# Sunset

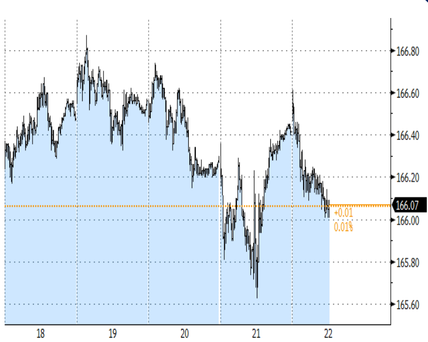
**Friday, 22 July 2016**

# Headlines

- **European shares opened lower this morning, but reversed their gains** supported by better than expected PMI data. Currently, most European shares trade little changed. **US Equities opened flat** despite better than expected earnings from GE and Honeywell.
- **The ECB will signal the future path of its quantitative easing programme in the fourth quarter**, ECB's **Nowotny** said, suggesting a decision is unlikely at the September meeting.
- **The euro zone's public finances have improved to their best level since the debt crisis with the overall government deficit dropping to 1.6% in the first quarter** from 2.3% at the end of last year. Total government debt however inched up to 91.7% of GDP from 90.7% at the end of 2015.
- **France's top court has ruled today that IMF chief Christine Lagarde must stand trial** in France over a 2008 arbitration ruling that handed 400 million euros to a politically-connected business magnate.
- **Brent crude oil prices remain under pressure today, hovering around $46/barrel and testing key support levels around $45;90/barrel.** The WTI remains under pressure too, trading at its lowest level in more than two months ($44.50/barrel).
- **During the weekend, G20 Finance Ministers and Central bankers meet in China.**

# Rates

## Core bonds under pressure




*German Bund (intraday, this week): range bound trading amid thin calendar and low volumes*

**Core bond markets lost some ground today while stock markets and the oil price traded volatile; but directionless. The Bund came under selling pressure at the start of European dealing as July EMU PMI data (see news) suggested that EMU business leaders don't really fear negative consequences of the Brexit-vote.** While the move in the Bund rapidly petered out, the slide of US Treasuries gradually continued throughout the trading session. **Investors' focus is probably shifting towards next week's FOMC meeting.** Will we get a repeat of the April/May period earlier this year when FOMC members started preparing markets for a near term rate hike?

**Unlike ECB president Draghi yesterday,** ECB Nowotny did give some comments on the future of the central bank's QE programme. Nowotny said that the ECB will decide in Q4 2016 whether or not asset purchases need to be tapered. The central bank will then also decide which signals to give to markets.

**At the time of writing**, changes on the German yield curve range between +1.2 bps (2-yr) and +2 bps (10-yr). The US yield curve moves 3.6 bps (30-yr) to 4.6 bps (5-yr) higher. On intra-EMU bond markets, 10-yr yield spread changes versus Germany are close to unchanged with Portugal (+3 bps) and Spain (+2 bps) slightly underperforming.

**Eurostat released EMU debt and deficit data for Q1 2016. The EMU debt ratio declined from 93% at the end of Q1 2015 to 91.7% at the end of Q1 2016.** The Belgian debt ratio dropped from 110.9% of GDP to 109.2% of GDP. Over this period, the highest increases in the debt ratio were recorded in Greece (+ 5.8 pp) and Finland (+3.7 pp), while the largest decreases were recorded in Ireland (-16.7 pp; due to recent GDP revisions), the Netherlands (-4.3 pp) and Germany (-3.3 pp). **The seasonally adjusted general government deficit ratio stood at 1.6% in the EMU at the end of Q1 2016 (vs -2.2% of GDP one year ago).** The Belgian deficit marginally narrowed from -3.6% of GDP to -3.5% of GDP.

