

Weekly Market outlook

21 - 27 January 2019

WEEKLY REPORT - An overview

| | | |
|-----|------------|---|
| p3 | Economics | Time For A Bullish EUR View - Peter Rosenstreich |
| p4 | Economics | Would OPEC's production cut be enough? - Arnaud Masset |
| p.5 | Economics | Postponement Likely Amid Brexit Stalemate - Vincent Mivelaz |
| p6 | Disclaimer | |

Time For A Bullish EUR View

Euro has been unable to gain traction against major G10 peers suggesting mounting downside risk. The rationale seems clear for bearish sentiment. Incoming economic data, led by weakness in Germany has been troubling. Brexit chaos has highlighted growing risk of populism while China failure to stabilize growth despite heavy policy actions indicates export markets are declining. As we have noted in our "2019 Perspective" the gap between EU and USA has become extreme. Whether it is equity valuations or PMIs, the US has outperformed the EU. The factors caused repricing Euro lower. Yet the winds of change are blowing created an opportunity to go long EURUSD.

After continued acceleration US growth appears to be decelerating which will tighten the growth gap. The political division and partial government shutdown is having a clear effect in eroding growth (estimated between 0.5 to 0.75% slowing in annual GDP). Should the effect of divided nation start to damage consumer confidence this will become a significant issue. Treasury yields meanwhile, have settled into a narrower trading range between 2.65% and 2.75% the fall in US yields aided undercut the USD. EU PMIs have bottomed indicated stabilization, helped by competitive EUR pricing, while EU is still enjoying strong labor market allowing for consumer spending insulating GDP. Fiscally the environment is starting to loosen with Germany's CDU has indicated that tax cuts are coming on top for Frances reversal of tax hike (due to yellow jackets protests). On the monetary policy front while M. Draghi recent comments have been dovish we suggest he has been focused on the near term and mid-term the ECB is on track to hike interest rates in September. In the US, expectation for additional rate hikes are waning as Fed Evans stated that this would be a good point for the Fed to pause. Tightening of yield spread differentials would certainly help the Euro as European investors, overweighed US assets, repatriate capital.

Elsewhere, news that Germany and China signed agreements to reinforce synchronization in banking, finance and capital markets, and promised to broaden and liberalize economic relations. China's weak outlook mean the news has a lower impact but remains significant to help Germany's economic fatigue. Whenever, FX markets become to one side it time to review the rationale. At this point we suspect the negativity around the Euro is accurately priced in and a reverse of bears trend is likely as negatives fade.

Would OPEC's production cut be enough?

After falling from \$76.90 to \$42.36 - a collapse of 45% - during the third quarter of 2018, the price of West Texas Intermediate crude reversed momentum into the New Year. The recovery that followed the market sell-off helped to push prices back to the \$50 area, up more than 20% from the low from December 24th. The decision of OPEC and its allies to trim production by 1.2 million barrels per day for the first six months of 2019 has been determinant - the cartel will reduce production by 800k barrel, while Russia and allies will cut by 400k barrels. However, we remain sceptical that every member of the deal would actually deliver what is expected. Indeed, it would not be the first time that such a situation would take place, especially since this is a clear opportunity for US frackers to maintain production and sell at a higher price.

Initially, it was a supply story. Indeed, US inventories have increased substantially between September and November last year, which is in our opinion is the main reason, together with the increase in OPEC's output, behind the sell-off. However, both US inventories and OPEC's production started to contract again starting early December, which helped to boost prices. Even though, this is only half of the story, the glut issue seems to be under control for now.

On the other side, the global growth outlook and more specifically the slowdown of the Chinese economy have led to major concerns over crude demand. China is now the largest importer of crude following by the US, with \$162bn and \$139bn worth of crude oil imported in 2017, respectively. Therefore, depending on growth developments worldwide, and especially in China, OPEC's decision to slash production might not be enough to lift prices on the medium to long-term.

Last week, crude oil prices edged slightly higher, with the WTI trading with a positive momentum as it climbed from \$50.30 to \$52.90. However, it has been unable to break the \$53-53.30 resistance area to the upside. On the downside, the low from Monday 14th is the nearest support.

