WEEKLY MARKET OUTLOOK

6 - 12 June 2016

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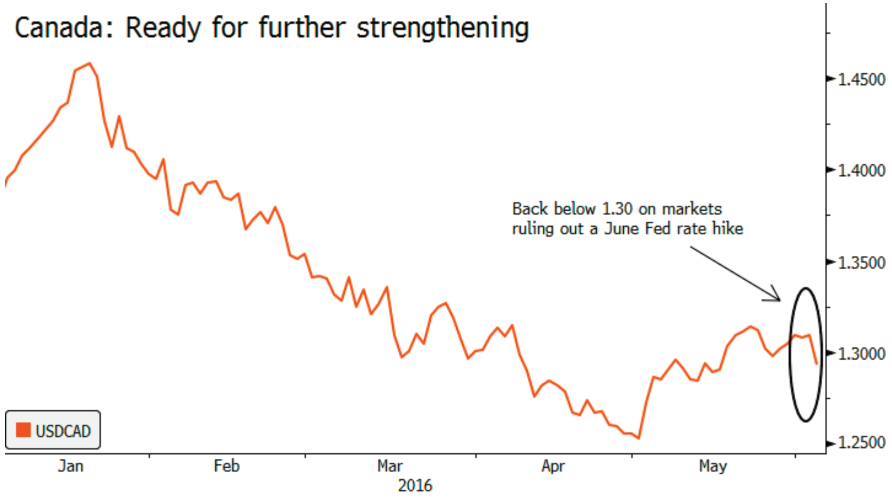
WEEKLY MARKET OUTLOOK - An Overview

Economics

Canada Outlook Improves On Oil Prices Rebound



Higher GDP but lower than expectations

There was strong expectations last week for Canada's Q1 GDP, which had been released at 2.4% y/y when it was expected to come in at 2.8% y/y. The data has printed nonetheless higher than the 0.85 y/y Q4 2015 data. The rebound in oil prices is, for the most part, providing with some relief to the Canadian economy. The loonie has appreciated strongly since the start of the year, gaining more than 15 figures against the greenback. Yet, fears that the rebound in oil prices was mostly due because of short-term supply disruptions are growing and the currency has weakening over the past month.

Oil prices are not the only driver of the USD/CAD pair. We believe that the Fed's monetary policy has helped to strengthen the Canadian currency for the four first months of this year as financial markets ruled out any Fed rate hike. Now that Fed members are back on the hawkish side, the Canadian currency is devaluing again. Nonetheless we believe it is temporary and we remain bullish on the Canadian dollar as the oil production should start again as well as upward pressure on the loonie. Our dovish stance on the Fed leads also us to think that markets may reverse, once more, to bearish US dollar.

BoC monetary policy should remain accomodative

Global uncertainties have pushed the Bank of Canada to maintain a patient stance and the central bank announced earlier last week that the overnight rate is to be kept on hold at 0.5%. Our bullish view on the Canadian dollar has to be qualified. Indeed, we consider that the Q1 data will be a small relief as the domestic environment is at stake. Business investments for example are clearly suffering. Also, natural disasters such as the recent Alberta wildfires would also clearly weigh on future revenues.

