Sunset

Tuesday, 17 January 2017

Headlines

- **European recovered most intraday losses as British PM May's speech triggered a relief rally. Most indices currently trade around 0.1% lower. Losses at US stock markets are slightly bigger** as US investors had some catching up to do after yesterday's holiday (Martin Luther King Day).

- **Theresa May promised a clean break for Britain from the EU.** She promised to seek an agreement with the bloc that meant "the freest possible trade" while allowing the UK to "control of the number of people who come to Britain from Europe". However, she did confirm that **both houses of parliament would have a vote on the final Brexit deal.**

- **German ZEW investor sentiment** unexpectedly increased from 63.5 to 77.3 in January (vs. 65.0 expected), the highest level since mid-2011. However, the important "expectations" index rose less than expected, from 13.8 to 16.6 (vs. 18.4 expected).

- **U.K. inflation** accelerated to the fastest pace in more than two years in December as the pound's decline drove a surge in import costs. Consumer-price growth increased to 1.6%, the highest since July 2014, from 1.2% in November. A separate report showed the cost of imports soared at the fastest annual rate in more than five years.

- **US January Empire Manufacturing disappointed.** The indicator declined from a downwardly revised 7.6 to 6.5, while consensus expected 8.5. The index is quite volatile, but it still illustrates the ongoing sting of a strong US dollar and tepid global growth on American factories.

- **Credit standards for loans to enterprises tightened somewhat in the fourth quarter,** driven mainly by developments in the Netherlands, according to the ECB's Bank Lending Survey. **Euro zone banks expect loan demand to rise and qualifying to borrow to be easier in the first quarter of 2017** as economic activity continues to expand.

- **Saudi Arabia's energy minister al Falih, said he did not believe the US could add 2-3m barrels a day of oil production any time soon,** despite the recovery in prices. Brent crude trades near the middle of the $54-58/barrel trading range which is in place since the beginning of December 2016.

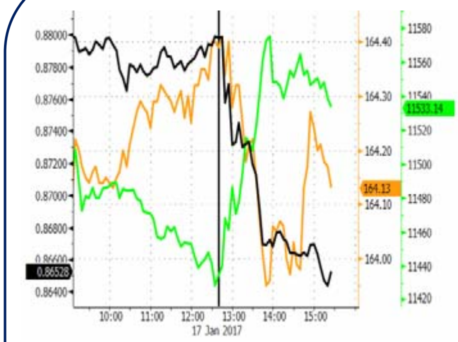
- **Chinese President Xi Jinping offered a vigorous defence of globalisation and free trade** in a speech at the World Economic Forum in Davos, which underscored Beijing's desire to play a greater global role as the US turns inward.

- **Morgan Stanley** said its quarterly earnings climbed 83% and beat analyst expectations as the bank logged its strongest Q4 profit since 2006. Morgan Stanley has tended to struggle toward year-end, in part due to legal set-asides that are now largely behind it.

Rates

Risk sentiment and British PM May drive trading

Today, global core bonds profited from initial risk aversion. However, they lost some of the gains as British PM May's speech triggered a relief risk rally. At the time of writing, the German yield curve bull flattens with yields 0.3 bps (2-yr) to 4.5 bps (30-yr) lower. Changes on the US yield curve vary between -4.9 bps (2-yr) and -8.1 bps (5-yr), but cover a two-day period. US markets were closed yesterday in observance of Martin Luther King Day. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany narrow up to 2 bps with Belgium outperforming (-5 bps) on supply reasons (see below). Greece underperforms (+13 bps).



German Bund (orange), Dax (green) and EUR/GBP (black) intraday: British PM May's speech triggers relief risk rally, though core bonds remain firm

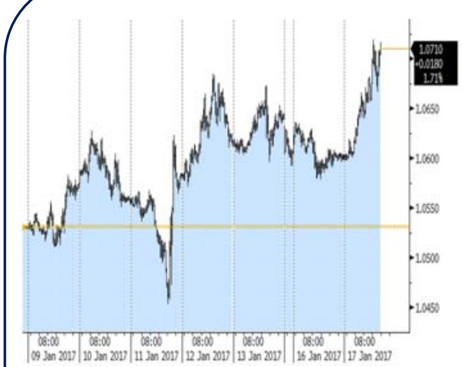
Intraday, global core bonds surged during European dealings. Risk aversion triggered safe haven flows in the run-up to British PM May's Brexit-speech. **German ZEW investor sentiment** was mixed, but ignored. As May disclosed the UK's intentions, she confirmed all rumours about **a hard/clean Brexit** published earlier this week (see currencies). Markets fell prey to **a relief rally (sell-the-rumour, buy-the-fact)** with sterling outperforming, stocks erasing intraday losses and bonds ceding some ground. A **weak US Empire manufacturing survey** provided a new bid for core bonds. Brent crude rose throughout today's dealings, but didn't weigh on bonds.

The Belgian debt agency launched a new 10-yr OLO via syndication (OLO 81 €6B 0.75% Jun2027). The bond was priced to yield MS + 10 bps, compared to MS + 11 bps guidance and MS + 13-15 bps initial price takings. In 2017, the Kingdom of Belgium aims to issue €35B via OLO's. Monday's planned auction is cancelled. **The German Finanzagentur tapped the on the run 2-yr Schatz (€5B 0% Dec2018).** Total bids amounted €5.07B, below the €5.7B average at the previous 4 Schatz auctions and meaning that the auction only just got covered. The Bundesbank set aside €0.97B for secondary market operations, resulting in a bid cover of 1. The auction only had a very tiny tail.

