SWISSQUOTE

WEEKLY MARKET OUTLOOK

15 - 21 August 2016

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

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

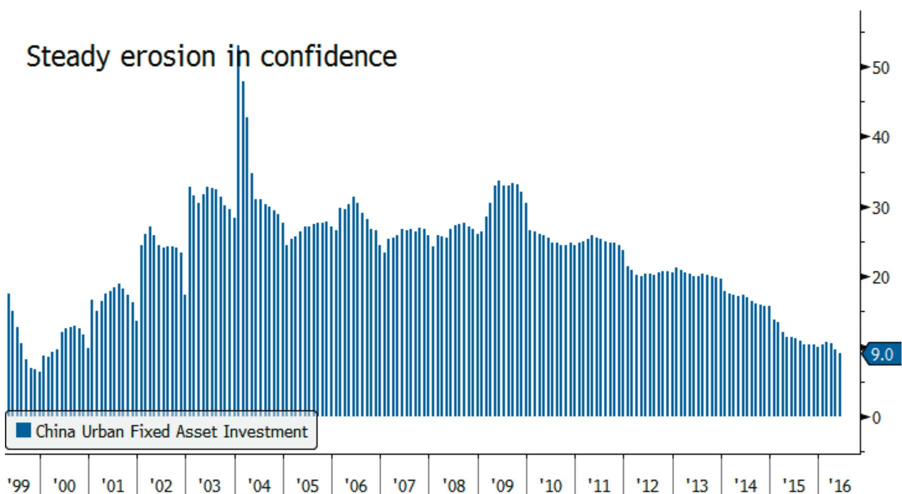
China Data Weakens

The sprint into yields continues unabated by the further contracting of rates across the globe. The August lull in trade has created the ideal scenario for risk seeking as volatility remains low and news flow thin. While we don't see any reason to swim against the current we need to stay vigilant of events that might derail the current risk euphoria.

Data released today indicates that China's economic stabilization strategy is wavering slightly. China's July activity data in industrial production, retail sales and investments all disappointed pushing forecasts for GDP growth below 7.0%. Today's data was not completely unexpected as PMI reads had shifted below 50 earlier in the month (China manufacturing PMI 49.9) and soft trade data release indicates that the economy is stressed. The Chinese consumer remains active but slower paced as annual retail sales rose to 10.2% (driven by a surge in passenger car sales increased by 23% y/y), against 10.6% prior read. Industrial production remains stagnant, rising an unimpressive 6.0%. Finally, urban fixed asset investment, which had been a bright spot for growth during Q1, declined to an annualized pace of 8.1% from 9.0%. The soft investment read reversed the prior uptick, which was driven by extensive government expansion program, continuing a worrying downward trend. Investment into state-own enterprises was elevated but turning lower. To make matters worse, private investment fell to a new record low at 2.1% as falling global demand hurt business confidence. As government policy is geared toward priming the investment pipes it is clear that official spending is not big enough to offset the contraction in private investment.

Setting policy mix has become significantly more complex as economic data has diverged and become regional. China's housing markets remain firm as sales surged 18.7% y/y, yet suggests that households have ratchet up leverage.

The government has been vocal over concerns about a housing bubble, continuing to implement micro-turning measures; slow expansion, however, PBoC loose monetary policy encourages speculation. Moving forward, it is likely that the policy mix will increasingly skew towards targeted fiscal spending over direct easing. Given the risk form, shadow banking and rising financial leverage interest rate cuts and adjustment to RRR will become less frequent. We anticipate that so long as growth deceleration does not become unstable, monetary policy will remain accommodative with a probability of a 25bp cut in Q4. As for the CNY, decreasing expectations for PBoC action should allow CNY to firm.