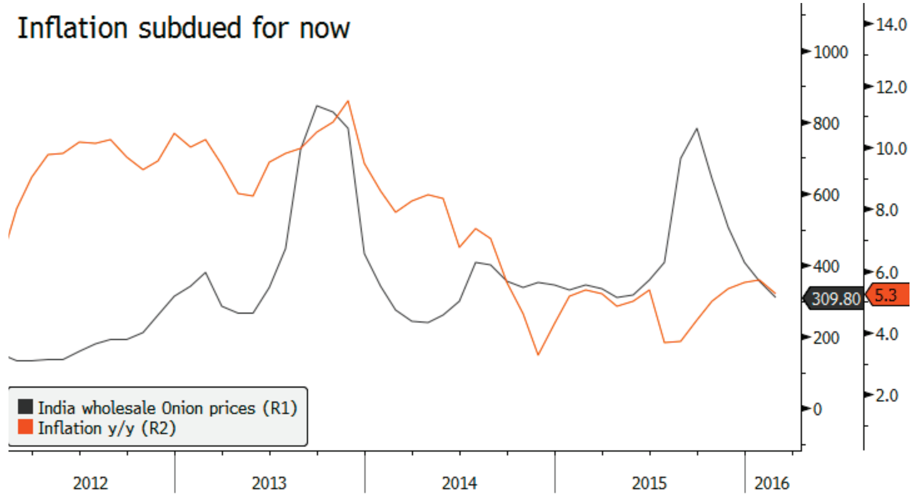
Economics

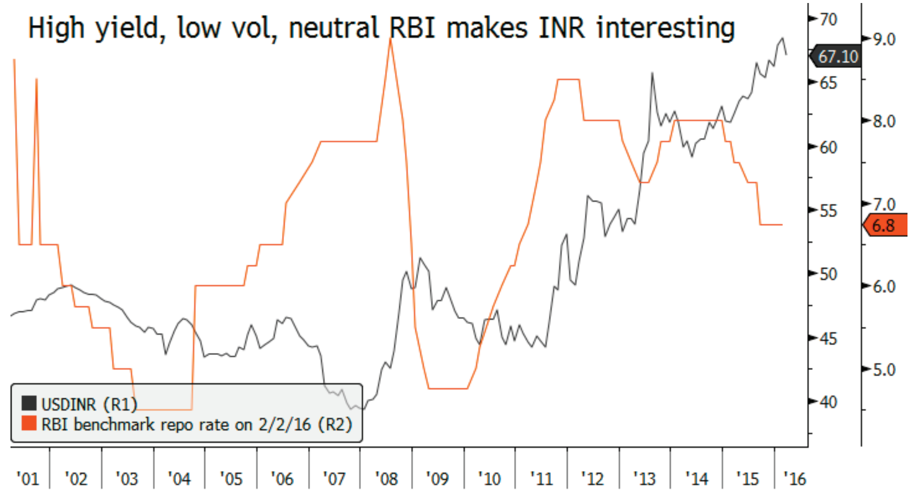
Neutral RBI Expected

This week, India upgraded its 1Q GDP y/y read to 7.9% from 7.3% indicated that the Asian economy continues to outpace regional rivals. While PMI service and composite came in slightly weaker than expected, manufacturing surprised marginally to the upside. Given the steady economic improvement we anticipate that the Reserve Bank of India (RBI) will not announce any additional cuts at its monetary policy decision meeting next week.

April's policy decision to cut its benchmark repo rate by 25bp to 6.50%, supported by accommodating statement was not real surprise. However, the RBI decision to support bank liquidity through structural measures was what really highlighted their commitment to easing. RBI governor Raghuram Rajan indicated that further measure were possible stating: "The stance of monetary policy will remain accommodative. The Reserve Bank will continue to watch a macroeconomic and financial development in the months ahead with a view to responding with further policy action as space opens up."

The central bank has had the possibly to support growth through five interest rate cuts, due to persistent deflation. Yet, negative effect of weak commodity prices has worn off and inflation has begun to trend higher. The most recent read indicated consumer CPI surged 5.39% against 5.05% exp. With the new inflation target of 4% with a band of +/- 2%, in place the RBI credibility is at stake. Inflation remains subdued in historical context and the markets believes that pressure will recede. Yet, with growth accelerating, and favorable monsoon season there is less confidence that inflation gains will decline. We will be listening for a less dovish RBI governor Raghuram Rajan indicating no further rate cuts in 2016 (but potentially focusing on policy transmission mechanism). Any development should be seen by the August meeting. Given the fall in volatility and fading expectations for a rate cut we are bullish on INR.





