WEEKLY MARKET OUTLOOK

28 November - 4 December 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

Copper Leads Base Metal Rally

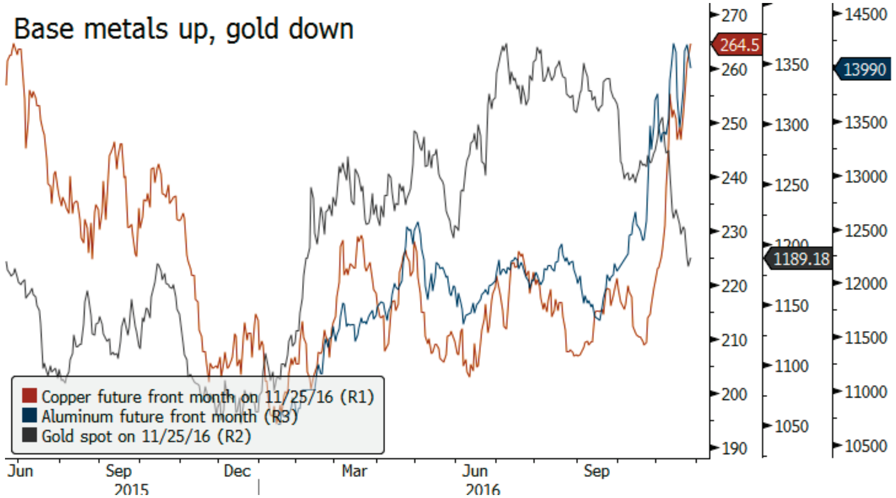
Metals continue to rally amid speculation of a President Trump infrastructure spend and declining global inventories. Copper reached a one-week high and is challenging levels not seen since the base metal complex collapsed. In Friday Asia, trading copper front month reached $269.90, just $5 short of the recent high. However, the factors driving the metal feel extremely strapped.

Investors are betting that the US president-elect's generous fiscal spend (expect close to $1trn) will drive growth and lower supplies due to China buying the metal as a yuan hedge. In addition, the bullish momentum has triggered demand from trend following funds, increasing buying pressure. Paradoxically, despite the strong USD, industrial metals continue to trade higher. Yet, as with much of this rally, the fundamentals rationale remains extremely weak in our view.

With traders looking at the world through fiscally-enhanced lenses, the marginal US data is now perceived as robust. Yes, the recent durable goods order increase of 4.8% was a solid read, yet leading indicator such as new home sales flattened -1.9% m/m, prior to election uncertainty and the recent rise in mortgage rates. Therefore, we are hesitant to forecast an increase in long-term inflation expectations on Trump's potential fiscal stimulus (which is actually, far from a sure thing). Secondly, while the Chinese are buying up copper as a hedge against yuan depreciation, data indicates that supply growth will remain high.

Also working against the current price rally are rumours that ShFe will raise margins and trading limits on most base metals (including copper, lead, nickel, zinc, tin and aluminium).

Without real demand coming into the market, we believe that the current rally is speculative and unsustainable. We would see the rally in base metals as on opportunity to reload on short commodity trades.



Economics

OPEC Meeting To Take Centre Stage

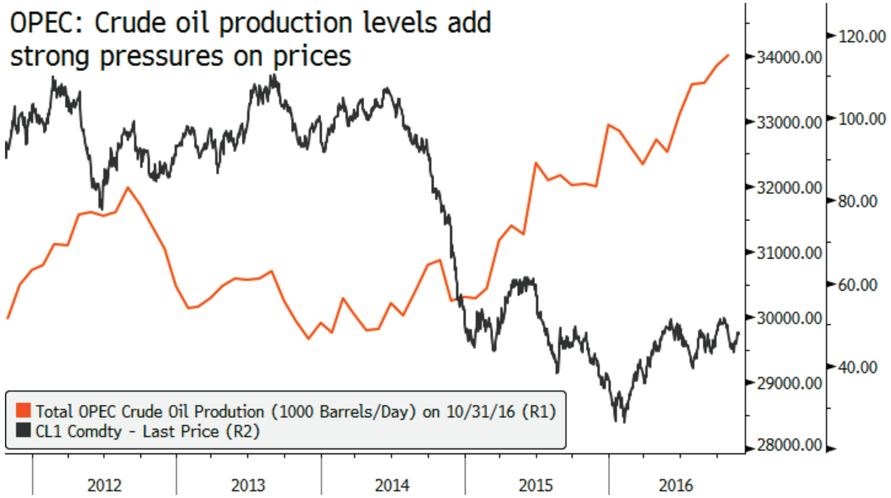
OPEC is certainly going to be next week's hot topic. On the 30th of November, we will know whether OPEC members have managed to coordinate a deal to freeze production. Saudi Arabia is pushing to convince other members to cut production to around 4%. Expectations that the supply glut could be reduced has sent crude oil higher. The commodity is recording its second consecutive weekly gain - above 47$ a barrel.