Economics

Russia: Heading Towards Another Rate Cut In September

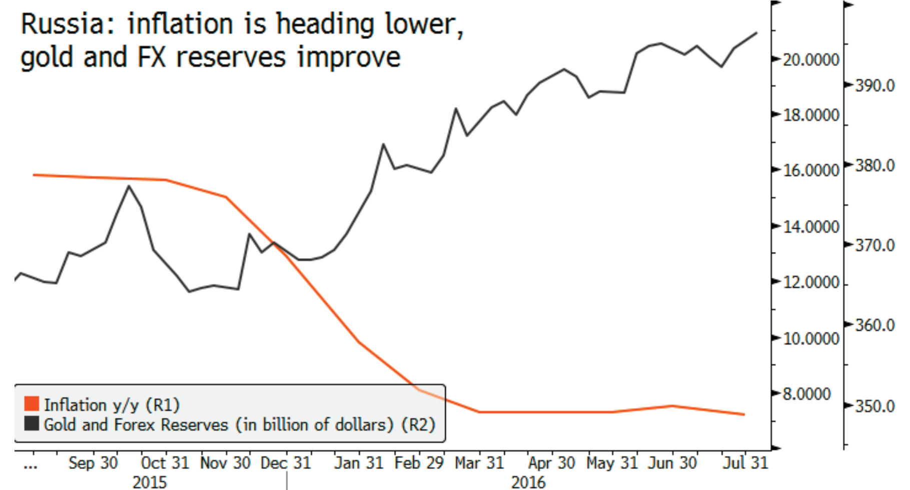
The ruble is following its upside momentum, currently trading below 65 ruble for a single dollar note. Things are looking up for the country as its economic prospects show definite signs of improvement. July's inflation data plunged to its lowest level in 2 years - to 7.2% y/y for July. It would appear that Elvira Nabiullina's monetary policy strategy is paying off. Moreover, the head of the Russian Central Bank has made clear that one of her primary objectives is to increase gold and FX reserves up to $500 billion in an effort to back its currency in gold as much as possible. This appears to be a smart move considering the current context of global uncertainty and the strategy is, in our view, definitely helping Russia to attract investors.

Last Thursday, Russian gold and FX Reserves have been released at $396.4 billion and are showing a continued increase towards the central bank's target.

For the time being, money is flowing into the ruble whereas oil is still trading at low levels, despite a continued rebound. The correlation between oil and ruble is diminishing. In fact, we believe that oil prices are not even the market's main focus at present.

From our vantage point, current ruble inflows rather comes down to a loss of central bank control. For example, the Bank of England, earlier last week cut its rate for the first time in seven years and announced that the asset purchase program target is to be largely increased. Money will continue flowing into the financial markets and as a result we believe that investors will, more than even, look for yields wherever it can. The structure of the markets is definitely changing. Stocks are now being bought for dividend yields, while bonds are being bought for capital appreciation. This is why we are seeing inflows in RUB.

The Russian currency is then strengthening and this overall increase needs to be monitored. For this reason we believe that it is likely that the Russian central bank will ease again at its September monetary policy meeting. The last rate cut happened in June when rates were lowered to 10.50% from 11%. We now expect a cut towards 10% - a rate that anyway cannot currently be achieved anywhere else in the markets. The RUB is definitely a good carry trade and should continue to appreciate. RUB is now taking on a kind of yields safe haven status.



