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MARKET OUTLOOK FOR EUROPE, THE UK, RUSSIA & INDIA

Financial & Grain Outlook by Paul Mylchreest, Equity Strategist for ADM Investor Services International Ltd.

The following is an overview of the European, Russian and Indian economic, political and crop situations as of ***20th October 2015.*** *This report is intended to be informative and does not guarantee price direction.*

FINANCIAL OUTLOOK

EUROZONE

We find it slightly surreal that the US CPI for September was 0.0% and the Eurozone CPI was -0.1% and the debate is whether the Fed will tighten policy and the ECB will provide additional stimulus? The PMIs provide further irony with the Eurozone Manufacturing PMI for September coming in at 52.0, nearly two points higher than the US ISM Manufacturing index at 50.2. While our sense is that the recoveries in the Spanish and Italian economies are losing a little of their momentum, this is probably compensated by slightly stronger conditions in France and a continuing rebound (from very low levels obviously) in Greece. German economic growth remains relatively steady, with surveys suggesting good levels of new orders and no significant impact from the Chinese slowdown.

UK

Given the dominance of the UK Services sector, the sharp decline in the Services PMI is beginning to worry us, a concern we signalled last month.

As recently as April, this indicator stood at 59.5 and has subsequently fallen to 53.3. This was the weakest reading since April 2013, and a slowdown in new business has been a significant factor. It almost goes without saying that the Manufacturing sector remains subdued, with notable weakness in new orders. With sluggish growth and the CPI slipping back into deflation – the second reading of -0.1% in 2015 – there is no pressure on the Bank of England to raise rates. We were surprised by the surge in mortgage approvals (+12.4% in August), which suggests that the boom in UK house prices might still have another leg to go. This might be beneficial given the recent levelling off in consumer confidence after a more than three-year recovery.

RUSSIA

Last month, we commented that Russia's military support for the Assad regime in fighting Islamic State militants looked like a geo-political masterstroke from the perspective of outwitting NATO. So far this is playing out, although it's far too early to say that we are seeing the renaissance of Russia as a super power. Indeed, one of the risks of Russia's Syrian strategy is that it has set its interests squarely against those of Saudi Arabia, which is hoping that the low oil price will force Russia to withdraw its support for Assad. In a sense, we may be waiting for one of the world's two largest oil producers to "blink."

In economic terms, the only encouraging news is that we've seen the Ruble recover to Rub61 versus the US dollar after its recent re-test of its Rub70 all-time low. The substantial decline in foreign exchange reserves has levelled out and even showed a modest recovery from US$297.1bn in April to US$307.9bn in August. We have been so bearish on the Russian economy that we are still skeptical, even when we see the emergence of some potential "green shoots." Nonetheless, both the Manufacturing and Services PMIs showed some improvement in September versus the previous month. Manufacturing rose from 47.9 to 49.1 and Services crossed over into expansion territory from 49.1 to 51.3. While industrial production in September declined by 3.7% year-on-year, this was the smallest drop in the last six months.

INDIA

We must confess that we find the immediate outlook for India's economy particularly difficult to read at the moment. Ironically, Finance Minister Arun Jaitley has just proclaimed that India is insulated from the global slowdown, as the decline in oil and other commodity prices is having a positive impact. He neglected to make any reference to the dramatic September decline in the nation's exports and imports of 24.3% and 25.4%, respectively.

The September Manufacturing PMI report registered a seven-month low of 51.2, well below the recent high of 54.5 at the end of 2014. The recent decline was led by a weakness in new orders and output trends – which doesn't augur well for the economy's prospects.

On an upbeat note, the latest data on industrial production showed an acceleration in year-on-year growth in August to 6.4% from 4.1% the previous month. The Reserve Bank of India took advantage of the decline in the CPI to 3.7% to cut the repo rate by a more-than-expected 50bp to 6.75% on 29 September 2015. This followed cuts of 75bp made in three steps earlier in 2015. With the central bank playing its part, it would be helpful if Prime Minister Modi could overcome the political gridlock to enact some of his planned reforms.

GRAIN REVIEW

EU GRAINS

Following last month's "catch-up" 6.3mt increase in USDA's forecast for 2015/16 EU wheat production, the agency increased its estimate in October by a further 1.1mt to 155.3mt. The increases keep coming, with the EU Commission raising its forecast by 2.0mt and consultancy Strategie Grains doing exactly the same to its estimate for this year's soft wheat harvest.

Forecasting EU wheat exports remains a more difficult proposition in our view. We have sympathy with Strategie Grains, which has cut its forecast for EU exports in 2015/16, in contrast to this month's increase from USDA. We've commented in recent months how major EU suppliers like France have struggled to be competitive in the face of Black Sea suppliers while also contending with better-than-expected harvests in traditional customers like Morocco. In a mid-October tender for 240,000 tonnes, Egypt took offers from Russia, Romania and France and accepted those from the first two.

To add insult to injury, several countries have raised domestic subsidies for wheat production in the recent past. Adding a new angle to protectionism, India announced an increase in customs duty on wheat imports from 10% to 25% this month. This was attributed to low international prices and the expected impact on local producers of overseas imports.

With forecasts for world wheat 2015-16 ending stocks still on the rise (e.g. USDA +1.9mt to 228.5mt), a bullish case for wheat remains difficult to craft. Not surprisingly, the funds remain positioned to the short side in Chicago Wheat Futures. However, the 31,506 net short position is considerably smaller than the record 77,000 net short earlier this year. On a bullish note, we still haven't seen much impact from El Nino. The Australian Bureau of Meteorology warned recently that the current El Nino could reach record levels by Christmas. Production estimates in the Southern Hemisphere remain vulnerable.

RUSSIA/UKRAINE GRAINS

Dry weather and below-normal temperatures have adversely affected planting in parts of the Russian and Ukrainian wheat areas. Indeed, about 70% of wheat planting areas in Ukraine were reported to be suffering from lack of moisture in mid-October. The encouraging news is that rains are forecast for later this month, which should improve prospects for the 2015/16 crop. Despite the difficult start, USDA raised its forecast for Ukrainian wheat production (again) by 0.5mt to 23.5mt and maintained its forecast for Russian production at 61.0mt (having increased it by 1.0mt in September).