WEEKLY REPORT

14 - 20 April 2014

WEEKLY REPORT - An overview

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Economics

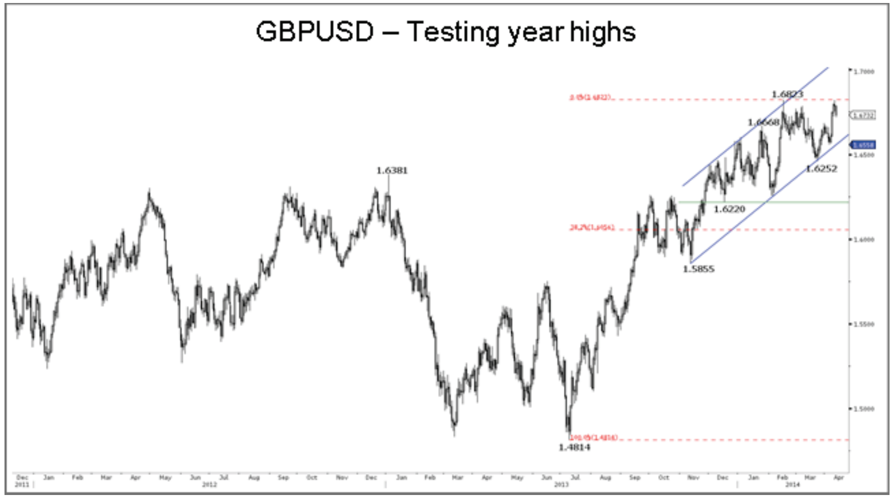
No fireworks out of the BoE

No fireworks out of the BoE

The BoE kept its monetary policy unchanged at the April 10th meeting. GBP/USD advanced to 1.6820 (slightly lower than the year high of 1.6823) as RICS house price balance bounced back to 57% in March from 45% printed in February. Although the Governor Mark Carney says that the responsibility of housing market is not on BoE's shoulders, markets react upwards at each similar release. The Cable closes the week with stronger bullish momentum. The next major resistance stands at 1.7031/43 (100% on Fibonacci projection of Feb rally on March pickup / Aug 2009 high).

Fading Growth Prospects

The IMF warned the UK regarding the weakness in business investment and exports requiring cheaper GBP and thus constraining the BoE to keep its rates low despite higher growth forecasts. The UK released improvement in trade deficit in February, yet the micro analysis has not been brilliant: exports contracted by 1.6%, imports fell by 2.2%. The BoE is now counting on higher foreign investor appetite and improved exports to sustain UK's economic recovery, but the GBP/USD keeps trending higher since Carney set up the forward guidance on July 2013.



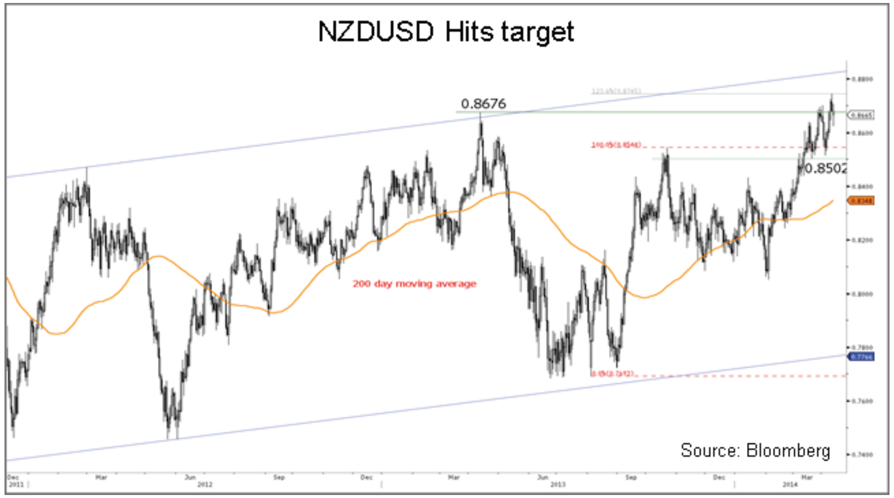
FX Markets

The Kiwi hits the target

The Kiwi hits the target

NZD/USD hit our 0.8745 target on April 10th, boosted by the post-FOMC sell-off in USD. The short-term trend is turning neutral from bearish; the MACD will suggest the extension of gains for a weekly close above 0.8680. Released this week, the business manufacturing PMI showed faster expansion in March (58.4 in Mar vs.56.2 in Feb). "The manufacturing sector is in a buoyant mood with the total PMI, production and employment indicators all near 10-year highs" stated BNZ. The strength in economic indicators boosts hawkish RBNZ expectations for further rate hikes. We are reminded that the RBNZ has been the first major central bank to step into policy normalization by lifting its policy rate from 2.50% to 2.75% at March meeting. The next RBNZ meeting is due on April 24th, the markets are braced for a second round of rate hikes. Over 15 leading banks have submitted forecasts to a recent Bloomberg survey, 75% bet in favor of a rate hike to 3.0% by the end of April, one thirds bet for a hike to 3.25% by June. By the second quarter of 2015, half of participants see the RBNZ rate at 4.0%. Given the policy expectations, the Kiwi can only appreciate against USD, subject to the first Fed rate hike by mid-2015 earliest.

