

WEEKLY MARKET OUTLOOK

12 - 18 September 2016

WEEKLY MARKET OUTLOOK - An Overview

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Economics

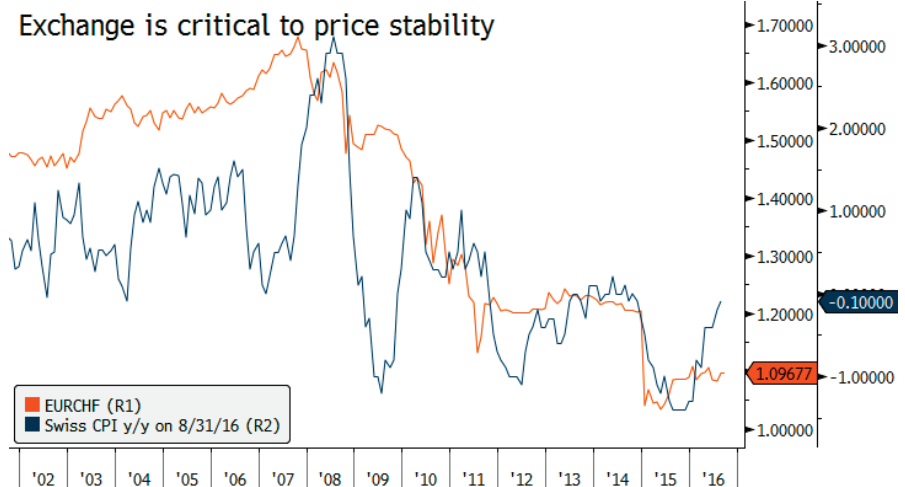
SNB to remain reactionary

Despite the feeling that dark storm clouds are building around the Swiss economy, there is limited indication that anything significant will occur at the Swiss National Bank's quarterly policy assessment. Since the SNB's last assessment, growth has outperformed expectations with PMI manufacturing rising to 51.0 and GDP accelerated 2.0% y/y (fastest pace since 2014), while inflation, still negative, continues to grind higher. But most importantly, the CHF exchange rate remains steady against the EUR, while marginally weaker versus the USD. At this week's policy announcement, we anticipate the SNB will maintain economic projections, keeping the deposited rate of -0.75% and pledging to limit the CHF from excessive appreciation.

The SNB remains in a challenge position. The alpine nation is overwhelmingly influenced by the policy actions of larger central banks. With a clear understanding of the bank's limitations the SNB policy strategy is responsive not pre-emptive. In this regard, development in Europe is being monitored. The ECB held policy steady opting to conserve firepower. However, the issues from Brexit are only now beginning to materialize both on the economic and political front. It's highly likely the effect will manifest in a way that will force the ECB to act. Merkel's election loss and growing backlash is a potential indication of the political volatility that Europe is facing.

Moving forward, direct FX intervention and interest rates will remain policy tool of the SNB. Price stability is the bank's mandate with a focus on the overvalued CHF. Intervention effectiveness has proved difficult to sustain over a long period but highly effective in the short term to discouraged speculators. In the longer term negative interest rates seem to be the SNB members' option of choice.

It's a simple way to maintain the interest rate differential with the Euro, making the CHF less attractive. However, NIRP punishes average savers and insurance companies promoting many to questions its helpfulness. Speculation that QE could be an option however, the lack of depth in Swiss bond markets (CHF67.1bn) and marginal effectiveness on influence CHF make this unlikely. Given the current environment the SNB will be comfortable to stay on the sidelines indefinitely. Only if a "shock" threatens the EURCHF exchanges rate will the SNB jump back with a policy response.



Economics**German Economy Suffers And ECB Is On The Dovish Side**

The first European economy is not looking that great. Over the past weeks, German data has provided quite a disappointment after July factory orders came in below expectations at 0.2% m/m vs. 0.5% m/m. Over the year, factory orders have shrunk by 0.7%. In addition, July industrial production was also very weak. Consensus bet on a quasi-flat print at 0.1% m/m but the figure was released in negative territory at -1.5% m/m. Germany's economic data is very troubling, especially when we consider that the country is the main driver of the Eurozone.

