Sunrise

Wednesday, 26 July 2017

Rates: Fed's expected message largely discounted?

We expect the Fed to keep its policy unchanged tonight. Announcing the start of balance sheet tapering is a wildcard, but September might be the better fit. Subdued inflation could get more attention, but shouldn't keep the Fed from hiking its policy rate one more time this year. Such message should be rather neutral for markets and by and large discounted.

Currencies: Dollar decline slows going into the FOMC decision

The dollar traded volatile yesterday, but finally rebounded on a rise in US yields. Today, focus turns to the Fed's policy statement. The Fed will probably show its concern in the recent easing in inflation. However, the dollar already discounts quite some bad news. Is the time ripe for some USD bottoming?

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	→

- **Wall Street trading ended positive yesterday, supported by** strong earnings figures. Overnight, **Asian equities are trading more mixed with China and Korea in the red. US Treasuries stabilize** ahead of the FOMC outcome later today.
- The **Australian inflation increased by 0.2% Q/Q (1.9% Y/Y) in Q2**, **less than the expected** 0.4% Q/Q (2.2% Y/Y). RBA chief Lowe said moves of other central banks to withdraw stimulus "has no automatic implications" for RBA policy.
- The **US Senate rejected** McConnell's **health proposal** at the start of several days of debate. The **Senate will now vote on an amendment similar to a 2015 repeal bill** passed by the Senate and vetoed by Obama. The vote is **expected to fail.**
- **The IMF warns for significant downside risks to the EMU's economic outlook** and urges the ECB to keep stimulus in place amid weak price pressures. ECB's Nowotny added the ECB shouldn't set a timetable for ending its bond purchases.
- **Oil extended gains** from the highest close in seven weeks **as industry data showed U.S. crude stockpiles plunged,** easing a glut. The Brent oil price is now around $50.60/barrel.
- The **US House of Representatives overwhelmingly passed legislation to impose new sanctions on Russia, North Korea and Iran**. The bill imposes new sanctions on Russia in response to the alleged meddling in the 2016 US election.
- The **main event on the eco-calendar** is the **Fed FOMC meeting.** Will the FOMC announce the starting date of the balance sheet tapering? The **first estimate of the UK GDP for Q2 is the only data of importance.**

Rates

US yields up 3.3 to 8.3 bps

German yields up 0.5 to 5.8 bps

Italy slightly underperforms on upcoming supply

	US yield	-1d
2	1,39	0,03
5	1,88	0,07
10	2,34	0,08
30	2,91	0,08

Core bonds sell-off heavily

Global core bonds lost a lot of ground yesterday, bear steepening the US and German curves with US Treasuries underperforming. The move started at the European opening and accelerated during US dealings. It's hard to pinpoint one specific factor to explain the move. A very strong **German IFO-indicator**, **US consumer confidence & Richmond Fed** manufacturing survey and a significantly **higher oil price** certainly helped. Several bellwether companies, including Caterpillar, announced good earnings and boosted **equity market sentiment** during European and early US dealings. The **German 10-yr yield's failed test of the 0.5% support** inspired some technical Bund selling. The **US refinancing** operation played in the disadvantage of US Treasuries and a successful 2-yr Note auction later on couldn't bring support. Finally, the upcoming FOMC meeting may also have contributed to the selling (repositioning).

FOMC to show some more concern about inflation

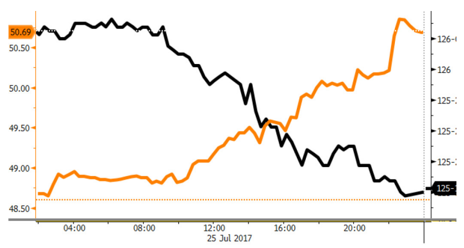
Keep door for Dec rate hike open

Balance tapering to start in Q4, announcement could come today

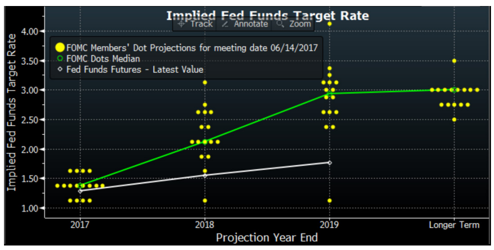
	DE yield	-1d
2	-0,65	0,00
5	-0,14	0,04
10	0,57	0,06
30	1,33	0,05

