SWISSQUOTE

WEEKLY MARKET OUTLOOK

18 - 24 July 2016

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

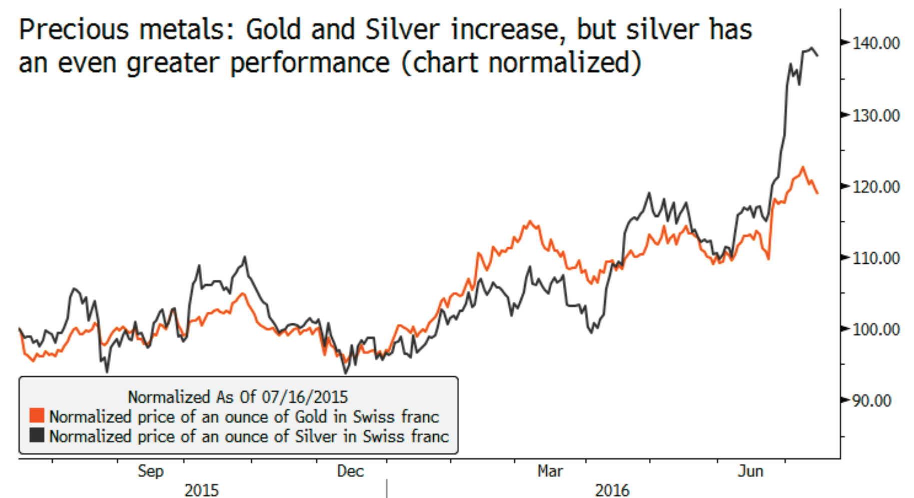
Is Safe-Haven Demand Sustainable?

The Brexit referendum has highlighted the major role of safe havens during periods of uncertainty. Bullish pressures on the Swiss franc and the yen have significantly increased. It is clear that it is not the economic fundamentals that are important but rather the political stability of these countries. Japan, like Switzerland is in the middle of a lasting deflation period. The yen is decorrelated from the Japanese economy while risk on this currency is far from low. In fact, we believe that interest rates may go deeper into negative territory. As a result it is not surprising to see precious metals go up as they constitute interest rate free insurance against a (albeit unlikely) collapse of fiduciary currencies.

The result of the Brexit vote has indeed revealed much. For the first time since the creation of the European Union, the risk of its dislocation has never been so high. To add salt to the wound, in Finland a referendum is also on the table as a petition is already close to having half of the required signatures. Investors are fully aware of these problematics and the demand for gold and silver has massively increased with these precious metals now being traded at levels unseen in three years.

There is nevertheless a paradox in this sharp increase in gold and silver. Banks, European banks in particular, are caught in the eye of the storm as the issuers of paper ounce. The supply increase, is keeping precious metals at lower levels and helping to maintain confidence in fiduciary currencies. It is worth noting that the supply of physical gold and silver has never been so high. There is a significant counterparty risk that could further weigh on precious metals prices, which could trigger a split between paper and physical precious metal markets. Let's remember that the size of the gold paper market is two hundred times the size of the physical gold market.

Will gold and silver increase in the next few months? There is a real bullish potential. Despite the Fed promising over the last four years that US interest rates would go up sustainably, financial markets have started pricing a likely rate cut before the end of 2017. Mistrust towards central banks is now the new driver for gold and silver. Negative interest rates are completely nonsensical to the extent that the one that lends needs to pay the interest. Moreover, we cannot see how the ECB or the Bank of England could obtain better results that the Fed or the BoJ. The road is now wide open for gold and silver!