# Currencies

## EUR/USD changes hands in the low 1.10 area

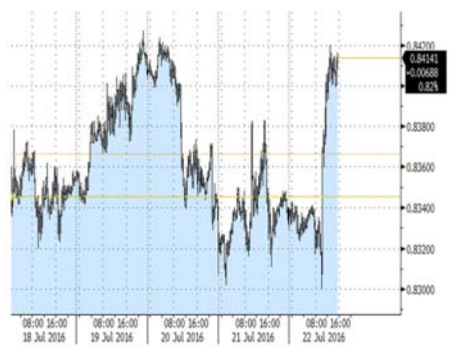
Despite slightly stronger than expected euro zone PMI's, the euro failed to really profit. **EUR/USD continues to hover in the low 1.10 area as risk-off sentiment eased soon.** USD/JPY stayed initially close to yesterday's lows, but the pair reversed a little of yesterday's losses as sentiment on European equity markets improved.


*EUR/USD continues to hover in a tight range around 1.10*

**This morning**, Asian equities traded with modest to moderate losses in line with US ones yesterday. Japanese equities underperform as the yen maintained the strong gains of Thursday. The Kuroda comments were still debated and created doubts on the room for aggressive fiscal and monetary stimulus in Japan. The hope on stimulus was an important driver for the risk-rally of late and for the decline of the yen. USD/JPY traded near 105.70 at the open of European markets. EUR/USD was again little changed in the 1.1025 area.

European shares opened lower this morning, although losses remained contained. **The first German and French PMI's (post-Brexit) were remarkably strong** with both even showing a limited improvement in business sentiment. The euro area PMI's were less buoyant, but also here the post-Brexit weakening remained very contained. Signs that the euro area economy held up well immediately after the Brexit supported sentiment and the euro. EUR/USD reached an intraday high in the 1.1040 area. Around noon, the euro weakened slightly supported by improving risk sentiment, with EUR/USD returning to the low 1.10 area, where the pair stabilized as US traders joined. Interest rate differentials between the US and Germany (2-year) widened, but failed to really support the US dollar. US Equities opened little changed, despite stronger earnings (GE and Honeywell). EUR/USD picked up slightly, hovering currently around 1.1020. USD/JPY recouped a small part of yesterday's losses, trading currently around 106.

## Poor UK PMI's weigh on sterling



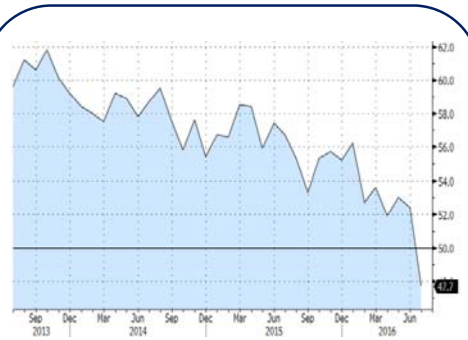
*EUR/GBP (this week) sterling under pressure after poor PMI's*

This morning, sterling remained well bid going into the release of the UK PMI's. Stronger than expected PMI's for the euro zone failed to really support the EUR/GBP pair. In contrast to the EMU PMI's, the UK's vote to leave the EU had a big impact on UK business sentiment. **The UK composite PMI showed a record 4.7 points drop**, pulling the index well into contraction territory. The services PMI was hit the hardest (47.4 from 52.3), but also the manufacturing PMI dropped below the benchmark level (49.1 from 52.1) and the details were awful too.

**Sterling reacted quite strongly to the data with EUR/GBP rising from the 0.8310 area to 0.8370.** Sterling weakened further during the European session as the poor data fuelled speculation on further BoE stimulus. Currently, EUR/GBP trades around 0.8410, still some distance away from first important resistance levels around 0.8470. **Cable** showed a similar reaction, trading around 1.3280 before the UK PMI's were published to hover around 1.31 currently. **The prospect of further Bank of England easing at the early August meeting will probably keep sterling under pressure.** Last week's highs of sterling against the euro (EUR/GBP 0.8250) and against the dollar (Cable 1.3480 area) are strong resistances. We prefer to sell sterling on upticks.

