

WEEKLY MARKET OUTLOOK

19 - 25 June 2017

WEEKLY MARKET OUTLOOK - An Overview

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Economics**Markets Return To A Focus On Central Banks**

Trading President Trump or European political uncertainty has done our heads in. Yet these rogue events have been the only true drivers of volatility while it has become difficult to say the least to provide plenty of price action directional and forecastable predictions. Last week the focus returned to Central Banks and monetary policy and we breathed a sigh of relief. We can handle these fundamentals more than random 3am tweets from Trump. For traders, monitoring Central Bank policy strategy will once again become profitable. On the whole, slightly more hawkish decisions by the Central Banks sent bond yields higher.

Setting the pace last week was the FOMC, which clearly indicated to investors to ignore short-term noise. The Fed delivered a 25bp hike to 1.0-1.25% and held the DOTS basically unchanged. Fed members discounted the recent inflation weakness (punctuated by a soft CPI read only hours prior), highlighting transitory effects and placing significantly more emphasis on the strong labour markets.

The failure to acknowledge soft inflation forced the markets to meaningfully price-in a December hike. But potentially more influential on rate and USD were the additional details on balance sheet reduction, which had the markets pulling forward the announcing to September (already our prediction). Moving forward, we expect the Fed will drive USD against low yielding G10 currency but remain weak against EM currencies.

The Bank of Canada surprised the markets with a hawkish shift due to positive economic momentum. The absorption of lower oil prices has already occurred and bubble-like behaviour in real-estate markets has increased the probability of the BoC starting its tightening cycle sooner than anticipated. We have a hike penciled in for early 2018, which combined with overly bearish CAD position and fading protectionist

threat will give CAD further bullish momentum.

The Bank of England looked above the political fray and Brexit chatter to strike a hawkish tone. Unexpectedly, three members on the MPC voted for a rate hike. Dissenters focused on strong labour market conditions and the threat of an inflation overreach.

We suspect despite mixed signals, this hawkish tone is correct given the BoE's long-standing challenge with battling inflation and our view of a "soft" Brexit. We still don't see a Brexit-induced correction in the UK consumer, although very weak retail sales has us vigilant, dragging down growth at this point.

With a rate hike on the table and political developments (on both sides of the channel) indicating a less punishing agreement and expectations for a stronger GBP, one of our strongest conviction ideas is long GBPCHF based on monetary policy deviations.

Economics

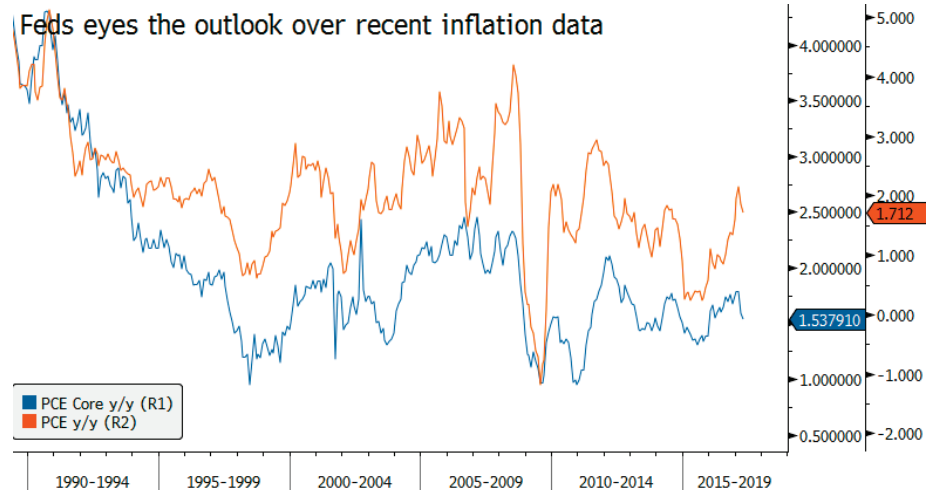
Fed Remains On Track Despite Inflationary Pressures

As broadly expected, the Federal Reserve lifted borrowing costs by 25bps following a two-day meeting. The decision was already priced-in by market participants. However, the Committee created a stir with a surprisingly hawkish statement and press conference from Janet Yellen despite the recent publication of lacklustre economic data. Indeed, the last CPI and retail sales reports came on the soft side and triggered a USD sell-off, just a couple of hours before the announcement of FOMC's decision. The consumer price index extended only 1.9% y/y in May versus 2.0% expected and down from 2.2% in the previous month amid sustainable downside pressure on crude oil prices. In addition, the core measure, which excludes the most volatile components such as food and energy prices, slid to 1.7% y/y, down from a previous reading and median forecast of 1.9%. Finally, retail sales printed in negative territory and contracted 0.3% m/m in May, well below market expectations of a flat reading, signalling that US consumers preferred to remain cautious against the backdrop of political jitters in the US and an uncertain economic outlook.

