WEEKLY MARKET OUTLOOK

14 - 20 March 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

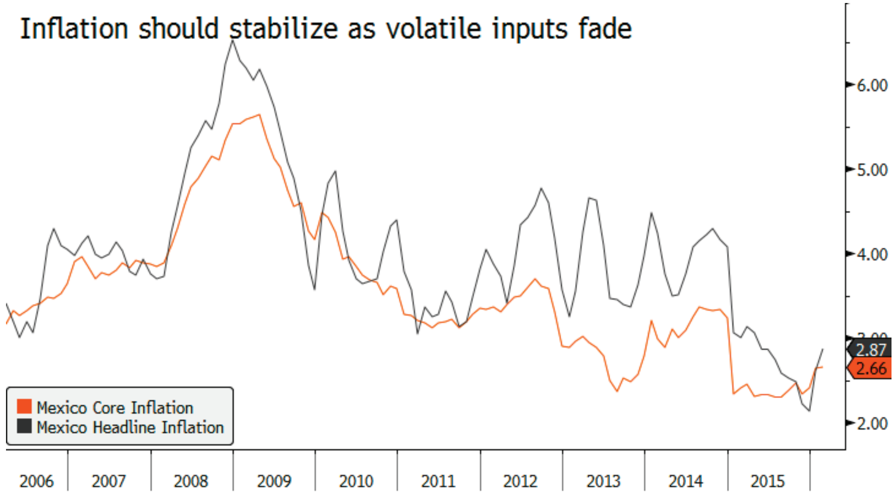
MXN Should Recover On Mixed Data

Latam traders continue watching economic data from Mexico as this week's data release indicates a country in deceleration. Auto production was soft in the start of the year, falling 4.1% y/y and auto exports dropped 1.2% y/y. In addition, consumer confidence February slipped to 88.7 from 95.5, suggesting softer consumption in the future.

Consumer prices in February advanced at a weaker-than-expected 0.44% m/m. In annual terms headline inflation continue to rise to 2.87% from 2.61% - very near to Banxico's mid-point target rate. Unstable fruit & vegetable prices were a primary driver of inflation during the month, advancing 2.8% m/m. Last week's release of Banxico's Quarterly Inflation report (QIR) for Q4 2015 indicated that inflation would temporarily rise above 3.0% due to season factors. Yet overall the inflation outlook remained stable with downside risks.

Industrial production surprised higher increasing 1.2% m/m due to the solid surge in construction. However, we view support from construction is transitory as public investment is likely to decrease. Manufacturing production was soft as expected but still holding up well due to domestic market. In the QIR GDP growth forecasts were lowered 50bp in both 2016 and 2017 to 2.0-3.0% y/y and 2.5%-3.5% respectively. The board acknowledged downside risk to growth from persistently low oil prices, weaker growth in the US and global uncertainty in financial markets. We suspect that their growth projects remain optimistic as a delay in US industrial recovery, slowing national oil production and prolonged demand weakness from China will stymie expansion. The weak MXN should provide some relief of exports yet QIR included an analysis indicating the low sensitivity of low real exchange depreciation to manufacturing exports in the short term.

We expect continued improvement of MXN against the USD in the near term as spreads with US rates should not compress further. However, we remain cautious as global risk appetite and commodity prices have a broader effect on the peso then yield spreads. Banxico will stay on the offensive to combat further MXN depreciation (following recent pre-emptive rate hikes aimed at fiscal risks rather than inflation) with additional surprise rate hikes. We anticipate no change at the 18th March Banxico meeting but outcome is depended on events at the 16th March FOMC decision. With Banxico finger "on the trigger" and stability in global markets, yield seeking currency traders should be selling into the current USDMXN recovery for a near-term test of 17.50.



Economics

SNB In A Tough Spot

As we were approaching the ECB meeting, the market has been increasingly worried about the potential effect of a massive easing move from the European central bank on EUR/CHF. Sight deposits at the Swiss National bank have increased substantially over the last few weeks, suggesting that the central bank intervened in the FX market to weaken the Swiss franc. Domestic sight deposits rose by roughly CHF 10bn since the beginning of the year to CHF 415bn in early March as EUR/CHF tested 1.12 before falling sharply to 1.0815.