FOMC Day

Beside the UK Q2 GDP, that is expected to show sluggish growth, **all attention will go to the FOMC meeting.** The FOMC won't hike rates today, but two issues will be of interest for the markets. **First, how much have worries risen within the FOMC on the inflation outlook after four months of surprisingly slowing inflation?** If the FOMC shows lots of concerns, that impacts their views of the current natural rate and the terminal rate (now 3% according to the Fed's rate projections). This will in turn affect the market's view on the Fed's rate path going forward. The market is however already much more pessimistic on the natural rate and rate path than the Fed. The FF futures discount slightly less than a 50% chance on an extra rate hike in 2017 and one rate hike in 2018. **That seems already very pessimistic so the hikes will probably not be priced out.** We expect the Fed to be more concerned about inflation but to keep the road for a December rate hike open. By not raising rates in September, they buy time to get more information and assess the issue of the current and terminal natural rate. **Second, the FOMC might give more information on the timing of the start of the balance sheet tapering.** In June, the Fed suggested the tapering could start this year if incoming information confirmed their outlook. Some governors said they expected the start to come relatively soon. **While September looks the most appropriate timing to announce the start (likely in October), there** is **a small chance that such an announcement could already be made in the press statement at the end of today's meeting.** The normalization of the balance sheet is a long term process that will run in the background (undisturbed by temporary changes in the economic activity or inflation). By announcing the tapering for Q4, the Fed buys time to evaluate the inflation developments in the next months before (likely) hiking rates in December. If inflation (and wages) show no rising tendency, the rate hike could be postponed.



T-Note future (black) & Brent oil (orange)(intra-day): Bond sell off from start European session to US closure on various factors.



Fed's (June) rate path (green) and market expectations (white line): Markets don't belief the Fed will hike rates several times

R2	165,55	-1d
R1	164,13	
BUND	161,6	-0,94
S1	160,17	
S2	159,1	

Very strong US 2-yr Note auction

The US Treasury started its end-of-month refinancing operation tonight with a strong $26B 2-yr Note auction. The auction stopped through the 1:00 PM bid side with a high bid cover (3.06). Strength in the combined buy-side bid (direct & indirect) indicates continued good demand from investment funds and foreigners. The auction yield was the highest since 2008. The Treasury continues its refinancing operation today with a $15B 2-yr FRN auction and a $34B 5-yr Note auction. The WI of the latter currently trades around 1.89%.

Fed's message largely discounted?

Asian stock markets gain slightly ground overnight with China and South Korea underperforming. Brent crude stabilizes, but manages to hold above the $50/barrel mark. The US Note future is flat. We expect a neutral opening for the Bund.

Today's eco calendar is thin, but includes the FOMC meeting. We expect an unchanged policy. Announcing the start of balance sheet tapering is a wildcard (September might be the better fit). Subdued inflation could get more attention, but shouldn't keep the Fed from hiking its policy rate one more time this year. Such message should be rather neutral for markets. Bar yesterday's correction, quite some softness on inflation is discounted during the July rally of the Note future. Any uptick should therefore be limited in magnitude and duration. An acceleration of yesterday's sell-off is rather unlikely unless the Fed surprises with a BS announcement or if Yellen continues to call inflation low because of temporary reasons. Resistance for US 10-yr Note yield stands at 2.40/42%

Technically, the German 10-yr yield retested previous resistance (0.5%), but a break didn't occur. This suggests that we might attack the 2017 high (0.619%), especially if the Fed signals willingness to continue its tightening cycle without attaching too much weight to the current dip in inflation readings. Next major events from the EMU side are Draghi's speech in Jackson Hole and the September ECB meeting. Speculation on winding down QE is negative for Bunds in the run-up to the event.

German Bund: failed test of 0.5% support in 10-yr yield suggests new test of contract low

US Note future: Fed's message largely discounted?

Currencies

Fed statement a tipping point for the dollar?

Dollar avoids a break of key support levels

R2	1,1811	-1d
R1	1,1714	
EUR/USD	1,1647	0,0005
S1	1,1119	
S2	1,0839	

The dollar traded volatile yesterday, but finally rebounded. A rise in core (US & EMU) yields supported USD/JPY. In US dealings, EUR/USD jumped temporary above 1.17, but a real test of the 1.1714/35 resistance didn't occur. A further rise in US yields after strong consumer confidence finally tilted the balance in favour of the dollar. The start of the debate on Obamacare was maybe also a minor support for the dollar. EUR/USD closed the session little changed at 1.1647. USD/JPY ended the session at 111.89, well off the sub-111 levels traded earlier in the session.

Dollar stays off the recent lows after yesterday's rebound

Aussie dollar declines on inflation data and soft speech of RBA's Lowe

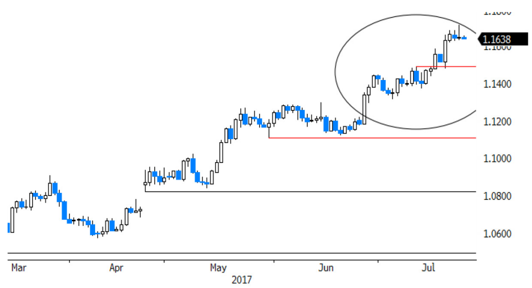
Asian equities trade mixed to slightly lower overnight. **Japan and Australia outperform on a decline of their currencies.** USD/JPY maintains yesterday's gain and trades just below 112. The rise of the oil price and of other commodities supports (US) yields and indirectly the dollar. The Aussie dollar doesn't profit from higher commodities. On the contrary, AUD/USD returned to the 0.79 area. Australian headline inflation unexpectedly dropped from 2.1% Y/Y tot 1.9% Y/Y (2.2% Y/Y expected). RBA governor Lowe also hinted that the RBA shouldn't join the tightening from other central banks. EUR/USD trades around 1.1635. The dollar maintains yesterday's rebound against the euro.

