

# WEEKLY MARKET OUTLOOK

**21 - 27 March 2016**

## WEEKLY MARKET OUTLOOK - An Overview

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**Economics****SNB Ready To React But No Need Right Now**

The SNB has clearly taken a reactive rather than a proactive stance. With pressure off the SNB will sit back and watch how things develop. As we expected, the SNB held its policy rates unchanged (Sight deposit rate -0.75% & 3-month libor -0.25% to -1.25%), while not tinkering with tightening banks' threshold exemptions on negative rates. Given the SNB's rather depleted toolbox, tightening exemption would be its first retaliatory strike (outside minor & systematic fx interventions). We heard the standard CHF "significantly overvalued" and "will remain active in the FX markets" rhetoric but expected no less and markets were numb to the threat. The SNB statement indicated that the conditional inflation forecast has to be revised downwards as the decline in oil prices has contributed to weaker inflation pressures. In what we view as optimistic thinking inflation is expected to return to positive territory in the coming year. In regards to the global outlook, the SNB stated economic performance as "slightly weaker" as "manufacturing and trade remained sluggish" resulting in the fact that "global economic outlook is somewhat less favorable than in December". The result was forecasted GDP growth of between 1% to 1.5%. Finally, slowdown in real estate prices momentum was "confirmed" as mortgages lending slowed reflecting weakness in growth fundamentals (toned down from prior statement).

Unlike previous ECB actions, which forced the SNB to react, the most recent ECB easing measures are perceived to be a precursor to negative rates. EURCHF has the greatest sensitivity to interest rate differentials, alongside risk appetite. Despite Draghi's pledge that rates could go lower, the subtle shift from using interest rates as opposed to credit easing, signals that reliance on further cuts is unlikely. The subsequent lack of CHF strength indicates that the market was satisfied, narrowing of spreads was less likely, and pressure on the SNB to act decreased. Moving forward, the SNB will remain vigilant on CHF and potential capital

inflows from Europe either ECB or event induced (i.e. Brexit, Grexit, Spanish elections etc.). Barring an event shock we anticipate the EURCHF will continue to trend higher in the near term. EURCHF resistance at 1.10229 remains the primary bullish target.

Despite SNB president Jordan's recent comments suggesting that Swiss monetary policy strategy has limited the appeal of the CHF we suspect that the SNB actually has less control. In addition, deeper negative rates lower band to -1.25% or expansion of balance sheet of 100%+ of GDP has the potential of destabilizing risks that are hard to model. We agree with SNB governor board member Andrea Maechler's statement that there are limits to central bank effectiveness. And believe the SNB is very close to those limits. Most likely the SNB will target negative interest rate exemption as first strike. For now it's unlikely the SNB will have to dig into their depleted tool kit, yet given the ECB deteriorating inflation and growth outlook we suspect that additional policy measures will be needed. We remain negative on the EURCHF in light of mounting European event risks and the steady demand of long-term safe haven assets.

**Economics****Norway Between Inflation And Competitiveness****Economic fundamentals decline**

Earlier last week, Norges Bank lowered its deposit rates to an historic low of 0.50% from 0.75%. The Norwegian central bank is trying to foster growth in a country where a quarter of its economy depends on the oil industry. In 2015, the GDP printed at 1% y/y, down from 2.3% the previous year, mostly due to the decrease in investments. However, consumer spending and exports improved last year, both increasing 2% and 2.6% respectively. Unemployment is on the rise and even though it remains relatively low, it has jumped from 3.5% in 2014 to 4.4% in 2016. Wage growth is expected to suffer. Declining economic conditions have been sufficient to convince Norges Bank to cut rates in order to import inflation and becomes more competitive.