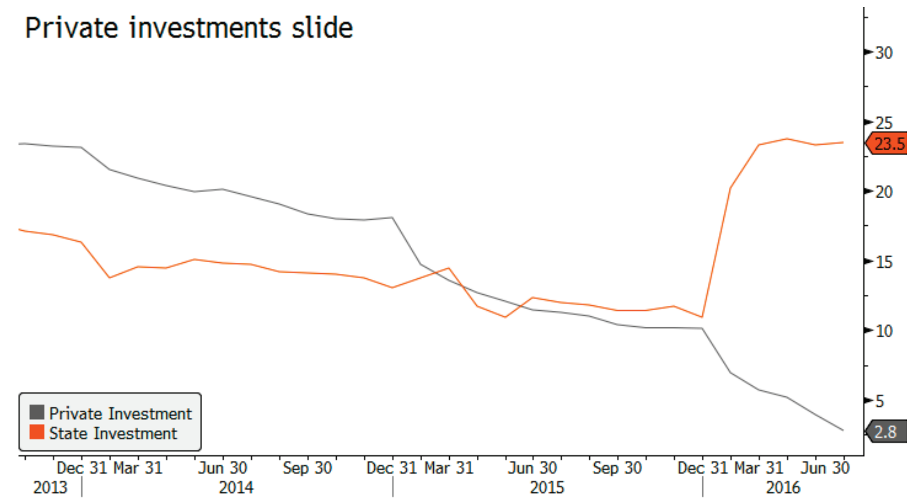
Economics

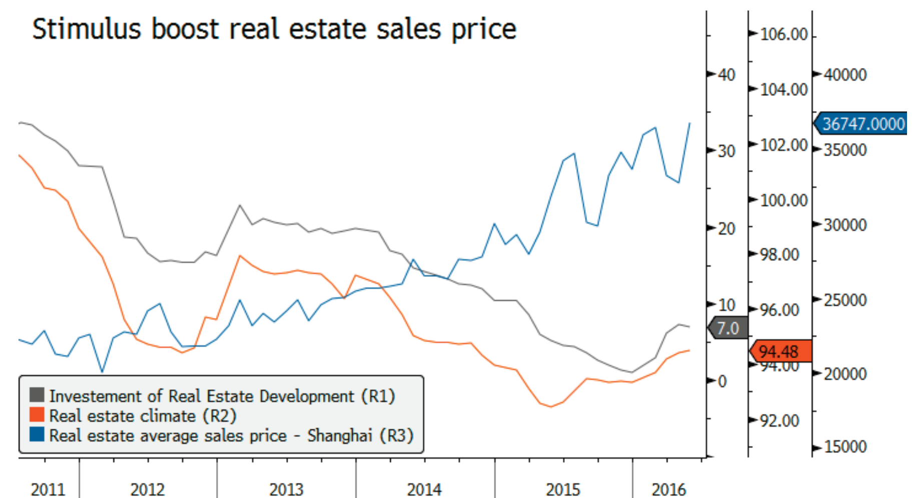
China Not Out Of The Wood Yet

At first glance Chinese growth data were rather encouraging for the second quarter of 2016 as the gross national product expanded 6.7%y/y in Q2, unchanged from the first quarter, but above market expectation of 6.6%. On a seasonally adjusted basis, the Chinese economy grew 1.8%q/q, beating median forecast of 1.6%, while first quarter's figure was upwardly revised to 1.2% from 1.1% first estimate, suggesting that the world's biggest economy weathered well the first half of the year and was even able to gain momentum, which is a good news the target for 2016 is 6.5%y/y. On the inflation front, headline CPI rose to 2.1% in the first and second quarter, compared to 1.5% in the December quarter last year. GDP deflator rose 1.80% in the second quarter from 0.49% in the previous, easing concerns about deflationary issues.

Nevertheless, the big picture is not that pretty as private investments continued to gain downside momentum as it rose only 2.8%y/y in June versus 3.9% in May and 5.2% in April. In the meanwhile state investment surged 23.5%y/y, versus 23.3% in May and 23.7% in April. Investment in real estate slowed down as well, suggesting that the government may have to increase the stimulus if it want to reach its yearly growth target by year end. Indeed the recovery was mainly driven by the property sector.

All in all, the substantial improvement in the inflationary outlook and continued capital outflow - estimated capital outflow kept increasing, reaching a total of USD343bn for the year as of end of May - should prevent the PBoC to ease substantially its monetary policy. On the other hand, the government will continue to provide further fiscal stimulus to soften the economic slowdown. We wonder however when the government will start seriously to address the overcapacity issues because it seems that deleveraging is not yet a priority.