Currencies

USD stays in the defensive as reflation trade eases further

Global risk sentiment drove USD trading. UK PM May's Brexit speech was an important intraday catalyst for risk sentiment. The dollar suffered in the run-up to the Brexit statement, but profited temporary from a global risk-on rebound after May's comments. However, sentiment faltered again as US trading resumed, weighing on the dollar. USD/JPY trades currently again in the 113 area. EUR/USD regained the 1.07 barrier.



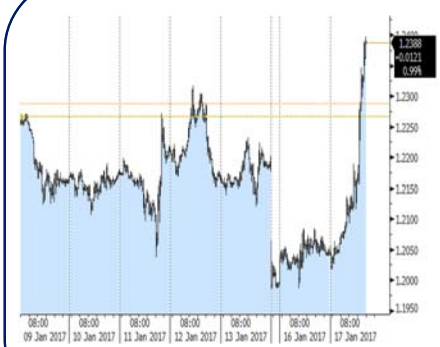
EUR/USD: dollar correction continues as reflation trade eases

Asian equities traded mostly with a positive bias. Japanese equities suffered from a stronger yen**. The dollar remained in the defensive with USD/JPY taking the lead as global political uncertainty (Brexit, recent Trump comments) was yen supportive.** USD/JPY changed hands in mid-113 area at the start of European trading, extending its recent decline. The dollar also drifted lower against the euro with EUR/USD trading in the mid-1.0650 area.

Investors kept a cautious bias ahead of the Brexit-speech of UK PM May. The potential reaction of US markets to recent comments from president-elect Trump was also a factor of uncertainty. **So, European markets fell prey to a risk-off move with equities and core bond yields declining.** The decline of core bond yields also caused a further unwinding of USD longs. USD/JPY was hit the hardest. The pair touched an intraday low in the 112.73 area just before the start of the May's speech. EUR/USD touch an ST correction top in the 1.0719 area.

The Brexit speech was largely as expected, but the tone was rather conciliatory. European markets reversed a big part of the initial risk-off correction with equities, yields and the dollar all reversing part of the intraday decline. However, the risk-on correction ran into resistance as the focus turned to the reopening of the US markets. US equities opened with modest losses, keeping the dollar slightly in the defensive. The NY empire manufacturing survey also printed softer than expected. This was maybe also a slightly negative for the dollar. USD/JPY trades currently in the low 113 area. EUR/USD is changing hands in the 1.07 area. So, EUR/USD tries to sustain north of the 1.0670/85 resistance. A sustained break would be a ST negative for the for the dollar.

Pond succeeds short-covering rally on May speech



GBP/USD: impressive sterling short squeeze after May's Brexit squeeze

Sterling lost about 2.5% against the dollar and slightly less than 2% against the euro since the announcement of May's Brexit speech on Thursday evening. EUR/GBP initially hovered in the 0.88 area. Sterling jumped temporary higher after the publication of higher than expected UK December inflation (0.5% M/M and 1.6 % Y/Y vs 1.4% Y/Y expected). **However, investors still avoided sterling longs going into the speech of UK PM May.** The UK PM held quite a conciliatory tone towards to the EU, but at the same time made it clear that the UK intended to go for a full, clear Brexit, returning the UK control on its boarders and on legislation. The speech more or less brought the message that was already known from the debate/leaks in the press during the weekend. Even so, during the speech, sterling was captured by a very aggressive sell-the-rumour, buy-the fact short squeeze. EUR/GBP dropped from the 0.88 area and trades currently in the 0.8650 area. Cable traded already off intraday lows at the start of the speech, but jumped also aggressively higher from the 1.2160 area to the 1.2385 area currently.

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,52%			0,30%			1,03%		
Greece (3-10-20)	7,04%	756	1,4	7,09%	679	10,9	7,62%	659	9,6
Portugal	1,92%	244	0,8	3,83%	354	0,6	4,79%	376	0,7
Italy	0,62%	114	-0,5	1,90%	160	1,0	3,08%	204	1,8
Spain	0,16%	68	-2,5	1,39%	109	-1,5	2,71%	168	0,0
Ireland (4-10-30)	-0,30%	22	-1,6	0,91%	61	-0,8	2,00%	97	-0,5
Belgium	-0,37%	15	-2,4	0,61%	31	-4,0	1,75%	71	-2,6
France	-0,08%	44	-2,1	0,76%	47	-1,3	1,76%	73	-0,5
Austria	-0,37%	15	-1,5	0,49%	19	-0,7	1,42%	39	-0,1
Netherlands	-0,34%	18	-1,9	0,40%	10	-0,8	1,13%	10	0,0
Finland	-0,40%	11	-1,7	0,42%	12	-0,8	1,14%	11	0,1
US	1,82%	233	-6,5	2,32%	202	-5,1	2,92%	189	-2,5
UK	0,53%	105	0,9	1,29%	99	0,3	1,96%	93	1,5

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