**Domestic risks are important**

The main issue in this competitive devaluation is that the ECB and Sweden are following the same monetary policy. The ECB is clearly trying to further devalue the single currency and Sweden has already adopted negative rates. Competitive devaluation is pushing Norges bank to maintain the stance of its monetary policy accommodative. In addition, the end of low oil prices would have the adverse effect to strengthening the Norwegian currency. We consider that this strategy of entering into competitive devaluation is not without risk as it could damage price stability. Indeed inflation is far from being weak - 2015 CPI printed at 3.1% y/y. Hence, Norges Bank is willing to increase upside inflation risks which would remove the increased competitiveness earned from a lower Krone. Last but not least, low rates could underpin a real estate bubble.

**Negative interest rates are on target**

The Norwegian economy's outlook is clearly uncertain. There is the need to increase competitiveness by devaluing the currency to increase growth and revenues as Europe and Sweden's monetary policy in particular are so aggressive as negative rates are still in place. In other words, Norway is currently taking a bet of sacrificing price stability for the sake of competitiveness.

## Economics

## Brazilian Assets On Rollercoaster Ride

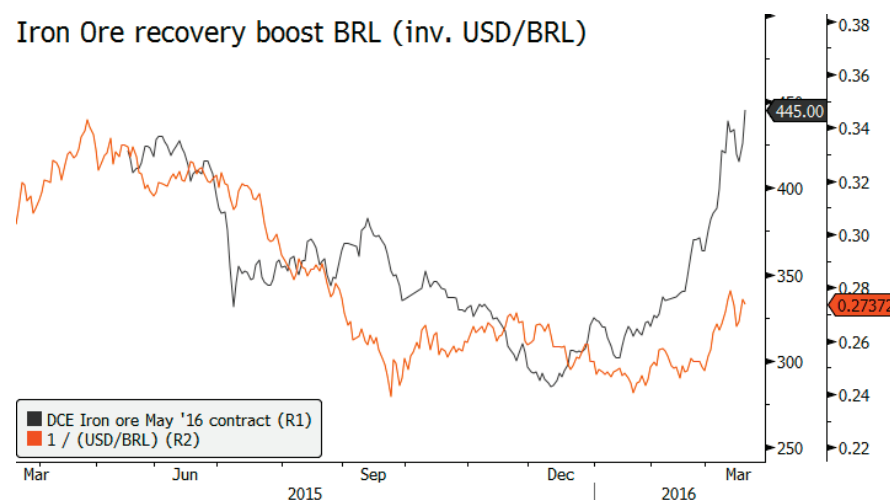
Over the past two weeks the Brazilian real has been caught in the crossfire between mounting political instability and a rally in commodity prices. As if volatility wasn't high enough, the Federal Open Market Committee surprised the market last Wednesday, which was pricing in a more hawkish signal, and lowered its projections for 2017 for the federal funds rate to 0.875%, compared to 1.375% at its December meeting, on concerns of worsening global slowdown and highly volatile financial markets. In other words, the Fed now anticipates two rate hikes as opposed to four for 2016.

Last Wednesday, the political crisis escalated another notch in Brazil after President Dilma Rousseff named Luiz Inacio Lula da Silva her chief of staff and a federal judge released a taped conversation suggesting that President Rousseff offered the position to protect Lula against ongoing prosecutions - the cabinet position provides immunity from the current charges of money laundering and the making of false declaration but not from the Brazilian Supreme Court. As a result, millions of Brazilians took the streets to call for President Rousseff to resign. You would be forgiven for thinking that the mounting political mess would weigh heavily on Brazilian assets but in fact the opposite is happening as investors see it more as a positive development that would help to remove the reform gridlock and put the country back on a growth path. In the latest twist, a judge blocked the appointment of Lula as chief of staff, arguing it could derail the ongoing investigation.

Separately, the fading risk-off sentiment and hopes for stronger Chinese demand supported iron ore prices, one of Brazil's key export sectors, and pushed prices by roughly 50% since mid-January. Similarly, most com-

modities have rallied heavily recently with the West Texas Intermediate testing the \$40 level for the first time since mid-December and gold rising 17% since the beginning of the year. The Brazilian real rose sharply on Thursday as protesters took the streets. However, we expect USD/BRL to come under renewed upward pressure as the commodity rally runs out of steam and investors focused on the rising uncertainty surrounding the country's political future.