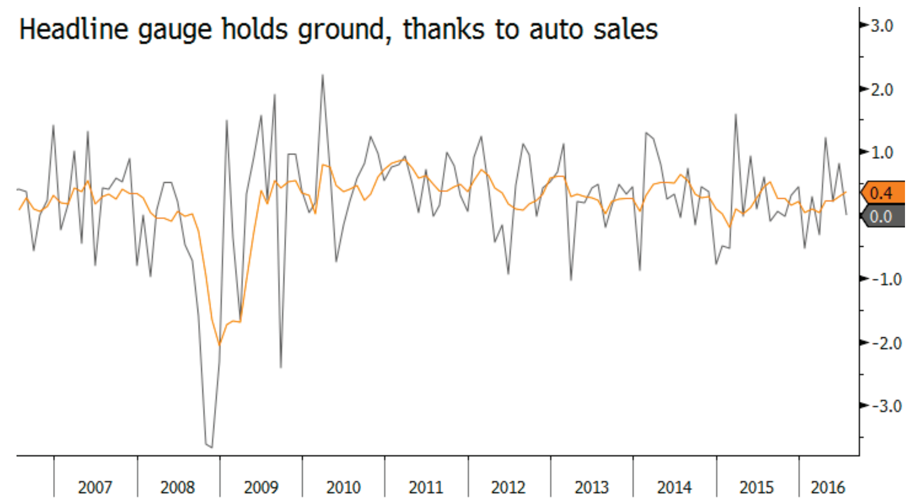
Economics

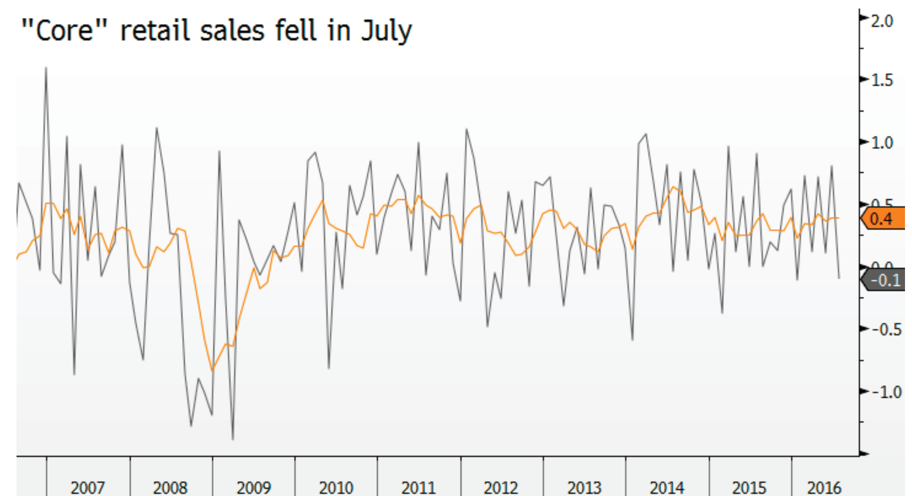
US Retail Sales Miss Forecast

Since the beginning of the year, the US economy has been sending mixed signals. Even though growth was expected to be uneven among the various sectors, economists anticipated that last year's drag would be a one-timer and that the world's biggest economy would gain momentum again. It is now obvious that the expected strong recovery is not yet being felt. In spite of a lacklustre overall picture, solid consumer spending since the beginning of the year saved the US economy from stagnation or even worst, a recession.

July retail sales were due last Friday and the least we can say is that it wasn't pretty. Advanced retail sales came in well below the 0.4%m/m expansion and printed flat, compared to an upwardly revised figure of 0.8%m/m in the previous month. The gauge excluding auto and gas contracted 0.1%m/m in July versus +0.3% expected and +0.8% in June. Overall, this was a very disappointing report as the trend in core retail sales growth is rather weak with the 6-month moving average currently at 0.4%m/m, suggesting the US economy is definitely not out of the woods just yet.

Indeed, continued strength in retail sales may be a game changer for the Fed as it would help to boost inflation against the backdrop of a strong US dollar that makes foreign goods cheaper. Indeed, the Fed finds itself in a tough position where central banks across the globe are further easing their respective monetary policies, while for its part, the Fed is desperately trying to move in the opposite direction. US consumers are therefore key to the Fed's normalization process and with July's disastrous report, we anticipate the Fed to stay definitely on the sidelines.





Economics

Switzerland: Good Jobs Data But...

Unemployment rate still below 4%

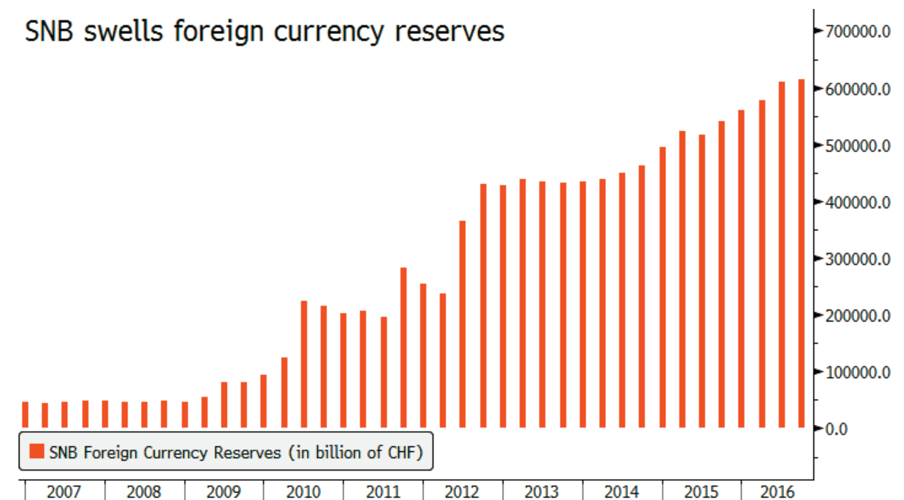
There were no major changes in Swiss unemployment data, which remained stable at 3.1% in July and 3.3% when seasonally adjusted. After peaking at 3.6% in February, there was fear of a growing upside momentum, which finally did not happen. Nonetheless, there are two things worth noting:

A too strong franc

Firstly, the franc remains largely overvalued (one euro is currently trading below CHF 1.09) and the true impact this has on the economy still needs to be assessed. For example, it is common knowledge that Swiss watch exports are suffering even though this does not necessarily translate in the statistics. Indeed, Switzerland has protectionist measures in place and several cantons are providing allowances to companies finding themselves obliged to reduce their employees' working hours. As a result, we can expect the unemployment rate to increase within the next year.

