SWISSQUOTE

WEEKLY MARKET OUTLOOK

5 - 11 December 2016

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

OPEC Agrees On An Output Cut Deal

Financial markets relieved by the OPEC deal
In eight years OPEC had never managed to reach an agreement on an output deal. Finally, contrary to our expectations, a deal has been struck. Indeed, we believed that the fundamental differences regarding production would not be solved at this meeting for some specific reasons especially since the dominance of Saudi Arabia is more challenged by Iraq and Iran. This is still even truer since the Trump's election.

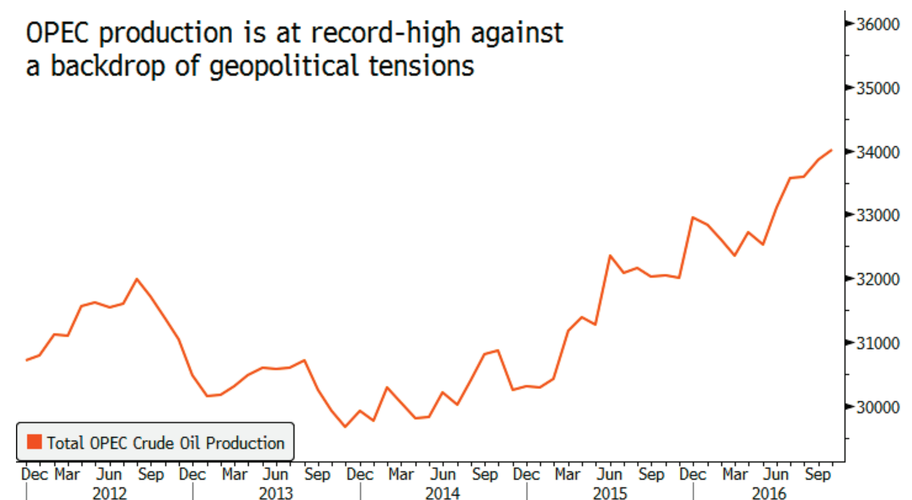
This deal seems to us very imperfect and there are several things to say about it. We consider that the real impetus was saving OPEC's credibility. After eight years of disagreement, an image of mistrust between members could have posed a major risk to the reputation of the intergovernmental organisation.

That said, markets appreciated the deal, and even Russia, a non-OPEC member, also agreed to cut its production by 300'000 barrels a day. As a result, a barrel of Brent increased by 10% and closed above $52.

Assessing what OPEC oil deal can deliver
In a recent report, we also highlighted Iraq and Iran's growing challenge to Saudi Arabia's dominance in the cartel. This challenge is now all the more obvious following Tehran's decision to not cut its output, which it actually raised to 3.8 million barrels a day - not exactly what Saudi Arabia had in mind from its neighbour. This is a significant victory for Iran which has lost market shares due to Western sanctions.

Oil inventories remain very large and we believe that the cut decided at the meeting is likely not to be sufficient to balance demand and supply. The output should be reduced by 1.2 million barrels per day starting in January. We remain nonetheless suspicious on whether the cut will be effective or not.

The OPEC deal is definitely not a strong agreement and for the time being, markets are largely in surplus and more would be needed in the medium-term to absorb the production. Unlikely winners are US Shale gas producers, which are now expected to rise in the medium-term.



