

WEEKLY MARKET OUTLOOK

27 August - 2 September 2018

WEEKLY MARKET OUTLOOK - An Overview

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Economics

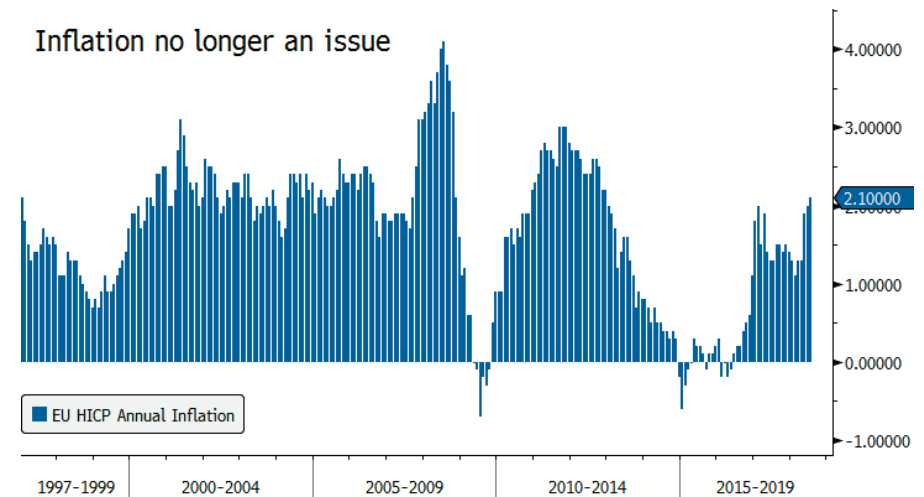
Trump In Crisis Drives Euro Higher

After a solid run, EURUSD has had a hard-time breaking thru the 50d MA (1.1610). Rather than pull our bullish bets we see the pause as temporary. While a meaningful reverse head-and-shoulder pattern has developed. The pattern dictates a reversal of bearish momentum and upside breakout. While the technicals look promising, the fundamentals remain the core driver of EURUSD strength.

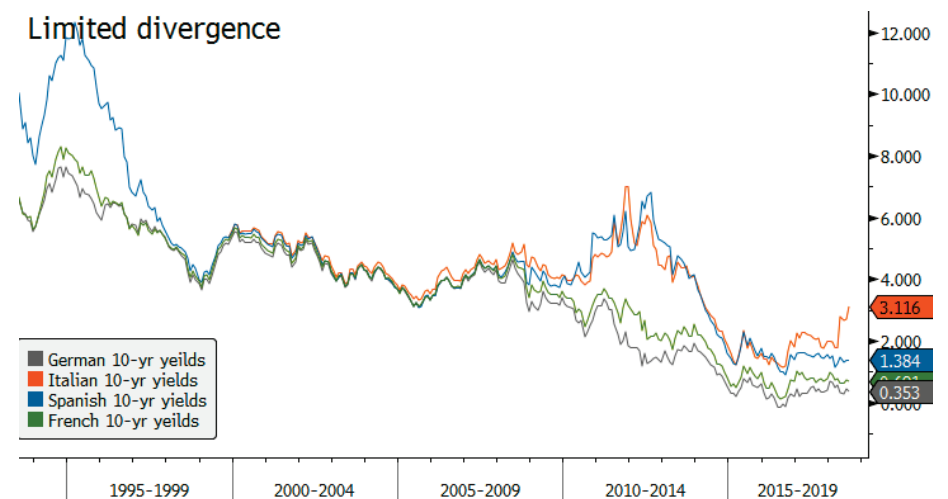
Make no mistake: the Trump Administration is in crisis. Convictions of two Trump deputies and an indictment of campaign finance violations are real problems that carry jail terms. This is not hype, Special Prosecutor Robert Mueller is building a legal sledgehammer. Now he can file criminal charges against Trump. Democrats and anti-Trumpists smell blood. They are blocking the advancement of Supreme Court nominee Brett Kavanaugh. Their strategy is to win the November mid-term elections to gain control of the House and the Senate. Then, they will try to impeach Trump (although they are unlikely to win over 67 Senators to remove Trump from office. House Democratic Leader Nancy Pelosi's final act will be to impeach Trump – falling on the sword as her political career ends.

