WEEKLY MARKET OUTLOOK

3 - 9 April 2017

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WEEKLY MARKET OUTLOOK - An Overview

FX Markets

False Positive In European Inflation

European investors have been cautiously watching last week's EU inflation data for likely forces driving the ECB's monetary policy strategy. Since February, consumer price inflation accelerated to its fastest pace since January 2013 and markets have been debating the rationale and sustainability of the ECB ultra-loose monetary stimulus policy. In addition, headline inflation which is trending higher towards the central bank's objective of below but close to 2%, with divergent core inflation, exuding persistent weakness, is a concern for Draghi.

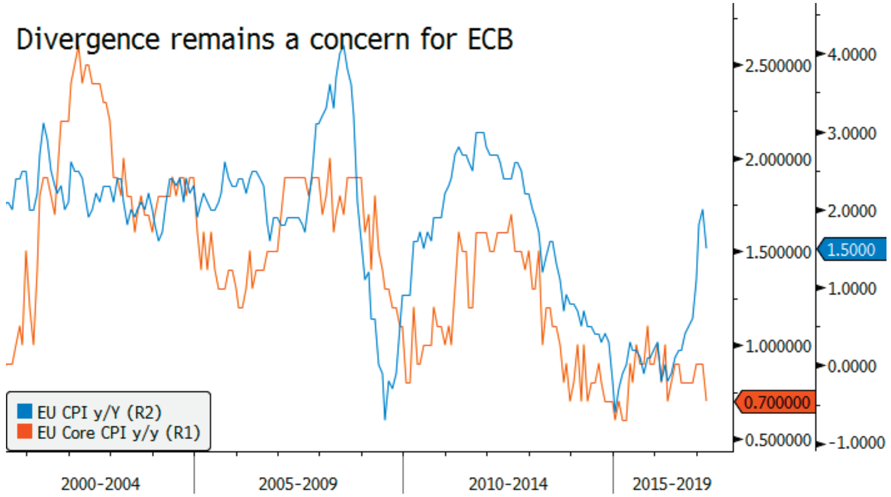
The data release is expected to temporarily suspend demand for exiting accommodating positioning. Eurozone flash HICP inflation dropped 0.5% to 1.5% in March below consensus of 1.8% while core inflation slid to 0.7% y/y from 0.9% in February, below expectations for 0.8% print. HICP components indicate that all three indexes contributed to the fall in headline inflation.

With the "courgette shortage" fading, fresh food prices have moderated, sending food, alcohol, and tobacco price inflations to 1.8% from 2.5%. In addition, with crude prices falling energy price inflation also weakened to 7.3% from 9.3%. Overall seemingly headline inflation peak of 2.0% in February seems like an anomaly and unlikely to concern the ECB. However, with solid economic data including stronger labour-market outlook we suspect that underlying inflationary trend is on track and March data is a temporary. We could see core inflation climb to 1.1% by June supported by Easter related price increases. Less important are expectations that headline inflation will rebound to 1.8% by June.

The ECB spent much of last week trying to control market chatter over the exit. ECB members have been increasingly concern that the market is getting ahead of itself by misreading communications.

Dovish comments from ECB members such as Nowotny have done little to shift our European outlook. Yet, between data and comments our suspicion remains, that calls for the end of extreme policy setting (negative rates, easy lending, and bond purchases) are getting heard. ECB board member Coeure stated that it was "legitimate" for the ECB to review its pledge to keep rate at record low levels.

Overall, we don't expect to see actual changes in asset purchases and negative interest rates until 2018. However, in between the dovish guidance we suspect there will be hints of tightening. We suspect that we will get higher deposit rate before QE ends in a strategy to keep the market off guard. We remain constructive on EURUSD barring any shift in the French election outlook.



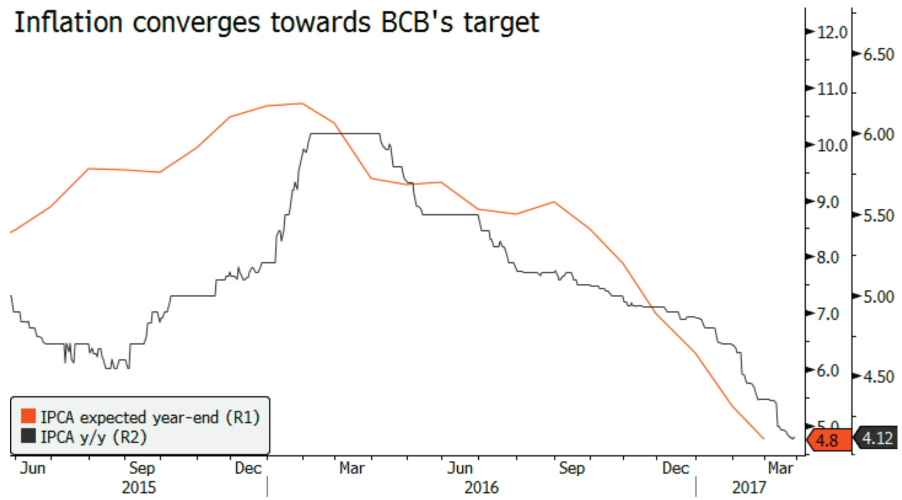
Economics

Brazilian Government Caps Spending

In spite of rising global uncertainty, emerging market currencies have been rather resilient over the last couple of weeks. However, one has to acknowledge that volatility also increased temporarily as investors preferred to remain cautious in the event that Donal Trump had to face another setback in implementing his programme. After completely erasing losses from last November and returning to around 3.05 in February, the Brazilian real has been trading in a volatile range since then, moving between 3.06 and 3.20 as investors await further clarity on the US outlook to emerge.