On Thursday, after a long wait, the ECB president announced the implementation of a new set of measures aimed at bolstering growth and inflation in the Eurozone. The ECB cut its three key interest rates and lowered the main refinancing rate to 0.0% from 0.05%. It also reduced the deposit rate by 10bps to -0.40% and cut the marginal lending facility rate by 5bps to 0.25%. The European central bank also increased the size of QE by €20bn to €80bn a month, expanded the quantitative easing program to high quality corporate bonds and announced a new series of targeted, long-term refinancing operations (TLTRO). However, just like a spoiled child, the market rejoiced at the ECB gift but quickly began to pout again. Indeed, investors are wondering whether this new set of stimulus will be sufficient to bolster growth and revive inflation.

So, what does it imply for the SNB? In the short-term, the market's disappointment has taken a weight off the SNB's shoulder as investors remained worried about the real effect of this new set of stimulus. However, on the medium to long-term, this is a different story as the pressure on European treasury rates would mechanically weigh on the single currency.

The ECB therefore put the SNB in a difficult situation as the CHF has a high sensitivity to European rate changes and the SNB has limited tools to defend the CHF with. In the case of renewed upward pressure on the CHF, the SNB stands ready to utilise verbal intervention, direct FX intervention, negative rates (tightening of exemptions of negative interest rates), and even capital controls to protect the CHF. We believe that all of these policy tools could be used at any time to defend the CHF from further appreciation (specifically against EUR). As stated previously, we anticipated this time around the SNB will be reactive rather than proactive in their policy response, monitoring closely how the market adapts to this new environment.

Should the EUR/CHF dip below 1.07, we believe it is very unlikely that the SNB will react first by cutting interest rates further into negative territory. Instead, we expect a tightening of the exemption, which remains the less costly tool to use, as it would limit the impact of negative interest rate on saving accounts. As usual, the SNB will almost surely use the threat of FX intervention, while only intervening moderately in the foreign exchange market. The dangerously expanded SNB balance sheet will limit the use heavy, and more effective, direct market intervention.

Economics

Mario Draghi Fires (Again) His Big Bazooka

There is definitely something that cannot be hidden, the current European crisis is deeper than expected. Few facts, overall unemployment rate in many countries is just increasing and debt amounts do not seem sustainable for most of them over the long haul. Until now, Germany, the European flagship, seemed to be the single beneficiary of the European Union. Indeed, it was the only country to be able to reduce its debt and to see its competitiveness increasing. This Europe was tailor-made for it.

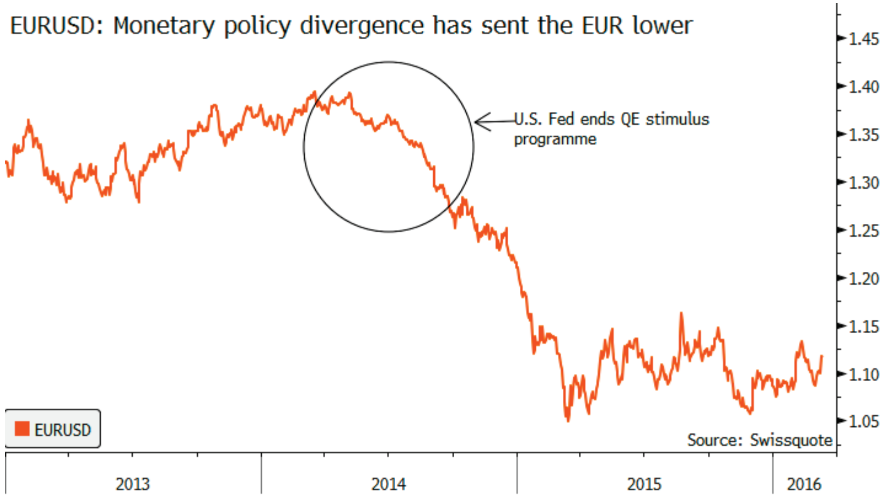
Behind this picture, recent German data confirms it is not any more an exception. Factory orders have declined for the second consecutive month in January printing at -0.1% m/m. Yet, December data has been revised up to -0.2% m/m. Concerns are even growing that Germany is not very satisfied with current European monetary policies.

It is clear that the European Central Bank is sending a wrong signal by using same monetary policies used in the U.S. and in Japan over the last decade with no satisfying results. At last ECB meeting, on March 10, the consensus was resoundingly clear and the ECB has not disappointed financial markets by boosting the pace of the QE by €20 billion to €80 billion. The deposit rate has been lowered to -0.4% from -0.3% while the refinancing rate has been sent to 0%.