In our view, it seems difficult that the OPEC will reach an agreement as geopolitical uncertainties have been significant since Trump's election. First of all, we believe that president-elect Donald Trump will follow through on his decision to render America energetically independent or at least he will push towards this direction. American drillers should benefit from this political view and we believe that shale gas is set to become more attractive. Trump's plan for day one is to fire up US shale gas. This is why the oil oversupply is far from over.

Secondly, Trump's policies are likely to boost interest rates and one major consequence will be a stronger dollar. As a result, there are downside risks for emerging markets for which a stronger dollar is definitely not great news, in particular for their oil demand as oil would become more expensive. This is why we feel that the OPEC is going to be reluctant to freeze production as it is perhaps too early to predict the real impact of EM demand regarding US policies.

Thirdly, another question that still needs to be answered is what foreign policies Trump will apply, in particular in the Iranian case. The strongest hypothesis for the time being is that the nuclear agreement reached in 2015 will be ripped up, in which case Iran would face renewed sanctions. Iran is now facing a difficult choice at the OPEC meeting, either agreeing on cutting production and not being able to produce enough oil before new sanctions arise, or refusing any cut knowing that US shale gas has become more attractive.

The geopolitical context is very mixed. At the OPEC meeting, Donald Trump will remain at the centre of the debate and we believe that the intergovernmental organization will wait for the start of Trump's presidency in order to better assess the geopolitical tone of the next four years. As a result, crude oil prices should adjust lower next week.



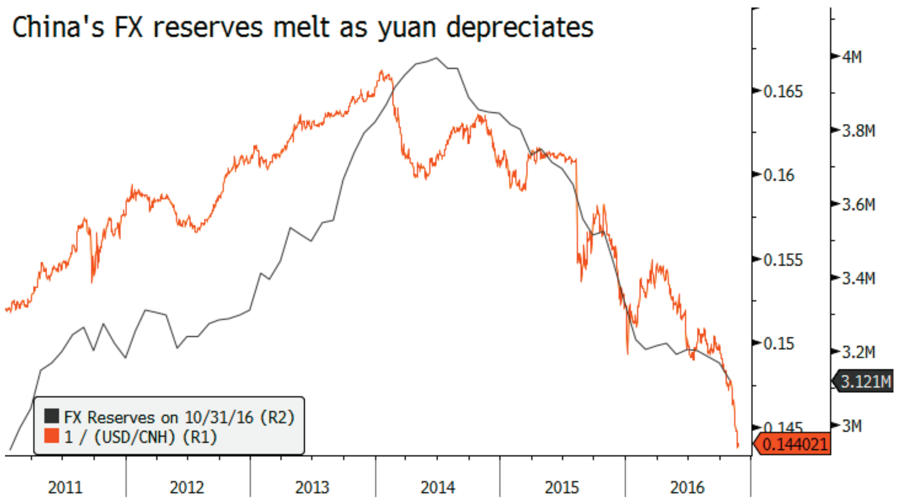
Economics

Chinese Yuan In Freefall

Since Donald Trump's election, the Chinese yuan has suffered a massive sell-off in expectation of tougher trade relations between the world's two largest economies. Indeed, the US is China's main trade partner, representing more than $480bn worth of exports (2015), while the US imports "only" $145bn worth of Chinese products. Therefore, growing protectionism under a Trump presidency could significantly hurt the Chinese economy, which is still heavily export-dependent in spite of the recent efforts to shift toward a domestic consumption led growth.

Needless to say, the imposition of punitive tariffs on Chinese imports would also have significant implications for the US economy. For now, they are just words and the market is still trying to estimate how far Trump will go and in fact, whether he will actually do anything at all. Indeed, since November 9th, president-elect Trump has already begun to soften some of his initial positions, namely those concerning Obamacare and immigration. This uncertainty is adding to the yuan's woe as it accelerates the sell-off and added pressure on the PBoC, which is already struggling with capital outflow. Indeed, the CNH is continuing its freefall against the greenback with USD/CNH hitting 6.9654 last Thursday, while China's foreign-exchange reserves melt like snow under the sun. In October, the reserves shrunk $45.7 billion or 1.44%, down to $3.12 trillion, the lowest level since March 2011. There is no doubt capital outflow will continue over the next few, the question is how fast. It is important to notice however that a big part of November's drop was due to valuation effects. Given the sharp depreciation of the yuan in November (-2.40% against the greenback), we expect the reserves to have taken another hit in November. There is no doubt capital outflow will continue over the next few months, the question is how fast.