In Europe, economic data continues to firm. There was deceleration due to negative cyclical and structural issues; but the economy should rebound a marginally in Q3. Capacity pressures should push headline and core inflation higher. This will force the ECB to continue its gradual march towards normalization. We still have September 2019 penciled in for the first hike in deposit facility rate but could see this date pull forward should political issues stay contained and Brussels accept May "soft" Brexit. Next week, Germany August's HICP inflation at 2.0% y/y, while euro area aggregate HICP inflation to rise by 2.0% on a y/y basis, against 2.1% in July. German Ifo Business Climate Survey to climb 102 in August due to positive current conditions and future expectations. In short, we expect EURUSD to grind higher, extending current bull rally to 1.2200.

Inflation no longer an issue



Limited divergence



Economics

Weak Bounce In Yen Despite Higher Inflation

Unexpectedly announcing a wider fluctuation band for its 10-year JGB yield, the Bank of Japan (BoJ) took the decision in order to support its banking sector, for which lending profits margins remained under pressure for more than two year and a half due to a short-term interest rate maintained at -0.10%, a decision that might deteriorate Japan's inflation outlook. For instance, inflation numbers for the month of July remained subdued, thus rendering BoJ 2% inflation forecast by 2021 less likely.

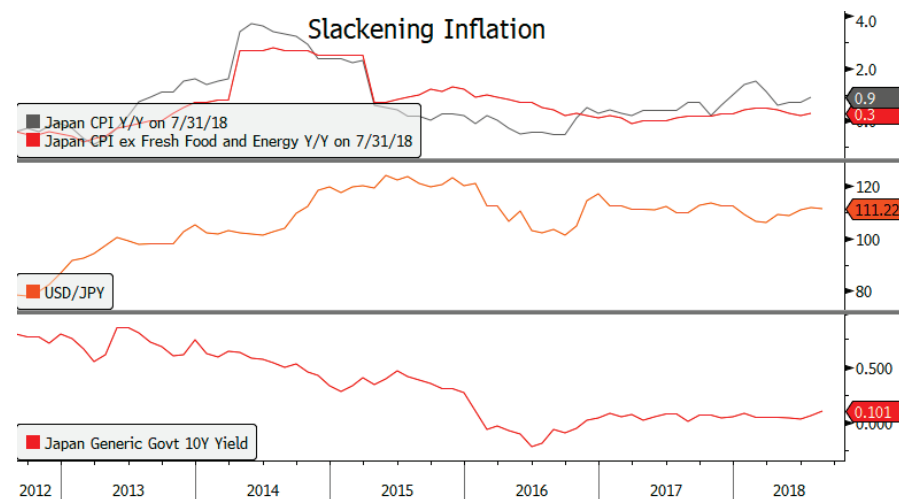
Indeed, although July nominal CPI increased by 0.90% (prior: 0.70%) amid increasing fresh food and fuel prices, core figures suggest a flattening of the measure, both given at +0.80% (ex. food) and +0.30% (ex. food and energy), like prior month and almost unchanged since the beginning of the year (+/- 0.20% range). Therefore, the likelihood of seeing the BoJ adjust its inflation forecast downward is becoming certain. During its monetary policy meeting in 31. July 2018, the MPC also confirmed that it would not be able to reach its inflation target by 2021.

Additionally, recent decision to allow a wider margin of its 10-year JGB yield, in order to lower risks induced by its long accommodative policy stance, will cause further yen appreciation due to rising yields, which is interpreted as a first step to normalization and therefore reduces the impact of inflation.