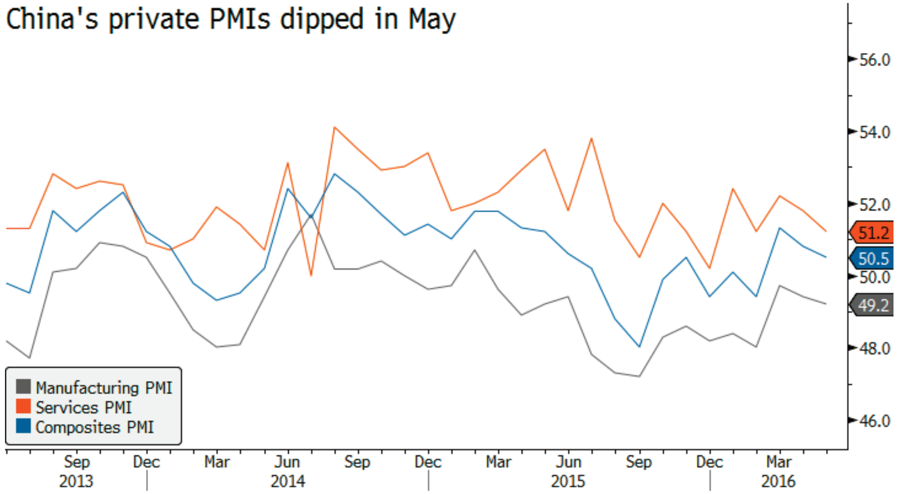
Economics

China's Slowdown To Set The Pace

The multiple PMI surveys released through the past week casted a shadow over China's prospect for global growth. Indeed, both the Chinese manufacturing and non-manufacturing PMIs came in on the soft side, raising questions about China's ability to shift from an industrial-oriented economy towards a services-oriented one in a timely manner. The official manufacturing PMI printed flat compared to last month at 50.1 in May, just slightly above the 50 threshold, which separates expansion from contraction in activity. However, the private measure provided by Caixin fell further in May, contracting to 49.2 from 49.4 in April. Most worryingly, the non-manufacturing PMI eased to 53.1 in May after printing at 53.5, suggesting that the services is struggling to gain momentum against the backdrop of weaker global demand and uncertain growth prospects.

On Friday, both the Services and Composite PMIs eased in May, confirming the soft PMIs released on Wednesday. The first one printed at 51.2 in May from 51.8 in April, while the latter came in at 50.5 compared to 50.8 in the previous month. The slowdown in the services sector is worrisome as the government is counting on a strengthening services sector to stabilise the economy. Nevertheless, the measure is above the 50 threshold, which indicates that the sector is still expanding.

The adjusting Chinese economy faces many challenges, as plenty of structural reforms are needed. The de-leveraging of the Chinese economy, as well the elimination of over-capacity and improvement of competitiveness will continue to be the main priorities of Chinese officials. Nevertheless, the Chinese economy will not be the only one to suffer from these adjustments as it is very likely that China will further export its over-capacity. Moreover, the weakening yuan will likely help to lighten the burden on China by making Chinese products more competitive. On Wednesday, the PBoC set the daily USD/CNY fixing at its highest level since February 2011 in response to a strengthening USD, boosted by mounting expectations for a summer rate hike in the US. We expect the government will continue implement measure aiming at stabilizing the economy, while the PBoC will most likely have to adopt a more balance approach in order to limit capital outflows.



Economics

The Swiss Economy "Fears" A Brexit

GDP lower than expected

Earlier last week Swiss GDP for Q1 came in below expectations at 0.1% q/q, while consensus was around 0.3% q/q. The Swiss economy has decelerated from the last quarter of 2015 when it rose 0.4% q/q. The Swiss franc barely reacted to the news and remains below 1.1100. For the time being, the Swiss National Bank still expects the economy will grow 1% this year.

In terms of GDP drivers, the financial services sector decreased while imports and exports increased. Overall the data is very mixed. It is clear that the economy has not fully recovered since the abandon of the peg in January 2015. Global economic slowdown, especially in Europe, are still largely weighing on the Swiss competitivity. The task of the Swiss central bank is definitely complicated. Last week also brought another ECB meeting and fortunately for SNB policymakers, no new stimulus have been added. They will also closely look at the 23rd of June Brexit referendum and hoping for the “remain” vote to win in order to avoid any capital inflows to the Helvetic country.

SNB Likely to intervene in the FX market

We also believe that mounting European uncertainties have pushed the SNB to intervene in the FX market by purchasing assets denominated in non-franc currencies to decrease upside pressures on the domestic currency. Since the start of the year, the reserves have expanded by more than CHF 30 billion going from 560 billion to 590 billion. May forex reserves will come in this Tuesday and should deliver new hints of the SNB's action.

