Weekly Market Summary

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A Critical Italian Referendum .. A Last Minute OPEC Surprise .. And US Jobs Data That Shouldn't Really Matter !!

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Two days before a Sunday referendum that could prove to be the biggest risk for markets going into year-end and decide his political future, Prime Minister Matteo Renzi got the latest indications with regards to Italy's economic health. The euro region's third-biggest economy expanded 0.3% in the third quarter, whilst second-quarter GDP was revised higher to show growth of 0.1% (rather than the original 0% stagnation). Unemployment fell slightly to 11.6% in October - its lowest level since December 2012 - and manufacturing PMI rose to 52.2, above the 50 level that divides expansion from contraction. But improvement in the Italian economy has come with a hefty price tag, with public debt pushing to the highest amount in the euro area at 2.21 trillion euros ($2.35 trillion, or 130% of GDP). Renzi has also benefited from the European Central Bank's unconventional monetary policy, the euro's more favorable exchange rate and cheap energy prices. All that surely helped Italy emerge from a double-dip, record-long, recession that began in 2008.

The new economic numbers might influence undecided electorates heading to the polls on December 4th to pass or reject constitutional reforms that Renzi says are needed to move the country forward. Voters will be asked whether they approve of amending the Italian Constitution to reform the appointment and powers of the Parliament of Italy, as well as the partition of powers of state, regions, and administrative entities. Should the bill be approved, it would achieve the most extensive constitutional reform in Italy since the end of the monarchy, not only influencing the organization of the Parliament, but also improving, according to its proponents, on poor government stability of the country. Otherwise if Italy votes "no" - as polls forecast - PM Renzi may quit (he has previously promised to resign if the electorate rejects his proposals!), with some analysts even suggesting that a "no" vote could spark an immediate financial crisis in Italy and ultimately lead to the destruction of the entire Eurozone and the collapse of the single currency. Additionally, the Italian bank recapitalization plan - recently enacted - would directly be in jeopardy (especially as Monte Paschi's capital hike is due to be launched around December 8th).

Moving to oil markets, OPEC sealed a last minute deal to limit oil production for the first time in eight years (deal rumored to have been struck following a phone call between Saudi's Energy Minister Khalid Al-Falih and his Russian counterpart Alexander Novak in the early morning hours of November 29th), confounding skeptics as the group struggles to clear a record global glut and prove its credibility. As a result, crude did rise as much as 12% in the past 72 hours, with Brent last at $ 53.50 (and a high of $ 54.73 yesterday!) OPEC will reduce output to 32.5 million barrels a day, Iranian Oil Minister Bijan Namdar Zanganeh told reporters in Vienna following a ministerial meeting last Wednesday. The breakthrough deal, effective January, showed an acceptance by Saudi Arabia that Iran, as a special case, can still raise production. "*This should be a wake-up call for skeptics who have argued the death of OPEC,*" said Amrita Sen, chief oil analyst at Energy Aspects Ltd.

After weeks of often tense negotiations, the eventual alignment of OPEC's biggest producers points to the increasing dominance of Iran among the group's top ranks. It was allowed to raise output to about 3.8 million barrels a day, a victory for a country that has long sought special treatment as it recovers from sanctions. Saudi Arabia, which raised oil production to a record this year, will reduce output by 486,000 barrels a day to 10.058 million a day, an OPEC document shows. Iraq, OPEC's second-largest producer, agreed to cut by 210,000 barrels a day from October levels, despite the country's previous push for special consideration (citing the urgency of its offensive against Islamic State). The United Arab Emirates and Kuwait will reduce output by 139,000 barrels a day and 131,000 a day respectively. The agreement also called for a reduction of about 600,000 barrels a day by non-OPEC countries, with Russia agreeing to cut its production by as much as 300,000 barrels a day "*conditional on its technical abilities*," according to Energy Minister Alexander Novak said in Moscow. Russia, the biggest producer outside the bloc, had previously resisted calls to trim its production, insisting it would only consider a freeze. As always, the strength of the deal will depend on whether all parties deliver on their commitment. Saudi Arabia and its Gulf allies the U.A.E. and Kuwait have traditionally stuck to their cuts, but some others have not, particularly when prices are low. Any doubt in the market could once again see prices come under pressure. Indonesia requested a freeze of its OPEC membership, though its suspension will not affect the size of the group's production cut, one delegate said.

Last - but not least - the monthly U.S. jobs report* for November will be released this afternoon (4:30 pm Bahrain time). As always, welcome to random number generator, also known as US Non-Farm payrolls ("NFP"): Bloomberg's consensus is for a 180,000 increase in jobs on the month (although the whisper number is possibly higher at 200,000 following the stronger-than-expected US ADP Employment release on Wednesday), a slightly lower/improved unemployment rate (4.8% versus 4.9% in October), an unchanged workweek (at 34.4 hours) and a benign wage component (+0.2% month-month, and unchanged 2.8% YoY). Unless the number prints substantially weaker-than-expected, the US Federal Open Market Committee (FOMC) will proceed with hiking interest rates at its December 14th meeting, validating what fixed-income markets have already fully priced in when it comes to short-term interest rates. The report, however, could contain insights that help shed light on the subsequent path of policy interest rates, especially that the balance of risks to the U.S. economy has shifted to the upside for both growth and inflation since the Fed last met in early November: Further strength in the labor market, which is getting a lot closer to "full employment," is being accompanied by bullish housing and equity news. In addition, the economic and financial headwinds from abroad have significantly abated (though recent history suggests that it could take less than 72 hours for such positive sentiment to reverse, with the usual suspects being weaker-than-expected economic data going forward, an Italian referendum that goes wrong, a further upside in yields that dent future stocks rallies, rising Chinese capital outflows, faltering oil prices, mounting global political and geopolitical tensions, … and the list goes on and on!). At least for now, some of the anticipation and excitement has been taken away from the highly watched data release on the first Friday of the month. But don't let that fool you! The employment report remains an important input for assessing the future of monetary policy

**The US job market – released later in the day - showed further progress towards full employment, but the overall report was more of a mixed bag. Positive news on job creation and unemployment was offset by a slip in labor force participation and wages. Nevertheless, the employment numbers easily surpassed the low bar needed to keep the Fed on track to hike rates later this month, and as such we remain confident that the Fed will go ahead and hike the overnight fed funds rate by 25 bps (from 0.375% to 0.625%) at its upcoming December 14th FOMC meeting. Non-Farm Payrolls showed an increase of 178,000, in line with consensus, with little revisions to the past two-months' pace of hiring. Moreover, the unemployment rate fell three ticks to 4.6%, but some of that was due to a fall in labor force participation. Wages were less upbeat, with hourly earnings falling 0.1% on the month (leaving the year-on-year up 2.5%, down from +2.8% in October).*

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