Weekly Update

C0 | EXTERNAL PUBLICATION

Oil market – no surprises from Vienna


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After weeks of speculation, Thursday's Organisation of Petroleum Exporting Countries (OPEC) summit reached a broad agreement to extend production curbs throughout 2018. What does this mean for the price of oil?

In September 2016, the 14 members of OPEC and a group of 10 non-OPEC producers led by Russia agreed to restrict output by 1.8 million barrels per day (mb/d) in an attempt to bring the world oil market into balance after several years of oversupply and falling prices. Compliance with the deal has been patchy until recently – according to the Energy Information Authority (EIA), maintenance work requiring well closures in Russia and Azerbaijan has enabled quotas to be met in the last two months.

Oil prices have experienced a sharp rally since this year's lows in late June, rising by around 40% by Thursday's close. This move has been driven by optimism about global economic growth driving demand for oil, and further fuelled by the output restrictions. In the run-up to the meeting, Russia had expressed reservations about extending the cuts, suggesting that the deal should be unwound if the market were to become too tight. In the event, a compromise was struck – Saudi Arabia achieved its aims with the restrictions being extended though to December 2018, and Russia obtained an agreement to review the agreement next June, thereby placating its oil companies who were worried about the impact on their bottom line.

However, we are sceptical that this week's agreement will spark a sustained rally in prices. First, with prices now back above 60$ per barrel, the temptation to exceed the quotas will be strong. Second, the maintenance work in Russia and Kazakhstan has now been completed. Finally, US production has continued to rise throughout this year.

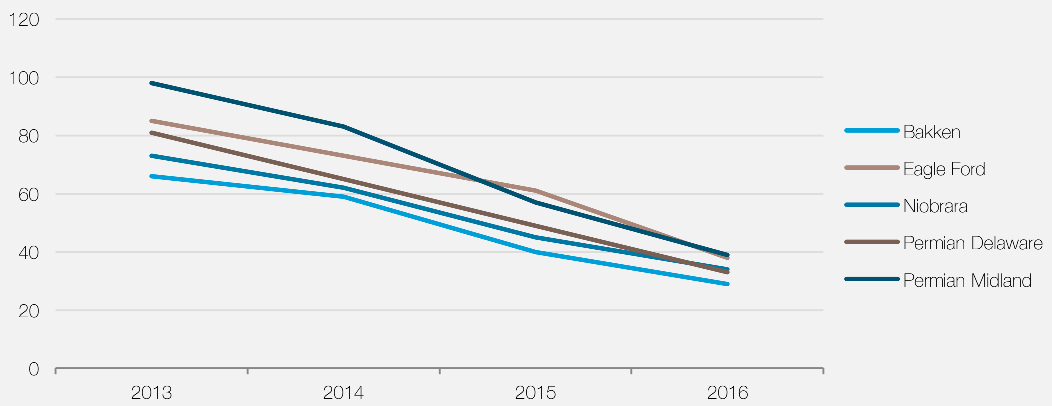
According to the EIA, US output has risen by 10.8% to 9.5 mb/d over the past twelve months, an increase of almost 1.0 mb/d. The EIA forecasts that 2018 average output will be even higher at 9.9 mb/d. This means that the additional US production since the curbs were first decided in late 2016 will compensate for the bulk of the OPEC-led output cuts.

The sustained rise is US oil production has been driven by efficiency gains in exploiting shale reserves. According to consultancy Rystad Energy, wellhead breakeven prices for the major shale fields now range from $29 to $39 per barrel, well below the $66-98 range in 2013.

Putting it all together, we continue to expect that world output will comfortably meet rising demand for oil in 2018, pushing Brent prices down – we forecast around $55 per barrel on a six-month horizon.

Shale oil is increasingly cheap to produce

Development in wellhead breakeven prices for key shale players (USD/barrel)



Sources: Societe Generale Private Banking, Rystad Energy NASWellCube (data as of November 2017)

This week and next

EUROZONE

- Eurozone economic confidence reached its highest level since 2000 in November. Over the same period, business climate improved further, breaking its 2001 high.
- The eurozone unemployment rate edged down from 8.9% to 8.8%, reaching its lowest point since January 2009.
- In October, German retail sales printed much below expectations, declining from 4.1% YoY to -1.4%.

Next week's key events		Per.	Prev.	Cons.
5 Dec	Eurozone: Markit composite	Nov	57.5	--
5 Dec	Eurozone: GDP (YoY)	Q3	2.5%	--
7 Dec	German industrial production (YoY)	Oct	3.6%	4.3%

UNITED KINGDOM

- The GfK consumer confidence index continued the decline initiated in mid-2015, falling from -10 to -12 in November.
- Mortgage approvals fell back from 66.1k to 64.6k in October.
- The PMI manufacturing confidence index rose further in November, increasing from 56.6 to a four-year high of 58.2.

