SWISSQUOTE

WEEKLY MARKET OUTLOOK

30 May- 5 June 2016

DISCLAIMER & DISCLOSURES

Swissquote Bank SA | Ch. de la Crétaux 33, CP 319 | CH-1196 Gland | Switzerland
Tel +41 22 999 94 11 | Fax +41 22 999 94 12 | forex.analysis@swissquote.ch | www.swissquote.com/fx

WEEKLY MARKET OUTLOOK - An Overview

Economics

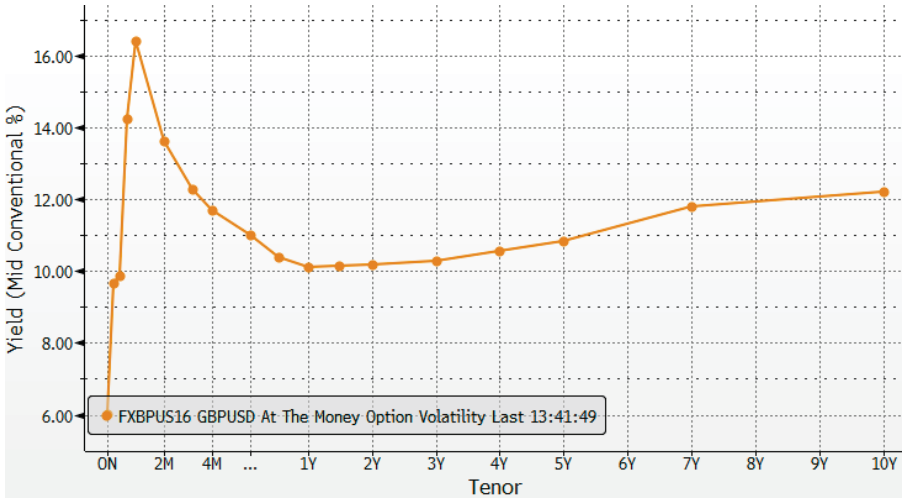
GBP volatility spikes

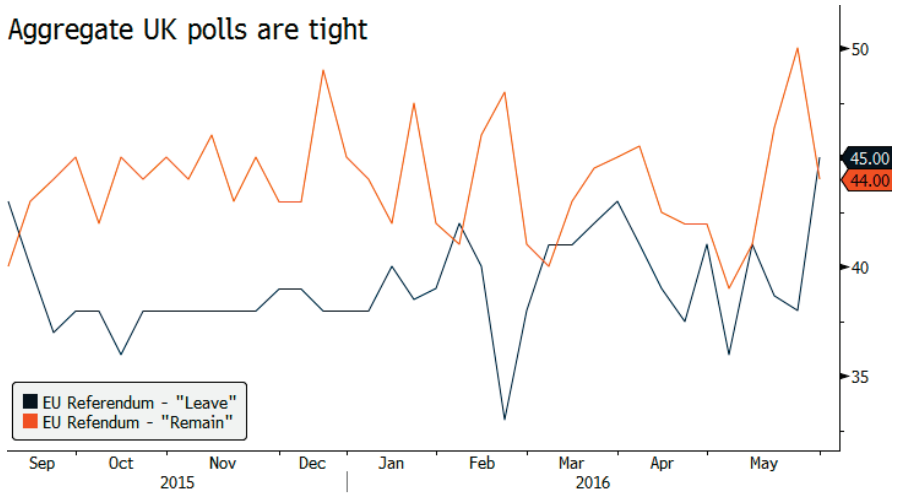
Uncertainty in UK polls remain

GBPUSD 1-month volatility went ballistic yesterday, as the contract duration now covers the unpredictable EU referendum. We anticipate that the GBP volatility will remain high as debate intensifies and the gap between bookmakers implied probability and aggregate polling results widen. Interestingly, GBP volatility curve completely drops off after the vote (and is trending lower), coming in-line with other G10 currencies volatility. GBPUSD puts continued to trade at a premium against calls as traders pricing in the downside risk. The average bookmaker's implied probability of a "leave" vote has decreased to 21% from 28% just two weeks ago. Yet, while the aggregate UK polls show a similar shift the extent of the move is less dramatic. Current all polls suggests 47% "remain" (up from 43%) verse 41% (down from 44%) "leave" vote. And adding uncertainty online polls are tied at 45% apiece.

