SWISSQUOTE

WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

Stay Cautious On USD Outlook

As widely expected, the FOMC increased interest rates by 25bsp, raising the target range for the federal funds rate to 0.50% - 0.75%. After weakening substantially ahead of the decision, the US dollar appreciated against most of its peers as Fed Chair Yellen unveiled a hawkish shift in the dots chart. Indeed, the market had plenty of time to price in the second interest rate hike of the cycle, exactly one year after the Fed started the normalisation process. However, the market only expected two interest rate hikes in 2017, while the Fed dot plot showed that a third tightening move was expected by the committee.

Looking at the statement, the committee made some minor changes, mostly hawkish ones, as it acknowledged the recent improvement of realised and expected labour market conditions and inflation. The unemployment rate dipped to 4.6% in November and reached what the Fed calls "structural" unemployment rate. In addition, the inflation outlook has improved substantially (even before the election of Donald Trump) with the core personal consumption expenditure measure continuing to drift higher (1.7%y/y in October), while the headline measure rose sharply amid a recovery in commodity prices.

In spite of this hawkish shift in the expected path of Fed policy in 2017-2019, we think it useful to recall that just like this year, the path of policy will be data-dependant. And according to historical data, the Fed has been most of the time pretty inaccurate when trying to predict its own monetary policy path. Remember that Fed members expected four rate hikes this year. Therefore, we believe that the market is once again getting ahead of itself (thanks to Trump who has boosted market expectations with his unknown fiscal stimulus plan) and has become overly optimistic on the US outlook against the backdrop of mixed economic data and highly uncertain political outlook.

Indeed, recent economic data has been rather disappointing and has failed to confirm the good figures released in October. In November, the improvement in the unemployment rate was mostly due to a drop in the participation rate which returned to 62.7%. Average hourly earnings contracted 0.1%m/m, while on a year-over-year basis the gauge eased to 2.5% from 2.8% in the previous month. Headline retail sales widely missed consensus, rising 0.1%m/m versus 0.3% expected, while the measure excluding auto and gas rose 0.2%m/m versus 0.4% expected. Finally, industrial production contracted 0.4%m/m in November which brought the 6-month average close to negative territory, suggesting that there is still substantial slack in the sector. A stronger could therefore only worsens the situation as it would dampen US exports and make foreign goods and services cheaper, which means that the US would import deflation.

Economics

Russia: CBR Held Rates But Hinted At A Rate Cut For 2017

Last Friday the Central Bank of Russia has released its key rate and as markets expected, it will remain unchanged at 10%. In our view, we expected the CBR to cut rates by 50 basis points to 9.5% due to several recent signs of improvement in Russia and in particular because of a strong ruble. The first of these is inflation, which has dropped to 5.7% from 6.1% since the end of September. The CBR still expects to reach 4% by the end of 2017, which means that Russian policymakers are likely to start a new easing cycle by next year. Indeed, they have hinted for a rate cut in early 2017.

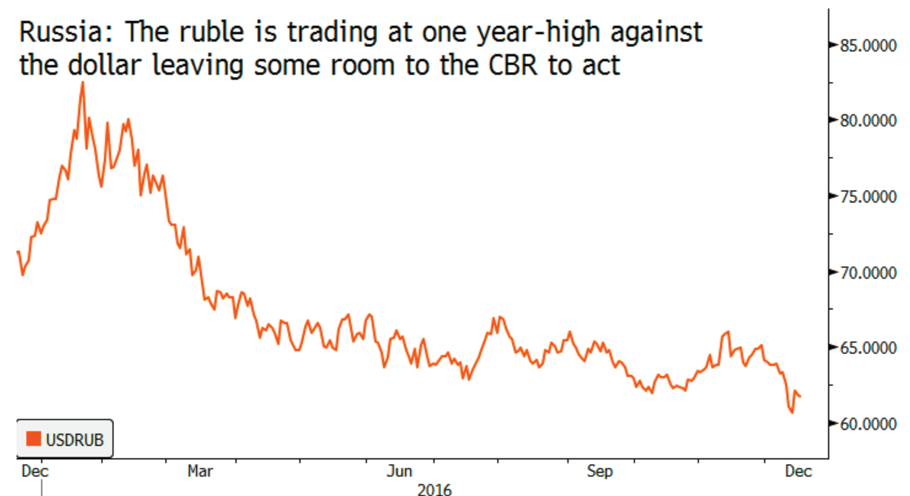
The fundamentals remain somewhat fragile. Even though the inflation is on its way down, the pace of decline still seems unpredictable, especially since consumer price growth is slowing down. Anyway, the consumer price index for food products has risen by 6% y/y in October.

It is also true that Russia is still suffering with an economic growth of -0.8% yield-to-date. Nonetheless, since oil prices recently largely appreciated, the economy may have expanded on an annualized basis which would also support a normalization path of the interest rates. The Russian institution even forecasts a GDP of 1.5% and 2% in 2018 and 2019 respectively.

Geopolitically, the situation looks better. The US sanctions towards Russia should be lifted off as relations with the US seem to be already improving since the Trump's election. Ironically the European Union has decided to extend economic sanctions against Russia for 6 more months because of the Ukraine crisis.

