WEEKLY MARKET OUTLOOK

5 - 11 September 2016

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WEEKLY MARKET OUTLOOK - An Overview

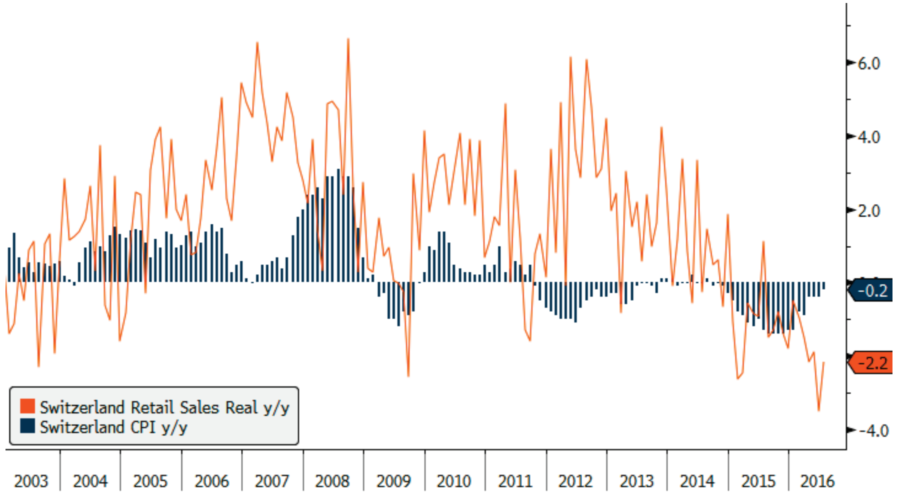
Economics

SNB Says No To “Helicopter Money”

Swiss economic data has come in mixed but nevertheless remains on the soft side prompting analyst to question what next for the SNB. Retail sales real y/y contracted to -2.2% following a revised -3.5% fall. Today's read was a minor recovery after a steady string of weak reads since mid-2015. There was also a positive recovery in food sales of 0.6% in nominal and a 0.8% in real terms rise. However, this rebound should be discounted as a result of the favorable summer weather. Sales data has been consistently low since the SNB abandoned the EURCHF minimum exchanged rate. The strong CHF has shifted Swiss consumer behaviour, undermining domestic sales as consumers search for bargains on durable goods and big ticket items in neighboring nations. This long term shift in consumer habits will add further negative pressure to inflation expectations as retailers reduce prices to compete with the exchange rate disadvantage

In an article published last week in Swiss newspaper Sonntagsblick, the Swiss National Bank’s Maechler provided basic reaffirmation of the central bank’s current policy mix, while rejecting potentially more extreme measures. Maechler commented that SNB members remain committed to negative interest rates and that they believe that the use of NIRP has successfully protected the CHF from further overvaluation. In very clear terms, she ruled out the use of “helicopter money” stating it as a “no-go.” Moreover, she suggested that for the SNB to give money to the government would be illegal. Perhaps the most interesting insight was the SNB's unconditional rejection of monetizing government debt. Evidence that Swiss economic conditions are deteriorating is coming in fast and heavy. There is clear proof that the overvalued CHF has reversed the temporally encouraging inflation outlook. However, expectations for further easing of monetary policy in the UK and ECB and mounting geopolitical risks will likely increase demand for safe-haven assets (even a rate hike in the US will provide uncertain directional FX flows).

As highlighted by Maechler, the SNB cannot influence the international environment, which puts the SNB in a purely reactive position. The central bank’s use of negative interest rates has already come under fire by insurance companies and pensions funds and is likely to find more critics as banks begin to pass the cost to private savers (which they have been reluctant to do). It is unclear why then, given the expected buying pressure on CHF and the limited maneuverability in NIRP, that more extreme measures are not on the table. We suspect that despite Maechler’s defiant, some form of “helicopter money” is actually closer to reality than this interview would have us believe. Remember, Switzerland's basic income referendum gathered 20% of the vote and SNB members were restating commitment to the 1.20 floor just days before abandoning the exchange rate policy. In the short-term we anticipate CHF will find buyers with EURCHF targeting 1.0863 (base & 55d MA).



