SWISSQUOTE

WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

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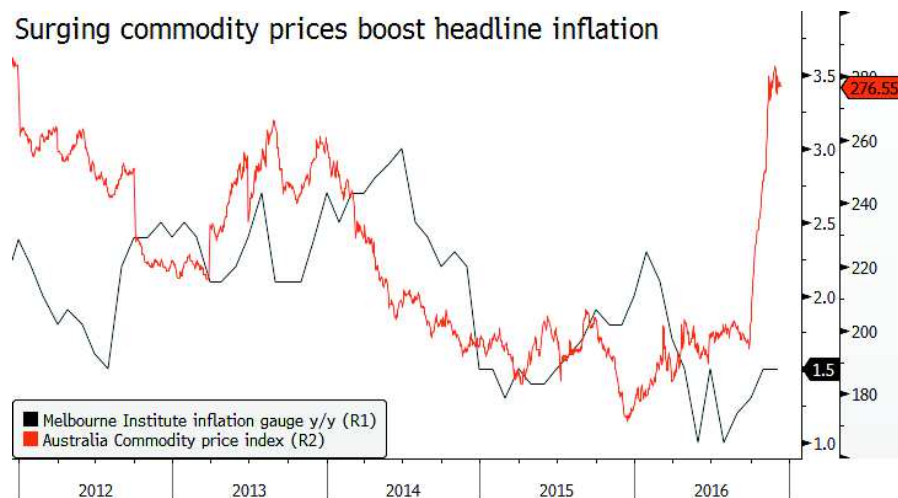
Economics

Mixed Outlook Keeps RBA Side-Lined

After testing the key resistance at $0.7489 (Fibonacci 38.2% on November debasement) - this is the second time in the past week that AUD/USD failed to break the latter resistance to the upside. The Australian dollar accelerated its fall after the Reserve Bank of Australia decided, as broadly expected, to leave its cash rate target unchanged at the record low of 1.50%. The central bank's governor, Philip Lowe, made some minor changes to the accompanying statement, reiterating that the economy is "continuing its transition following the mining investment boom" and adding that even though the unemployment rate has improved this year, "labour market indicators continue to be mixed" as part-time unemployment remains significant.

On the inflation front, Governor Lowe maintained his cautious approach as the "subdued growth in labour costs" casts a shadow on the inflation outlook. The latest official inflation report, released at the end of October surprised slightly to the upside (1.3%y/y versus 1.1% expected). However, with the market expecting a contraction in GDP growth in the third quarter (-0.1%q/q versus 0.5% in the June quarter), core inflationary pressures should have remained subdued in the September quarter - most of the lift may come from the rise in commodity prices.



In the foreign exchange market, the Aussie is most likely to suffer in the month ahead as traders shift investments towards the US. Indeed, over the last few months, investors across the globe have struggled to find higher returns, which has prompted them to load on risk, lifting high quality commodity currencies such as the Aussie and the Kiwi but also emerging market currencies on a broad basis. Nevertheless, the party may be over for higher yielding currencies as the US yield outlook shows signs of improvement. We therefore believe that the risk is on the downside in AUD/USD against the backdrop of another rate cut from the RBA.