Iron Ore recovery boost BRL (inv. USD/BRL)



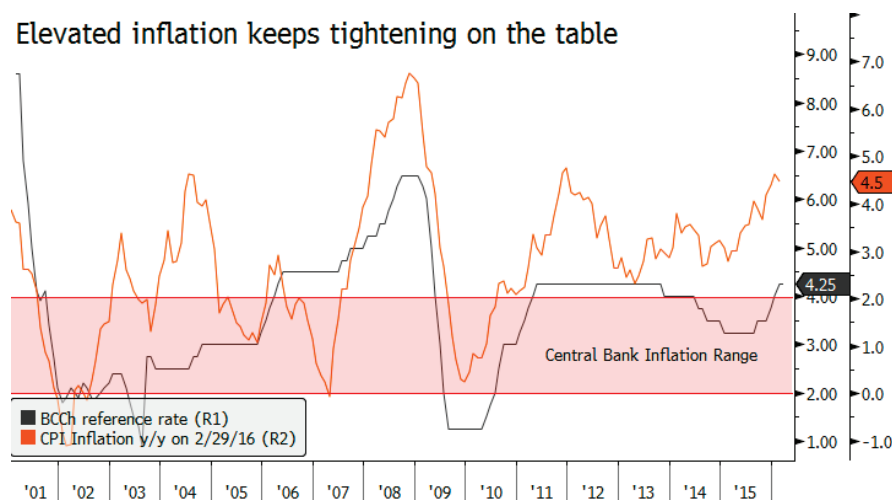
## Economics

## Peru Hold Rates As Growth Deteriorates

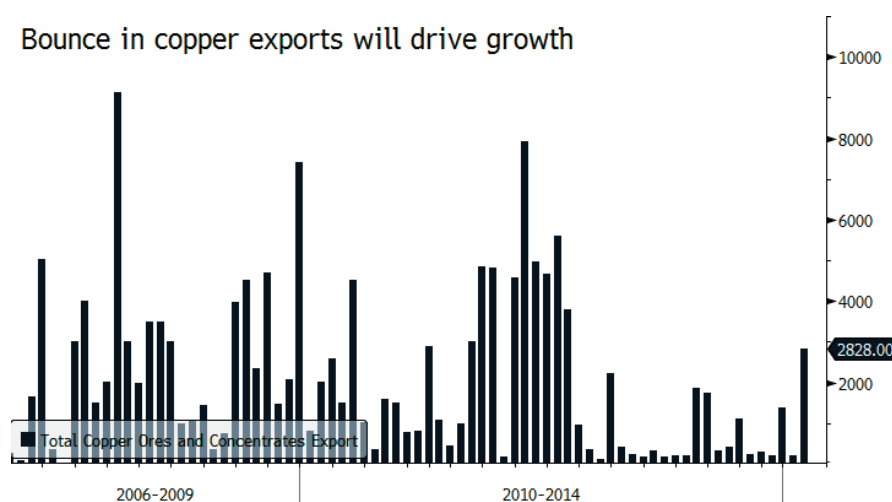
In context of the current base metal rally, FX traders have refocused their attention on Chile. The positive combination of a dovish Fed, recovery in commodities, and high yields has allowed the Chilean peso to recover. GDP growth 4Q confirmed deteriorating growth as data disappointed by advancing 1.30% verse 1.60% exp and prior 2.20% read. However, leading data has improved as domestic confidence recovered which is critical for acceleration in growth. Copper exports bounced to \$2267.6 from \$2054.1 potentially indicating a bottom for the economically critical commodity. Consumer confidence rose 3.3pp to 37.6% in February. Impressively, the rise coincided with the FM announcement that further fiscal charges would be required in light of weak copper prices. Business confidence also improved, to a lesser extent, suggesting overall that sentiment measures have trough in 1Q (coinciding with reverse of commodities decline). Inflation expectations remain soft as February headline inflation decelerated to 0.3% from 0.5% m/m but annual reading is holding at 4.7% well above the official 2-4% tolerance range.

