

Oil tanks while US midterm theatre reaches financial markets



By Ole Hansen

Global stock markets bounced and the dollar weakened following comments from President Trump that trade discussions with China were “moving along nicely” and after he supposedly, and later denied, ordered a draft of a US-China deal.

Commodities struggled despite the weaker dollar with crude oil heading for its worst week since February in response to rising production and a potential lower-than-expected Iran sanctions impact.

The dollar reached a fresh 16-month high against a basket of currencies before running into long liquidation in response to Brexit optimism, China announcing additional measures to stimulate its economy and not least the above-mentioned trade comment from President Trump.

Trump and China’s Xi Jinping will meet at the G20 meeting in Argentina between November 30 and December 1.

Earlier this week, the US president threatened to apply

tariffs on all remaining Chinese imports but then a phone call, the first in six months, between the two leaders suddenly lifted expectations that a solution could be found. We would strongly suggest that this is nothing more than theatre designed to boost the market ahead of next Tuesday's midterm elections.

The increased risk appetite failed to extend to commodities with the Bloomberg Commodity Index trading lower for a fourth consecutive week. The index, which tracks 24 major raw materials across energy, metals and agriculture, was hurt by a continued selloff in energy and post-Brazilian election profit taking in sugar and coffee.

The weaker dollar especially against the Chinese renminbi helped give the metals a boost. John Hardy, Saxo Bank's Forex Strategist noted that: "We have speculated over the last couple of days that the CNY boost could be a move by China to pull the currency well away from its assumed floor (7in USDCNY terms) ahead of the G20 meeting".

These developments, nevertheless, helped lift industrial metals, and with that demand for semi-precious investment metals such as silver and platinum.

Both of these have struggled to keep up with gold during the past few weeks. Silver showing signs of life with a break above \$14.85/oz signalling a possible extension, initially to \$15.23/oz.

The biggest mover was crude oil which was hit by a triple dose of price negative news which further help support the negative momentum that had built up following the sharp rejection above \$80/barrel just a few weeks ago.

Instead Brent crude has returned to its \$70/b to \$80/b range that prevailed between April and August.

While we still maintain the view that Brent crude oil could reach \$80/b before year-end, the risk of an extension above has been sharply reduced this week with the change in sentiment being caused by these three major drivers:

n The EIA reported last week that US oil production jumped 3.8% in August to reach a fresh record of 11.346mn

barrels/day, a staggering year-on-year jump of 2.1mn barrels/day. Russia meanwhile said its October production reached 11.412mn barrels/day, a post-Soviet record.

n Reuters and Bloomberg Opec production surveys for October both showed that production, despite the drop from Iran, had reached the highest level since 2016.

The most noticeable increases came from Libya (+170k b/d), Saudi Arabia (+150k b/d) and UAE (+80k b/d). Iran's production only slipped by 10k b/d and is down 400k b/d since May when sanctions began to bite.

n The US is expected to give eight countries, including China and India, waivers from the Iran sanctions. This move should ensure that Iranian exports will be impacted by less than originally feared, thereby helping prevent the sanctions from lifting the price of oil.

While US oil production is rising at a record pace, Opec has now abandoned the collective agreement to keep production capped.

This comes in response to threats during the past few months that US sanctions against Iran could trigger a price spike which relatively quickly would lead to demand destruction and much lower prices.

After breaking the uptrend from early 2017 and the 200-day moving average Brent crude looks set to test support at \$70/b, the lower end of the range that prevailed between April and August. We believe crude oil will find support before long and begin a climb back towards the higher end of the mentioned range.

The reasons being a sharp reduction in hedge fund longs, reduced spare capacity leaving the market exposed to a future disruption and not least the yet unknown impact of US sanctions against Iran.

Gold had a roller-coaster week which left it close to unchanged for the period. This followed a mid-week sell-off when rising stocks, dollar and bond yields sent it looking for support.

On Monday, we raised some concerns about gold's short-term

ability to move higher after finding that hedge funds had cut what was a record bullish bets by 74% in just two weeks.

With the tailwind from short-covering beginning to fade, we concluded that gold was increasingly in need of supporting fundamentals to carry it higher.

The above-mentioned reversal in the dollar, not least against the Chinese renminbi, combined with a steady increase in holdings across exchange-traded funds backed by gold, helped support a strong bounce which from a technical perspective has left the yellow metal with two key levels to focus on in the short term.

After finding resistance at \$1,240/oz, the 38.2% retracement of the April to August sell-off, gold then challenged and found support at \$1,211.6, the first line in the sand as per the below chart. We maintain a bullish outlook for gold and would only begin to worry about a deeper correction should the price drop below \$1,192/oz.

A weaker dollar would not only support gold given its inverse correlation, it would also support a pick-up in demand from emerging market consumers and central banks who have suffered from greenback strength.

However, next week's US midterm elections will help determine the direction of the dollar and potentially also gold.

Should Trump, against current expectations, lose both the Senate and Congress, his domestic agenda would be left crippled.

Instead he would likely divert his focus towards his international agenda. Given his comment that a trade war is easy and winnable this could lead to a reduced appetite for seeking a compromise with China.

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