NZD/USD recovered from last week's sell-off on weak dairy auction prices. The short-term trend and momentum indicators recovered from last week's bearish shift. We revise our next target to 0.8869 (Fibonacci 138.2% projection on Aug-Oct 2013 rally), then 0.8903 (Aug-Oct projection on recovery starting from Feb 4th). AUD/NZD slowly drills the strong resistance at broad downtrend channel base & 100 dma and is likely to close the week at the bullish consolidation zone. The RBNZ/RBA divergence should weigh on the antipodean pair walking towards a 1.1000 psychological threshold.



Economy / FX Markets

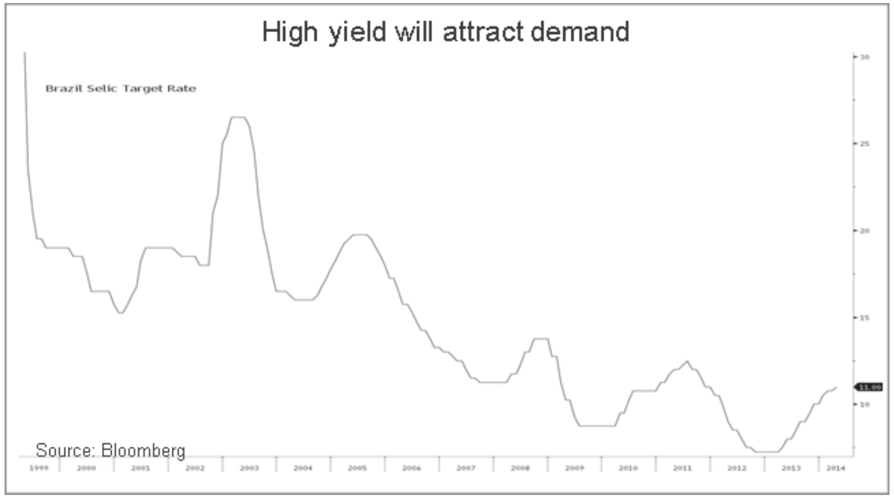
Carry trades still attractive, Short USDBRL

Loose policy, stable growth & low volatility good for carry

Given global conditions, the environment is still conducive to carry trades. With a broadly loose policy background and low volatility, carry trades should be extended-especially long BRL positions. While the US is clearly on pace to end asset purchases this summer, US growth is not strong enough to support official monetary policy tightening till early 2015. Meanwhile the ECB sounded relatively dovish (while denouncing deflation) suggesting policy is likely to stay loose for an extend period of time. In Asia, Japan's inflation potion of the Tankan report and fading economic data indicates that we will see current quantitative easing policy extended and broadening in July. Meanwhile China’s decision last week to push forward fiscal stimulus to support sagging growth indicates an assurance to backstop economic deceleration and slow the rate of credit tightening. These events should keep growth stable and provide a secondary effect of lower volatility.

BCB providing BRL with attractive yield

This week as anticipated, the Brazilian Central Bank raised the Selic rate by 25bp, to 11.00%, in a unanimous decision. In the post-decision communiqué, Copom clearly indicated that further policy action would be data dependent and at the May 28th meeting would either pause the tightening cycle or hike another 25bp. With growth data continually surprising to the upside and inflation data remaining uncomfortably high, we expect an additional hike. Despite the strong recovery rally in BRL, for yield-starved investors willing to take 5.0% for Greek 5yr paper, BRL will continue to be an attractive play. In addition with only a few months till Brazil hosts the World Cup, the build up until this premier event should keep BRL well bid.