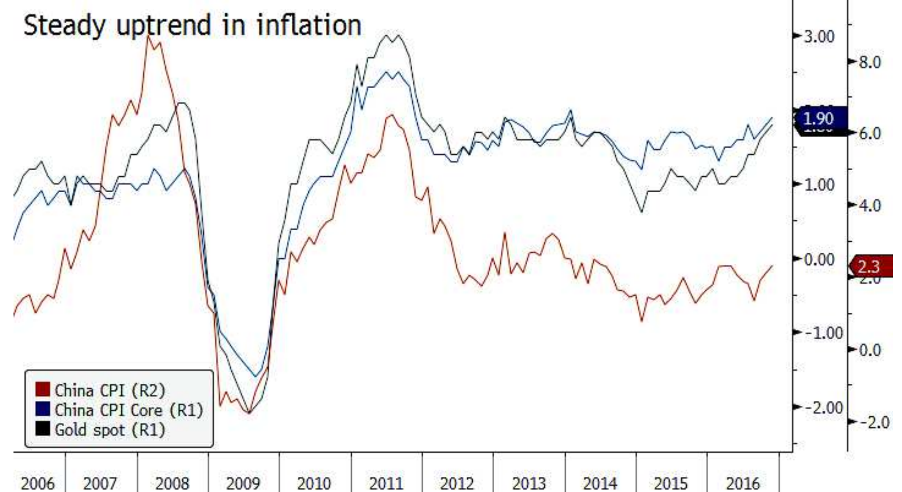
Economics

China's Economic Stabilization

Quietly China economic conditions are showing signs of further recovery. While financial markets have been focused on China's rapidly declining reserves and speculation for additional RMB devaluation, economic stabilization is now firming. The PBoC reported that total November FX reserves stood at $3.052trn, versus $3.121trn ($69bln decline). China's CPI inflation continued to trend higher in November climbing up 2.3% y/y from 2.1% in October. PPI inflation jumped to 3.3% in the same time period indicating the quickest pace increase since January 2010. Consumer non-food inflation was heavily influenced by housing prices which rose 2.0% nearly a three year high. Producer price surges were due to a rally in commodity prices and strong domestic demand. China November commodity imports surged across the board (crude oil, copper & iron ore and coal recorded big increases) indicating economic strength in the industrial sectors. Combining today's inflation read with improving trade data and better PMI (including export order components) reads there are clear signs of stabilizing growth and potential for GDP to surprise to the upside. In USD terms, exports increased 0.1% y/y, from a dismal -7.3% in October, reversing more than a year of contraction. Interestingly, China's trade with US, Japan and Europe all improved significantly. Current expectations point to Q4 GDP 6.4-5% which seems low considering the improvement.

In regards to monetary policy, the depreciation in the RMB and upward trend inflation suggest a mild tightening stance. Given our single 25bp hike for the Fed in 2017, it is unlikely that the PBoC will adjust the benchmark interest rates. However, should the Fed normalization path steepen or "Trumponomics" trigger further unstable capital outflows from China we could anticipate a rate hike.

The PBoC will stay focused on managing pressure on RMB through direct FX intervention and pushing up borrowing costs among other micro-tuning methods. As for the RMB, we are less negative on the currency than the street due to under appreciation of the current economic recovery and the importance of currency "optics" to China. Heading toward a clear showdown with US President Trump, China is likely to control further depreciation in order to look less culpable. In the mid-term we would be seller of USDCNH, content to pick up the yield differential.



Economics

Italy Says No, ECB Still On The Dovish Side

It was clear that against a backdrop of global crisis, Italy would defy its government and not allow it the chance to apply European austerity policies. Matteo Renzi has made a wise decision by announcing his dismissal as he does not represent what Italians want.

Some are calling the result of the referendum as the third surprise of the year after Brexit and Trump's election. There is a definite pattern here. It is certainly not the case that Italians do not want any change but what is sure is that they fear the possibility of becoming the new Greece.

It is now going to be very interesting to assess any consequences of this result. Italian banks are already suffering as markets begin to price in the lower likelihood of a bailout. From our point of view, the bailout will happen regardless as the Eurozone simply cannot allow the Italian banking sector to collapse, especially as this would have consequences for other European institutions.

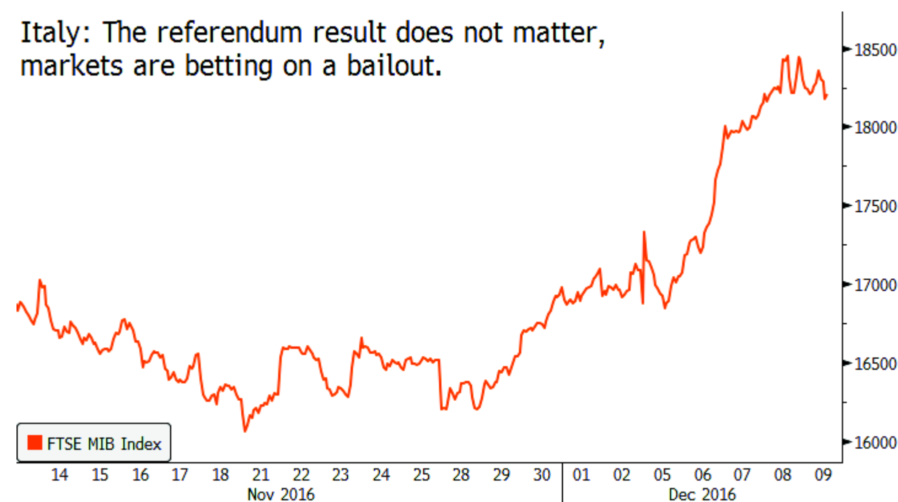
The single currency is at such a weak point that with every new referendum, rumours of tension and collapse resurface. This is a trend that will weigh heavily on the Eurozone throughout 2017.

However, the tensions felt by the single currency are ironically helping the European Central Bank in the currency war against the US dollar. At the last ECB meeting, Mario Draghi announced the extension the QE programme until December 2017 and the pace of the asset purchase is going to be lowered to €60 billion euros each month.

Over the last few months, the ECB was on a wait-and-see mode. Financial markets knew that the bonds scarcity would become more of a problem. And this is why the ECB attempted to address the rules regarding the type of bonds it may buy under its QE programme. There is not the possibility to buy bonds with rates below the depo-floor of -0.4%. However, the institution cannot own more than 33% of a country's debt.