Communication key to public opinion

The vote remains tight, and without debating the merits of the referendum, but judging from its current confused state, we suspect that the outlook for the "leave" campaign will be unsuccessful July 23rd. At Thursday night BBC "Brexit" debate the Ms. James, a Leave campaigner, stumbled on questions, including "just don't know" whether Brexit would mean people would require visas to travel around Europe. The stay campaign looks to have won the night. In general the scaremongering of the "remain" side, has provided the UK public with a more compelling and organized argument. Unless the "exit" block gets its act together with a clear, unified communication strategy, we anticipated the UK will remain with the EU.





Economics

Russia Still Concerned By Its Massive Inflation

The Russian economy is still suffering. Retail sales, which surged to 5.1% m/m in March declined by -1.6% m/m for April. Consumer spending is definitely very volatile and it is clearly difficult for the Russian Central Bank to assess precisely the current economic outlook as policymakers will need to make decisions concerning interest rates at the next monetary policy meeting to be held in June.

The central bank is concerned about upside risks on inflation and in particular about nominal wages, which last March's print indicated a 9% y/y increase. This spike in wages reflects the rebound in oil prices. When adjusted for inflation, wages growth is very volatile going from +1.5 y/y in March to-1.7% a month later.

Monetary policy will be considered as successful once inflation has been lowered. We do not believe that it is going to be the case in the short or even medium-term. The central bank may then be forced to further tighten rates or to intervene in the event of the ruble gaining too much in order to avoid damaging its GDP. We remain bearish on the USDRUB as the major driver will be the end of hopes for a possible 2016 rate hike for the Fed.

Russia, gaining positive momentum

Thinking that the current oil price rebound will last, Russia has a good change to recover sustainably. The recent oil rebound is undoubtedly helping the country, which is heavily dependent on this commodity. A barrel of Brent is now above 50 dollars a barrel, representing a 7-month high. According to a recent survey of 37 economists, the Russian economy should shrink by 1% in 2016 vs. a previously expected contraction of 2%.

Looking for more independence

Last week, Russia disclosed its gold and forex reserves for the week ending May 27. Russia's goal of reaching $500 million is getting closer with current reserves amounting to $388 million. Russia plans to remove the dollar, as much as possible, from its international exchanges in order to gain more credibility. This would also afford Russia a certain degree of protection against global uncertainties.

Economics

Fed Rhetoric Increases But Data Is Mixed

Data released yesterday indicates that key areas of the US economy remain soft, keeping the Fed on hold for June. Areas in the economy directly are exposed to external demand. Orders for durable goods increased 3.4% from 1.9%, significantly higher than expected as nondefense aircraft orders surged. However, the increase was expected after not showing up in the April report. Despite the decent headline numbers, the report indicates that factory demand is not showing any signs of significant recovery from its Q1 weakness. Orders for nondefense aircraft climbed 65%, adding 2.9% to the top line print; however, the rest of the report was less impressive. Orders for non-transportation good rose 0.4%, while core capital goods disappointed, contracting 0.8%.

Despite the questionable data, Fed members continue their hawkish rhetoric. Fed Governor Powell provided the clearest signal of his preference for a near-term rate hike, as long as the data allowed. Powell stressed his decision was not absolute and that the policy path was also highly contingent on incoming data. US front-end yields, and therefore USD, are being driven not by Fed hawkish hype, but economic data. Reacting to the disappointing data, the US yields curve shifted lower, with US 2-year yields slipping sharply 5bps to 0.86%. DXY fell .04%, to 95.15.

We still expect weak global demand to continue to spill over into US growth. This contagion has been highlighted by a steady erosion in manufacturing PMI, challenging the recent 2Q growth acceleration. In addition, labor market weakness in April's job report should endure next week with a sub-100k NFP read. While indications from Fed fund futures are now against us (July 54% probably of a 25bp hike), we do not expect the Fed to hike interest rates this summer.

We are waiting for Fed Chair Yellen to provide cautiously dovish support for our theory. Fridays speech at Harvard did not provide any policy signaling. More likely we will hear policy direction at Yellen's 6th June policy speech in Philadelphia. This will be a critical opportunity for Yellen to signal the FOMC's intentions prior to going silent ahead of the 14-15th June policy meeting. From a fundamental stand point we remain short USD, based on our view of a single 25bp rate hike in Nov/Dec 2016.