Europe's first economy is clearly decelerating and the benefits from the ECB's QE program remain to be seen. Since January 2015, the ECB QE program has topped 1 trillion euros in purchases. The program was set to cease once an adjustment in the inflation path occurred. For the time being, German and European CPI are at 0.4% and 0.2% y/y respectively.

Draghi has mentioned at the following ECB press conference last Thursday that inflation is set to remain low, exactly like in Japan. In terms of growth, the ECB has slightly raised its forecast for growth in 2016 to 1.7% from 1.6% but has revised down the ones for 2017 and 2018 (both to 1.6% from 1.7%). Mario Draghi has said that the Eurozone growth is weighed on by Brexit. But before the Brexit we cannot assert that everything was looking that good.

However, the ECB has maintained its rates unchanged as widely expected by markets. Some policymakers have recently expressed the concern that negative interest rates could be detrimental to the banking sector and put banking profits at risk, especially in the event of rates going even deeper in negative territory.

Surprisingly, Mario Draghi has not mentioned if the QE program will be extended beyond March 2017. When looking to QE in Japan or in the US,

it shows that a 2-year QE program is definitely not sufficient to stimulate growth and inflation. We are now in an era where central banks need to keep their credibility so revealing the less looks to be the new ECB strategy. Announcing too early an extension of the QE program could have been taken like an acknowledgement that the QE is not working as it should be. It would actually mean much about its inefficiency. And as a result, the free money party is set to continue for stocks and bonds investors.

As most of the other central banks, the ECB starts to be out of weapons. Indeed, the scarcity of bonds is making it increasingly difficult for the ECB to continue its massive asset-purchase program. Recently, bond yields have slightly risen, on renewed hopes that the end of free money will end by the Fed raising rates again. So this small rally is definitely supporting central banks and in particular the ECB. Still, those slight higher yields are certainly helping, for the time being, the ECB from having to add further stimulus.

At some point, we may consider other monetary policy tools such as buying stocks or helicopter money despite Draghi kept on repeating this has not been discussed yet amongst policymakers. Anyway stimulating the economy must be done or a great recession can be triggered.

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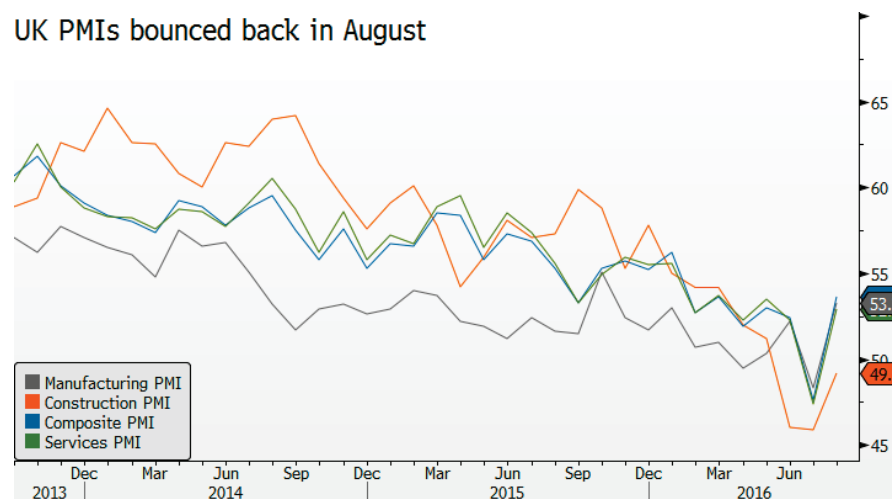
Solid UK Data Will Keep BoE Happy

The UK economy continues to send some incredibly good signals in spite of the Brexit vote and the release of a downbeat forecast that immediately followed the announcement of the referendum. Over the last few weeks, the Bank of England has gained a clearer insight on the effects of its interest rate cut and increase in its bonds purchase programme announced in early August. Economic data, from the industrial sector to the housing market, printed systematically above market expectations.

