SWISSQUOTE

WEEKLY MARKET OUTLOOK

3 - 9 October 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

WEEKLY MARKET OUTLOOK - An Overview

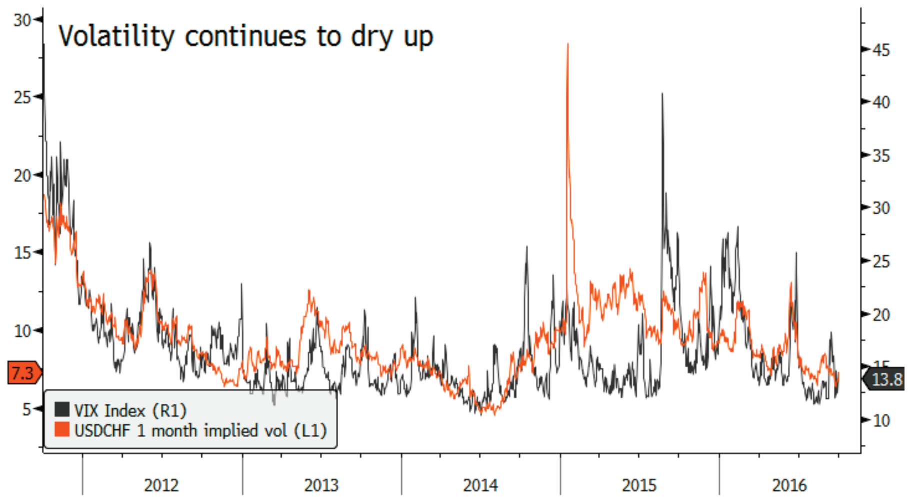
Economics

Risk Trades Still Look Attractive

Despite the slight steepening of global yield curves, carry-based EM trades remain attractive. Markets have a tendency to over analyze during periods of calm, searching for potentially disruptive forces. While remaining vigilant, it is highly recommended that there does come a point of acceptance. Yes, there are risks in the peripherals, but so far none look wide enough to derail the current risk-on sentiment. Politics has become the "hot" topic, with the US presidential cycle heading towards conclusion and renewed risks in Spain, but neither at this point, is market upsetting. If the markets can shrug off the potential fragmentation the world's largest economic union as the result of the Brexit vote, then we wonder what else it can handle. A Trump in the White House should not necessarily spell the end of days, although it would make them considerably queasy. We believe markets are currently in this so called "goldilocks" environment, and savvy traders should seize the opportunity. Even the current risk off sentiment which is due to the Deutsche Bank sell off should blow over as the DOJ is more likely to accept a small fine than be responsible for the collapse of Germany's largest bank and (potentially) another financial crisis.

With the risk of a Fed hike abating and questions swirling over the effectiveness of further easing actions, markets are well supported by steady monetary accommodative policies and increasing pressure for additional fiscal spending. Global growth should come in marginally north of 3.0%, but above any recessionary concerns. We should see a deceleration of growth in the US, Europe and UK yet, China and the EMs, led by Asia are rebounding. Regarding prices, while deflationary forces have receded marginally, inflation prices are weak at best.

On the market side, despite growing expectations for higher yields, on the short end there is scant evidence that this view will be realized, while any rally in yields faces a "wall-of-money" that has been stuck in negative yielding paper and dying to get out. Volatility across asset classes, but especially in FX markets has basically disappeared. Rogue waves of short duration volatility have quickly run into sellers, making for profitable mean-reversion trades.



