CRUDE OIL PRICES SAW ANOTHER BOUT OF STRENGTH FOLLOWING OPEC+ HEADLINES

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Crude oil prices surged to three month highs on the news that OPEC+ will meet on Saturday to discuss extending output cuts until the end of July. The news came after a week of mixed headlines in which OPEC+ first wanted to meet earlier than the planned June 9th-10th meeting to discuss potential extensions on output cuts, but decided to cancel the earlier meeting as reports appeared that not all OPEC+ members had complied with the agreed output cuts.

Russia and Saudi Arabia were reluctant to bring the meeting date forward without having full insight on whether or not the nations complied, but on Thursday, headlines discussed that the OPEC+ alliance will hold a virtual meeting on Saturday already, signalling that the dispute over adherence may no longer be an issue. The new deal follows a commitment from Iraq that the nation will improve its compliance to the curbs as it only cut half of its agreed 1 mln barrels a day in May.

> On Friday, reports suggested that all allies agree to extend the historic oil output curbs. Crude oil prices further rallied on the back of this, with Brent oil shooting just above $42/b while WTI also traded a leg higher at $39.50/b, both trading over 13% compared to Monday's open.

Commodity-linked currencies such as CAD, NOK, and AUD found support in the crude oil price action and further extended their gains against the dollar after a full week of broad-based dollar selling pressure.

OPEC will hold a videoconference on Saturday at 13:00 BST, followed by a conference including the OPEC+ allies at 15:00. Failure to reach an agreement this weekend could undermine a tentative recovery.

While countries globally are easing lockdown measures and gradually reviving their economies, the question remains if oil prices will be able to move back to pre-virus levels swiftly.

Even with nations emerging from lockdowns, many countries still advise their population to work from home when possible and continue holding the social distancing rules, while air traffic remains thin as well. The cutting of oil output so far has helped to engineer a 100% increase in Brent prices since April and allowed major energy companies like Royal Dutch Shell Plc and Exxon Mobil Corp. to revive, all illustrating the importance of OPEC's careful management of output quantities.

The general consensus is an agreement to roll over current quotas as headlines suggested and not reduce the current historical production cuts, but it would not be the first time for the cartel to surprise markets and turn crude oil price action upside down. Markets will turn their full focus to this weekend's meeting that may pave the way for the coming weeks' oil price action.

THE FED STANDS READY TO SWITCH TO SPEEDY RECOVERY MODE

The Federal Reserve is unlikely to trigger any policy moves at the next meeting on Wednesday 10th. Instead, the event is expected to set a transitioning tone from restoring market and liquidity stability to a more traditional policy approach: boosting financial conditions to speed up the economic recovery. While the debate on negative interest rates is broadly at ease after Fed officials cooled down expectations, the central bank continues to expand firepower under several facilities to money markets, municipalities and credit markets as the economic outlook clears out.

> “In light of the current uncertain scenario facing the US economy, any additional efforts on monetary stimulus would be rather premature.”

The main task ahead for Fed Chair Jerome Powell is to set the policy toolkit for a new stage intended to promote growth and restore employment after an ample degree of instruments has already been displayed.

Such support to economic activity could come in the form of lower long-term borrowing costs…

