Sunset

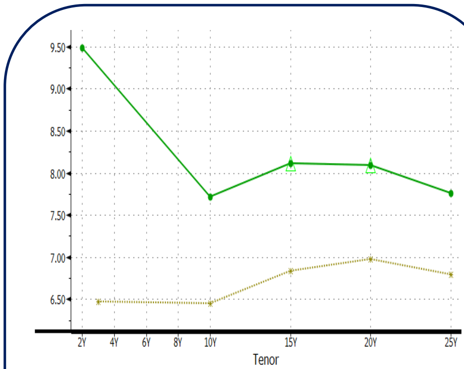
Tuesday, 07 February 2017

Headlines

- **European stock markets** gain around 0.5%, reversing part of yesterday's losses, as tensions on EMU bond markets ease. **US equity markets** opened in positive territory as well.
- The **US trade deficit narrowed to $44.3B in December,** from $45.7B in the previous month, marking the slimmest level since October, according to the Commerce Department. Wall Street economists had forecast a slightly higher reading of $45B.
- **China's foreign exchange reserves fell below $3tn for the first time in nearly six years** last month as its central bank spent more of its war chest on propping up the value of the renminbi and Beijing imposed new capital controls in an effort to slow the pace of outflows.
- **Britain's tax burden will rise to its highest in over 30 years by the time of the next national election in 2020,** as the government tries to cut borrowing at the same time as leaving the European Union, leading think tank IFS (Institute for Fiscal Studies) said.
- **UK home prices declined at the start of the year, underscoring predictions for a slowdown in 2017,** according to Halifax. Values fell 0.9% M/M, posting their first slide since August, the mortgage lender said. Values in the three months to January rose 5.7% Y/Y, that's almost half the 10% peak seen in March.
- ***"If the real economy remains solid and the pickup in the nominal data continues, this could soon suggest an increase in the bank rate,"*** BOE policy maker Forbes said.

Rates

Tensions on EMU bond markets ease, apart from Greece



Greek yield curve today (green) and 3 months ago (yellow): curve inverts as July redemption dates approach without agreement on third Greek bailout with Troika

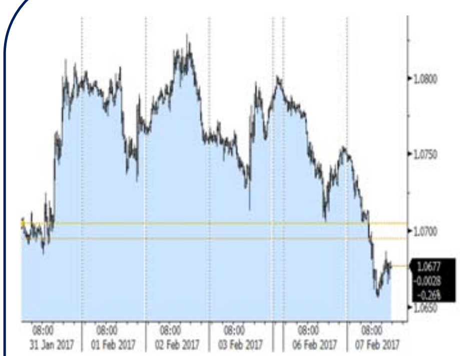
Global core bonds lost part of yesterday's gains as risk sentiment on EMU bond markets didn't deteriorate further. Weak German production data and a slightly smaller than expected US trade deficits, the only data on the agenda, couldn't influence trading. **At the time of writing, the German yield curve bear steepens with yields 0.1 bp (2-yr) to 2.9 bps (30-yr) higher. Changes on the US yield curve vary between +1.6 bps (2-yr) and +2 bps (5-yr). On intra-EMU bond markets, 10-yr yield spreads narrow 3 to 5 bps versus Germany (Spain, Ireland, Italy, France, Belgium) with Greece underperforming (+15 bps).** The front end of the Greek curve underperforms with the curve inverting further. Greece has big redemption dates in July, but the Troika are still bickering over the conditions for the IMF's involvement in the 3rd bailout programme.

The Kingdom of Belgium successfully launched two new OLO's via syndication: 7-yr OLO 82 (€3B Oct2024) and 40-yr OLO 83 (€3B Jun2057). Thanks to these deals, the Belgian debt agency completed already 34% of its OLO funding need. Books were in excess of €7.7B for OLO 82 and €12.5B for OLO 83. OLO 82 was priced to yield mid-swap flat compared to MS + low single digits guidance and

MS + mid-single digits IPT's. OLO 83 printed at MS + 87 bps, compared to MS + 90 bps area guidance and MS + low 90s IPT's. **The Dutch debt agency issued a new 10-yr DSL (€5.7B 0.75% Jul2027) via Dutch Direct Auction.** The bond was priced to yield 33 bps above the German reference (DBR 0.25% Feb2027). The amount raised was near the upper bound of the targeted €4-6B. **The Austrian treasury tapped the off the run RAGB (€0.6B 1.75% Oct2023) and on the run 10-yr RAGB (€0.7B 0.75% Oct2026).** An additional 10% of the allotted volumes was set aside as a quota for the Bunds. The auction bid cover was strong (2.21). **Later today, the US Treasury starts its mid-month refinancing operation with a $24B 3-yr Note auction.** Currently, the WI trades around 1.45%. **The Finnish treasury announced the launch of 5-yr and 30-yr benchmarks in the near future, likely tomorrow.**