# News

## EMU PMI's hold up surprisingly well in contrast to the UK's



*UK composite PMI well in contraction territory*

According to the preliminary estimate, the **euro zone composite PMI** weakened only marginally in July, from 53.1 to 52.9. **The outcome was well above the market consensus of 52.5, but still meant a 18 month low.** The deterioration was mainly based in the manufacturing PMI (51.9 from 52.8), while services PMI stayed broadly unchanged (52.7 from 52.8). After the UK's surprise decision to leave the EU, the decline is however very limited. Also the details are still quite strong with new orders little changed from the previous month and job growth strengthening to its highest level in more than five years. Also input prices picked up further, to hit a one-year high. Data from Germany and France were even stronger with the German composite PMI rising from 54.4 to 55.3 on the back of a strong performance from the services sector. The French composite PMI rose to 50 in July, from 49.6 in June as the services sector returned to expansion, while the rate of contraction in the manufacturing sector slowed. Outside of Germany and France however, the PMI's weakened. **Overall, the euro area economy continues to grow at a moderate pace at the start of the third quarter, suggesting that the UK decision to leave the EU is having limited impact on activity for now.**

For the first time, Markit also published preliminary PMI data for the UK. In contrast to the euro zone, the Brexit is having a significant impact on the UK economy. **The UK composite PMI dropped in July from 52.4 to 47.7, its biggest one-month drop in the survey history.** The index is now also at its lowest level since 2009. The services sector is hit the hardest with the services PMI falling from 52.3 to 47.4, while the manufacturing PMI dropped from 52.1 to 49.1. The details are poor too with plunges in new orders in both sectors and business expectations in the services sector showing a record 10.4 decline. Both the manufacturing and services sector recorded job losses while input prices picked up due to the plunge in sterling. **The dramatic drop in UK business confidence is worrying and suggests the UK economy might contract in the third quarter. The survey results won't pass unnoticed within the Bank of England and are another reason to ease policy next month. Nevertheless, the true impact of the Brexit is still uncertain and will probably be only visible in the coming months and quarters.**

16:00 CET

**Daily EMU spread changes (bps)**

| | 5-yr | | | 10-yr | | | 30-yr | | |
|---|---|---|---|---|---|---|---|---|---|
| | Yield | Spread | Change | Yield | Spread | Change | Yield | Spread | Change |
| Germany | -0,49% | | | -0,01% | | | 0,51% | | |
| Greece | #VALUE! | #VALUE! | #VALUE! | 7,99% | 800 | -5,0 | #VALUE! | #VALUE! | #VALUE! |
| Portugal | 1,93% | 242 | -1,5 | 3,09% | 310 | 3,0 | 3,95% | 343 | 0,6 |
| Italy | 0,32% | 81 | -0,8 | 1,26% | 127 | 1,0 | 2,30% | 178 | 0,2 |
| Spain | 0,22% | 71 | 0,1 | 1,14% | 116 | 1,4 | 2,24% | 173 | 0,7 |
| Ireland | 0,00% | 49 | -1,0 | 0,50% | 51 | -0,1 | 1,23% | 72 | -0,8 |
| Belgium | -0,40% | 8 | 0,1 | 0,25% | 27 | 0,5 | 1,10% | 58 | -0,1 |
| France | -0,34% | 15 | -0,1 | 0,22% | 23 | 0,0 | 0,99% | 48 | 0,3 |
| Austria | -0,38% | 11 | 0,3 | 0,21% | 22 | 0,4 | 0,85% | 34 | 0,0 |
| Netherlands | -0,40% | 9 | -0,1 | 0,11% | 12 | 0,7 | 0,59% | 8 | 0,2 |
| Finland | -0,41% | 8 | 0,6 | 0,14% | 15 | 1,1 | 0,60% | 9 | 0,2 |
| US | 1,13% | 161 | 2,1 | 1,58% | 159 | 1,5 | 2,30% | 179 | 1,7 |
| UK | 0,37% | 86 | -2,7 | 0,82% | 83 | -1,7 | 1,72% | 121 | -0,1 |

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