Thin eco calendar today

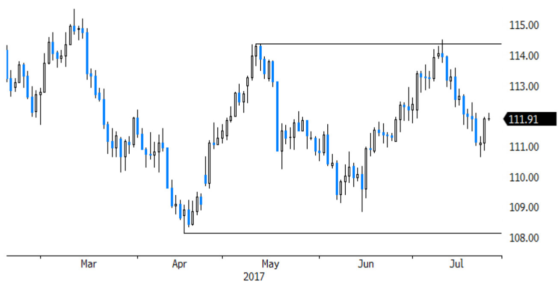
Fed statement in focus

Will the Fed be that soft to trigger a new USD downleg?

Markets will keep their focus on the Fed's policy statement this evening (see above for analysis). The Fed will keep its policy rate unchanged. Markets will closely monitor the central bank's assessment on the recent softer inflation data. We expect the Fed to be more concerned on inflation, but to keep the door open for a December rate hike. The FOMC might give more information on the start of the balance sheet tapering, even as an announcement in September is most likely. The market implied probability of a December rate hike is currently less than 50%. We don't expect to Fed to be that soft that markets reduce expectations further. **If (ST) US interest rates bottom, one might assume that there is also quite some negative news discounted for the dollar.** Especially USD/JPY might find some support if US rates bottom out. The story for EUR/USD is different as markets ponder the next steps of ECB policy normalisation to be announced in autumn. The jury is still out, but yesterday's price action of the dollar overall and of EUR/USD in particular suggests the dollar decline has already gone quite far. There is more really good US eco news needed to trigger a sustained USD rebound. **However, assuming that the Fed statement won't be overly soft, we expect no sustained break of the key 1.1714/35 resistance already now.**



EUR/USD: top MT consolidation pattern under heavy strain, but no break yet.



USD/JPY: decline halts going into the Fed policy statement

USD: technical picture remains fragile, but …

EUR/USD rebounded above the 1.1300/66 resistance at the end of June. Recent US data were not good enough to trigger a sustained USD rebound. Finally EUR/USD broke beyond a first important resistance at 1.1489/1.15, paving the way to the LT-correction tops at 1.1616/1.1714. **A sustained break would end the long consolidation that followed the sharp decline of EUR/USD** in 2014/early 2015**. Such a key area is not easy to break. We don't preposition for a break, but the pressure is mounting.** Return action below 1.13 would be a first indication of a loss in upside momentum.

USD/JPY rebounded in the 108.13/114.37 range after the June 14 Fed meeting. The pair regained interim resistance at 112.13, but follow-through gains remained modest. USD/JPY 114.37 resistance was tested, but rejected. The pair drifted lower in the broader consolidation pattern between 114.50 and 108.83/13. Yesterday, this correction halted. The jury is still out, but a short-term test/break of the key 108.83/13 support is becoming less likely. We look out whether the bottoming out process will be confirmed after the Fed decision/statement.

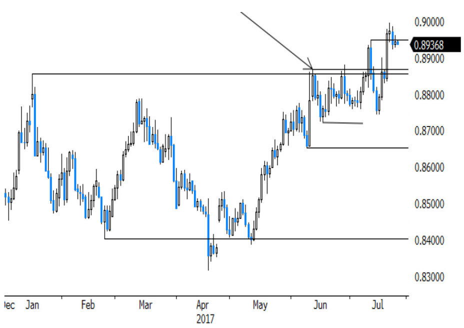
UK Q1 GDP data in focus for sterling trading

R2	0,9142	-1d
R1	0,9049	
EUR/GBP	0,8943	0,0007
S1	0,8757	
S2	0,8652	

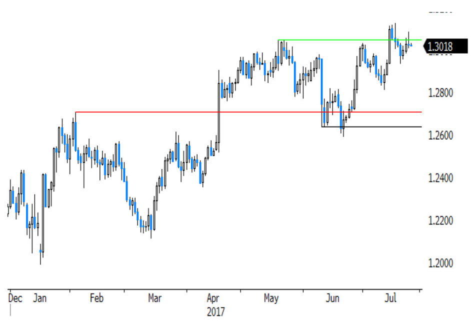
Sterling showed no clear directional trend yesyterday. EUR/GBP hovered in the mid 0.89 area, stabilizing within reach of the recent low against the euro (EUR/GBP 0.8994). Cable initially rebounded on USD softness but declined as the USD staged a comeback later in the session. UK eco data/stories were mixed and had no lasting impact on sterling trading. EUR/GBP closed the session little changed at 0.8943. Cable finished the session at 1.3025.

