Weekly Update

C0 | EXTERNAL PUBLICATION

Crude, but effective

Alan Mudie
(41) 22 819 0255
alan.mudie@socgen.com

Xavier Denis
Head of investment Strategy
(33)1 5637 9817
xavier.denis@socgen.com

Antonio Bertone
Global strategist
(33)1 42 13 24 06
antonio.bertone@socgen.com

Sophie Fournier
Global strategist
(33)1 42 14 59 36
sophie.fournier@socgen.com

Oil prices – probably the most important raw material for the global economy – have been on a volatile roller-coaster these past two weeks. At end September, oil was the best-performing asset class we follow. A few short weeks later, prices have entered a bear market, defined as a drop of over 20% from recent highs. What can explain such a sharp reversal? And what's the outlook for coming quarters?

Until the sharp drop prices had been driven higher by several factors. First, strong global growth has meant strong demand for oil – according to Organisation of Petroleum Exporting Countries (OPEC), the thirst for oil rose 1.5% this year to a record 98.8 million barrels per day (mb/d). The market has also suffered various supply disruptions, such as the collapse in Venezuela's output, down 50% since 2014. Furthermore, compliance with OPEC's September 2016 agreement to cut production was high, by members and allies alike, most notably Russia. Lastly, the announcement of new US sanctions to block Iranian crude exports raised fears of a supply shock, sending prices sky-rocketing.

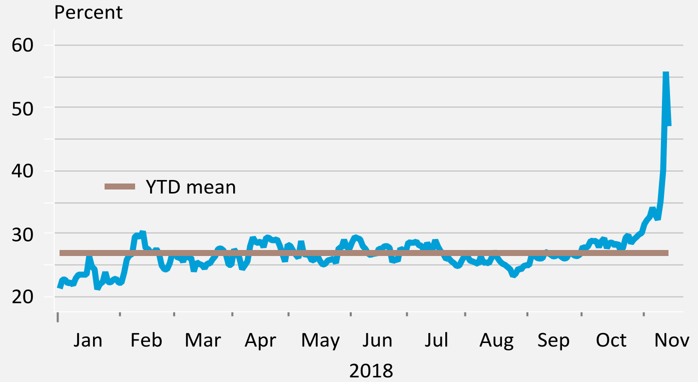
In addition to the pressure placed by Donald Trump on Saudi Arabia to ramp up output, other factors have combined more recently to push prices lower. The marked slowdown in some major economies has caused OPEC to revise the cartel's output forecasts down for next year, -3.4% to 31.5mb/d. The White House has also offered temporary waivers to a number of large importers of Iranian oil in an attempt to prevent the sanctions triggering another price spike. And finally, US crude production continues to rise – according to the Energy Information Agency, US output should be up by 11% in 2019, after +16% this year, driven by shale oil fields.

All data taken from Bloomberg (15/11/2018).

As long as fossil fuels drive the global economy, changes in oil prices will exert great influence on the economic cycle. For both companies and households, fluctuations in energy bills act like changes in the tax rate. So, the rapid rise in oil prices up to October certainly contributed to the economic slowdown, notably in Europe. By the same token, the recent falls in bills should offer support to the global economy, with the ancillary benefit of quelling inflationary pressures.

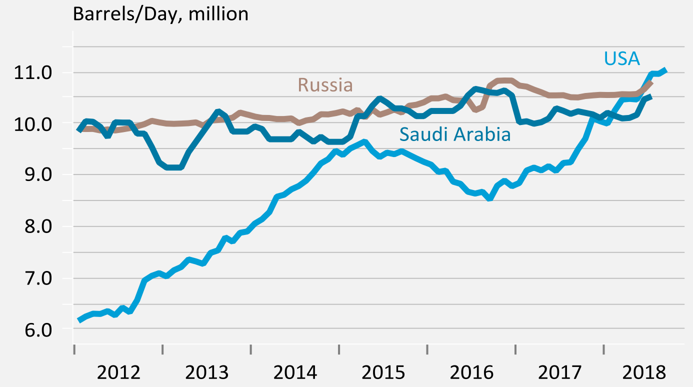
Putting it all together. We expect oil prices to stabilise next year, with Brent trading around a $70-80 per barrel range. Downside should be limited by the need for several countries, for example Saudi Arabia, to preserve public revenues given the increasing public debt. And upside should be capped by the inexorable rise of US output, already the world's largest supplier of oil.

Crude oil volatility has recently surged
Crude oil volatility, OVX index



Sources: SGPB, Macrobond, CBOE, data as of 14/11/2018

United States now the largest global oil producer
Crude oil production (the 3 major producers)



Sources: SGPB, Macrobond, EIA, data as of September 2018

This week and next

EUROZONE

- GDP grew 0.2% QoQ in Q3 vs. 0.4% in Q2. On a year-on-year (YoY) basis, GDP rose 1.7% in Q3 after a 2.2% increase in Q2 as momentum is easing.
- Germany's GDP fell 0.2% QoQ in Q3 vs. a 0.5% rise in Q2, the first contraction since 2015 as the manufacturing sector is struggling.
- Eurozone industrial production fell 0.3% MoM in September, vs. a 1.1% rise in August. The YoY rate was unchanged at 0.9%.
- Overall, the eurozone inflation rate was unchanged at 2.2% YoY in October, as expected.

