Sunset

Thursday, 20 July 2017

Headlines

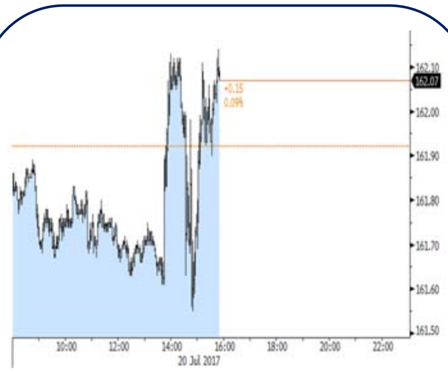
- **European equities started the day on a strong footing, supported by constructive earnings and dipped only temporarily during the ECB press conference.** Daily gains of the Euro Stoxx 50 hover around 0.50%. **American markets also opened in positive territory but gains are more limited than in Europe.**
- Unsurprisingly, the **ECB left its policy rate unchanged and maintains the pace of bond purchases. ECB present Draghi maintained a soft assessment. He acknowledged that the euro's strength "received some attention"** and said **a sudden change in financing conditions would be "the last thing the governing council wants"**. He **also said "financing conditions remain broadly supportive** to secure a sustained return of inflation rates towards our inflation aim".
- **UK June Retail Sales June surprised to the upside, helped by warm weather conditions and early timing of the Muslim festival of Eid.** Retail sales excluding auto fuel rose 0.9% M/M (3.0% Y/Y) while only a 0.5% rise was expected (2.5%). In the previous month, retail sales had declined by 1.5%.
- The **weekly initial jobless claims in the US came in better than expected at 233K while 245k was expected, confirming healthy labour market conditions.**
- The **Philadelphia Fed's headline General Business Activity index declined** more than 8 points from 27.6 in June to 19.5 in July. **Consensus expected a smaller decline to 23.** The number however still points to solid expansion. The survey also showed that **price pressures moderated but price expectations for the six months to come rose**.
- **EU and UK negotiators ended their four-day round of talks** today **with little common ground found on the role of the European Court of Justice, the divorce bill or the Irish soft border.** The clock is ticking on Brexit but talks on the free-trade agreement have to wait until "sufficient progress" has been made on the above mentioned issues.

Rates

Soft Draghi cannot really convince bond markets

Global core bonds moved up and down after the release of the ECB statement and during the press conference, but couldn't choose a firm direction. The statement was dovish, as the decision was unchanged from June, including the easing bias on the APP (asset purchase programme ,see below). The text of the statement was virtually unchanged and during the press conference **Mario Draghi held a dovish tenure.** The ECB doesn't want an unwarranted tightening of financial conditions and will eventually react if condition do tighten (easing bias). He was optimistic on the growth outlook, but doesn't see any tangible signs of a sustained upturn of underlying inflation. He said **the general council was unanimously in its decision, including in having no precise date for when**

to decide on policy changes. The council left that deliberately open. The **Committees were not charged with technical preparations** for the implementation of the APP after end 2017 and **he even suggested that the final discussion would not necessarily happen in September**. It might be later. Despite this dovish performance, Bunds couldn't really catch a sustained bid.



German Bund (intra-day): Quite some volatility (in limited) range but no firm direction despite dovish Draghi performance. .

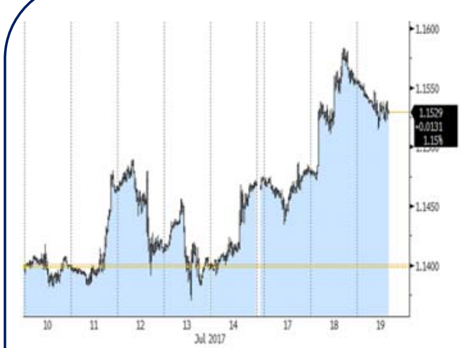
The ECB kept, as expected, both its rates (repo: 0%, depo:-0.40%) and its guidance on rates unchanged. It expects rates to remain at the present level for an extended period of time and well past the horizon of the asset purchases. The ECB also confirmed the $60B/month asset purchases till at least the end of December 2017 and, contrary to about halve of the forecasters, it also kept its guidance on this point intact. "*If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, we stand ready to increase our asset purchase programme in terms of size and/or duration.*"

At the time of writing, German yields fell very modestly by 0.5 (2-yr) to 2.1 bps (5-yr). The 30-year yield rose 0.4 bp. **Changes on the US yield curve** were limited too and range between flat (2-yr) to -2.2 bps (30-yr). **On intra-EMU bond markets,** peripherals benefitted from the Draghi comments. 10-yr yield spread changes versus Germany ranged from -4 bps (Portugal) to -7 bps (Italy/Spain).

