Wednesday, 21 March 2018

Rates: Hawkish Fed and sell-off at long end?

The Fed will hike its policy rate, but we also expect changes to the dot plot: a higher estimation of the neutral rate (3% from 2.75%) and a potential shift already in 2018 (4 from 3) and/or 2019 dots. Markets partly frontrunned on the short term shift, but don't anticipate a higher neutral rate. Therefore, we mainly expect a sell-off a the longer end of the US yield curve.

Currencies: Fed 'dot-plot' to support a further USD rebound?

EUR/USD easily reversed Monday's ECB' driven rise yesterday. Focus turns to the Fed policy decision today. Powell and Co indicating four rate hikes this year and lifting the neutral rate back to 3.0% might trigger a further USD rebound. Sterling traders will look out whether the UK labour data confirm the case for a May BoE rate hike.

Calendar

Headlines

S&P	→
Eurostoxx 50	↗
Nikkei	→
Oil	↑
CRB	↗
Gold	↘
2 yr US	↗
10 yr US	↗
2yr DE	→
10 yr DE	→
EUR/USD	↘
USD/JPY	↗
EUR/GBP	↘

- **US stock markets slightly rebounded after Tuesday's heavy sell-off, but Facebook continued to lag behind.** Asian stock markets rebound as well with Japan closed for Vernal Equinox Day.
- **The Fed will hike rates at Fed Powell's inaugural meeting at the helm of the central bank. We also expect a more upbeat economic assessment and a hawkish shift in the new dot plot, including a higher neutral rate.**
- **The Trump administration has dropped a demand that all vehicles made in Canada and Mexico for export to the US contain at least 50% US content,** the Globe and Mail report, citing sources with knowledge of the NAFTA talks.
- **The White House is preparing to crack down on what it says are improper Chinese trade practices** by making it significantly more difficult for Chinese firms to acquire advanced US technology or invest in American companies, individuals involved in the planning said.
- **The world's financial leaders (G20) rejected protectionism and urged "further dialogue" on trade, but failed to diffuse the threat of a trade war** days before Washington is to announce measures against China.
- **Fitch affirmed its A+ rating on China,** and said tighter regulations have curbed financial risks without jeopardising growth targets, but warned that it remains to be seen if Beijing would stay committed to debt stabilisation.
- Apart from the Fed meeting, **today's eco calendar** contains the UK labour market report, a German Bund auction and the RBNZ's policy decision.

Rates

	US yield	-1d
2	2,34	0,04
5	2,69	0,04
10	2,90	0,04
30	3,12	0,04

	DE yield	-1d
2	-0,59	0,01
5	-0,02	0,01
10	0,59	0,02
30	1,22	0,00

Hawkish Fed and sell-off at long end?

Core bonds lost ground yesterday with US Treasuries again underperforming German Bunds ahead of today's FOMC meeting. Last minute positioning suggests that (US) investors don't want to be wrong-footed by a potentially more hawkish Fed. Rising oil prices (Iran deal at risk?) weighed as well. Stock markets stabilized after Monday's heavy selloff, but we didn't find the rebound convincing. Disappointing German ZEW investor confidence also helped explain the Bund's resilience compared to the US Note future. The US yield curve bear steepened with yields 3.7 bps (2-yr) to 4.4 bps (30-yr) higher. The US 2-yr yield reached a new cycle high (highest level since 2008). Changes on the German yield curve ranged between +0.3 bps (30-yr) and +1.6 bps (10-yr). Peripheral yield spreads vs Germany narrowed 3 to 8 bps (Italy).