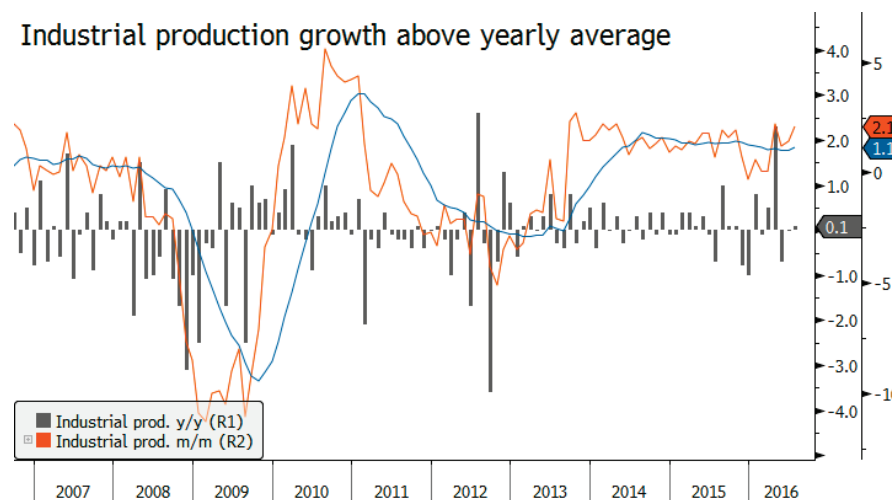
Nationwide, house prices rose 0.6% m/m in August, while the market was expecting prices to have contracted 0.1%. Markit manufacturing PMI crossed the 50 threshold, which separates growth from contraction, and printed at 53.3; up from 48.2 and above median forecast of 49. Similarly, Markit construction PMI ticked-up to 49.2 from 45.9, beating consensus of 46.3. Both services and composite PMIs came in at 52.9 and 53.6 respectively (versus 50 and 50.8 expected). Finally, industrial production expanded 2.1% y/y in July, above estimates of 1.9% and previous reading of 1.4%.

Next Thursday (September 15th), the BoE will give a first assessment of the change in monetary policy made in August. We do not expect any kind of excess optimism from the BoE as the pound sterling needs to stay weak in order to guarantee a smooth transition once the actual effects of Brexit begin to kick in. Moreover, the pound has been strengthening substantially over the last few weeks, gaining roughly 4% against the US dollar and the Japanese yen and 3% against other G10 currencies. We wouldn't be surprised if the UK did not effectively leave the EU this year, therefore we expect further GBP strength in the short-term, especially now that the Fed is backing away from an interest rate hike in September.

UK PMIs bounced back in August



Industrial production growth above yearly average



Economics

Policymakers To Speak Before Fed Meeting

Now that the ECB meeting is over, all eyes are on the next Fed meeting on 21st of September. For the time being markets are pricing in a small probability (28%) of a Fed rate hike. There is too little time left for policymakers to send hawkish signals that would allow markets to fully reprice a rate hike.

There will be many much-anticipated speeches over the next week such as those from Governor Lael Brainard, New York Fed President Dudley or Vice Chair Fischer. In our view, these speeches will, as usual, only provide mixed signals. We do believe that a rate hike will happen - at least not before year-end.

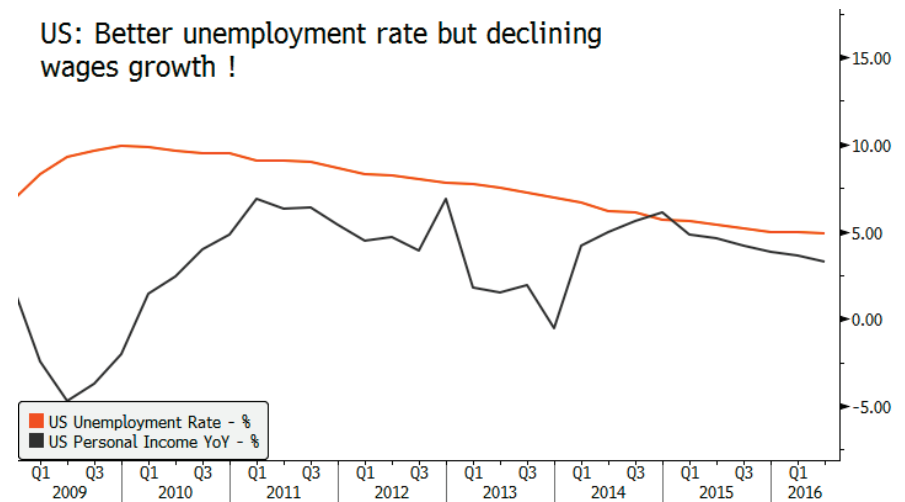
Currency-wise, the demand for dollar is going to increase as long as the Fed maintains its stance that a rate hike is possible in the near-term. The Fed has been sending hawkish signals for a while, with no real action being taken. Last December's rate hike was only a move for the credibility. Our research tends to confirm that the state of the US economy is completely overestimated and will stick with this view.