The ECB is doing whatever it takes to paint everything in a dovish light. This is why the ECB extended the QE duration while lowering the pace of the purchase.

Currency-wise, we believe that the upside risk on the single currency remains somewhat limited and we may see a further test of the area between 1.08 and 1.09. Nonetheless, markets look optimistic regarding the US outlook for the end of this year and the EURUSD pair is clearly oriented downwards.



Economics

Investors Already Looking Into 2017

First the ECB...

The US dollar was the big winner yesterday amid the ECB's decision to extend its quantitative easing programme as it surged on a broad basis with the dollar index gaining 1.40% up to 101.20 last Thursday, while the single currency fell 2%. The European central bank announced an extension of its QE by nine months until December 2017 but trimmed the monthly purchase target to €60bn per month from €80bn. In addition, Mario Draghi eased the buying rules, allowing the purchase of bonds yielding below -0.4% - the current ECB's deposit rate - and extending the maturity range for eligible securities. Together, all those measures may be seen as the beginning of tapering; however we believe the ECB is more concerned about potential liquidity issues, which would explain the lowering of the size of the QE. But to mitigate the negative impact this QE reduction would have had on the market, he announced the two latter measures, preventing a sharp EUR appreciation, and argued that it was mostly due to the fact that deflationary risk had largely disappeared. EUR/USD fell 2% to 1.0610 after the announced and has been trading trendless around that level since then.

... Then the Fed

The December meeting of the Federal Reserve has been long awaited as it was seen as the only opportunity for an interest rate hike. The Fed has therefore done the job and prepared the market for this move. We believe that the upcoming tightening move is fully priced in, meaning that the Fed could only disappoint should Janet Yellen send some dovish signals at the press conference that follows the rate decision. The "Trump effect" is also slowly fading as market participants realised it will take months, if not years, for the upcoming US president to give life to its campaign promise. All in all we believe that the dollar rally is coming to an end as downside correction is becoming more and more likely. Be ready for dollar weakness as we start 2017.

Themes Trading

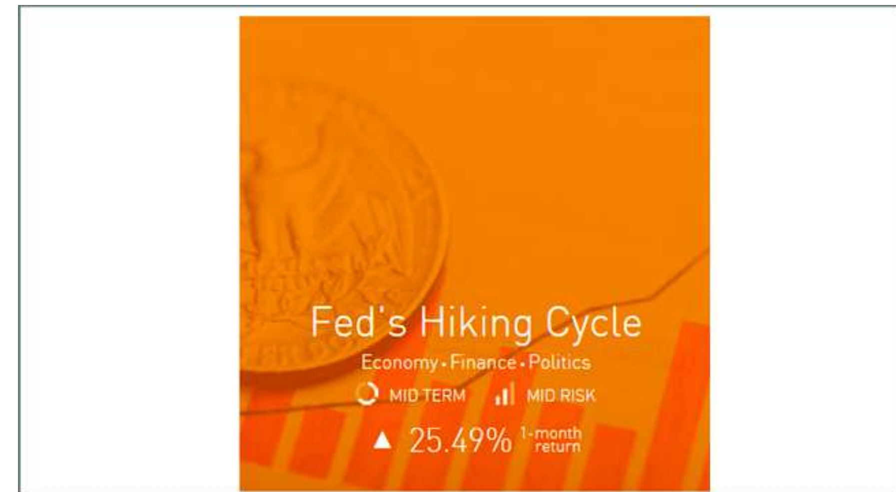
Feds Hiking Cycle

After nearly a year since the US Federal Reserve's last interest rate hike, members are likely to raise the fed fund rate another 25bp in December 2016. While so far the Feds path of "normalization" is significantly shallower then historical tightening cycles, forecast are increasing for a multiple hikes in 2017. Most analysts expect a tighten cycle to end with rates at 2.0 – 2.50%, so still more room for additional hikes. Comments by the incoming US President Trump suggests fiscal stimulus and tax reform could accelerate growth and inflation pressure, forcing the Fed to become more aggressive in tightening monetary policy.

To support the fragile US economy, the Federal Reserve had held short-term interest rates close to zero since the 2008 financial crisis. But many – including the Fed – believe the time had come to raise rates. An uplift in rates and shifting of the yield curve should create clear winners in the stock market. In theory, a rate rise should be negative for stocks as their value relative to bonds decreases. But recent history suggests that, since tighter policy indicates an expanding economy, stocks respond positively to rising rates. However, not all stocks benefit equally, so it's important to choose the right ones:

We put together this theme by filtering on US banks, payroll processors and insurance companies whose revenue is positively correlated with interest rates.

https://www.swissquote.ch/url/investment-ideas/themes-trading



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