The US Note future has a marginal upward bias overnight. Asian stock markets rebound in line with WS. We expect a neutral opening for the Bund. **Today's trading session will probably be range bound ahead of the FOMC meeting.** The Fed will hike its policy rate, but we also expect **changes to the dot plot. More specifically, we expect a higher estimation of the neutral rate (3% from 2.75%) and a potential shift already in 2018 (4 from 3) and/or 2019 dots.** Markets partly frontrunned on the short term shift, but don't anticipate a higher neutral rate. **Therefore, we mainly expect a sell-off a the longer end of the US yield curve.** The Fed's gradual lowering of its neutral rate from 4.25% in 2012 to 2.75% worked as a cap above the US 10-yr yield. **Reversing these dynamics lifts scope for higher long term yields, especially if we add the prospect that the US' fiscal policy will lead to a significant increase in twin deficits in the longer run. Technically, 3.07% is KEY resistance. A higher neutral rate suggests that we might go for a test in coming days. Medium term, we position for a break higher.**

General geopolitical sentiment remains a short term wildcard via safe haven flows if it translates into uncertainty on stock markets. Investors fear a hawkish shift on Iran policy at the Saudi/US Summit, the US government faces a government shutdown on Friday and Trump adds to his protectionist rhetoric with more trade actions directed to China.

German Bund continues outperforming against the US Note future

US 10-yr yield: final push towards key resistance if median Fed estimate for neutral rate rises to 3%?!

Currencies

R2	1,2598	-1d
R1	1,2555	
EUR/USD	1,2242	-0,0093
S1	1,2165	
S2	1,2055	

R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8746	-0,0050
S1	0,8690	
S2	0,8657	

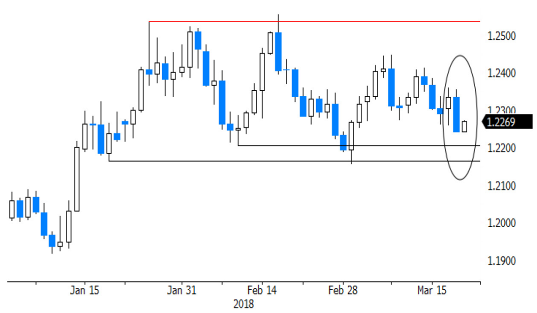
New Fed ‘dot-plot’ to support the dollar?

The focus of FX traders turned again to the Fed after an ‘ECB-driven’ rally of the euro on Monday. **Interest rate differentials widened in favour of the dollar.** Currency investors apparently didn’t want to be positioned short USD. EUR/USD reversed Monday’s rise and closed the day at 1.2242 (from 1.2335). The gain of USD/JPY was more modest. Still, the pair closed at 106.53, well off the recent lows.

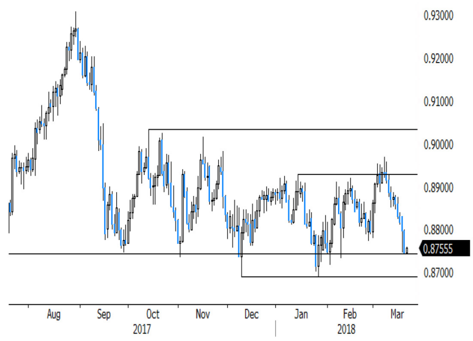
Overnight, Asian risk sentiment isn’t too bad as investors look forward to the Fed’s policy decision. Japanese markets are closed. BOJ deputy governor Amamiya indicated that **one can’t rule out the BOJ to adjust rates before the 2% target is reached, but that there is no reason to consider a rate hike now.** USD/JPY lost a few ticks after the Amamiya headlines. EUR/USD also regains slightly ground.

Today, all eyes are on the Fed’s policy decision. A 25 bps rate hike is discounted. Markets will mainly look at the new Fed forecasts (dots) and at Chairman Powell’s assessment at its first press conference. For an in depth analysis, see the Fixed income part of this report. We assume that the Fed dots will signal four rate hikes in 2018. **We also closely monitor whether the Fed raises the neutral rate back to 3.0%.** If so, it could be important for global markets and for the dollar. **Yesterday’s price action was already USD constructive.** Monday’s EUR/USD rise was easily reversed. **This suggests that the market still found itself a bit too much euro long/USD short. If our dots-scenario materializes, there is room for a ST USD rebound.** EUR/USD 1.2155 is the first important support. A break opens the way to the 1.20 area. The gain in USD/JPY might be more modest than in USD/EUR.