"Competitive" devaluation is weighing on Switzerland

Secondly, the Brexit vote is still too recent for anyone to properly appraise the implications for the Swiss economy. For the time being it has forced the SNB to massively intervene to defend the swissie, which has increased its balance sheet. At some point, a monetary expansion program could also be required to help Switzerland fight in this currency war. We feel that it is therefore too soon to congratulate ourselves about such low unemployment data. In our view, higher unemployment rates would raise deflation issues and as a result cause the SNB to take a step forward.



FX Markets | IMM Non-Commercial Positioning

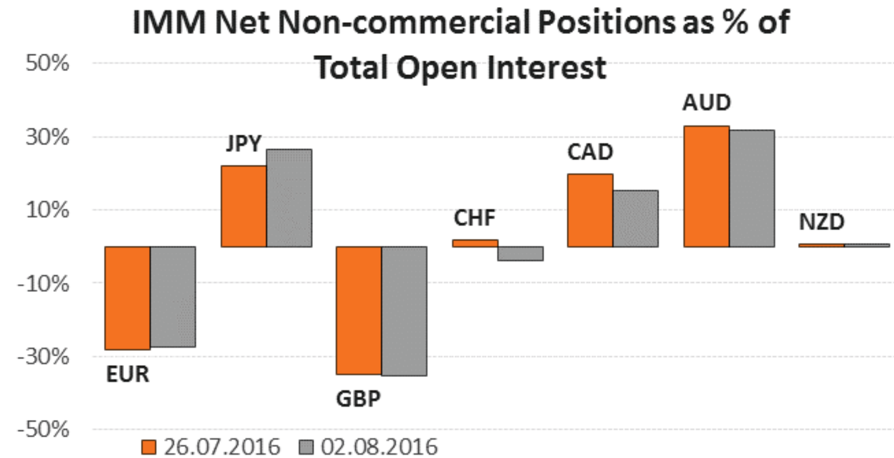
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

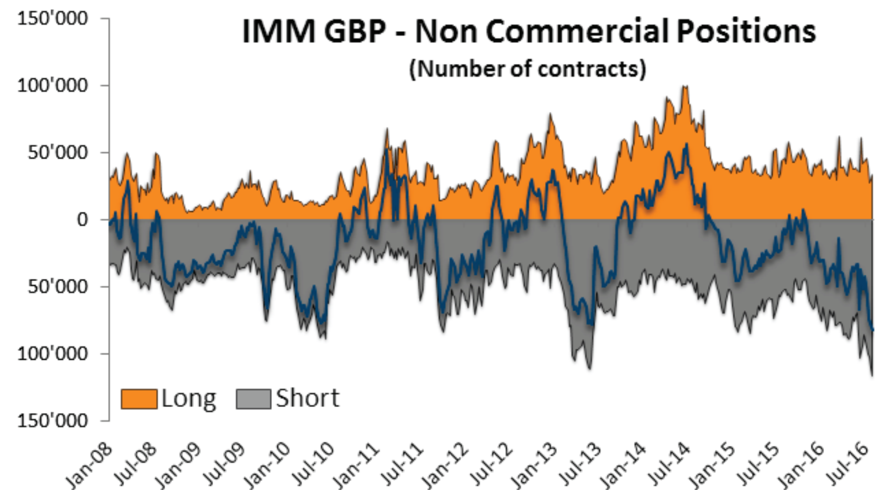
The IMM data covers investors' positions for the week ending August 2nd 2016.

The GBP short positions have remained at very high levels as investors bet the pound sterling still has substantial downside potential. Since the UK referendum, short positions have increased steadily and are not ready to diminish anytime soon as the consequences of the "leave" vote just started to appear slowly.

Similarly, EUR short positioning have remained elevated due to the huge uncertainty surrounding the Brexit vote.

The long CAD and NZD positions have decreased slightly compared to the previous week as the commodity lost steam. However, the chase for higher yields will favour long position in higher yielding currencies such as the Canadian and Australian dollar.





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