Economics

TRY In Death Spiral

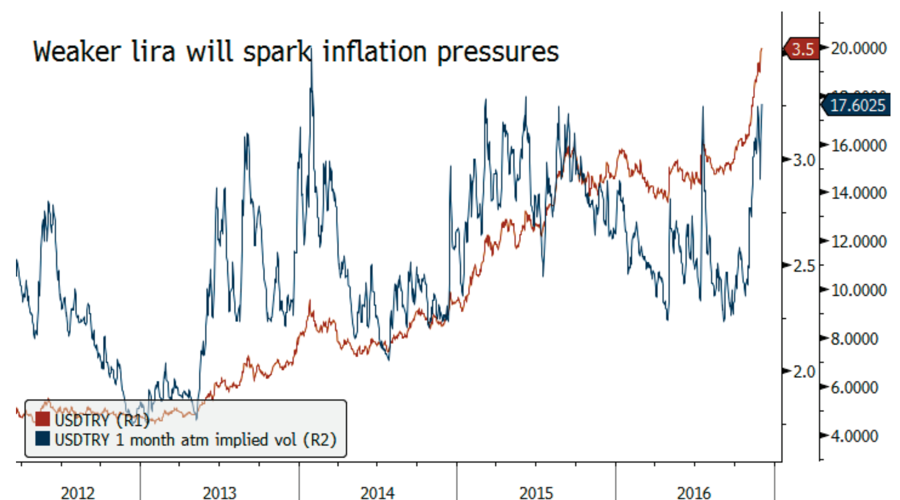
USDTRY surged to 3.5935 in the European session Friday, a new all-time high. There are rumors that the Turkey's central bank intervened in the FX markets attempt to slow the selling of TRY. Clearly the CBT's decision to raise its benchmark rate by 50bp to 8.0% (increasing upper band of marginal funding rate by 25bp to 8.50%) was not effective in convincing investors to stay in TRY assets. One reason was the RRR was lower to ease lending conditions in order to help the decelerating economy yet soften the tightening effect / conviction. Political concerns have been compounded by the European Parliaments discussion to temporarily suspend Turkeys EU accession path.

The inability for higher interest rate to halt TRY liquidation, stems from speculation that the mix of policy actions are being manipulated by the government (lack of CBT independence). The "surprise" aspect of the CBT hike was not that the underlying fundamentals need support, only when the CBT would have the maneuverability to make the move. There is lingering concern that should the economy demand additional measures, CBT will lack the independence to take action. In our view, so far the CBT has failed to deliver the needed interest rate adjustment to slow the lira depreciation and is unlikely to have the freedom moving forward. This suggests that further lira weakness should be anticipated. We are currently forecasting an additional rate hike in early 2017 of 50bp. But likely to little to late.

The CBT comments regarding the lira bearish trend and effect on inflation seem to be on point. There is increasing concern that Turkey is about to trigger a debilitating inflation – exchange rate death spiral, especially if oil prices continue to move higher. Falling aggregate demand will not be great enough to offset rising exchange rate risk to inflation outlook.

Concerningly, key political advisors to the PM still suggest that interest rates should come down to address soft economic activity and that inflation is a non-issue, without understanding the market implications of cutting rates while developed markets yields are going higher. There is increasing market perception that tightening is for optics rather than economic necessity; one-off hikes rather the tightening cycle.

We have a hard time forecasting where real interest rates reach to limit lira selling but were are clearly not there. We remain long USDTRY on fundamental reasons with a target to 3.600 mid-term.