BCCh remained on hold at 3.50% for the third straight month adopting a wait-and-see strategy after hawkish moves in 2015. The decision was in-line while language retained its tightening bias. In the accompanying statement, the BCCh highlighted that global monetary policy will remain more expansionary while outlook for developed markets growth and inflation forecasts has been further reduced. On the inflation front the statement indicated that medium term inflation expectation remained anchored at 3%, indicating that short term pressures would be transitory. Given our expectations for marginal recovery in commodity prices, providing support for growth, we have marginal conviction in an additional 25bp hike to 3.75% for 2016. Yet the risk given lowered global growth outlook and naturally lessening inflation expectations, and fear of over appreciating PEN suggests an extended pause is likely. Approaching monetary policy report (IPoM) should provide clarity to our projections and end of tighten cycle theory.

### Elevated inflation keeps tightening on the table



### Bounce in copper exports will drive growth



## Economics

## Fed Pulls Back From Four Rate Hikes

As expected the Federal Reserve has maintained its rates unchanged at 0.25% to 0.50%. Anyway, financial markets had ruled out any rate hike from the March meeting. Now, markets are currently pricing in a rate hike to happen before September.

In the FOMC statements, the key words were as usual oriented towards the labour market and the inflation target. Yet, continued improved job conditions have not provided the expected boost in inflation despite the slight pick-up in recent months. Nonetheless, it continues to run below the 2% longer-term objective. The Fed is confident that the effect of declining energy and import prices will fade and increase upside inflation pressures. Energy prices may go up, but we think that overall weaker demand will continue to push prices down. The Fed's inflation target of 2% seems far away.

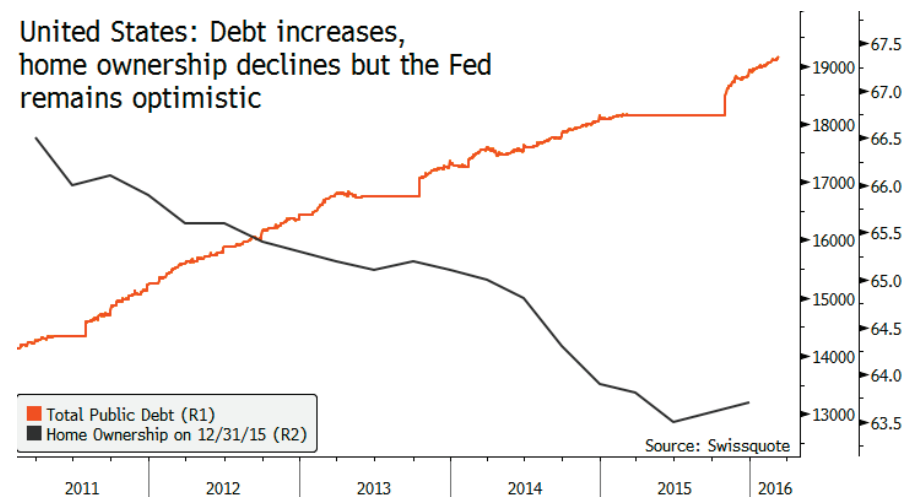
It is also true that, according to official data, the job market conditions are constantly improving. The unemployment rate has fallen now below the 5.0% mark, despite continued weakness in the manufacturing sector. The situation was pretty much the same in December and it did not prevent the Fed from hiking. In other words, we believe that the labour market is not the primary driver of a rate hike if of course it remains as resilient as it is right now.