Economics

OPEC reaches pre-agreement: End of the game of chicken

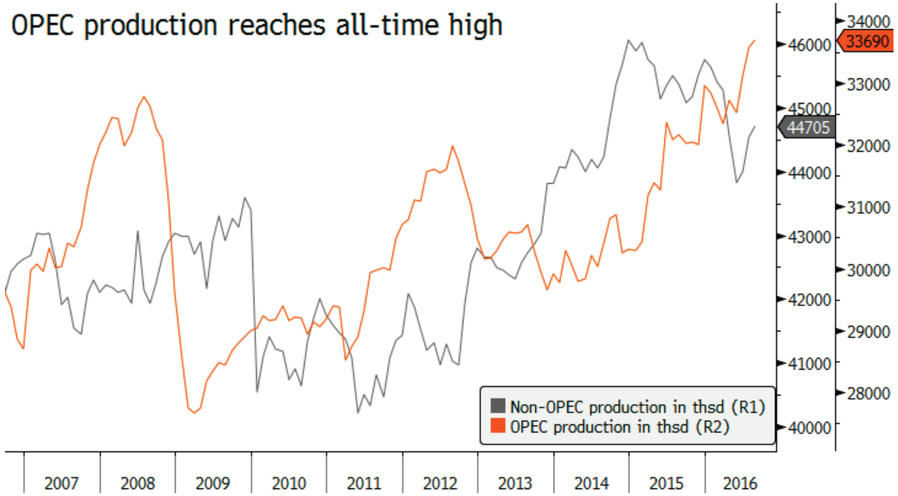
OPEC ministers reached an expected deal yesterday on the sidelines of the International Energy Forum in Algiers. After months of unsuccessful talks, it seems that the members of the intergovernmental organization are finally singing from the same hymn sheet. However, it is not a done deal as Iran has been consistently emphasizing that it wants to return to pre-sanction production levels, while Saudi Arabia is only willing to back a coordinated production cut if Iran cooperates. In our opinion, this is the one and only way to lift crude oil prices as the supply glut is here to last against the backdrop of a slowing global economy and the continuous development of less energy-intensive technologies.

On the data front, even if US rig count growth has stabilised over the past few weeks, the momentum is here. The same is true for US crude oil inventories which have been shrinking significantly over the last four weeks; inventories are still flirting with all-time highs. Last week, US stockpiles shrank by 1.9mio barrels to 501.7mio barrels versus an expected increase of 3mio barrel. The drop was however offset by a sharp increase in gasoline stockpile, which suggests that less crude will be refined.

The pre-agreement between OPEC members may be the signal that the market has been waiting months for. Indeed, at first glance, it looks very promising but we remain suspicious as there is nothing binding in the agreement, which is nothing more than a declaration of intent. True, the oil ministers agreed to cut production to a range of 32.5mio to 33mio barrels a day (in August OPEC production reached 33.69mio barrels a day), but the agreement says nothing about who will take the cut or how it will be divided. Therefore, we remain cautious concerning the effects of an actual trim in production, especially in view of the OPEC's history of consistently failing to reach a consensus.

It will however be the best solution to quickly life oil prices as the demand outlook looks rather subdued. It is very interesting to draw a parallel between what is happening in the FX market, i.e. the global central bank currency war to revive inflation and boost growth by devaluating respective currencies, and the situation at OPEC, where none of the members is actually willing to take a cut and instead waits for someone else to make the first move. In the best case scenario, OPEC should also coordinate an output cut with non-OPEC members such as Russia in order to make the cut more effective.

OPEC production reaches all-time high



Economics

Kuroda On His Toes

It feels as though the Fed and BoJ have now left the building. After last week's market friendly monetary policy action (or non-action), it seems as though central bank credibility has hit a new low, just like the FX market's sensitivity to their comments. Despite a heavy speaking schedule, comments by Yellen, Draghi and Kuroda that only a few days ago would have had volatility swinging, were simply shrugged off. Instead, the news cycle was filled with second string stories of Deutsche Bank stock collapse, OPEC micro supply tuning and the US presidential debate, which hardly managed to fill the void. With no central bank manipulations we anticipate that USDJPY will trade down to 100 in the near term.

US 2-year yields are range bound with real yields falling as expectations for higher inflation on the back of strong oil prices. The probability of a December interest rate hike has increased to 57% as US data continues to firm. However, traders are unlikely to follow the carrot after a whole nine months of bait and switch. In addition, there are signals that the US economy is heading into a soft patch. At Yellen's semiannual testimony before the House Financial Services Committee, there followed the usual pattern of defending a Q4 rate hike, yet stating that there was no "fixed timetable". Even Fischer's speech, which highlighted the risk of misallocation of capital should interest rate remain ultra-low failed to significantly drive hike expectations. Without the threat of an impending rate hike and our desk view of a no hike in December, it is likely that the USD will remain a funding currency.