Economy / FX Markets

More patience required before further BoJ's easing

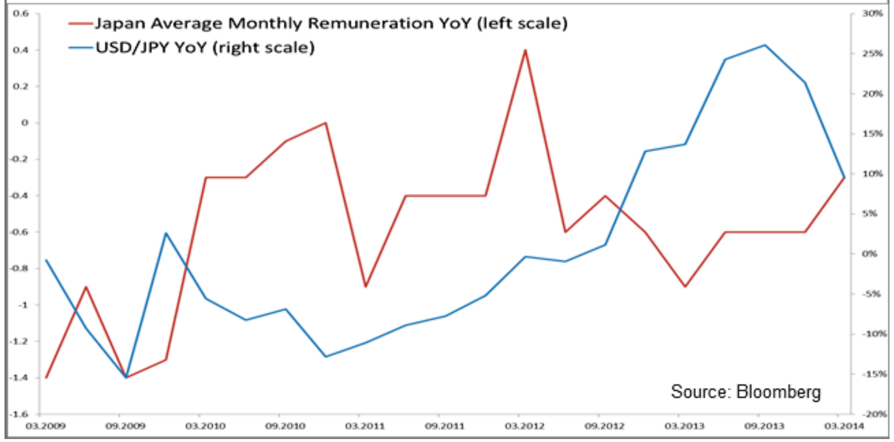
The BoJ in no hurry to ease further

As expected, the Bank of Japan (BoJ) left unchanged its monetary policy on 8 April. The lack of any hint in the statement about potential new easing measures suggests that the BoJ is unlikely to act before getting more information on the effect of the sales tax increase to the growth and inflation outlook. On that respect, the semi-annual Outlook for Economic Activity and Prices (OEAP) to be released on 30 April (the same day of the next BoJ's meeting) is likely to lead to a downgrade of the BoJ's growth outlook, which is currently above consensus. However, since the BoJ seems thus far confident with its monetary stance, a downgrade in the inflation outlook is unlikely. As mentioned in previous reports, we continue to believe that the waning inflationary effect of the weaker yen will not be fully compensated by higher wages. As a result, we expect that the inability to close the gap between the BoJ's 2% target and its actual value will eventually be clearly recognized, leading to a downgrade of the inflation outlook. Such a downgrade would be met by new easing measures from the BoJ. The July meeting, when the BoJ will conduct an interim assessment of its semi annual OEAP, is our best guess for such new easing measures.

Patience required for long USD/JPY positions

Looking at USD/JPY, it means that a sustainable rise is unlikely in the short-term, at least from the JPY component. Furthermore, the elevated short JPY positions held by investors leave prices vulnerable to a reduction of these bets. However, with the key supports at 100.76 (04/02/2014 low, see also the 200 day moving average and the rising channel) and 99.57 (19/11/2014 low, see also the 50% retracement from the low at 93.79 to the top at 105.44), we suspect that the USD/JPY is likely to remain trendless until the BoJ provides signs that its inflation outlook needs to be revised downward. As mentioned above, the first clue will likely come from a revision of its growth outlook on 30 April.

Wages unlikely to offset the waning effect of a weaker JPY



USD/JPY is close to strong support levels

FX Markets

Purchasing Power Parity favours a stronger USD

From time to time, we like to look at Purchasing Power Parity (PPP), which is an economic theory allowing us to estimate the long-term "fair value"of a currency relative to another. As can be seen by the chart on the right, the Australian dollar and the Swiss franc are the only currencies with significative divergence from their theoretical fair value. More precisely, both are overvalued compared to the US dollar.

Long-term AUD upside likely limited

The over-valuation of the Aussie confirms our view that the long-term upside potential in AUD/USD is likely to be capped by the strong resistance at 0.9758 (23/10/2013 high). Indeed, the Reserve Bank of Australia would not welcome a too strong AUD, as it could hurt the rebalancing of the economy. Meanwhile, the short-term boost offered by unwinding of short positions (see next page) has been exhausted, suggesting that the "easy" part of the advance is now behind us.