Economics

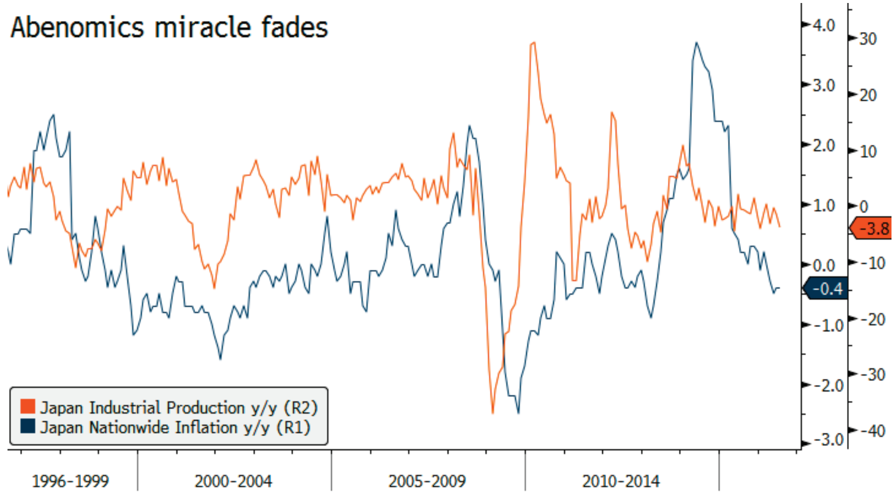
Reprieve For JPY While BoJ Policy Is Examined

Bad news for the experiment dubbed "Abenomics" continues to pour in. After a disappointing core CPI, which decelerated to a meagre -0.5% y/y in July and weak consumer spending today, industrial production seems to have all but disappeared after it fell -3.8% y/y in July following a -1.5% contraction. This marks the lowest read since February tracking the steady appreciation of the JPY.

In acknowledgement of Japan's current predicament PM Abe's adviser Hamada admitted that Abenomics is "not doing well." Japan's string of weak data releases has only increased expectations for the BoJ to act on the 21st of September. However, the current thinking is that any actions will be unimpressive and unlikely to significantly move the proverbial needle. In fact, as discussed on CNBC yesterday, we believe that the BoJ will be the first central bank to "hit the wall". Once this happens, the BoJ will lose control of the wheel as its monetary policy mix becomes ineffective in enforcing a credible strategy. The primary policy measures in negative interest rates, quantitative easing and purchasing private sector assets are no longer having the anticipated result, more specifically to weaken the JPY.

Given the market view that the endgame is near, even excessive easing will not have any long-lasting effect. Clearly, lower interest rates and additional purchases will have no effect on JPY strength or changing Japan's gloomy economic outlook. However, BoJ policy makers continue to stress that they have not exhausted policy options as BoJ's Funo suggested this morning. Potentially this means that the BoJ is inching towards the policy innovation: "helicopter money lite". While we wait for more clarity on this position USDJPY continues to depend on US yields and the shifting view of a Fed rate hike to drive prices.

Given our base scenario that September's FOMC will not bring a 25bp hike, we remain bearish on USDJPY. Chief Cabinet Secretary Suga's comments that Japan is ready to respond with appropriate force should FX prices become disorderly, indicates a loose floor at the 100 handle. USDJPY's current rally should be capped by 103.50 (65d MA), with expectations of a reverse towards 101.84 then 100 targets.



Economics

UK Economy Improves Despite The Brexit Vote

The Markit UK PMI for August had been released and data largely beat expectations. The figure came in higher at 53.3 vs 48.3 for July - 50 indicates expansion - while it was expected below 50 for the second consecutive month. Although having been on tenterhooks since the Brexit vote, UK data has surprised in recent weeks and shows no signs of slowing in activity.

The true consequences of the Brexit vote still need to be pinpointed as we continue to closely scrutinize all new data. Other data such as the Nationwide House Price data came in largely above expectations at 0.6% m/m in August and by 4.8% y/y, supporting our rationale that Brexit fears have been largely overestimated. Indeed, UK adhesion to the EU was, before the vote, already subject to many conditions which will not dramatically change the future of the island.

In terms of monetary policy, we believe that the BoE is likely to stay on hold at the September meeting, which will be held one week before the Fed meeting. There is no emergency to stimulate the GDP which rose 0.6% in the second quarter and the central bank will likely await additional data before further easing. The cable has further upside room to appreciate and we should not see the pound go below 1.30 dollars. The Brexit vote has been positive in terms of helping the BoE to devalue the currency. As a result, policymakers have gained some time to further adjust their strategy.