Sterling gained further ground against a declining euro yesterday and held stable against the dollar despite softer CPI data. **UK labour data take center stage today.** Modest labour growth is expected, but average earnings are expected to rise slightly to 2.6% Y/Y. We don’t have much reason to take a different view from the consensus. However, **a positive surprise might reinforce BoE rate hike expectations and be slightly supportive for sterling.** A test of the EUR/GBP 0.8690 support might be on the cards, especially if EUR/USD declines after the Fed



EUR/USD Fed to open the way for further USD gains?



EUR/GBP: drifting lower after UK/EU transition deal. 0.8690 support is again on the radar

Calendar

Wednesday, 21 March		Consensus	Previous
US			
13:30	Current Account Balance (4Q)	-$125.0b	-$100.6b
15:00	Existing Home Sales / MoM (Feb)	5.40m/0.4%	5.38m/-3.2%
19:00	**FOMC Rate Decision**	**1.50%-1.75%**	**1.25%-1.50%**
UK			
10:30	Claimant Count Rate (Feb)	--	2.3%
10:30	**Jobless Claims Change (Feb)**	**--**	**-7.2k**
10:30	**Average Weekly Earnings 3M/YoY (Jan)**	**2.6%**	**2.5%**
10:30	Weekly Earnings ex Bonus 3M/YoY (Jan)	2.6%	2.5%
10:30	**ILO Unemployment Rate 3Mths (Jan)**	**4.4%**	**4.4%**
10:30	**Employment Change 3M/3M (Jan)**	**84k**	**88k**
10:30	Public Finances (PSNCR) (Feb)	--	-26.4b
10:30	Public Sector Net Borrowing (Feb)	-0.5b	-11.6b
12:00	CBI Trends Total Orders (Mar)	8	10
12:00	CBI Trends Selling Prices (Mar)	--	25
Norway			
08:00	Unemployment Rate AKU (Jan)	4.0%	4.1%
New Zealand			
21:00	**RBNZ Official Cash Rate**	**1.75%**	**1.75%**
Events			
11:30	Germany to Sell €3bn 0.5% 2028 Bonds		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	2,90	0,04		US	2,34	0,04	DOW	24727,27	116,36
DE	0,59	0,02		DE	-0,59	0,01	NASDAQ	7364,302	20,06
BE	0,87	0,01		BE	-0,53	0,02	NIKKEI	21380,97	0,00
UK	1,49	0,04		UK	0,88	0,05	DAX	12307,33	90,31
JP	0,04	0,00		JP	-0,15	0,00	DJ euro-50	3412,08	17,29
IRS	**EUR**	**USD**	**GBP**	**EUR**	**-1d**	**-2d**	**USD**	**-1d**	**-2d**
3y	0,05	2,75	1,22	Eonia	-0,3680	0,0000			
5y	0,43	2,84	1,39	Euribor-1	-0,3700	0,0000	Libor-1	1,8407	0,0000
10y	1,03	2,93	1,59	Euribor-3	-0,3290	0,0000	Libor-3	2,2225	0,0000
				Euribor-6	-0,2730	-0,0010	Libor-6	2,3905	0,0000
Currencies	**Close**	**-1d**		**Currencies**	**Close**	**-1d**	**Commodities**	**Close**	**-1d**
EUR/USD	1,2242	-0,0093		EUR/JPY	130,42	-0,46	CRB	194,15	1,26
USD/JPY	106,53	0,43		EUR/GBP	0,8746	-0,0050	Gold	1311,90	-5,90
GBP/USD	1,3998	-0,0026		EUR/CHF	1,1709	-0,0022	Brent	67,42	1,37
AUD/USD	0,7683	-0,0035		EUR/SEK	10,0646	-0,0130			
USD/CAD	1,3071	-0,0007		EUR/NOK	9,4832	-0,0433			

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