It is important to remember that downside pressure on the EURUSD is fading as markets start to question the true nature of the monetary policy divergence. The Fed is definitely struggling to hike rates and for the first time negative interest rate have been discussed. However, as we know this is not an option as Euro competitiveness would take the biggest hit in the event that markets further price in no rate hike this year.

European inflation forecasts has been slashed to 0.1% from 1% for 2016, which is far from the ECB inflation target of 2%, while growth projection has been cut to 1.4% from 1.7% due to continued global uncertainties and weaker global demand. Mario Draghi has fired the big bazooka. He gave even more than what the market expected. Yet, we are afraid it will not be sufficient in the short-term. After years of QEs, U.S. and Japan's inflation are stalling around 0. So, what to expect from the ECB ? Definitely not more than what is happening overseas.

EURUSD: Monetary policy divergence has sent the EUR lower



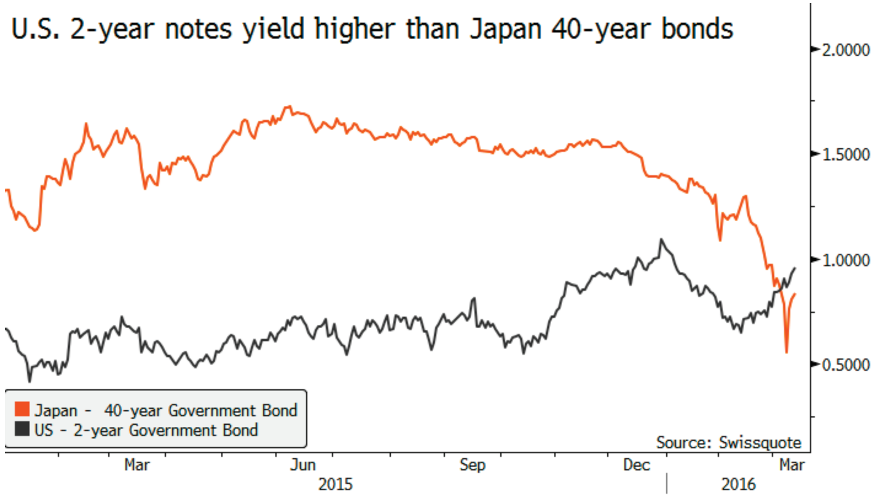
Economics

Deflation Never Ends For Japan

The war against deflation continues in Japan and is far from being close to stop. Despite massive efforts over the last ten years, the release of the February producer price index has shown a decline of 3.4% y/y. It is the 11th straight month of decrease. Strong easing has not yet provided the necessary impulse to pull the country out of deflation and we doubt it ever will. Monetary policies used over the last decade have only sent the debt at stratospheric levels. For the time being, the government debt stands at around $9.1 trillion.

Current Abenomics can be considered everything but a success. Japanese Prime Minister Shinzo Abe has failed to stimulate the economy. In particular spurring consumer spending was the primary target as it accounts for 60% of the Japanese economy. Recent data has shown retail sales still stand on the soft side with January spending contracting by 1.1% m/m. In addition, the fiscal arrow of the Abenomics had a larger impact than expected in 2014 when the sales tax rate increased to 8% from 5%. We believe that the Japanese Government is very reluctant to increase again the sales tax to 10% as it would certainly prevent inflation from reaching the inflation target of 2%.

The major issue is that the central bank of Japan is already all in. The world is witnessing Japan's debt becoming unsustainable without inflation ever picking up. Governor Kuroda ends his term in March 2018 and it is very unlikely that the vicious circle will end by this time. For the time being, the yen is only appreciating on safe haven status which is very ironic being a shelter to one of the most indebted countries in the world.