The size of the balance sheet is growing

The Swiss national bank does not only have negative interest rates at his disposal but also FX intervention or SNB's negative interest rates to decrease upside pressures on the Swiss franc. Yet, the SNB balance sheet is now massive and it represents about more than 90% of the Swiss GDP. We then think that FX intervention is no longer unlimited and that having a balance sheet which is worth more than the revenues that the Swiss economy can generate in a single year is clearly concerning. Indeed the currency risk is massive and in case of a Brexit the euro collapse will start to be priced in by financial markets and it would certainly have dramatic consequences for the Swiss economy even if it sounds like a black swan. The SNB jumped in the currency war with both feet, but it is very complicated to compete against the giant euro machine. For the time being, we would suggest to reload short positions on the EURCHF at 1.1100.

FX Markets

IMM Non-Commercial Positioning

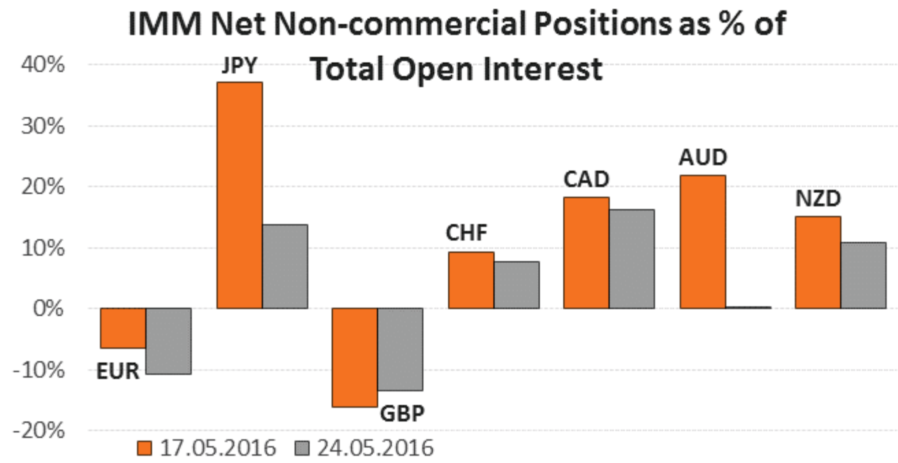
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

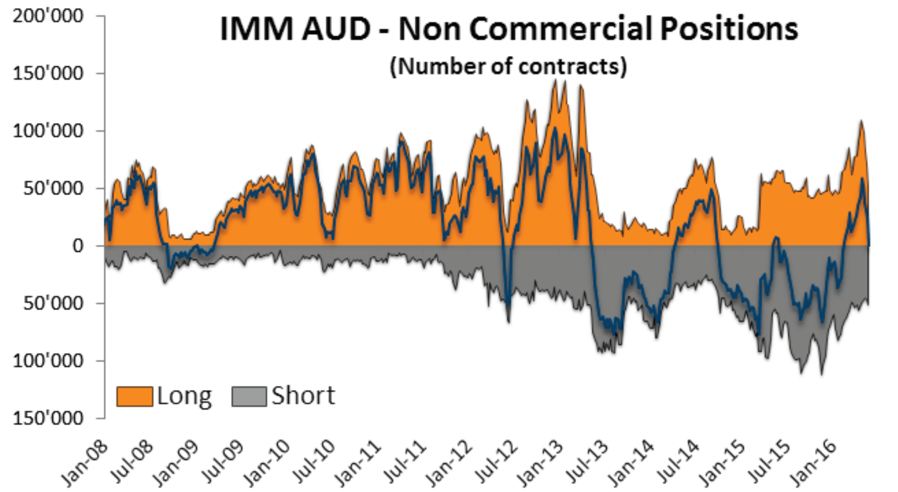
The IMM data covers investors' positions for the week ending May 25th 2016.

The AUD net long positions have decreased drastically compared to the previous week as speculators lost faith in a potential rebound in AUD. Long net position in AUD fell to nearly 0% compared to 22% a week ago and 30% two weeks ago as the RBA cut interest rate to 1.75%, while rate hike expectations gathered pace in the US.

The GBP net short positions slightly decreased as the odds of a Brexit diminished. However, given the highly uncertain outcome of the 23 June vote, we do not expect to see major swing in those figures.

The JPY net long positions have decreased massively amid mounting speculations about further easing from the BoJ . However, in the wake of the poor May NFP figures, net long positions in JPY should increase again.





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