On top of that, currency conditions are ideal at the moment. Indeed, the ruble has strengthened strongly against the US dollar and is now trading at than 62 ruble for a single dollar note - making it easier for the CBR to react.

Next meeting of the CBR will be held the 3rd of February 2017 and a rate cut is very likely at that point.



Economics

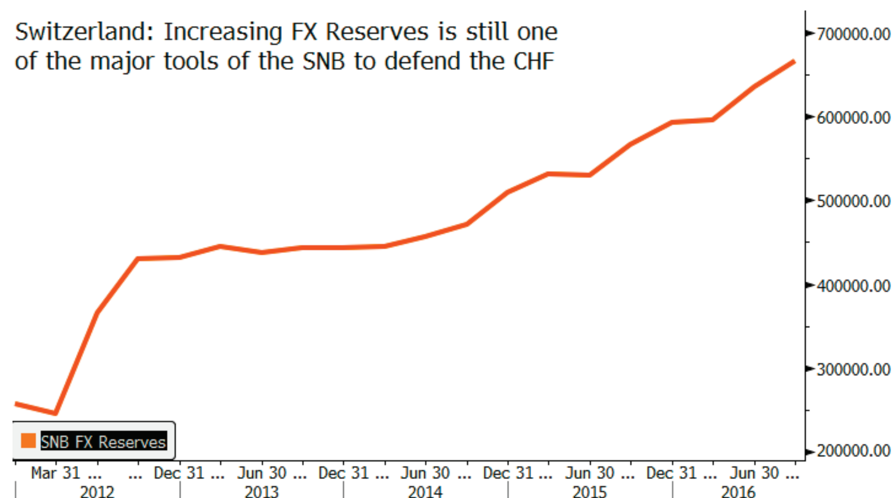
Did The SNB Quietly Change Their FX Policy?

What is generally a dull affair turned out to contain some real fireworks. The SNB held its 3-month LIBOR target range at -0.25 to -0.1.25% as widely expected. In the accompanying monetary policy assessment the SNB indicated that they view the CHF as overvalued and that they will continue to intervene in FX markets. The statement went on to mention that SNB action in the FX markets was intended to make “Swiss franc investments less attractive.” The inflation forecasts were revised marginally downward from September's report, in the short term but recovering in 2017 from a revision lowered to 0.1% from 0.2%. Mentioning the US economic acceleration, the SNB indicated that the global economy continued to recover in-line with forecasts, while the spillover effects from Brexit were less than originally predicted.

On the brighter external environment the SNB projected GDP growth at “roughly” 1.5% in 2017. The unexpected shift in the Fed's “dots” has failed to relieve pressure from the CHF as the SNB is primarily focused on EURCHF pricing.

Uncharacteristically the conservative SNB provided a bit of speculation in the language of the monetary policy assessment. "At the same time, the SNB will remain active in the foreign exchange market as necessary" standard wording seen in the September assessment. But then added new text "while taking the overall currency situation into consideration." After the meeting SNB Jordon dismissed the suggestion that the addition was a signal. Yet, central banks don't just add words so clearly this addition has meaning. From our vantage point the SNB is signalling that great flexibility in foreign exchange will be tolerated.

Significantly Fed-driven selling in EURUSD has pressured EURCHF to 1.07307. Given the rise in inflation, the SNB is likely to accept a small amount of EURCHF deprecation. Due to mounting event risks in Europe in the mid and long term, CHF will continue to gain versus EUR posing a significant problem for Swiss policy makers (as interest rate differential are less important to FX pricing in this case). With official FX reserves over 100% of GDP meaningful FX intervention is likely however, with negative interest rates already damaging bank balance sheets and consumer saving more negative rates are not a palatable option.



Economics

Emerging Markets Stabilise

After suffering a massive sell-off, which was triggered by a hawkish shift in the Fed rate path projections, emerging market currencies recovered somewhat last Friday as the US dollar weakened on a broad basis. Eastern European currencies made the most of the greenback's weakness with the Russian ruble and Polish zloty getting some colour back. The Turkish lira also enjoyed some relief after tumbling as much as 2% amid the terror bombing attack in Istanbul last weekend. South American currencies had a choppy session ahead of the week-end with the performances of the Colombian and Chilean peso flirting with the neutral threshold. The Mexican peso and the Brazilian real moved in opposite direction as the former remained under pressure against the USD, while the latter edged slightly higher.

The Brazilian real, just like most EM currencies, has been insensitive to local developments with investors focused exclusively on the US dollar and the recent FOMC meeting. Even the Brazilian senate's approval of a constitutional amendment aiming at limiting growth in public spending went unnoticed. The upper house voted 65 to 14 for PEC 55 (previously PEC 241) in spite of massive street protests as it is widely seen as another hard blow for the poor. The un-elected president who entered into office due to Dilma Rousseff's impeachment last August is facing growing discontent as he continues to push reforms that would never been accepted under Rousseff's government. In spite of these new austerity measures that would help the country climb out of recession, the uncertainty stemming from elevated political risk is keeping international investors on the back foot which is weighing on the real and Brazilian assets in general.

Even though we believe that the USD overshoot remains the main threat as we enter 2017, the current political uncertainty may prevent a rapid recovery in the real. Moreover, the unpredictability of the upcoming US government is prompting investors to stay invested in USD.

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