Economics — BoE And BoC Kept Rates Unchanged

Bank of Canada opts for the status quo

Markets correctly expected the BoC's rate to remain on hold at 0.50%. The Canadian economy is still adjusting from tumultuous oil prices and consequently the BoC has decided to wait for further developments in terms of growth before making any change to its monetary policy.

Our perspective is bearish for the next meeting that will be held at the beginning of September. We believe that the Bank of Canada is likely to cut rates from a quarter point in reaction to declining oil prices and Canadian job creation, which was negative in June, as well as in February and April. Downside pressures on inflation are awaited and the BoC may be anticipating such issues.

There are also mounting concerns that household debt is growing at a too fast pace and that it will negatively impact retail sales in the near future. In our analysis of Canada's current situation we have also factored in the Alberta wildfires, the impact of which is still not exactly known but may be severe. Also, the Brexit consequences still have to be quantified and qualified but the underlying difficulties faced by banks may soon also spread to Canada. Currency-wise, we are bearish on the loonie and we target the pair to increase again towards 1.35 in the medium-term.

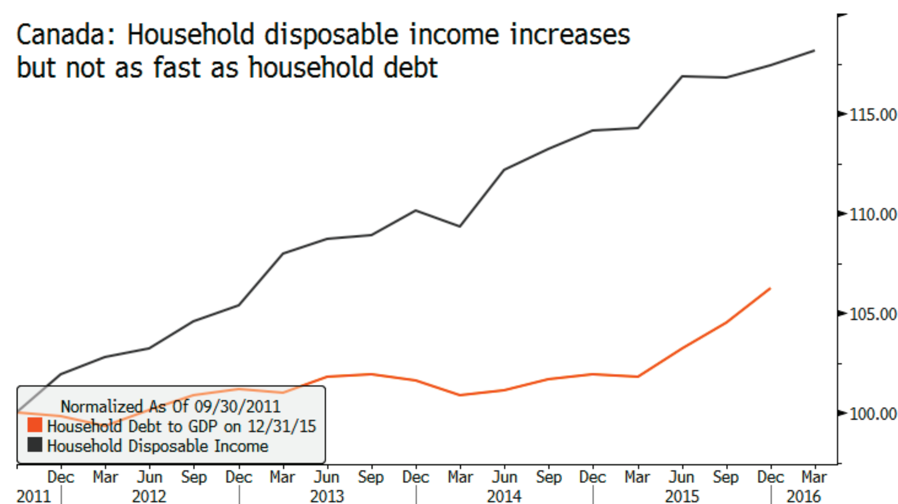
Markets overestimated a rate cut from the BoE

The Brexit vote's results still have to be appraised but the Bank of England, which has repeated many times that it is awaiting further referendum developments, maintained its bank rate at 0.50%. We need to wait before attending to the first rate cut in more than seven years.

In our view, market expectations concerning a rate cut were clearly too strong. Since the referendum, there had been a lack of economic data that would have actually helped the BoE to make a proper decision.

The BoE has not decided to cut its bank rate and such a move would have been premature. Nevertheless, what is clear is that the Bank rate should stay low for some more time. The inflation target of 2% by the end of 2017 still looks attainable and a rate cut would add more upside pressures on consumer prices. The pound has reached a 31-year low and while exports are clearly benefiting from that weakness, the outlook on inflation still has to be correctly assessed.

However, we have the feeling that the BoE believe it is the right time to cut its Bank rate at its August meeting. Nonetheless, The UK bank rate has been on hold for so long that such haste is difficult to understand.