From our standpoint energy prices and imports are far from being the only driver of a Fed raising rates - global economic and financial conditions are also important factors preventing the American central bank from acting - . However, the Fed clearly refuses to admit that the Chinese slowdown has exposed the underlying difficulties of the U.S. economy. Chinese exports dampened by 25% in 2015, meaning that western countries have simply bought less from the Asian economy. As a result, the U.S. manufacturing sector is suffering, putting pressure on the

labour market. Unfortunately, there is no mention of these domestic difficulties in the FOMC's statements showing that the Fed may be over-optimistic regarding the current health of its economy.

It is also important to note that this year's presidential elections are likely to spur the U.S. consumer sentiment as patriotic feeling tends to improve at such times. This may provide a fresh boost to domestic consumption and push (slightly) inflation higher, which would add some support to the raising of rates but would not be sufficient, in our view, to trigger a rate hike this year.

**United States: Debt increases, home ownership declines but the Fed remains optimistic**



## FX Markets

## IMM Non-Commercial Positioning

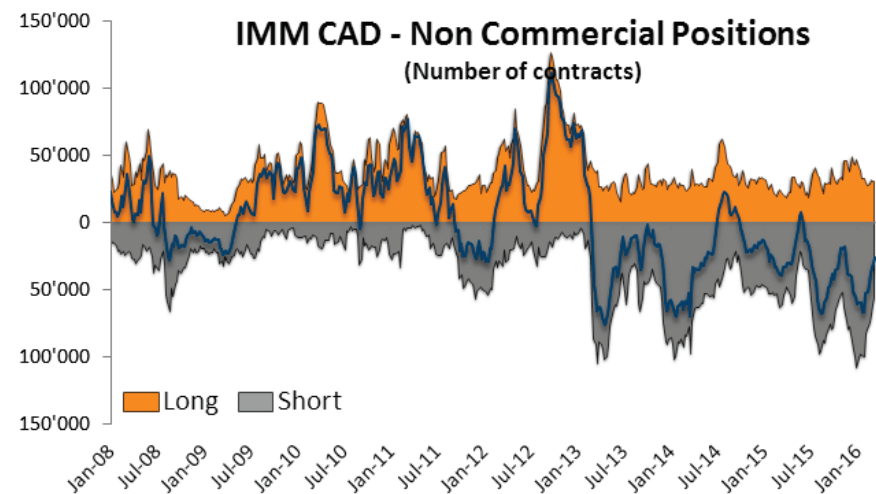
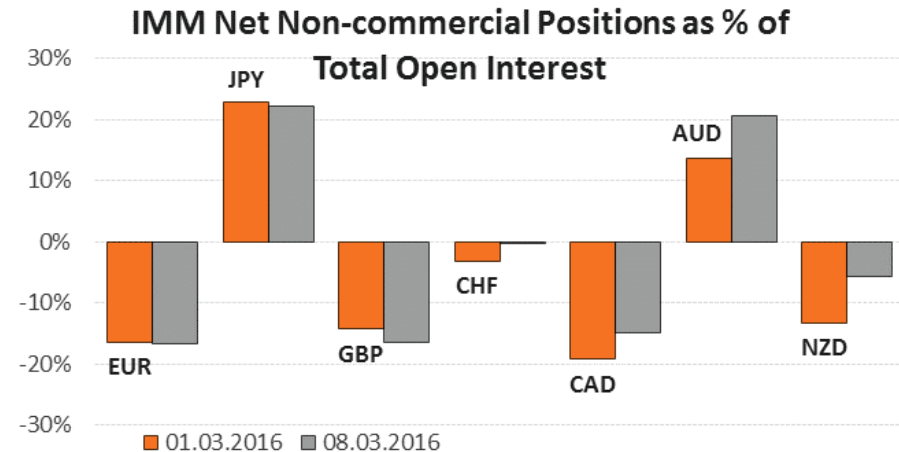
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending March 8th 2016.