Kuroda emphatically stated that the BoJ will adjust policy when necessary and that this may include the expansion of monetary policy. However, his comments simply fell on deaf ears. The BoJ's comprehensive assessment saw the focus of its easing strategy go from size domination to negative rates with yield curve control. While the tactic of negative rates looks to have the desired currency effect, judging from the European and Swiss experience, we expect JPY appreciation to slow but not stop. Even an interest rate cut in November (which we do not expect) is unlikely to reverse the bearish trend. Prime Minister Abe, in front of parliament, stressed the working partnership of the government and the BoJ indicated that tighter coordinated fiscal and monetary policy is likely the next response.

Economics

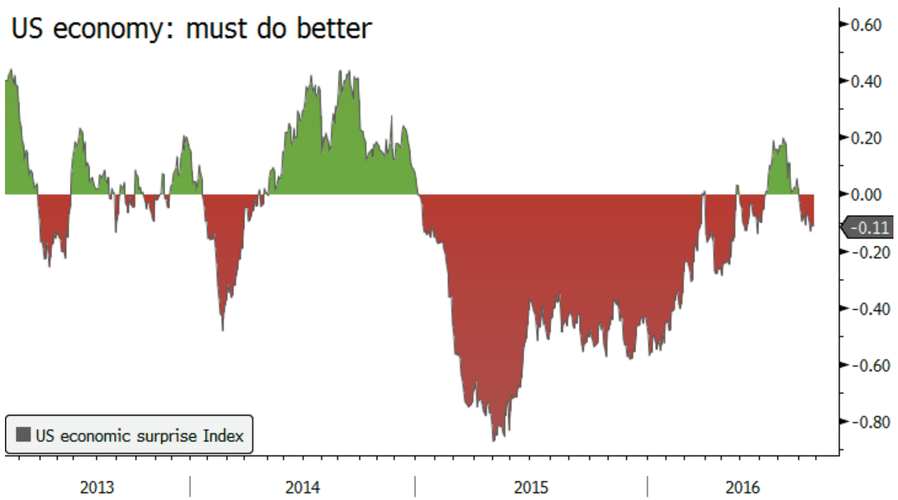
US Data To Take The Main Stage

It has been more than a week since the Federal Reserve decided to leave interest rates unchanged. Since then, the US dollar has been unable to reverse the negative momentum as market participants continue to lower rate expectations. The probability of a December rate hike, as extracted from the Fed fund futures, has dropped below 50%, while the market has completely ruled out a November hike. Just like the Fed, the market attention is turning to economic releases to gauge the likelihood of rate hike before the end of the year.

Last week was a busy one in term of economic data. The preliminary Services and Composite PMIs were slightly encouraging but nothing to get carried away. Markit services preliminary PMI for September rose to 51.9 from 51 in the previous month, slightly above the market's expectation of 51.2. Preliminary composite PMI ticked up to 52 from 51.5. Growth figures were release on Thursday with the third estimate on second quarter GDP printing slightly above the median forecast. The US economy expanded at an annual pace of 1.4% in Q2, beating the median forecast of 1.3%. On the other hand, personal consumption was revised slightly lower to 4.3% q/q (seasonally adjusted annual rate) compared with a prior estimate of 4.4%. US growth is clearly being driven by consumer consumption with personal and household consumption setting the pace.

Finally, personal spending and income came in roughly in line with expectation in August, printing at 0.0%m/m and 0.2%m/m respectively (versus 0.1% and 0.2% consensus). On the inflation front, the Fed's favourite gauge of inflation, the core personal consumption expenditure measure, matched forecast, coming in at 1.7%y/y compared to 1.6% in July.