As we head into 2017, we expect further yuan weakness as the country will continue to face slowing exports and capital outflow. Moreover, tougher trade relations with the US could darken the bigger picture.



Economics

Germany: Significant Speculation On The Bund

The situation of the first European economy always reflect underlying economic difficulties of the European Union. Last week, plenty of German economic data have been released, notably Q3 final GDP, which printed exactly in line with preliminary data. No revisions were made and the economy strengthened 1.5% y/y but only expanded by 0.2% q/q. The German recovery looks mixed.

German business confidence remains unchanged according to the IFO Business Climate survey for November. The Trump's election has not changed much the view regarding the business situation in Germany. Private consumption also rose during the third quarter to 0.3% q/q. Nevertheless, we think that the economic data is not sufficient to push the euro higher for the time being, indeed the ECB remains largely dovish.

German yields are in an upward trend and 10-year bund yields are stalling below 0.25%. At the same time, 2-year German yields have dropped to record-lows. Indeed there are strong speculations that the ECB will tweak its asset-purchase program in order not to run out of bonds. Markets are therefore not focused on data but on central banks. We are in an era where economic data plays second fiddle to central bank policy. In our view it is very likely that the ECB will allow itself to buy bonds with yields below the depo-floor (-0.4%), which explains the current speculation of the German 2-year bund.

In the near-term we may wonder as well what will be the impact of a potential Brexit along with Trump's victory. Germany exports to the US amount for $173 billion for 2015 which represents around 13% of the total exports. The protectionist measures could threaten up to a million jobs in Germany in case strong protectionist measures are implement in the US according to IFO institute estimates…

Economics

Switzerland: A Catch Up

After surging 5%m/m in September, Swiss exports contracted significantly in October, falling 4.7%m/m in real term amid further contractions in watch (-25.5%), jewellery (-12.3%) and machine & electronics manufacturing (-5.6%) exports. On the other hand, pharmaceutical and chemical industries recorded the biggest surge in exports and helped to partially offset the drop in other sectors. Pharma exports grew 7% m/m in October. Compared to October 2015, working day-adjusted real exports contracted 3.3% as pharma went down 3.3%, machine & electronics manufacturing contracted 7%, watchmaking was off 17.8% and jewellery slid 30%.

Imports rose across the board in October with 10 out of 12 sub-groups growing. Real exports surged 2.8%m/m, led by pharma (+19%) and textile & clothing imports (16%). Compared to October 2015, working day-adjusted real imports grew 3.7%. All in all, the strength of the Swiss franc continued to provide a boost to importations, especially from the eurozone. On the other hand, exports' growth to were subdued. In spite of the recent positive trend in exports, we still expect a cloudy future for Swiss exports, especially due to the strength of the Swiss franc.

On the bright side, Swiss industrial production rose 0.4% from a revised lower -1.3% y/y, while industry construction output increases 1.1% from a revised lower -1.9%y/y. After a weak 2015, industrial data is finally trending nicely higher. The stabilisation of the CHF has elevated some of the exchange rate fears that have dominated sectors such as luxury goods. SNB verbal intervention continued with the SNB's Maechler stating that the central bank stood ready to "act if needed". While the USD rally has lessened, pressure on the CHF and the long USD/CHF trade has become a favourite for yield differential traders. With the Fed shifting towards further normalization and the SNB keeping interest rate negative negative indefinitely (Maechler mentioned that weak CPI data indicated that current policy was appropriate), the trade feels like a sure bet. Interestingly, Maechler mentioned that the SNB was ready to act over the Italian referendum. Italy is expected to vote on constitutional reforms on Dec 4th and the resulting uncertainty could trigger significant FX volatility. CHF continues to provide a strong trade in calm markets but remains the safe haven trade of choice for most geopolitical disturbances. Looking at the 2017 calendar (especially the European risk events) it is hard to forecast one directional CHF weakness. In addition, in the mid and long term we remain bearish on USD on expectations that the Fed normalization cycle will peak at 1.5%, rather than the 3.0% the Fed forecasts.

After the US election, EUR/CHF tested the 1.07 threshold many times but never broke it to the downside. The rise in domestic sight deposits (+CHF5bn) suggests that the SNB stepped in to protect the franc. The pair returned to 1.0740 last week; however given the significant political risk in the eurozone over the next year, we do not expect this pressure to ease yet.

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