Today, the first estimate of the UK Q1 GDP will be published. UK growth is expected at 0.3% Q/Q and 1.7% Y/Y (0.2% Q/Q and 2.0% Y/Y in Q1). We don't have strong arguments to take a different view from the consensus. A figure in line with consensus (or softer) is probably enough for the BoE to maintain its wait-and-see approach at next week's BoE meeting. In theory, this might be slightly negative for sterling. That said, before EUR/GBP make further progress beyond 0.90, a further rise of EUR/USD is probably needed. Assuming that the Fed won't be overly soft this evening, a sustained break higher for EUR/GBP is currently not that likely.

From a technical point of view, EUR/GBP broke above the 0.8854/66 resistance (2017 top) to set a new correction top north of 0.89, but the rally slowed at the end of last week. A break below 0.8720 would suggest that upside momentum is easing. For now, we don't see a trigger for a sustained rebound of sterling against the euro. **We still look to buy EUR/GBP on more pronounced dips. For that to happen, EUR/GBP probably needs some help from a correction in EUR/USD.**



EUR/GBP: consolidation near recent top



GBP/USD: rally takes a breather as USD decline slows

Calendar

Wednesday, 26 July		Consensus	Previous
US			
16:00	New Home Sales / MoM (Jun)	615k/0.8%	610k/2.9%
20:00	**FOMC Rate Decision (Upper Bound)**	**1.25%**	**1.25%**
20:00	**FOMC Rate Decision (Lower Bound)**	**1.00%**	**1.00%**
Japan			
01:50	PPI Services YoY (Jun)	A: 0.8%	0.7%
07:00	Small Business Confidence (Jul)	A: 50	49.2
UK			
10:30	**GDP QoQ / YoY (2Q A)**	**0.3%/1.7%**	**0.2%/2.0%**
10:30	Index of Services MoM & 3M/3M (May)	0.1%/0.4%--	0.2%/0.2%
France			
08:45	Consumer Confidence (Jul)	108	108
Italy			
10:00	Economic Sentiment (Jul)	--	106.4
10:00	Manufacturing Confidence (Jul)	107	107.3
10:00	Consumer Confidence Index (Jul)	106.3	106.4
Spain			
09:00	Retail Sales SA YoY (Jun) M/M Y/Y	--/2.2%	3.8% /2.4%
Events			
Q2 earnings	Daimler (07:30), Coca Cola (Bef-mkt), Boeing (13:30), Mondelez, Facebook (22:00),…		
03:30	BOJ Nakaso speaks at press conference in Hiroshima		
11:00	Italy to Sell 2019 zero Bonds (I/L) (up to €2B) & €1.25B 1.3% IL 2028 bonds		
17:30	ECB Lautenschlager (hawk) speaks in Berlin (book: 100 yrs of Women's vote)		
17:30 & 19:00	**US to Sell $15B 2-yr Floating Rate Notes & $34B 5-yr Notes**		

10-year	Close	-1d		2-year	td	-1d	Stocks	Close	-1d
US	2,34	0,08		US	1,39	0,03	DOW	21613,43	100,26
DE	0,57	0,06		DE	-0,65	0,00	NASDAQ	6412,173	1,36
BE	0,83	0,06		BE	-0,45	0,02	NIKKEI	20050,16	94,96
UK	1,26	0,07		UK	0,31	0,03	DAX	12264,31	55,36
JP	0,08	0,01		JP	-0,11	-0,01	DJ euro-50	3473,54	20,37

IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,02	1,76	0,71	Eonia	-0,3620	-0,0010			
5y	0,28	1,96	0,92	Euribor-1	-0,3710	0,0030	Libor-1	1,2328	0,0000
10y	0,94	2,30	1,31	Euribor-3	-0,3290	0,0000	Libor-3	1,3139	0,0000
				Euribor-6	-0,2720	-0,0010	Libor-6	1,4528	0,0000

Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1,1647	0,0005	EUR/JPY	130,31	0,96	CRB	177,67	1,43
USD/JPY	111,89	0,79	EUR/GBP	0,8943	0,0007	Gold	1258,50	-2,20
GBP/USD	1,3025	-0,0003	EUR/CHF	1,1093	0,0078	Brent	50,20	1,60
AUD/USD	0,7937	0,0013	EUR/SEK	9,5602	-0,0050			
USD/CAD	1,2509	-0,0001	EUR/NOK	9,2871	-0,0349			

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