Net long USD positions continued to decrease as speculators adjusted their portfolio ahead of the Federal Open Market Committee. Market participants are becoming more and more bearish about the USD outlook as the global slowdown and volatile financial markets should prevent the Fed to hike rates for now.

Net short NZD positions decreased substantially in reaction to accelerating commodity rally. Short net positions contracted to 5.7% of total open positions from 13.2% a week earlier. This trend should gain momentum as speculators continue to reverse their positions.

Short CAD positions also decreased, reaching 14.7% of total open interest as the Canadian got boost from the crude oil rally. The CAD should continue to benefit from the commodity recovery. Since mid-January, the CAD rose more than 10% versus the US dollar.



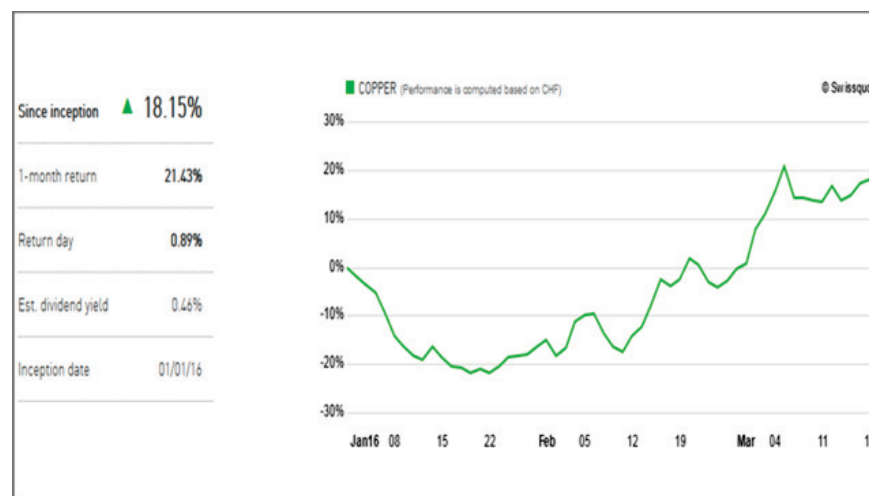
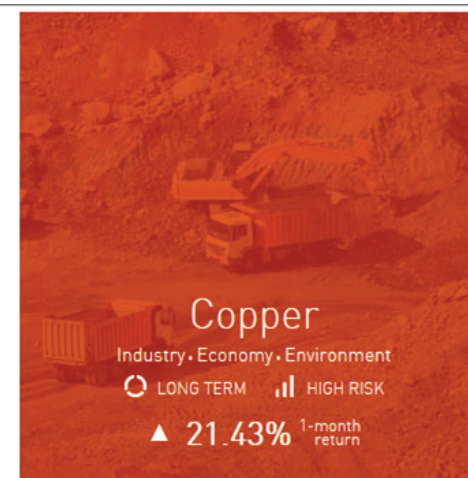
## Themes Trading

## Copper

After years of decline, copper – alongside other industrial metals – is staging an impressive rally. As well as being one of the most popular industrial metals to trade, copper is a leading barometer of global economic health. Copper is used in everything from circuit boards to plumbing and is an important part of developing nation's economies.

The collapse of copper prices from 2010 onwards forewarned of the global stagnation that continues to haunt the world to this day. However, the stabilization in the growth outlook in 2016, led by the ECB and BoJ providing additional stimulus, has given the industrial metal a lift. Meanwhile, China's commitment to a GDP target of 6.5% to 7.0% will keep prices improving, with the country accounting for 45% of the world's copper demand. In the short term, copper remains in "backwardation", indicating supply concerns as production cutbacks finally help balance the market. With optimism spreading and demand forecast to outpace supply, this unique commodity should continue to improve.

We built this theme using stocks of mining companies with a majority of revenue from copper production, plus an ETF that is directly correlated with futures prices.



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