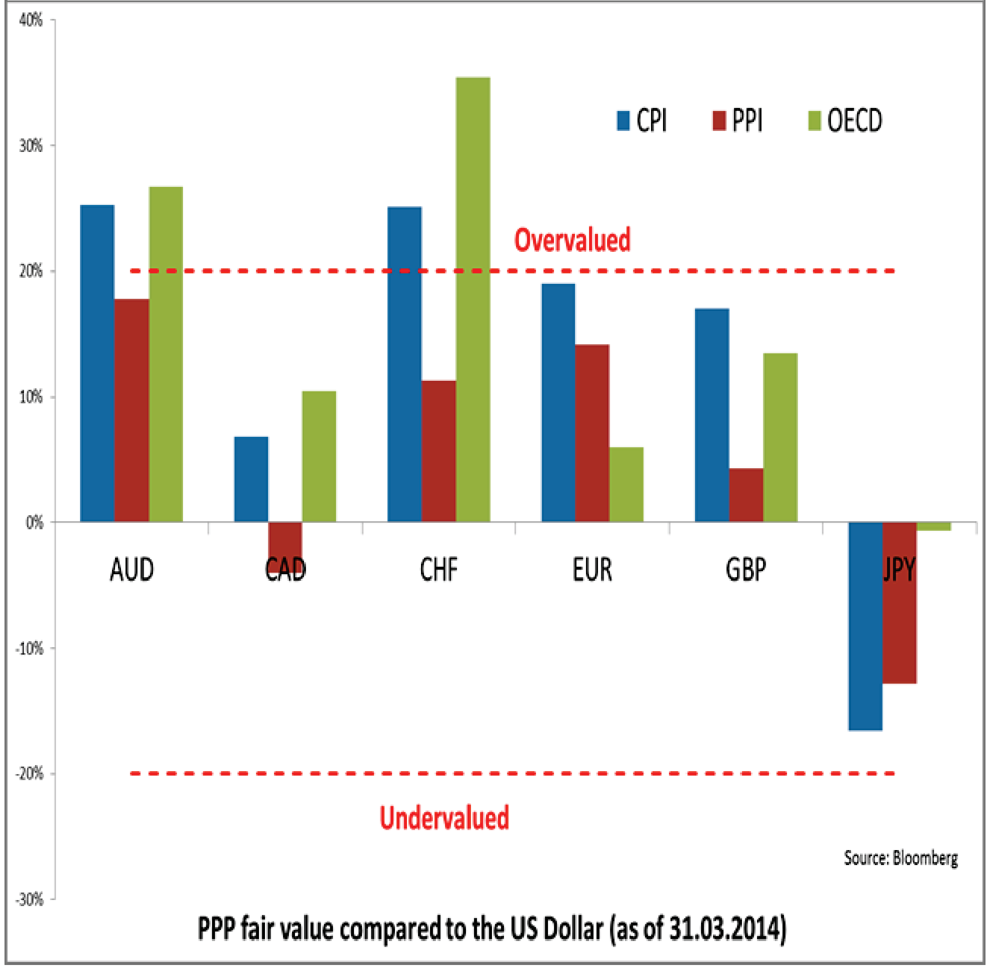
Could the CHF rise in front of a potential rise in volatility?

With a market filled with elevated long CHF positions, a 1.20 threshold in EUR/CHF and a potential gradual recovery in the Eurozone, the Swiss franc over-valuation favours a short CHF strategy. However, the recent new all-time highs in the US stock markets mixed with geopolitical tensions and the gradual removal of the safety net provided by the Fed suggest a more risk-averse environment, which represents a serious threat to any short CHF strategy.

PPP favours a stronger US dollar

Given that most currencies are rather overvalued compared to the USD, it means that the USD is de facto rather undervalued compared to all currencies (except JPY). As the PPP suggests an eventual return towards its "fair value", it is supportive of a stronger USD.

AUD and CHF are overvalued from a PPP standpoint



FX Markets

AUD positions back to neutral levels

The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending 1 April 2014.

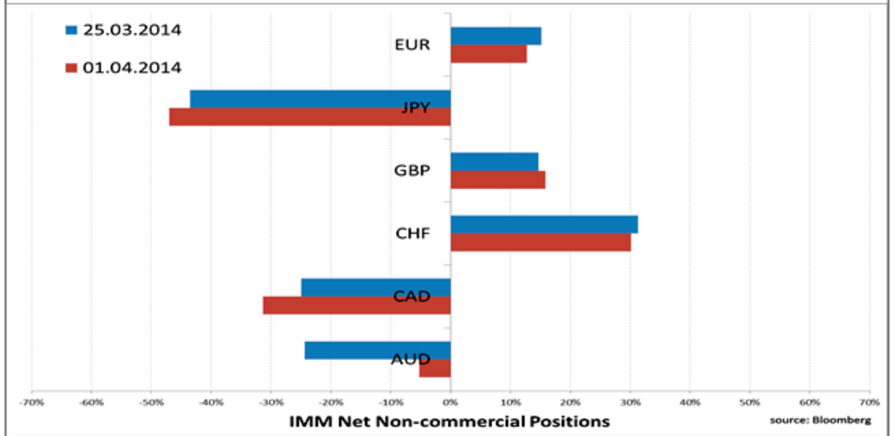
The Australian dollar has experienced a sharp reduction in short positions and is now close to neutral levels (-5.19%). As a result, from a positioning point of view, there is no remaining fuel to push the AUD higher. Meanwhile, the Canadian dollar remains at elevated short levels, calling for short-term caution given the recent decline in value of the loonie.

Net long Euro positions have slightly decreased while net long Sterling positions have slightly increased. This discrepancy is likely partly due to market perceptions that the ECB has further easing to do while the BoE could start raising rates in a not so distant future.

The Japanese yen remains the most heavily sold currency. Given the lack of any easing signal from the BoJ during its last monetary meeting, JPY is likely to suffer in the short-term from potential investors closing their short exposure.

It is worth noting that the resulting effect of increased long positions in EUR, GBP and CHF, coupled with the reduction in short AUD positions, have brought back the USD aggregated positions to neutral levels.

No major changes, except in AUD



AUD short positions have almost been cut back to neutral