Overall, we expect that US data will continue to point toward a slowing economic activity in the third quarter, which could eventually put a December hike in jeopardy. Nevertheless, we wouldn't be surprise if the Fed pushed the button in December even though the data is not strong enough. Indeed, just like it did last year, a slight increase in the interest rate would be a small concession, but nevertheless necessary to send a much-needed signal of confidence.



Economics

SNB Steps In To Protect CHF

The current worries hanging over the European financial sectors is the absolute worst thing for the SNB, which had been praying for risk appetite to remain firm. The natural weakening of the CHF had been working well for the SNB, which had exhausted much of it policy firepower. While we have no direct conformation from the SNB, anecdotal evidence suggests that the rogue spike was actual intervention. What we do know for sure is that the SNB is already steadily intervening to smooth out drops in EURCHF and dissuade heavy speculation. We also know that the recent demand for safe-haven currencies, triggered by Deutsche Bank concerns, is especially acute in Euro holders, which has negated much of the work the SNB policy has achieved over the last 3 months. The SNB wants to reverse expectations that the CHF is the ideal regional risk-off trade before the trade gains more traction. The SNB has made their stance perfectly clear, that they stand ready to protect the CHF from further appreciation, with unlimited firepower. Traders should remain vigilant - further declines in EURCHF will risk additional intervention.

Swiss UBS consumption indicator for August climbed unexpectedly to 1.526 from 1.45 (revised from 1.32) the highest level since 2014. The indicators surge was due primarily to the recovery of tourism and higher car sales. However, the weak labor markets conditions were a drag on the positivity of the report. The excellent summer weather encouraged domestic tourism as overnight hotel stays increased 1.6% m/m (yet overall hotel stay in Switzerland decrease -0.4% m/m and -1.0% y/y). Worryingly, foreigner overnight hotel stays fell -2.0% m/m (-2.4% y/y) clearly indicating the CHF lack of competitiveness is having a corrosive effect on travelers behaviors. September has also be unseasonable warm and dry suggesting that domestic tourisms should continue to remain supportive of strong Swiss growth. Swiss GDP growth is running at accelerating 2.0% y/y pace.

However, unless the labor markets can improve and shake the uncertainty there is little hope that the consumer sentiment meaningfully contribute to improvement. The SNB will continue to remain reactive to macro-conditions that could further strengthen the CHF. However, the IMF suggestions to halt direct FX intervention and defend the currency buy moving deeper into negative rates will likely be ignored. Despite the SNB well circulated view that negative rates have been effective its clearly taking a toll on banks and private savers. Removing the political motivations for more cuts unless absolutely necessary.

DISCLAIMER

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Swissquote Bank and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions, or regarding the accuracy, completeness or reliability of the information contained herein. This document does not constitute a recommendation to sell and/or buy any financial products and is not to be considered as a solicitation and/or an offer to enter into any transaction. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or in any other kind of investments.

Although every investment involves some degree of risk, the risk of loss trading off-exchange forex contracts can be substantial. Therefore if you are considering trading in this market, you should be aware of the risks associated with this product so you can make an informed decision prior to investing. The material presented here is not to be construed as trading advice or strategy. Swissquote Bank makes a strong effort to use reliable, expansive information, but we make no representation that it is accurate or complete. In addition, we have no obligation to notify you when opinions or data in this material change. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments.

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient’s individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning Swissquote Bank, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. Swissquote Bank does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are for information purpose only and are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Swissquote Bank as a result of using different assumptions and criteria. Swissquote Bank shall not be bound or liable for any transaction, result, gain or loss, based on this report, in whole or in part.

Research will initiate, update and cease coverage solely at the discretion of Swissquote Bank Strategy Desk. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. Swissquote Bank is under no obligation to update or keep current the information contained herein and not liable for any result, gain or loss, based on this information, in whole or in part.

Swissquote Bank specifically prohibits the redistribution of this material in whole or in part without the written permission of Swissquote Bank and Swissquote Bank accepts no liability whatsoever for the actions of third parties in this respect.