It goes without saying that local developments in EM countries have been largely ignored recently - with the exception of the political turmoil in South Africa last week - as market participants were too busy trying to anticipate Trump's next move. In Brazil, the economy is slowly gearing up as the central bank progressively eases its monetary policy. The Selic rate is currently at 12.25% but the market anticipates the benchmark rate to reach 9% by the end of the year as inflation is expected to return within the BCB's target range of 4.5% +/-1.5%.

All in all, looking at the hard data it seems as though Brazil is on the right track, however on the domestic side, the political situation is in complete upheaval and the uncertainty that stems from it should prevent the real from returning quickly towards its pre-recession levels. Moreover, the austerity measures planned by the government will further delay a speedy recovery as the lower classes of the Brazilian society are losing purchasing power. On the other hand, it will restore confidence and attract foreign investments. In the short-term BRL gains cannot be ruled out as investors are still chasing returns and Brazil's temporary stability is quite attractive. Nevertheless, the market is in wait-and-see mode and has slightly shifted to risk-off.



Economics

UK: The Exit Process Has Finally Begun

Nine months after the Brexit vote, Theresa May has finally started the exit process by triggering Article 50 of the Lisbon Treaty. The UK Prime Minister has spoken in front of the House of Commons last Wednesday. A letter has then be delivered by 1.30pm to Donald Tusk. Negotiations should last at least two years but the UK will still benefit many bilateral agreements in the meanwhile.

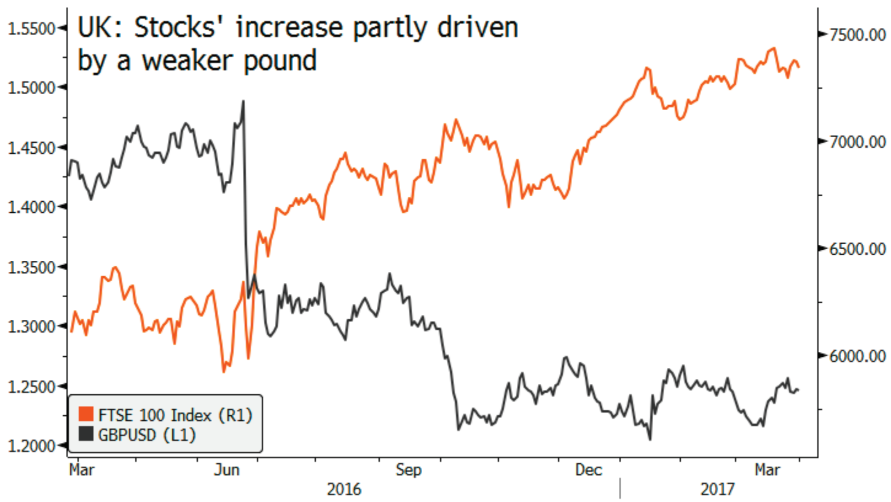
The pound fell the day before from 1.2460 to 1.2380 against the dollar. In our view, we believe that the markets are still overly pessimistic about the UK situation. Recent economic data is improving, but we also believe that the pound should appreciate in the medium-term. It is clear that economists widely missed the target with their doomsday prophecies and ironically, it is this very market pessimism that is supporting the UK economy by increasing the competitiveness of its exports.

Now that Brexit is officially a done deal, the next questions will revolve around the nature and tone of negotiations. 27 counterparts must accept and agree with the UK's terms with each country holding a veto over these conditions. It is for this reason that it is so difficult for countries to renegotiate treaties in general. For this reason, we find the promise to renegotiate treaties somewhat scammy.

Last week, in the two days following the triggering of Article 50, the Footsie 100 has risen and is now trading 16% higher than pre-Brexit levels. It makes the increase even more impressive since the 2016 Brexit vote also sparked a sell-off

Now our view for the negotiations is that we believe there won't be any hard Brexit. It is nonetheless clear that negotiations will be tough with all members having to agree on the final deal, which means that the next two years will be a serious rollercoaster ride.

We are also bullish on the pound which we should further appreciate this year. Strengthening of the pound is now very likely especially as Europe faces a veritable minefield with the upcoming French and German elections. Time to reload GBP.



Themes Trading

Swiss Small Gems

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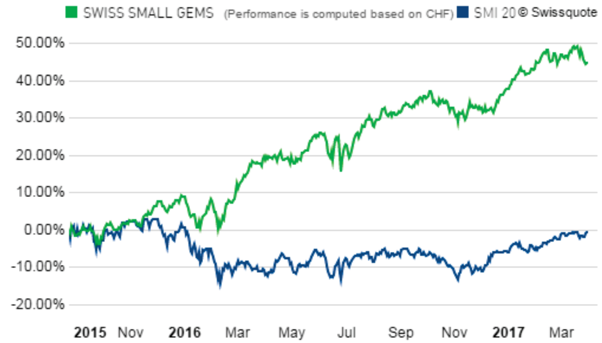

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