Furthermore, Japanese government decision to reduce mobile wireless carrier fees by 40%, a business that contributes to 2.3% of CPI nominal gauge appreciation, might not be the right solution to revive domestic private consumption contrarily to what initially motivated the authorities when willing to implement the initiative. Following the announcement on Tuesday 21. August, KDDI, NTT Docomo, Rakuten and Softbank lost -5.22%, -4%, -3.59% and -1.63% respectively.

Accordingly, despite recovery in Q2 GDP growth figures thanks to higher business investment, wage growth at historical high due to labor shortages and a low unemployment rate, Japanese inflation is expected to remain along 1% by the end of the year. Slowing private consumption as well as stagnating industrial production (i.e. manufacturing production) remain key economic challenges that the economy needs to meet.

Trading along 111.30, USD/JPY is currently valued along its 50 DMA, and is expected to trade sideways.



Economics

Crude Oil Climbs Its Way Back

In early July, the price of a barrel of WTI climbed as high as \$75.27, rising more than 18% in roughly two weeks and reached multi-year highs amid anticipations that the oil cartel would curb output for a longer period of time. Nevertheless, the euphoria was short-lived as the escalating US-China trade war threatens economic growth and therefore oil consumption. It didn't take long for investors to quickly unwind their long positions. In addition, the decision by several OPEC members, most Gulf countries, to pump more oil only accelerated the oil debasement, with the price of WTI quickly sliding below the \$70 threshold and then \$64.50 at the end of the month of July.

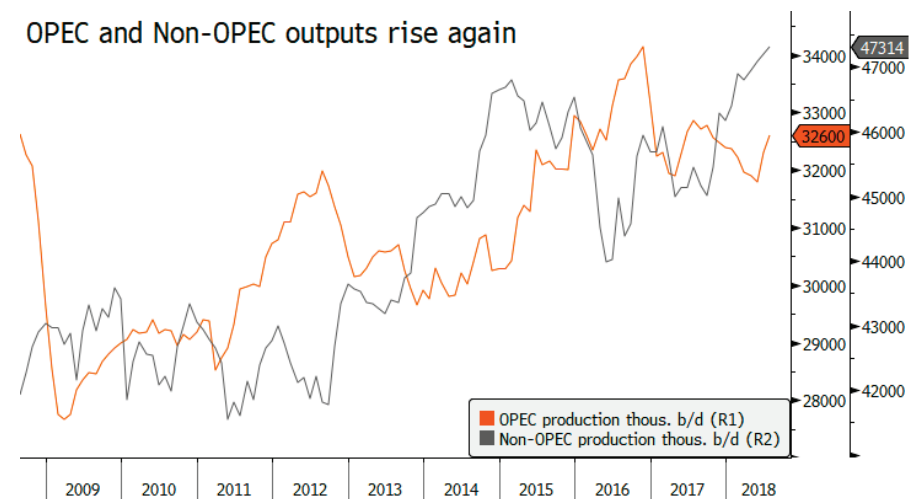
Indeed, over the summer, OPEC's oil output increased substantially to reach 32.64 million barrels a day in July, compared to 31.8 million bda in May. Regarding non-OPEC countries, the production has been increasing steadily since the fourth quarter last year, with Russia and Canada increasing output. However, the renewed sanctions against Iran and the economic crisis in Venezuela has eased worries about excess supply, in the short-term at least.

According to the last rumours, OPEC and certain non-OPEC countries are expected to agree on a mechanism to be better monitor their crude oil production. An agreement is expected to be reached by the end of the year, which would make this mechanism effective as soon as next year.

For now, the upcoming US sanctions against Iran will most likely boost oil prices, even though China is set to continue importing Iranian oil. The OPEC/Non-OPEC committee that monitors output compliance will take place on 23 September in Algeria – Iran will take part of the event. Until then, there will be wild speculations, which would ultimately lift crude oil volatility.

Finally, it looks like the already tense situation between Saudi Arabia and Iran could only worsen over time as both of them defend actively their market share. A lengthy OPEC internal war could only raise uncertainty and therefore oil prices.

OPEC and Non-OPEC outputs rise again



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