Economics

Bank of Japan Ready To Act, Once Again

BoJ Governor Kuroda, in a speech held at the Japan parliament last Wednesday, confirmed that further stimulus will be added "without hesitation" if the yen strengthens too much. He said that it would threaten the country's objective of reaching the BoJ's inflation target of 2% over the medium-term.

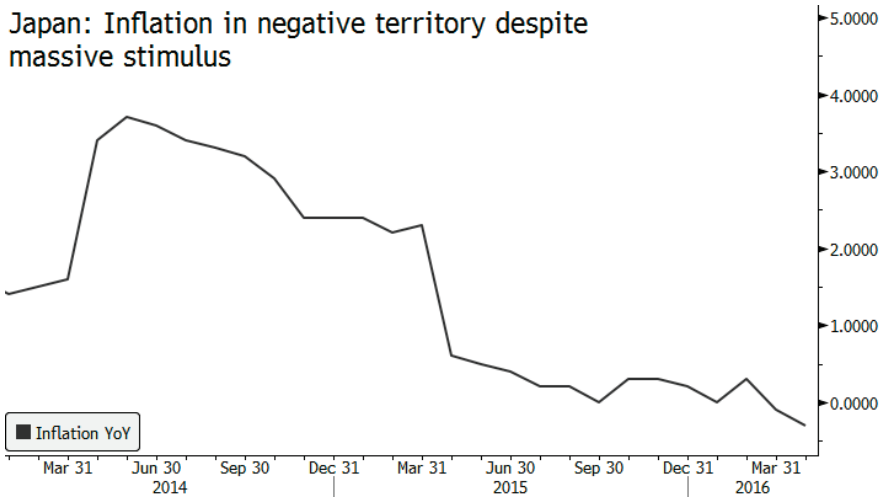
For the time being, financial markets do not know which price will trigger an intervention from the BoJ. Yet we believe that this threshold is not very far away from current prices and should lie around 106/107 yen for a single dollar note. Nonetheless, we feel that the BoJ will likely try to avoid additional stimulus and that the yen target is only a central bank indicator at which the situation is considered not sustainable. From our vantage point Kuroda's declaration was a simple verbal intervention. We do not believe that Japan is satisfied with heaping on even more stimulus.

On support of our view, Japan's National CPI for April came in higher than expected at -0.3% y/y, but still lower than prior March data. The other inflation figure, the Tokyo CPI also printed below prior data at -0.5% y/y for this month. The very soft data will make it difficult to achieve the inflation target of 2% by the end of 2017. Common sense makes us wonder exactly how a country can achieve its inflation target in a year and a half when it has failed to do so for the last two decades.

The reality is that it is also the second straight month that inflation has been lower. The BoJ may believe that the recent yen strength is adding too much downside pressures on inflation. We clearly believe that the sales tax hike, planned to take place in 2017 will now be delayed or even taken off the table completely. We consider that the BoJ will try to avoid any unnecessary turmoil concerning their domestic economy.

So following Kuroda's comments, fresh stimulus should be added today as there are already massive downside pressures on inflation. However it is true that the JPY is taking a small breath against the US dollar on renewed likelihood of a June Fed rate hike. Unfortunately for Japan those hopes won't last long, US economy is also suffering, and bearish pressures on the USD/JPY will soon be back before the BoJ will be forced to intervene in a never-ending monetary policy.

Other issues are now likely to arise and Japan's number may well be up. Rating agencies are starting to wonder whether Japan should be downgraded as future economic expectations now completely uncertain. The island's massive debt, a debt-to-GDP ratio of 250%, will bury hopes for a sustainable recovery for a very long time.