Currencies

From euro weakness to USD strength



EUR/USD (1w): decline continues as USD rebound regains momentum

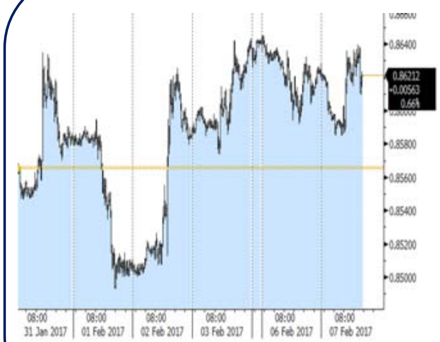
Today, the European risk-off trade eased. Yesterday, euro weakness was name of the game on global FX markets. Today, the dollar succeeded a broad-based rebound as risk sentiment improved and as core bond yields reversed part of yesterday's decline. USD/JPY returned north of 112 (currently 112.35). Overall USD weakens reinforced the EUR/USD downtrend (currently around 1.0675).

Overnight, Asian equities traded in line with the US yesterday evening (minor losses). USD/JPY touched an intraday low in the 111.60 area, but bottomed out as risk sentiment wasn't that negative and as the dollar found a better bid overall. USD/JPY traded in the high 111 area going into the European open. EUR/USD traded in the 1.07 area, testing the post-payrolls low.

European equities traded nervous at the start, but there were no follow-trough losses on yesterday's European risk-off trade. **Equities bottomed and so did core bond yields. Intra-EMU spreads narrowed a few basis points,** but were unable to reverse yesterday's widening. USD/JPY bottomed out and even rebounded back north of USD/JPY 112. **Despite the turnaround on other markets, EUR/USD continued yesterday's decline.** However, the driver behind the move was different as euro weakness yesterday was replaced by a broad USD rebound today. So EUR/USD trended further south and filled bids in the 1.0655/60 area in European mid-morning before settling in the 1.0670 area, awaiting guidance from the US.

The US trade deficit was marginally smaller than expected and the details were constructive as exports rose more than imports. The report had no lasting impact on USD trading. Core bond yields rebounded further early in US dealings and kept the dollar within reach of the intraday highs, but the rally couldn't be extended. EUR/USD trades currently in the 1.0675 area. USD/JPY is changing hands around 112.40. **The dollar trades well off the recent lows, but the jury is still out whether this will mark the start of a sustained rebound.**

Sterling maintains slightly negative bias



EUR/GBP: holds north of 0.86 despite overall euro weakness

Sterling continued to trade with a negative bias today. Cable remained on a downward trajectory as the UK currency was a prominent victim of the overall comeback of the dollar. Soft BRC retail sales, below consensus Halifax house prices and lingering uncertainty on the Brexit debate in Parliament were all good reasons for investors to stay cautious on the UK currency. EUR/GBP returned to the 0.8640 area, close to the recent highs even as EUR/USD traded with a negative bias, underscoring overall sterling softness. During the afternoon session, sterling finally received some support from comments of BoE's Forbes. She said that *"If the real economy remains solid and the pickup in the nominal data continues, this could soon suggest an increase in bank rate."* Forbes' hawkish view is still a minority in the BoE's MPC. Last week, BoE Carney kept a much more balanced assessment at the policy statement. EUR/GBP trades currently in the 0.8615/20 area. Cable is changing hands in the 1.2390 area.

16:00 CET

Daily EMU spread changes (bps)

	5-yr (benchmarkt change GE)			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,40%			0,38%			1,17%		
Greece (2-10-20)	9,76%	1016	82,8	7,83%	745	15,9	8,19%	702	10,1
Portugal	2,04%	244	-4,5	4,22%	384	-3,2	5,15%	398	-3,9
Italy	0,94%	134	-4,3	2,34%	197	-3,9	3,48%	231	-4,0
Spain	0,38%	77	-2,3	1,75%	137	-4,3	3,09%	192	-4,1
Ireland (4-10-30)	-0,20%	20	-2,8	1,19%	81	-5,0	2,27%	110	-4,6
Belgium	-0,05%	35	-3,7	0,97%	60	-5,0	2,03%	86	-3,7
France	0,13%	53	-1,7	1,11%	73	-3,9	2,15%	98	-3,9
Austria	-0,34%	6	-0,2	0,64%	27	-0,9	1,56%	39	-0,2
Netherlands	-0,26%	14	-0,7	0,56%	19	-1,2	1,29%	12	-0,6
Finland	-0,36%	4	1,8	0,61%	23	0,4	1,33%	16	-0,2
US	1,87%	226	1,9	2,43%	205	1,3	3,07%	190	-0,5
UK	0,52%	91	-0,7	1,31%	94	-0,9	2,01%	84	-2,9

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