Next week's key events		Per.	Prev.	Cons.
22 Nov	Consumer confidence index	Nov	-2.7	-3.0
23 Nov	Markit Manuf. PMI	Nov	52	51.7

UNITED KINGDOM

- The unemployment rate rose to 4.1% in Q3, from 4.0% in Q2.
- The inflation rate was unchanged at 2.4% YoY in October, as falling food prices offset the rise in oil prices.
- Retail sales fell unexpectedly for the second month in a row, by 0.5% MoM in October. On a YoY basis, retail sales volumes grew by 2.2% in October, at the slowest pace in six months.

Next week's key events		Per.	Prev.	Cons.
20 Nov	CBI trends (total order books)	Nov	-6.0	--
21 Nov	Public sector net borrowing (ex. Banks)	Oct	£4.1bn	£6.3bn

UNITED STATES

- US inflation rose 0.3% MoM in October, from 0.1% a month ago. This is the largest monthly increase since early-2018, due partly to higher oil prices, leaving headline inflation at 2.5% YoY.
- New York Empire Manufacturing index rose unexpectedly to 23.3 in November, from 21.1 in October, with a positive reading indicating growth in regional manufacturing activity.
- US retail sales rebounded sharply to 0.8% MoM in October, from -0.1% in September, due mainly to better motor vehicles and building materials numbers.

Next week's key events		Per.	Prev.	Cons.
21 Nov	Durable goods new orders MoM	Oct	0.7%	-1.8%
21 Nov	U. Mich Sentiment index	Nov	98.6	98.5

ASIA & EMERGING COUNTRIES

- Japanese GDP contracted by an annualized 1.2% QoQ in Q3, on natural disasters and a 1.8% decline in exports.
- China's industrial output grew 5.9% YoY in October, while fixed-asset investment rose 5.7% YTD. Both came in above expectations, and above September. However, retail sales growth was lower than expected, down from 9.2% to 8.6%.
- Indonesia recorded a $1.82bn trade deficit in October after a $230bn surplus in September, confirming the negative trend.

Next week's key events		Per.	Prev.	Cons.
19 Nov	Japan: Trade Balance (Yen)	Oct	139.6B	-70.0B
23 Nov	Japan: Manufacturing PMI	Nov	52.9	---

Sources: Datastream, Bloomberg, 16 November 2018, 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; PMI = Purchasing Managers Index

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.13	1.15
GBP/USD	1.28	1.32
EUR/CHF	1.14	1.15
USD/JPY	114	110
Brent	$67.2	$75
Gold	$1213	$1220

Oil price forecast cut.

Forecast figures are not a reliable indicator of future performance

Question time

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

FIXED INCOME: TOTAL RETURNS ON US BONDS ARE NEGATIVE SO FAR THIS YEAR

A very rare occurrence

In this week's Q&A, we look at the Fixed-Income category

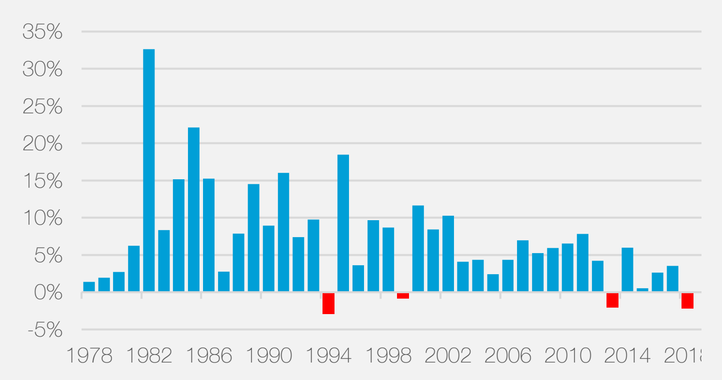
Total returns on US bonds are negative so far this year, a very rare occurrence.

Most global equity markets are negative year-to-date, but so are US bonds, an asset class which often provides diversification benefits to investors.

10-year US Treasury yields have been stuck above the 3% mark for the last two months – the highest level since 2011 – on the back of solid job creation, strong business confidence and the US mid-terms results. Risks remain on the upside however, due to above-trend growth and rising inflation – we expect yields to end the year around 3.25% and to tick higher in 2019.