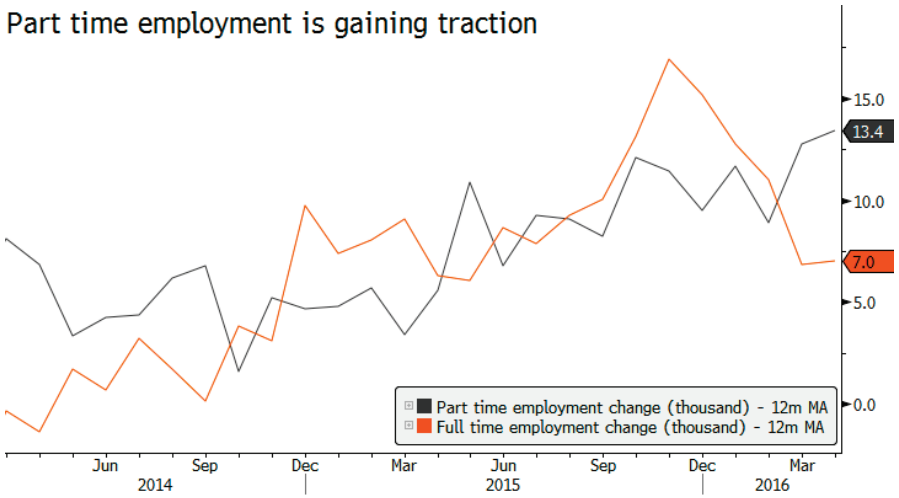
Economics

AUD Exposed To Further Downside Move

The Australian dollar had a nice bull run during the first quarter as commodity prices recovered and the Aussie economy adjusted relatively well to the prospect of weaker demand from China. AUD/USD also enjoyed a boost from fading Fed rate hike expectations with the currency pair hitting 0.7835 in the last week of April. However, the Aussie failed to consolidate those gains as the greenback rebounded in full force in May, boosted by renewed US rate hike expectations. Meanwhile in Australia, the economic outlook deteriorated further.

First, in early May the NAB business confidence fell 1 point to 5 against the backdrop of downbeat global economic outlook, while the business condition gauge fell to 9 in April from 12 in March. Secondly, the weak inflation outlook remains a cause for concern for the Aussie economy - negative inflation quarter-over-quarter in Q1 2016 (-0.2%q/q or 1.3%y/y). On May 3rd the RBA cut the official cash rate by 25bps to 1.75% (as expected: See Weekly Market Outlook from April 29th), arguing that the strength of the Aussie - at that time - could derail the fragile economic recovery. Thirdly, the job market is showing signs of weakness. The stable unemployment rate (5.7%, down from 6% at the beginning of the year) is misleading as full time employment looses steam, while part time employment continues to raise steadily. Finally, private capital expenditure (capex) contracted 5.2%q/q in the first quarter of 2016, missing consensus for a smaller decrease of -3.5% and also below the upwardly revised figure of +1.8% in the last quarter of 2015. These weak figures show that Aussie companies are not buying the economic recovery story and are waiting to see further improvement, especially from China. Indeed, the iron ore recovery during the first quarter gave false hope as prices collapsed more than 30% in May.

We continue to expect further weakness from the Australian dollar against the US dollar. However, the debasement should be limited as we expect the Fed will keep rates unchanged in June, forcing the market to price in a delay in the tightening path. On the other hand, we also believe that the commodity rally has reached a critical point and will therefore consolidate for now. However, we anticipate that there is room for further AUD/NZD downside as the resilience of the Kiwi economy has been underestimated.



Themes Trading

Title

DISCLAIMER

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Swissquote Bank and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions, or regarding the accuracy, completeness or reliability of the information contained herein. This document does not constitute a recommendation to sell and/or buy any financial products and is not to be considered as a solicitation and/or an offer to enter into any transaction. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or in any other kind of investments.

Although every investment involves some degree of risk, the risk of loss trading off-exchange forex contracts can be substantial. Therefore if you are considering trading in this market, you should be aware of the risks associated with this product so you can make an informed decision prior to investing. The material presented here is not to be construed as trading advice or strategy. Swissquote Bank makes a strong effort to use reliable, expansive information, but we make no representation that it is accurate or complete. In addition, we have no obligation to notify you when opinions or data in this material change. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments.

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning Swissquote Bank, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. Swissquote Bank does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are for information purpose only and are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Swissquote Bank as a result of using different assumptions and criteria. Swissquote Bank shall not be bound or liable for any transaction, result, gain or loss, based on this report, in whole or in part.

Research will initiate, update and cease coverage solely at the discretion of Swissquote Bank Strategy Desk. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. Swissquote Bank is under no obligation to update or keep current the information contained herein and not liable for any result, gain or loss, based on this information, in whole or in part.

Swissquote Bank specifically prohibits the redistribution of this material in whole or in part without the written permission of Swissquote Bank and Swissquote Bank accepts no liability whatsoever for the actions of third parties in this respect.