger domestic demand to offset the loss of growth stemming from adapting toward its "new normal".

USD/CNY rose as high as 6.3758 while the fixing was set to 6.3655 on Friday. Since the PBoC does not seem prone to devaluating the yuan using the fixing, as it is trying to establish a reserve-currency status, it mechanically increases the probability that the bank would use more traditional tools to further support the Chinese economy. We therefore expect further cuts in the RRR and the 1-year lending rate.



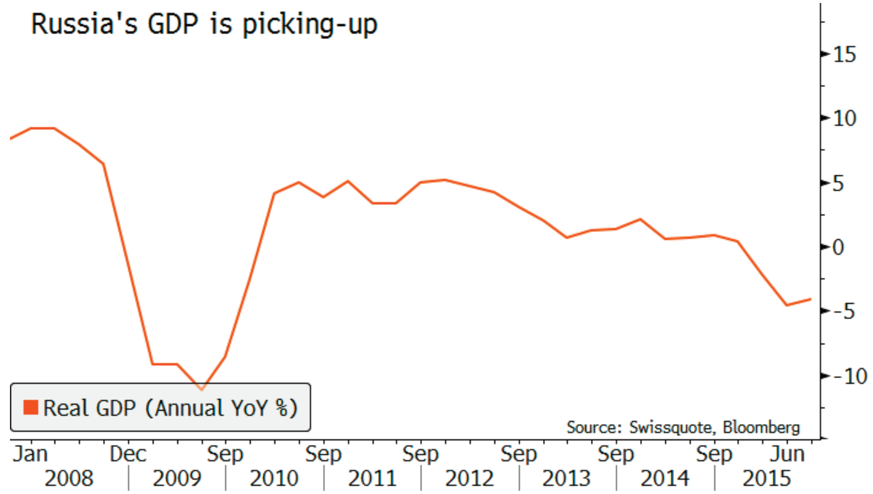
Economics

Russia’s Economy Continues To Contract

Russia GDP Q3 improved to -4.1% y/y from -4.6% y/y. This figure is only an advanced data as the preliminary GDP will be released in December. We clearly did not have high expectations for this quarter as the lingering low oil prices are still weighing on the Russia's revenues. This is not likely to stop anytime soon as the barrel now holds below 42$. It is also very important to note that the correlation between the ruble and oil prices has never been so high. In addition, the greenback is worth a little over 65 rubles. The pair is still driven upside by the stronger-than-expected last Friday's NFP, U.S. December rate hike expectations and low commodities prices.

On a monthly basis, we note that the Russian economic data are improving especially the manufacturing PMI, the industrial production and the overall investment. We saw a deceleration in the contraction of capital investment. Nonetheless, retail sales and wages keeps on collapsing. For example, last retail sales showed a 10% m/m decline in October. Despite sign of hopes in a recovery, the economy is still facing difficulties in the consumption side.

However, Russia's economy is not in agony but inflation remains a serious concern. This week, Russia's consumer price index has risen by 0.2% for the fifth week in a row. Inflation does not show any sign of deceleration. Annual CPI should end up around 15%, which is seriously limiting the room for the Russian central bank to cut rates. Between very negative growth and high inflation, Russia is struggling. We believe that the key rate will hold at 11% at December meeting.



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