Daily Forex News(2016.01.26) Source: Fxprimus Forex Broker (Review and Forex Rebates Up to 85%) Many markets rallied last week as oil jumped over 10% in one day, but that bout of mean reversion didn't last long. A whole host of markets that had suddenly recovered turned around again yesterday - oil prices fell back and with them stocks and bond yields dropped too while credit spreads widened out again. It appears that oil fell because of speculation about this week's inventory data, which is expected to show a further large (4mn barrel) rise in US oil inventories. The curious point for the markets though is why oil is driving everything else. If it were because of oil's role as an indicator of economic activity, then collapsing oil prices would be a good barometer of a collapsing world economy and there'd be plenty of reason for stocks etc to fall in line with oil. But **the correlation between oil prices and other asset markets is rising to unusually high levels just as the fundamental relationship between them is breaking down.** Oil prices aren't falling because of a lack of demand but rather because of an increase in supply that's caused by technological change, which should be a good thing. The correlation should be decreasing, not increasing. That's one part of what's being called **the oil conundrum**. The other part is why lower oil prices haven't benefited the world economy as much as they did in the past. Oil prices act as a tax on consumers. When oil prices fall, consumers are left with more money to spend on other things, and usually that benefits the economies of oil-consuming countries. Why it hasn't done so as much as usual this time around is the other part of the oil conundrum. **One reason for the higher correlation between oil and other asset classes may be because of the increasing use of automated trading.**It could be that computer-driven trading programs are picking up the fall in oil prices and trading automatically based on past relationships. Then other algorithmic trading programs pick up the pattern and trade on that in a self-reinforcing circle. In that case, **I expect that eventually people will realize that there has been a regime change and will write new programs that behave differently.** The correlation will break down and assets will be able to move on their own fundamentals again. But that may take some time. **The trigger for a breakdown in the correlation would probably be a visible improvement in the world economy that demonstrates the beneficial effects of lower oil prices. Looking at last week's disappointing preliminary PMIs for the Eurozone, we're not there yet, and this week's US Q4 GDP figure isn't likely to change anyone's mind about it, either.** So the correlation rightly or wrongly is likely to continue for some time, and that means further volatility in asset markets. **USD as the ultimate safe-haven currency is likely to benefit; AUD, CAD and other commodity currencies may suffer further. CAD in particular seems vulnerable to me after last week's lower-than-expected Canadian CPI figure**, which leaves some room for Bank of Canada to ease. JPY has been strengthening recently on some safe-haven flows, but much depends on what the Bank of Japan does. So far BoJ Gov. Kuroda seems convinced that inflation is returning to his target level, even if he has to lower the target somewhat to reach it, but we will learn more about their thinking after the Policy Board meeting on Friday. www.fxprimus.com