FX Markets

IMM Non-Commercial Positioning

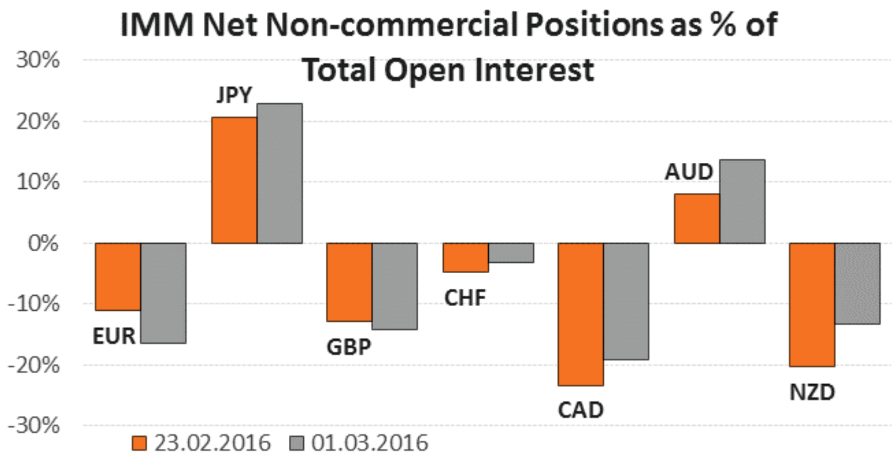
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

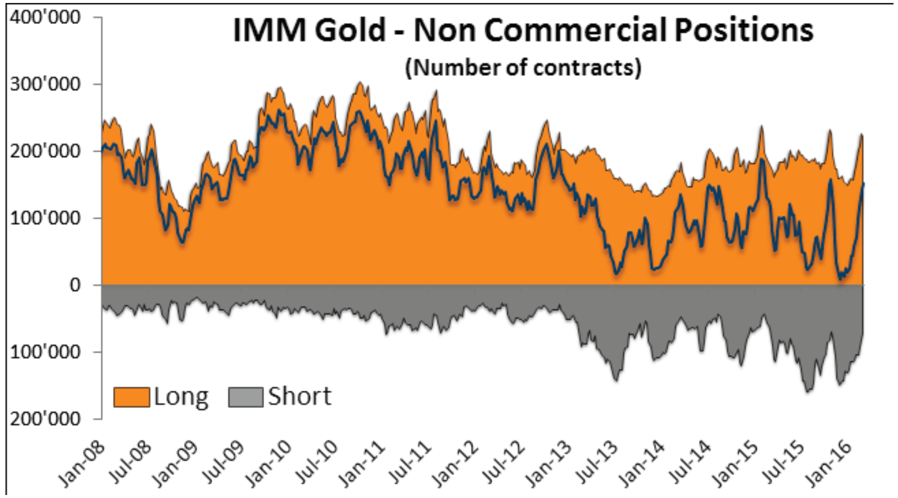
The IMM data covers investors' positions for the week ending March 1st 2016.

Net short EUR positions have increased substantially as traders were adjusting their portfolio ahead of last Thursday ECB meeting. Short positions rose to 16% of total open interest from 11% a week earlier. We expect speculators to reduce short EUR position as they price in the central bank's decision.

Net long gold positions continued to increase. The highly uncertain environment - deteriorating trust in central banks ability to spur inflation, weak global demand and slowing Chinese economy - gave another boost to the yellow metal. Long gold positions rose another 5%.

Net long yen position also continued to build up as speculators rushed into the safe haven currency. Given the extreme level of long positions, we expect this figure to decrease over the following week.





Themes Trading | Brazil Recovery

Since September 2014, Brazil has been in the eye of an economic and political storm. The local currency – the Brazilian real – has lost more than 50% of its value against the US dollar, falling to an all-time low in September 2015 as investors fled risky assets for safe haven investments in an attempt to weather the country's political turmoil. In addition, anticipation over the Federal Reserve's tightening cycle has sent capital back to global investors. For the first time since 2009, the local benchmark equity gauge, the Bovespa index, has moved below 44,000 points, while yields on Brazil's bonds sky-rocket as prices plummet. To cap it all, Brazil lost its investment grade credit rating in early September 2015, when S&P downgraded it from -BBB to BB+ with negative outlook (followed by Moody's last February) as the government struggled to shore up the fiscal deficit.

With the political crisis in full swing, the Brazilian real under constant pressure and the stock market bottoming, we believe it is time to start looking for investment opportunities. Also, at the macro level, with mounting expectations of disinflation and growth decelerating, major central banks – including the Federal Reserve – will likely delay any rate hikes until 2017. This would indicate a period of risk-taking and return-seeking in emerging markets. Many Brazilian stocks issued by high-quality companies are now available at very attractive valuations.

Analysis & Portfolio - Swissquote Bank Strategy Desk

Since inception	▲ 13.59%
1-month return	34.94%
Return day	-1.23%
Est. dividend yield	1.34%
Inception date	02/10/15

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