Recent data such as the ISM non-manufacturing & manufacturing report have sharply declined. The manufacturing sector is in contraction, while the non-manufacturing industry should soon contract according to recent data.

When looking at the unemployment rate and wage growth, it is clear that there is something wrong. Unemployment and wages growth cannot be so low at the same time. Full employment should push wage growth higher, which is not the case and is absolutely conflicting. The fact remains that the unemployment rate in the US is largely underestimated.

At the same time, US corporate profits are still subdued or negative. Equities are on the rise, but this is only because of the era of free money.

US: Better unemployment rate but declining wages growth !



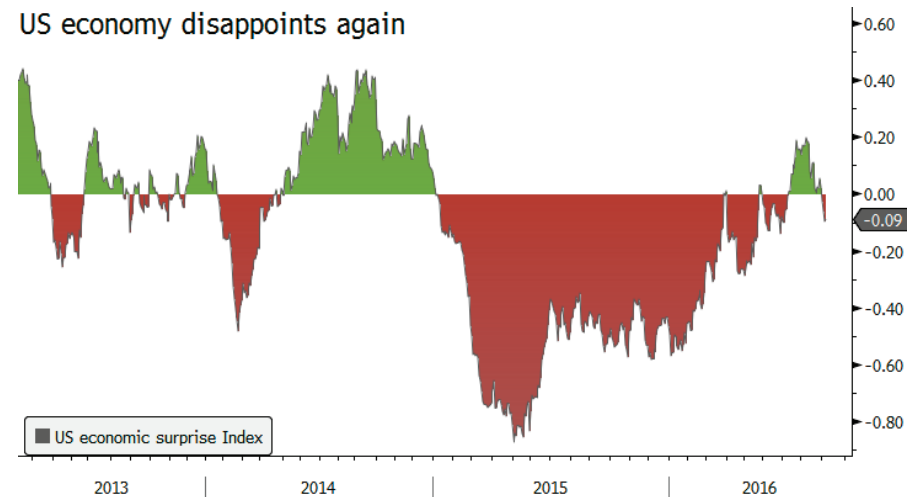
Economics
US Data Dashes September Hike Hopes

Over the last few weeks, the Fed has reiterated its motto that the US economy is on a firmer footing and that the case for monetary policy tightening has become stronger.

Unfortunately for most hawkish Fed members, the latest batch of economic data does not paint a very bright picture of the world's largest economy. After a brief respite over the summer months (mostly June and July), economic data has begun to surprise to the downside again. More interestingly, the jobs market, which was the mainstay of the Fed's economic recovery story, has been sending mixed signals which suggest that the job market is going through a period of stabilization rather than a period of expansion. In August, the US economy created 151k private jobs, missing estimates of 180k and well below July's figure of 275k. More worryingly, the negative trend seems to have accelerated over the last twelve months. Over this period, average monthly gains eased to 204k jobs, while over the last six months, monthly gains eased to 175 - compared to 238k and 211k a year ago. This trend reversal clearly suggests that America's best days are behind it.

Similarly, after a solid second quarter, the manufacturing industry went under renewed pressure in August with the ISM manufacturing printing below the 50 threshold at 49.4, down from 52.6 in July (versus 52.0 median forecast). Markit manufacturing PMI remained stable at 52.0 (versus 52.1 in the previous month).

Even before the release of the last batch of disappointing economic data, we had already ruled out a September rate hike. It is clear that it is now off the cards. On the other hand, December is still on the table, but there will need to be an improvement on the data side, unless the Fed will stand still.

US economy disappoints again


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