Economics

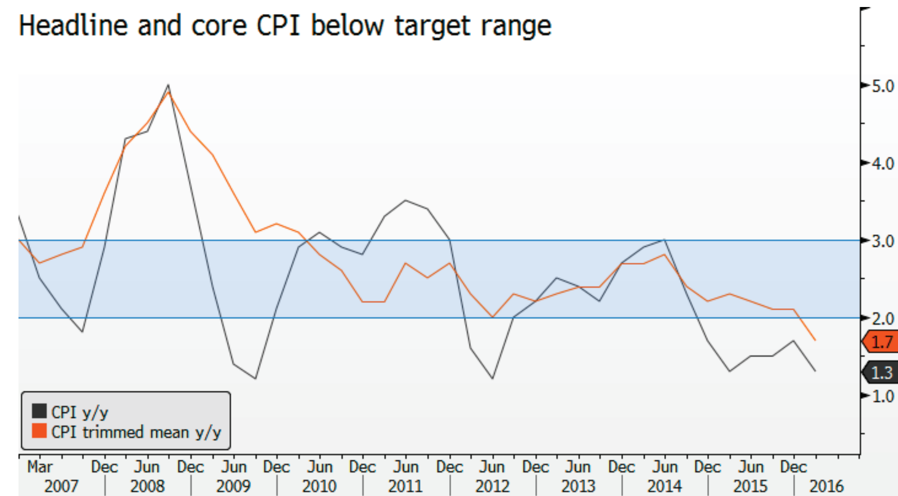
RBA: August Rate Cut On Table

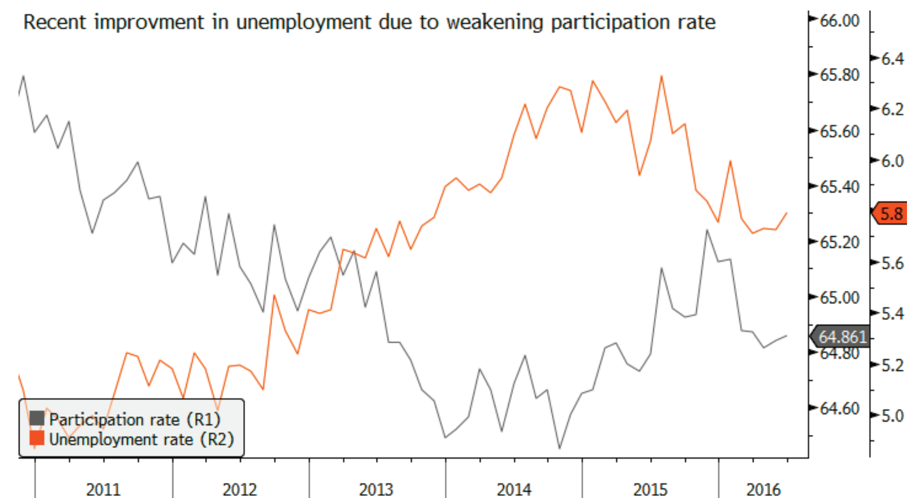
Released last Thursday, Australia's June jobs report provided a pleasant surprise, despite the slight increase in unemployment in the last month of the second quarter of 0.1% to 5.9%. This increase was largely driven however by a boost in the participation rate, which rose to 64.9% from 64.8%. The economy managed to create 7.9k jobs (versus 10k expected and upward revision of 19.2k in May), while full-time employment rose by 38.4k and part-time employment decreased by 30.6k.

One could interpret the strong gains in full-time employment as a sign that the economy is finally gaining traction; however this assumption overlooks the fact that the overall trend over the last few months has been rather discouraging. The participation rate has continued its decline since the beginning of the year. Despite the creation of 62.3k part-time jobs since January, 19k full-time posts have been lost over the same period.

Therefore, for now, we are taking a cautiously patient, rather than bullish stance on the Aussie economy. Moreover, we fully expect the RBA to proceed with an additional rate cut at its August meeting, after leaving the door wide open for a rate cut in its July meeting. The decision will however be highly dependent on developments in inflation levels and given the disappointing numbers of the first quarter and the very low expectations for the second, it seems that another easing move from the RBA is inevitable.

In the FX market, the Aussie completely erased the post-Brexit losses as it returned to $0.7650. On Friday, AUD/USD was still testing the 0.7648 as the risk rally started faltering. If broken, the next resistance can be found at 0.7849 (high from June 18th) but will hard to pass as traders keep in mind the RBA's easing bias.





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