Politically speaking, it would be a very bad move, from Theresa May to now trigger any fear that a Brexit will not happen as it is in the country's interest to hold on to their weaker currency. This is why the UK prime minister continues to hold firm on her position that the Brexit vote result must be respected. We remain skeptical however and will only believe it once article 50 is triggered.

Investors are ready to step in the pound and while the Brexit consequences have been overestimated, it is also important not to forget that we are in an era of low interest rates and that clearly deflation pressures are largely pushing higher. For example PMIs have all declined in developing countries. Last but not least, the BoE maintained rates on hold for seven years until the Brexit referendum. Needless to say that this meant that the UK economic momentum was not positive. Now that the pound has largely devalued, the BoE has gained some time to fight its real enemy, which is not Brexit, but rather deflation.

Economics

Brazilian Impeachment: What Now?

After months of waiting, the Brazilian Senate finally voted 61-20 last Wednesday to remove Dilma Rousseff from office after she illegally used money from state banks to fill budget holes.

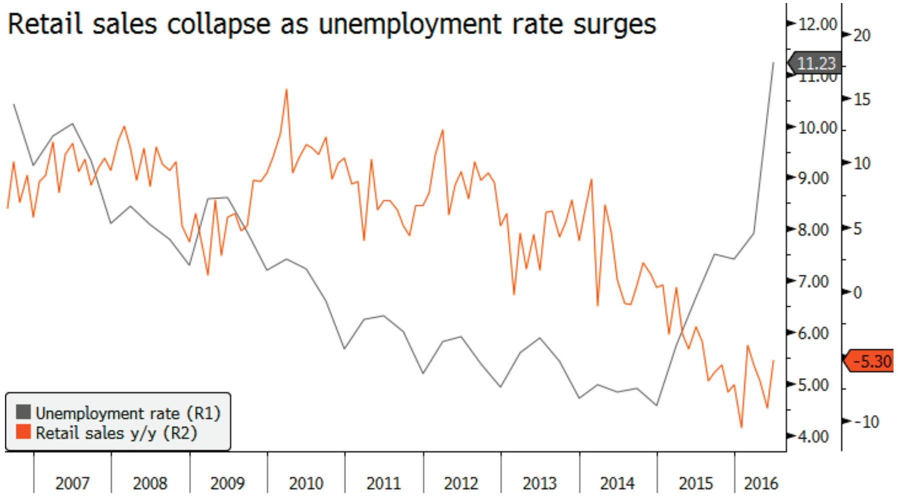
Michel Temer, the former vice-president, has already been sworn in as the new head of state until 2018. Since the beginning of the impeachment process, traders have consistently bet that the removal of Rousseff would give the government more flexibility to shore up fiscal deficits and put the country back on a sustainable growth path.

Market expectations are in fact very high, placing a heavy burden on the new government. The stock market has surged massively over the last few months as central banks across the globe continuously pump liquidity in the global economy and investors continue to chase higher returns. The Bovespa index has surged almost 60% from January's lows and Brazilian rates have fallen sharply as investors forecast a brighter outlook. Currency-wise, the real has surged 30% against the US dollar.

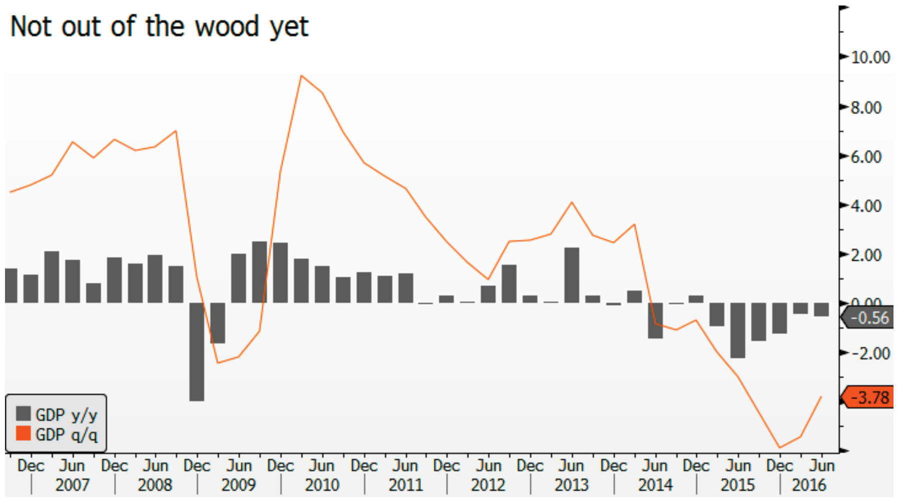
On the other hand, economic data continues to worsen as the real GDP declined 3.8%y/y in the second quarter of 2016, after falling 5.4% in the first. The labour market also remains under significant pressure with the unemployment rate surging to 11.6% in July - compared to 8.6% a year ago. This will weigh heavily on Brazil's consumption and therefore decelerate the recovery process.