Committee members seemed committed to hold the line and keep steady the tightening pace as announced at the preceding meetings. Moreover, the Fed remains highly confident the recent set-back in inflation developments is only temporary and expects to increase by another notch the federal funds target before the end of the year. In our opinion, the fact that the Fed is not really concerned about the disappointing inflation readings suggests that the institution may have started to reconsider the ground for reaching at all cost the 2% inflation target. Indeed, overall the US economy is not in such a bad state as it is not in recession anymore and the economic growth is the envy of many countries. Finally, the Committee discussed further about balance sheet unwinding as it drafted carefully a plan for policy normalisation; and it is expected to be implemented before the end of the year.

However, the Fed remained extremely cautious by stating that "the Committee would be prepared to resume reinvestment of principal payments received on securities held by the Federal Reserve if a material deterioration in the economic outlook were to warrant a sizable reduction in the Committee's target for the federal funds rate".

The USD was broadly higher this morning and erased partially the losses triggered by the release of the CPI and retail sales report. Housing starts and building permits also came in largely below expectations. EUR/USD is back below 1.12 and currently into a positive short-term momentum.



Economics**Economic Uncertainties Still Prevail In Japan**

A set of data has been released earlier last week and it seems it is a never-ending story for Japan.

April machine orders just collapsed at -0.31% m/m while markets had estimated an increase of 0.5. This data is often used as a proxy for the capital expenditure.

Other recent fundamental data showed improvement in Japan's economy. Japan's demand has accelerated according to a report released last Wednesday and central bankers, once more, expect this demand to keep growing, in particular the foreign demand. Nonetheless the inflation is standing well below the target, and this has not changed for the past decade. CPI is currently standing at an annualised data of -0.4% .

Investors seem to be reluctant to invest domestically, due to several possible reasons including uncertainties about President Trump's trade policy and about Japan's economic future.

Later last week, the Japan producer price index came in flat at 0% and it represents the weakest PPI result in nine months. Already last week, the growth rate had been revised down to 0.3% from 0.5%.

The yen has slightly strengthened against the US dollar because of a risk-off sentiment in the market over the past few weeks.

Upside pressures on the currency remain but the BoJ cannot tighten its monetary policy or it would largely hurt its economy. The safe haven status is also one key issue, as whatever the state of Japan's economy, investors would drive their money as soon as a risk-off sentiment arises.

But we consider the economy in Japan is still struggling to recover. The sad reality is Japan has not succeeded in boosting private consumption, which accounts for 60% of the GDP.

This is why BoJ had no choice than to hold its monetary policy unchanged for now. The base rate has been kept on hold at -0.1% last Thursday and the central bank will continue to focus on maintaining the 10-year yield to 0 by purchasing massive amounts of Government bonds (80 trillion yen annually).

The BoJ seems definitely stuck in its very loose monetary policy as deflationary pressures are still important.

We believe that Japan, in the medium-term, will try to expand the monetary policy divergence with the US in order to help reduce pressures on its currency. Yet, we consider that the US economy is overestimated and may trigger again inflow towards the Japanese yen. We reload bullish yen positions around 112 against the greenback.

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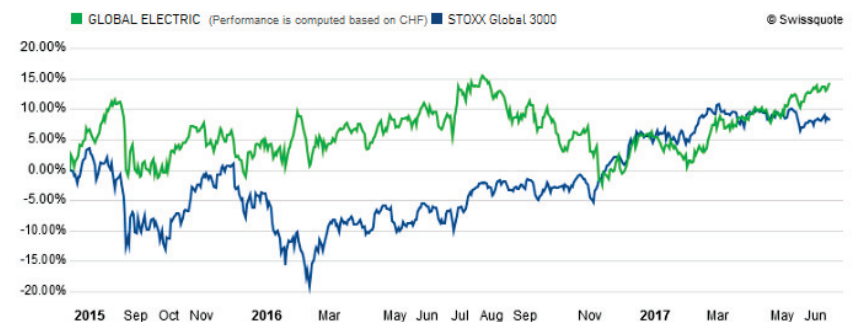
The growth in electric energy consumption continues to be a reliable investment theme. According to the IEA 2014 report total final world consumption from 2000 to 2014, increased by 60% and is forecast to grow at an equally fast pace. While the sources of energy have become diverse and abundant, the electricity sector remains a stable revenue generator. The explosion of electrical devices growing alongside the expansion of the global middle class has demand for electricity and utility services are driving the sectors returns.