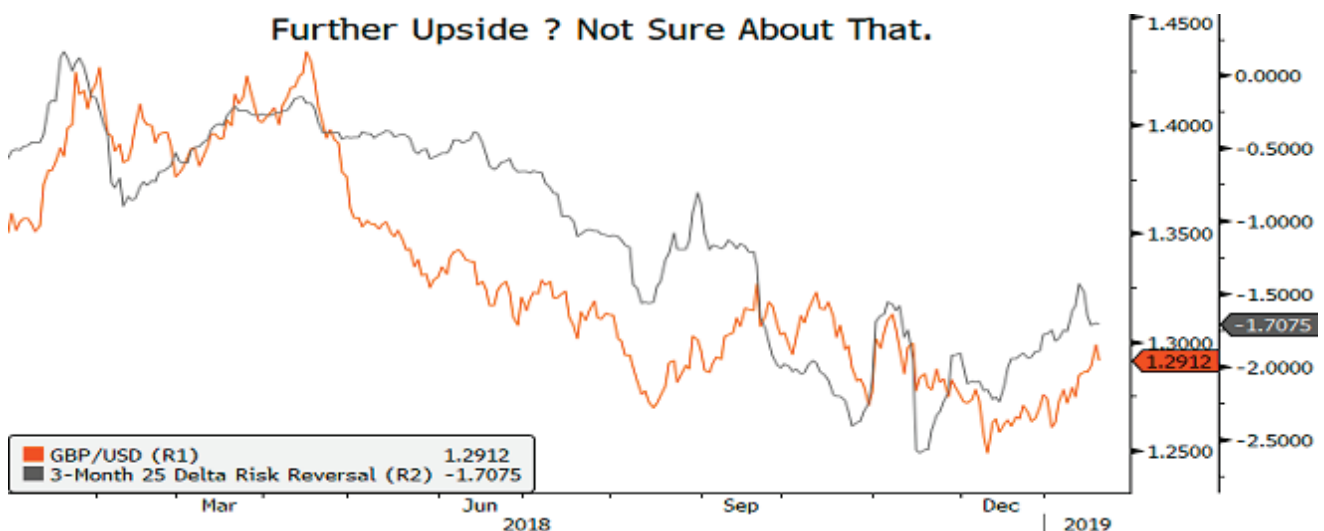
Postponement Likely Amid Brexit Stalemate

The recent development in the House of Commons has brought further uncertainty on the British economy. Last week parliamentary vote and major defeat of PM May's camp, losing the votes by a clear 432 to 202, has been followed by apparent discontent from the side of foreign businesses and British people wishing further clarity as to the future UK – EU relation.

Indeed, despite having emerged unscathed from a second vote of no confidence in a month, with a tight difference of 19 votes in its favor (prior: 83), it seems that Tory party leader is losing more and more support, thus suggesting parliamentary stalemate. Additionally, May's opposition to Labour Party Leader Jeremy Corbyn statement supporting the idea of a second referendum or closer ties with the EU is causing problems for stakeholders, as the turn of the divorce and the future direction of the British pound remains a big unknown. Although investors are currently supporting a bullish GBP bias, as shown by the progression of GBP/USD 3-month 25 Delta Risk Reversal (difference between call and put prices) given at -1.70, it seems that the trend could rapidly change.

The likelihood of seeing a largely supported plan B by Monday, which would be debated the week after, remains highly uncertain. For these reasons, the scenario of a postponement of current Brexit deadline of 29. March 2019, which would also require the validation of EU members, remains the most realistic solution for now. This would allow the UK to buy three more months until next EU elections would kick off on 23 May 2019.

Therefore, it is very difficult to forecast the future direction of the dossier. However, if the new European Parliament voted in May 2019 will not show further concessions, including on the existing North Irish backstop, the events of a second referendum or even general elections in the UK are most likely. For now, it seems that long GBP trades are highly speculative, although the risk of a hard Brexit is still subdued as for now.



DISCLAIMER

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Swissquote Bank and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions, or regarding the accuracy, completeness or reliability of the information contained herein. This document does not constitute a recommendation to sell and/or buy any financial products and is not to be considered as a solicitation and/or an offer to enter into any transaction. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or in any other kind of investments.

Although every investment involves some degree of risk, the risk of loss trading off-exchange forex contracts can be substantial. Therefore if you are considering trading in this market, you should be aware of the risks associated with this product so you can make an informed decision prior to investing. The material presented here is not to be construed as trading advice or strategy. Swissquote Bank makes a strong effort to use reliable, expansive information, but we make no representation that it is accurate or complete. In addition, we have no obligation to notify you when opinions or data in this material change. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments.

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning Swissquote Bank, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. Swissquote Bank does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are for information purpose only and are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Swissquote Bank as a result of using different assumptions and criteria. Swissquote Bank shall not be bound or liable for any transaction, result, gain or loss, based on this report, in whole or in part.

Research will initiate, update and cease coverage solely at the discretion of Swissquote Bank Strategy Desk. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. Swissquote Bank is under no obligation to update or keep current the information contained herein and not liable for any result, gain or loss, based on this information, in whole or in part.

Swissquote Bank specifically prohibits the redistribution of this material in whole or in part without the written permission of Swissquote Bank and Swissquote Bank accepts no liability whatsoever for the actions of third parties in this respect. © Swissquote Bank 2014. All rights reserved.