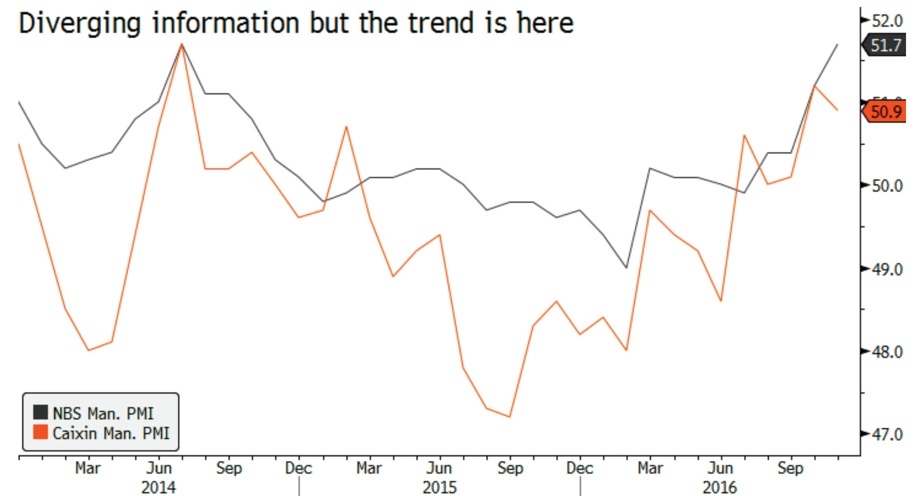


Economics

China's PMIs Point In Opposite Direction

According to China's National Bureau of Statistics (NBS), activity in China's manufacturing sector expanded more than expected in November, suggesting that an acceleration in the manufacturing industry is finally happening. The official purchasing manager index printed at 51.7 in November, beating the median forecast of 51.0 and was above the previous month's reading of 51.2. The good news came on the back of a continuous debasement of the yuan, which has fallen another 2% against the greenback over the last five weeks with USD/CHN hitting 6.9650. The non-manufacturing gauge accelerated to 54.7 from 54.0 in October. On the other hand the private measure, the Caixin manufacturing PMI, eased to 50.9 from 51.2 in October and below estimates of 51.0, which may suggest that the recovery is not as strong as reflected by the official data. Indeed, the two measure are pointing towards an opposite direction, even though both gauges are above the 50 mark, which separates contraction from extension. All in all, we think that traders should not get carried away by the encouraging official statistics as there are dark clouds on the horizon once Trump ascends to the White House. In the short-term, the threat of tougher trade relationships with the US should maintain investors away from China. On the longer-term however, we expect the yuan to get some colour back as the People's Bank of China continued to act together to limit capital outflow (limiting net renminbi transfers by China companies to 30% shareholder's equity, curbing gold imports or limiting international payment in renminbi).

USD/CNH eased to 6.88 last week after hitting 6.9654 last week. Even though we expect further stabilisation in the yuan - and even a recovery as the market realised the dollar rally has been overdone - we do not think it is time to lower our guard as the big picture is actually not that bright on the economic side.



FX Markets | IMM Non-Commercial Positioning

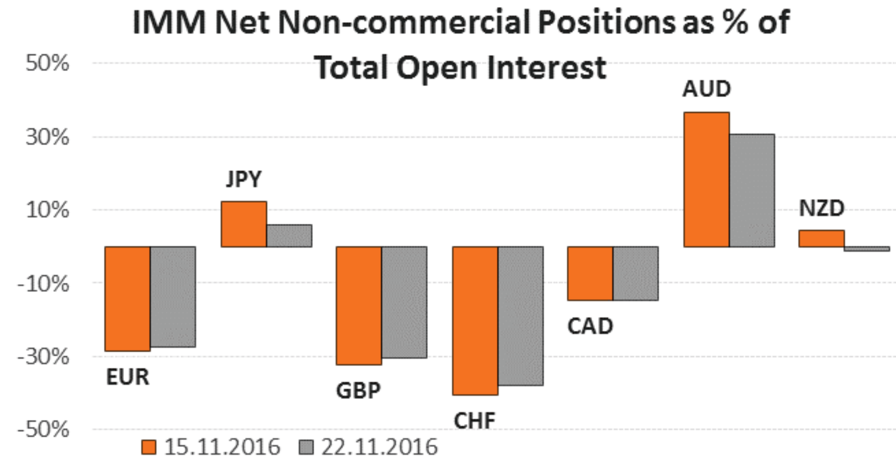
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

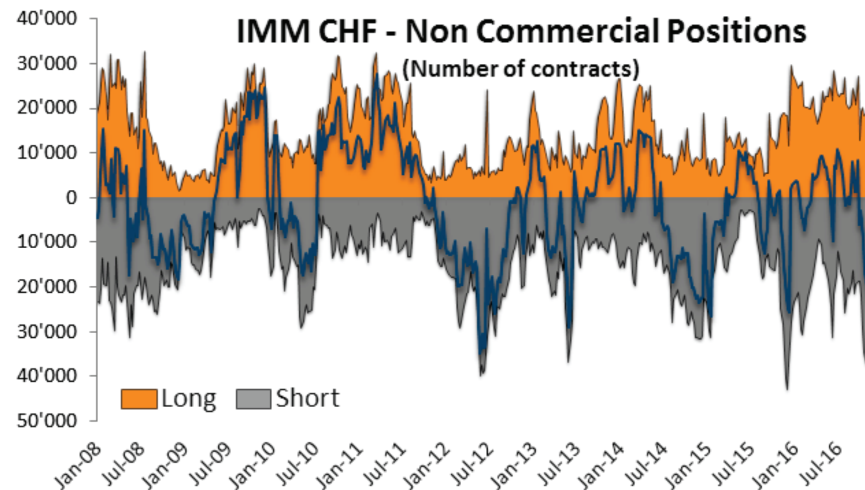
The IMM data covers investors' positions for the week ending November 22th 2016.