We expect the market to return its focus to the fundamentals now that the political stalemate caused by Rousseff's impeachment is over. When we compare market expectations with the current state of the Brazilian economy, it is pretty straightforward to conclude that something is definitely wrong. Therefore, we expect Brazilian assets to correct downward over the next few weeks as traders slowly realise that they can't live up to the hype.

Retail sales collapse as unemployment rate surges



Not out of the wood yet



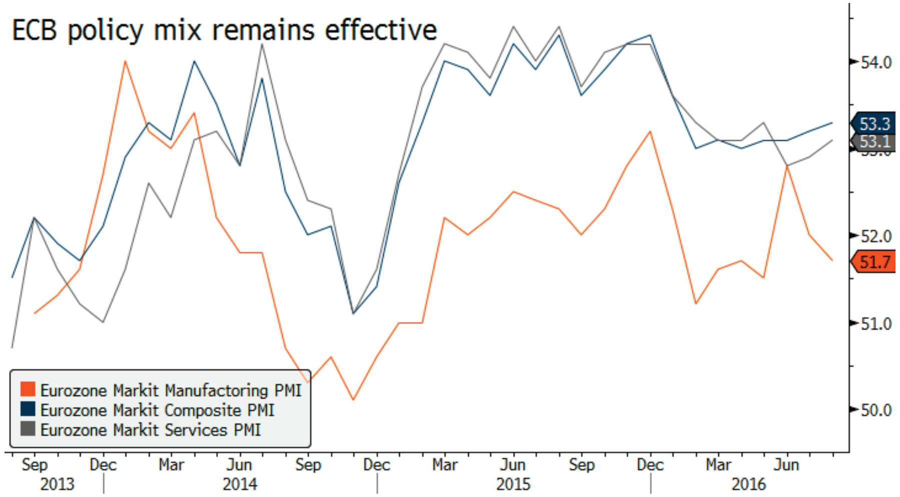
Economics

ECB This Week...Don't Expect Much

It has been almost three months since the UK Brexit referendum and economic data in the eurozone seems largely unaffected. Given the general assessment that the eurozone has dodged a bullet, we suspect that the ECB will only marginally tweak forecasts and will be less likely to expand its easing program. We expect that Draghi will opt for a wait-and-see strategy based on the impact of the Fed policy decisions. In the absence of any sudden shifts in Europe's economic outlook, the ECB will stay on the sidelines with its current policy mix. ECB economic projections could however be adjusted lower to reflect the less optimistic consensus read. Expectations for significant growth shock sent the 2017 growth forecast down to 1% from 1.2% (2016 unchanged at 1.6%) however, so far, fears have been unwarranted. Given the ECB's current growth projections of 1.7%, we could see a marginal adjustment to 1.4%-1.5%.

Considering the weaker state of the Euro due to Fed raising policy rates, the currency competitive valuation would help backstop a deeper correction. Inflation remains a concern for the ECB at its current persistently low level. The conversation at the ECB over the reasons for weak inflation dynamics has heated up with many suggesting that the ECB's own bond buying program is the root cause of the depressed long term inflation outlook. Despite the downward adjustment to growth, we suspect that inflation will remain basically unchanged for the next two years. The ECB's policy mix of negative interest rates, asset purchases and unlimited cheap funding to banks has achieved good results for the European economy. If not at this meeting, it's highly likely that the ECB will signal an extension of its bond purchasing programme through March 2017 (to reduce market uncertainty). We anticipate that the ECB will wait for the December meeting before announcing any official extension to QE and combine it wi

We anticipate that the ECB will wait for the December meeting before announcing any official extension to QE and combine it with further adjustments to economic projections. By December's meeting, the longer term effects of Brexit should begin to become more apparent.



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