This year's bond performance will be among the worst in forty years

Bloomberg Barclays US aggregate bond index



Sources: SGPB, Bloomberg, data as of 14/11/2018

Given these higher yields, US bonds have struggled this year with total returns at -2.2% *vs*. 4.0% on average over the last 10 years, according to the *Bloomberg Barclays US Aggregate Bond index* (source: Bloomberg, 14/11/2018). This broad-based benchmark measures the performance of US investment grade fixed-rate taxable bonds. Negative total returns for US bonds have been extremely rare over recent decades with only three years of negative total returns in the past 41 years (benchmark creation), namely 1994 (-2.9%), 1999 (-0.8%) and 2013 (-2.0%).

However, yields have reached levels sufficiently attractive to tempt some investors back to the market. The renewed appetite for fixed-income instruments has recently been reflected in fund flows; according to EPFR data, US net inflows totalised $6.2bn in the first week of November, the strongest subscriptions since early July.

Nevertheless, bondholders are likely to see negative returns this year. In our recently released Monthly House Views, we highlighted that we still favour US short maturities, inflation break-evens and floating rate notes to hedge against inflation surprises.

Market performance

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

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	-1 bp	→	-1 bp	-2 bp	-1 bp
3mth Euribor (EUR)	-32 bp	0 bp	→	0 bp	1 bp	1 bp
3mth Libor (USD)	264 bp	3 bp	↑	33 bp	95 bp	122 bp
3mth Libor (GBP)	89 bp	3 bp	↑	8 bp	37 bp	36 bp
10-year US Treasury bond	312 bp	-11 bp	↓	rke	71 bp	78 bp
10-year German bond	36 bp	-10 bp	↓	6 bp	-7 bp	-2 bp
10-year French bond	75 bp	-7 bp	↓	8 bp	-3 bp	2 bp
10-year UK bond	137 bp	-20 bp	↓	14 bp	18 bp	8 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	-0.2%	↓	-1.1 %	-0.9 %	-1.1 %
BAML EURO Corp HY	-1.4%	↓	-1.8 %	-2.0 %	-1.6 %
BAML GBP Corp IG	0.0%	→	-1.7 %	-2.3 %	-0.7 %
BAML US IG	-0.1%	↓	-1.7 %	-3.7 %	-2.8 %
BAML US HY	-1.6%	↓	-1.4 %	-0.1 %	1.4 %
JPM Global EM Sov. Plus	-0.7%	↓	0.0 %	-6.6 %	-4.8 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.13	-0.3 %	↓	-0.1 %	-5.7 %	-3.9%
EUR/CHF	1.14	-0.2 %	↓	1.2 %	-2.5 %	-2.1%
GBP/USD	1.28	-2.2 %	↓	0.6 %	-5.4 %	-3.0%
USD/JPY	114	-0.4 %	↓	2.6 %	0.9 %	0.7%
USD/BRL	3.78	0.6 %	↑	-3.1 %	14.2 %	14.2%
USD/CNY	6.94	0.1 %	→	0.1 %	6.6 %	4.8%
USD/RUB	65.9	-1.5 %	↓	-2.1 %	14.2 %	9.4%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.7 %	↑	-0.3 %	-0.9 %	-1.2 %
United Kingdom (3-7yr)	1.0 %	↑	0.5 %	0.5 %	0.7 %
Germany (3-7yr)	0.4 %	↑	-0.3 %	0.6 %	0.0 %
Japan (3-7yr)	0.0 %	→	0.1 %	-0.1 %	-0.1 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	487	-2.5 %	↓	-3.7 %	-2.9 %	1.3 %
Eurostoxx 50	3,190	-1.5 %	↓	-4.8 %	-5.9 %	-6.9 %
DAX	11,354	-1.5 %	↓	-6.7 %	-12.1 %	-12.5 %
CAC 40	5,034	-1.9 %	↓	-4.9 %	-2.4 %	-2.0 %
S&P 500	2,730	-2.7 %	↓	-2.6 %	3.9 %	8.6 %
FTSE 100	7,038	-1.2 %	↓	-5.2 %	-4.8 %	-0.3 %
SMI	8,870	-2.5 %	↓	-0.5 %	-2.2 %	1.0 %
Topix	1,639	-2.5 %	↓	-2.7 %	-8.0 %	-4.0 %
IBOV Brazil	85,973	0.4 %	↑	11.5 %	12.5 %	21.4 %
MICEX Russia *	2,381	-2.3 %	↓	5.0 %	12.9 %	11.7 %
MSCI EM	981	-1.3 %	↓	-3.7 %	-13.1 %	-9.2 %
SENSEX 30 India	35,261	0.8 %	↑	-6.6 %	5.6 %	8.9 %
Hang Seng (H-K)	26,103	-0.4 %	↓	-3.6 %	-9.7 %	-6.3 %
Shanghaï Composite	2,668	1.2 %	↑	-2.0 %	-19.3 %	-21.6 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$67	-6.0 %	↓	-4.6 %	0.8 %	8.3 %
Gold	$1,213	-0.9 %	↓	2.9 %	-6.9 %	-5.1 %
Silver	$14.3	-1.3 %	↓	-1.3 %	-16.1 %	-16.1 %

Source: DataStream, on 15/11/2018. 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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