Next week's key events		Per.	Prev.	Cons.
5 Dec	Markit Services PMI	Nov	55.6	55.0

UNITED STATES

- New home sales rose unexpectedly to a 10-year high of 685k in October, beating expectations (628k). Meanwhile, pending home sales jumped from 0% to 3.5%.
- The Dallas Fed manufacturing activity index edged down from 27.6 to 19.4 in November.
- Consumer confidence reached a 17-year high in November, at 129.5.

Next week's key events		Per.	Prev.	Cons.
5 Dec	Non-manufacturing ISM	Nov	60.1	59.0
8 Dec	Change in non-farm payrolls	Nov	261k	210k

ASIA & EMERGING COUNTRIES

- In Japan, retail sales fell 0.2% YoY in October. However, industrial production corrected the slowdown recorded the month before (0.5% MoM and 5.9% YoY).
- The Japanese unemployment rate stayed flat at 2.8% in October. Inflation remained muted, with the headline index down from 0.7% to 0.2% YoY and the core index up from 0.7% to 0.8%.
- In China, the PMI manufacturing confidence index edged up from 51.6 to 51.8 in November.

Next week's key events		Per.	Prev.	Cons.
4 Dec	Japan: Monetary base (YoY)	Nov	14.5%	--
5 Dec	Japan: Nikkei composite PMI	Nov	53.4	--
5 Dec	China: Caixin composite PMI	Nov	51.0	--

Sources: Datastream, Bloomberg, 1 December 2017, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets

CURRENCIES & COMMODITIES

	Thursday close	6mth target
EUR/USD	1.19	1.20
GBP/USD	1.35	1.28
USD/RUB	58.5	60
AUD/USD	0.76	0.72
EUR/CHF	1.17	1.18
USD/CNY	6.61	7.1
USD/CAD	1.29	1.37
USD/JPY	113	118
Brent	$63.8	$55
Gold	$1279	$1225

We maintain our 6-month targets this week.

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not been seen as a guarantee of future returns.

EQUITIES

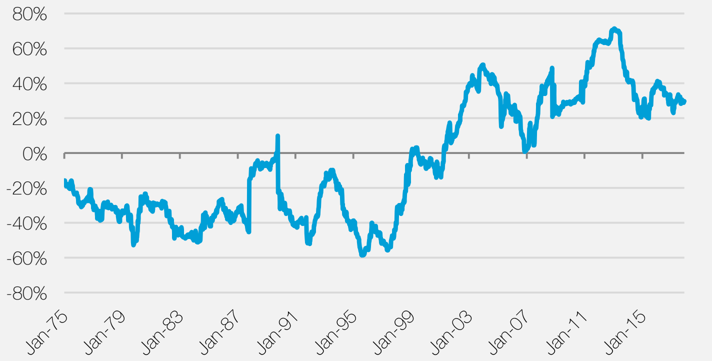
How could higher US yields impact equity valuations?

1st December 2017

According to financial theory, higher Treasury yields should be a negative for stocks in that they are often used as the risk-free rate when estimating potential equity returns (e.g. dividend discount model). Simply put, the fair value of a stock can be calculated as the present value of all future earnings, discounted by the prevailing risk-free rate. All else being equal, a rise in long-dated yields would lower a stock's present fair value, suggesting a potential price decline.

Correlations between rates and equities have not remained stable over time

2-year rolling correlation between the S&P 500 & 10yr US Treasuries



Sources: Societe Generale Private Banking, Bloomberg, Datastream, data as of 23 November 2017.

However, correlations between rates and equities have not remained stable over time (see chart above).

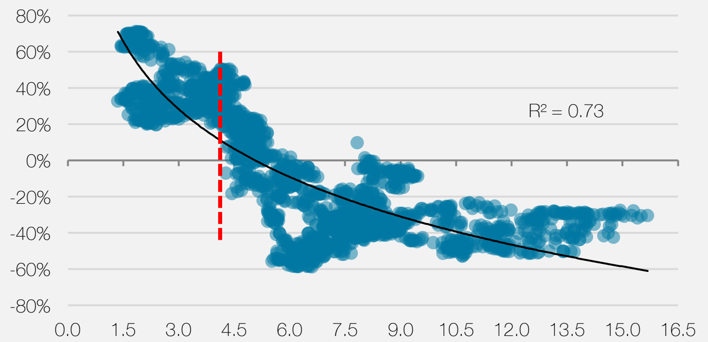
- During the late 1970s, correlations were negative – inflation fears caused sharp increases in interest rates while equities initially corrected.
- Since 2000, correlations have been positive. For example during the taper tantrum in 2013, US equities kept rising while US interest rates increased from 1.75% to 3% in one year.
- Over a long timeframe, the correlation between yields and equities has tended to be positive whenever US 10-year rates have been below ~4% (see chart below).

Looking ahead, much depends on the reasons driving any increase in yields.