After reaching extreme levels, net short positions in CHF started to reverse trend. Net short positions eased to 38% of total open interest from more than 40% a week earlier. This trend should persist over the next weeks as investors continue to close their long USD positions initiated in the aftermath of Trump's election.

The AUD net long positions have decreased slightly as traders returned to the USD. Indeed the high quality commodity currencies such as the New Zealand dollar and Australian dollar have taken advantage of the systematic chase for higher returns that pushed investors to load on more risk. We the perspective of higher interest rate in the US, they started to close their long positions in those currencies.

The net short GBP positions have also slightly decreased and will most likely continue to do so as the market has started to see limited downside risk in GBP/USD.





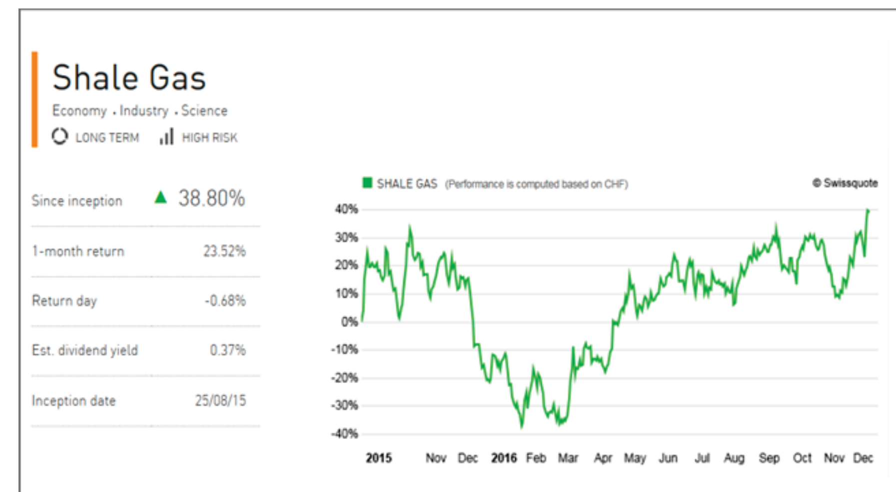
Themes Trading | Shale Gas

OPEC surprise production cut pushed crude prices higher. While global demand led by strong US expansion increase the risk of further upside in oil. Shale gas burst onto the energy scene around 2000 with advances in hydraulic fracturing and horizontal completions and changes in the regulatory environment. By 2010, with the "shale revolution" in full swing, 20% of US natural gas production was from hydraulic fracturing. Shale gas refers to natural gas confined within shale formations. The appeal is simple: natural gas is a cleaner source of energy than traditional fossil fuel, and there is a plentiful supply. Capital poured into the industry and wells ballooned, producing over 4.5trn cubic feet of gas per year. In his 2012 State of the Union address, President Obama stated, "We have a supply of natural gas that can last America nearly a hundred years." Valuations in the shale gas segment went ballistic. However, the total collapse of oil prices caused natural gas prices to fall and producers to stop frackin.

While questions remain as to the actual breakeven cost of shale gas, its environmental impacts and the real size of reserves, there has been a real shift towards natural gas. The plentiful supply of domestic oil and natural gas provides a rationale for ending the oil export ban and fast-tracking support for liquefied natural gas (LNG) export terminals. Global nations are looking to US firms' expertise to help harness their natural gas reserves (China is estimated to have the world's largest shale gas reserves). In the US, retooling has begun.

We built this theme based on the US shale gas pure-play exploration and production based in Barnett, Fayetteville, Haynesville, Marcellus, and Eagle Ford fields and market capitalization above $1bn.

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



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