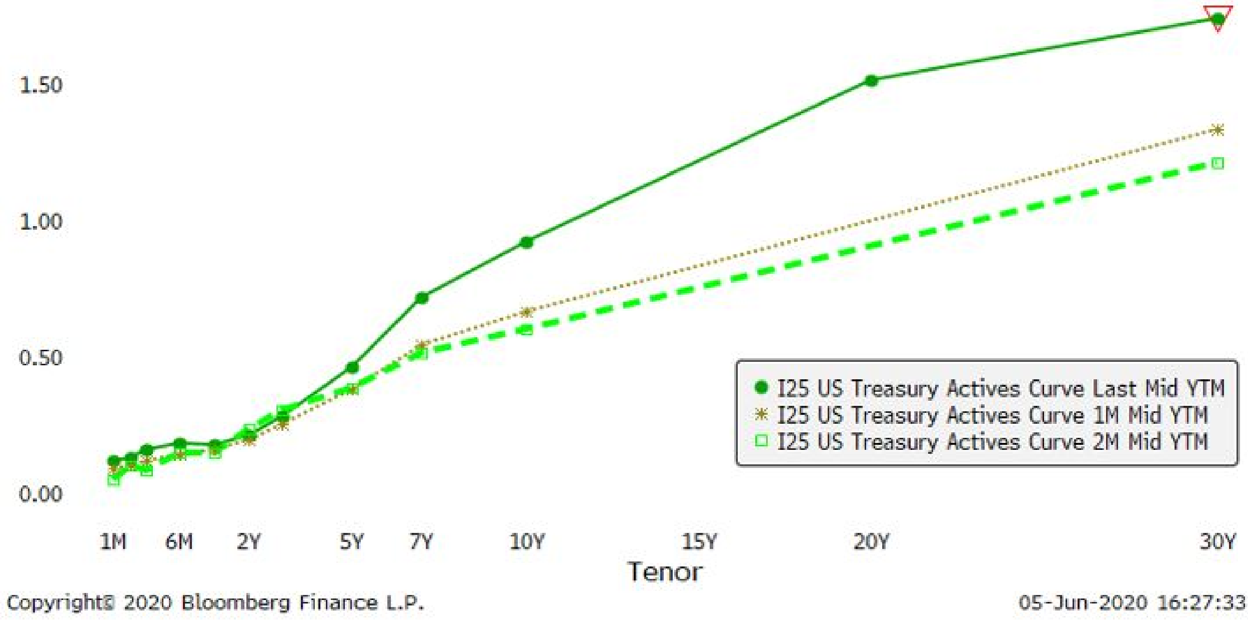
Rising long-maturity costs have reshaped the Treasuries yield curve into its steepest form in three years, translating into other borrowing costs in the economy as well. While the steepening phenomenon typically is a signal of improving growth prospects, the rather poor forward-looking activity indicators combined with a buoyant risk-on mood in equities warns for unwanted policy effects. Market proxies for inflation expectations show U.S. consumer prices printing below 2% for decades, although a touch higher than their March lows. Forward inflation swap rates in the U.S. and the euro-zone, favoured by policymakers for long-run inflation expectations, have also rebounded but remain below long-term averages.

One way the Fed could tapper high yields in order to stimulate short-run real investment is by setting clear limits on their ceiling, that is, adopting the so-called Yield Curve Control (YCC).

While the extensive quantitative easing undertaken by the Fed aims at bringing down long-term rates sufficiently, the Fed remains blindsided by the amount of bond-buying required to trigger a fine tuned move. Alternatively, committing to a certain yield cap by purchasing whatever is needed to enforce it, would be a more straightforward approach. Since short- and medium-term borrowing rates are already low, targeting longer-term rates could be rather handy. However, committing to long-term yield control over a rather clouded economic outlook is a risky step to undertake in the current stage, as excessive inflationary risks could arise in the future. Even though the Fed would welcome some flare-up to current inflation expectations, an anticipated move in this direction could render undesired economic effects in the years ahead.

In the next policy meeting, the Fed will release the first set of economic forecasts since December after suspending its March release on the back of unprecedented uncertainty. While the new forecasts will also be judged with wide scepticism, fresh macroeconomic projections should set the tone for further policy action and the likelihood of undertaking the YCC road. The consensus view across surveys indicates low expectations for a decision on yield-curve control at the June meeting, as also hinted by Cleveland Fed President Loretta Mester in a Bloomberg interview on May 29th. However, a narrow majority of surveyed economists expect yield targeting at some point this year, something that Fed officials have been "thinking very hard" about according to New York Fed President John Williams.

US Treasury yields curve stands at its steepest position in three years.



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