- If higher yields are a result of strong economic growth and gradual Fed policy normalization, we would expect positive equity returns driven by reasonable growth in corporate profits.
- However, if US yields spike towards 3% as a result of an unexpected event – such as an upside surprise on inflation, forcing the Fed to be more aggressive than currently expected – equity markets could react negatively.

The correlation between yields and equities has tended to be positive whenever US 10-year rates have been below ~4%

2-year correlation between the S&P 500 and the US 10-year Treasury bond yield (%)



Sources: Societe Generale Private Banking, Bloomberg, Datastream, data as of 23 November 2017.

However, our 2018 rates projection does not suggest substantial risk to equity valuations.

- Our outlook remains benign – although we expect US 10-year Treasury yields to rise, we believe they will stay below the 3% mark throughout 2018.
- We do not see a significant rise in headline inflation. Wage inflation has remained pretty muted, despite unemployment falling to record lows, and we expect this to continue, given increased global competition.

Market performance

Past performance should not been seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-24 bp	12 bp	↑	10 bp	9 bp	10 bp
3mth Euribor (EUR)	-33 bp	0 bp	→	0 bp	-1 bp	-2 bp
3mth Libor (USD)	149 bp	3 bp	↑	17 bp	49 bp	55 bp
3mth Libor (GBP)	52 bp	0 bp	→	24 bp	15 bp	14 bp
10-year US Treasury bond	242 bp	9 bp	↑	29 bp	-3 bp	5 bp
10-year German bond	37 bp	2 bp	↑	8 bp	26 bp	17 bp
10-year French bond	55 bp	1 bp	→	-11 bp	-13 bp	-18 bp
10-year UK bond	136 bp	7 bp	↑	28 bp	12 bp	-6 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.0%	→	0.7 %	2.7 %	3.3 %
BAML EURO Corp HY	0.0%	→	1.4 %	6.8 %	8.8 %
BAML GBP Corp IG	-0.4%	↓	-1.4 %	3.5 %	5.9 %
BAML US IG	-0.4%	↓	0.0 %	5.6 %	6.2 %
BAML US HY	0.2%	↑	1.0 %	7.2 %	9.3 %
JPM Global EM Sov. Plus	0.2%	↑	0.3 %	11.0 %	12.3 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.19	0.4 %	↑	-0.1 %	13.2 %	12.4%
EUR/CHF	1.17	0.6 %	↑	2.6 %	9.3 %	8.7%
GBP/USD	1.35	1.6 %	↑	4.6 %	9.6 %	8.2%
USD/JPY	113	1.2 %	↑	2.3 %	-3.7 %	-1.7%
USD/BRL	3.27	1.6 %	↑	4.0 %	0.6 %	-3.3%
USD/CNY	6.61	0.4 %	↑	0.3 %	-4.8 %	-4.0%
USD/RUB	58.5	0.0 %	→	0.8 %	-4.6 %	-8.8%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	-0.3 %	↓	-1.3 %	1.3 %	1.3 %
United Kingdom (3-7yr)	-0.3 %	↓	-1.4 %	-0.3 %	0.4 %
Germany (3-7yr)	-0.1 %	↓	-0.3 %	-0.7 %	-0.4 %
Japan (3-7yr)	-0.1 %	↓	-0.1 %	0.0 %	0.0 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	505	0.7 %	↑	6.2 %	22.6 %	25.3 %
Eurostoxx 50	3 570	-0.1 %	→	4.6 %	12.0 %	20.9 %
DAX	13 024	0.1 %	↑	8.0 %	13.4 %	22.4 %
CAC 40	5 373	-0.1 %	↓	5.9 %	13.8 %	21.1 %
S&P 500	2 648	2.0 %	↑	7.7 %	20.5 %	22.9 %
FTSE 100	7 327	-1.2 %	↓	-0.7 %	6.6 %	12.3 %
SMI	9 319	0.0 %	→	4.5 %	17.1 %	22.2 %
Topix	1 792	0.9 %	↑	11.7 %	20.3 %	24.5 %
IBOV Brazil	71 971	-3.4 %	↓	1.6 %	19.5 %	16.3 %
MICEX Russia *	2 101	-2.2 %	↓	3.9 %	-5.9 %	-0.2 %
MSCI EM	1 121	-2.7 %	↓	3.3 %	32.9 %	33.3 %
SENSEX 30 India	33 149	-1.3 %	↓	4.7 %	26.1 %	26.0 %
Hang Seng (H-K)	29 177	-1.8 %	↓	4.9 %	37.8 %	33.0 %
Shanghaï Composite	3 317	-1.0 %	↓	-1.3 %	6.9 %	2.1 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$64	0.6 %	↑	22.0 %	12.5 %	27.4 %
Gold	$1 279	-0.9 %	↓	-2.8 %	10.5 %	9.0 %
Silver	$16.3	-4.7 %	↓	-7.0 %	1.8 %	-1.1 %

Source: Datastream, on 1st December 2017 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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