Currencies

Soft Draghi not soft enough to hurt the euro

Today, the focus for global FX trading was on the ECB policy decision. The ECB left its policy unchanged, kept its commitment to extend asset purchases if needed and didn't commit on the timing of a policy reassessment. Despite this soft ECB communication, the euro rebounded during the press conference as the ECB president wasn't very worried on the recent rise of the euro. EUR/USD currently trades in the 1.1550 area. USD/JPY is little changed in the low 112 area.



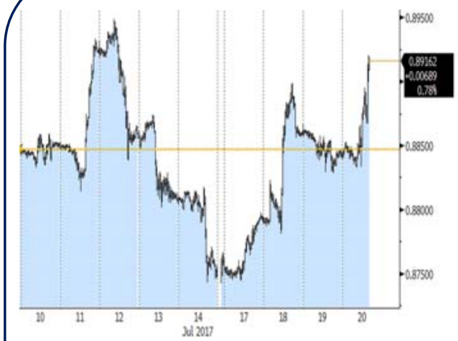
EUR/USD (2-w) holding near the recent top despite soft Draghi assessment.

The BoJ kept its policy unchanged overnight, as expected. **The yen weakened slightly on the prospect that the BoJ will lag the Fed and the ECB on its way to policy normalisation.** USD/JPY returned north of 112. However, changes were negligible. EUR/USD drifted lower toward the 1.15 mark as investors took partial profit on the recent rally ahead of the ECB decision.

During the morning session, trading in the major dollar cross-rate developed in wait-and-see modus as investors looked forward to the ECB policy decision and press conference.

The ECB, as expected, left its policy unchanged. **The euro dropped temporary below the 1.15 mark as the ECB maintained its language that it stands ready to increase asset purchases in size and duration if the economy worsens.** Sentiment changed however during Draghi's press conference. On **a question regarding recent euro strength, the ECB president said that the euro repricing received some attention in the meeting** but at the same time said that financing conditions remain broadly supportive. The 'objective' message from the ECB president was little changed from recent soft ECB communication but the

market apparently expected that he would be more worried about the recent rise of the euro and the rise in EMU yields. This 'feeling' propelled the euro higher in the 1.15 area. EUR/USD currently trades in the 1.1555 area. The US eco data were mixed with the claims lower/better than expected and the Philly Fed index softer than expected, but the data hardly had any impact on the dollar. The fall-out from the ECB press conference had little impact on USD/JPY. The pair still trades in the low 112 area. **Conclusion: the ECB president was soft, but not soft enough to weaken the euro. A decline of EUR/USD clearly needs support for a stronger dollar too.**



EUR/GBP (2-w) rebounds north of 0.89 on Brexit-related sterling weakness and euro strength

Lack of progress in Brexit-talks weighs on sterling

Today, **Brexit-noise rather than the retail sales data unexpectedly dominated the price action in sterling.** UK trade secretary Fox in an interview repeated that the UK will try to secure a deal, but that it can survive without a deal. Comments from negotiators from both sides were more balanced, but couldn't hide deep differences on key issues at the end of this week's negotiations. EUR/GBP started a gradual rebound of the intraday lows in the 0.8835 area. The UK June retail sales (0.6% M/M and 2.% Y/Y) rebounded more than expected, but were not able to reverse the negative sterling sentiment. EUR/GBP soon resumed its intraday rebound to the high 0.88 area. Cable also lost about a full big figure and dropped to the 1.2950 area. This afternoon, the rebound of EUR/USD during the ECB press conference also filtered through into the major sterling cross-rates. EUR/GBP trades north of 0.89 again. Cable regained some ground in lockstep with EUR/USD and trades in the 1.2970 area.

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.16%			0.53%			1.29%		
Greece (2-10-20)	3.51%	367	4.5	5.28%	475	3.1	6.49%	521	0.2
Portugal	1.28%	144	-0.2	3.02%	249	-3.7	3.90%	262	-4.3
Italy	0.82%	98	-2.5	2.12%	159	-6.6	3.23%	194	-6.8
Spain	0.26%	42	-3.4	1.48%	95	-6.6	2.76%	147	-5.0
Ireland (4-10-30)	-0.26%	-10	0.8	0.82%	29	-1.1	1.89%	61	-1.7
Belgium	-0.07%	9	0.2	0.80%	27	-0.7	1.79%	50	-1.1
France	-0.06%	10	-0.5	0.78%	25	-1.2	1.81%	52	-1.6
Austria	-0.16%	0	0.0	0.70%	17	0.2	1.62%	34	0.3
Netherlands	-0.21%	-6	0.1	0.65%	12	-0.1	1.35%	6	-0.0
Finland	-0.13%	2	0.7	0.52%	-1	0.0	1.42%	14	-0.1
US	1.81%	197	0.9	2.24%	171	-1.3	2.81%	153	-3.9
UK	0.58%	74	1.7	1.20%	67	1.6	1.84%	55	0.4

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