Utilities generally sell electricity through regulated markets by operating generation, conduction and distribution services. These legal monopolies are good for income seekers as they produce dividend yield, which are stable and higher-than-average. This theme sources the global top 15 corporations according to market capitalization as the massive barriers to entry will discourage new entrants and reward large players. of the



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FX

RBNZ Could Surprise

The RBNZ's 22nd June rate decisions might be more interesting than generally expected. Markets suspect that the bank will be concerned over the slowing growth due to disappointing 1Q GDP. However, there is scope for a slightly more hawkish communication. Last week's data flow sent Antipodean traders into a spin with good Australia and weak New Zealand data. However, we suspect temporary dislocation will normalise with New Zealand economic momentum picking up.

New Zealand's 2.5% from 2.7% annual GDP growth read might have been slower than expected, however growth pace remains solid within the G10 ranking. The underlying GDP private spending components indicate strong trend, supported by surveys outlook (PMI manufacturing rose to 58.5). On the inflation side, the forecast puts the read on the higher side as 2Q CPI stands at 2.2%. Commodity prices will clearly drag across the board, yet dairy prices remain buoyant.

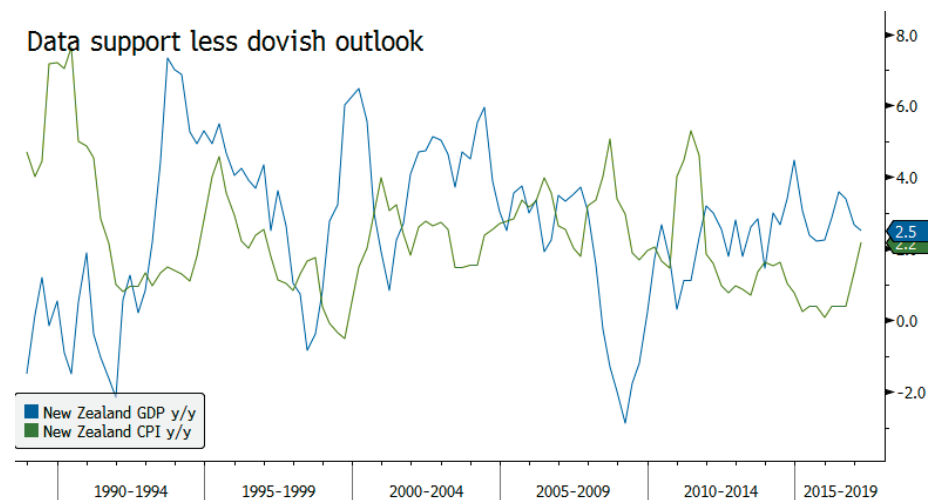
Overall, we should not overlook that New Zealand economic data has generally surpassed market expectations. The RBNZ sees interest rates on hold until H2 2019, but markets are pricing-in 13bp of rate hikes by May 2018. This monetary policy decision is not a forecasting meeting with only an accompanying statement. The primary message will remain unchanged that monetary policy will continue "accommodative for a considerable period," indicating that NZD depreciation will support rebalancing and inflation pressure is likely to increase slowly.

While traders are now focused on AUDNZD reversal based on stretched growth differentials, forecasts would watch NZDJPY. Last week the BoJ held its assessment on inflation and the economy providing only the slightest optimistic tone on household

consumption. But for those traders who were expecting that political pressure and marginally positive economic data would force the BoJ to discuss exit strategies, they were mistaken.

At the accompanying press conference Governor Kuroda clearly stated that communicating exit strategy was not appropriate since the bank's targets were not reached. In addition, he indicated that talk of US and EU exit strategies were not suitable for Japan's economic condition. Should we get even a most minor of RBNZ tone shift (a BoC type of redirection) monetary policy divergence will continue to benefit long NZDJPY trades.

Data support less dovish outlook



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