



Sunrise

Wednesday, 14 February 2018

Rates: Core bond consolidate higher; more gains after US CPI?

Core bonds continue consolidating higher in a fragile risk sentiment. Today's eco calendar heats up with US CPI and retail sales. A below or at consensus inflation figure argues in favour of a continuation of the short term correction higher. As long as risk sentiment remains vulnerable, it's even doubtful that core bond sellers will already return on higher CPI readings.

Currencies: USD/JPY drops below 107.32 neckline

A sharp decline of USD/JPY kept the dollar under pressure yesterday across the board. This trend continues this morning. USD/JPY dropped below the key 107.32 support. Later today, the focus of FX trading turns the US January inflation data. The dollar probably needs a figure above consensus to change sentiment for the better.

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 equities managed to recover some more ground** despite the worrying rise of the Japanese yen. **USD/JPY hits the lowest level since end 2016** this morning. Asian bourses are mixed with China outperforming ahead of Lunar NY.
- **Cleveland Mester is being considered for the central bank's vice chair post**, sources said. Mester is known for her mildly hawkish views on monetary policy. SF Fed Williams and Mohamed El-Erian have also been considered.
- **The Japanese economy grew less than forecast in Q4** (0.1% Q/Q vs 0.2% Q/Q), but both consumption (0.5% Q/Q) and investments (0.7% Q/Q) contributed positively. The current Japanese expansion is the longest since the 80s boom.
- **German SPD leader Schulz resigned**, hoping to end turbulence that has rocked the centre-left party since it agreed a coalition deal with Chancellor Merkel's conservatives.
- **NZD/USD hit a one-week high** this morning above 0.73 after a quarterly central bank survey showed that **2-yr inflation expectations rebounded from 2.02% to 2.11%**.
- **Israeli police recommended charging PM Netanyahu with bribery, fraud and breach of trust** in two separate cases, a decision that could spark the biggest fight of his political life.
- **Today's eco calendar contains US CPI inflation and retail sales.** The Swedish Riksbank is expected to keep its interest rate unchanged at -0.5%. EMU industrial production and the second reading of Q4 GDP will also be released.

Rates

Core bonds consolidate in fragile risk climate

	US yield	-1d
2	2,10	0,03
5	2,54	-0,02
10	2,83	-0,03
30	3,11	-0,03

	DE yield	-1d
2	-0,57	0,01
5	0,09	0,00
10	0,75	-0,01
30	1,37	0,03

Core bonds eked out some small additional gains yesterday. Risk aversion played a role during European trading with USD/JPY significantly losing ground and European stocks under pressure. The eco calendar only contained stronger-than-expected NFIB small business optimism. Risk sentiment on stock market improved during US trading, but caused no turnaround on the bond market. Changes on the German yield curve were limited between +0.6 bps (2-yr) and -0.6 bps (10-yr) with an underperformance of the 30-yr yield (+2.4 bps). The US yield curve flattened with yield changes varying between +2.8 bps (2-yr) and -3.2 bps (30-yr). **Voting Fed-member Mester**, who is rumored to have a good shot at becoming next Fed vice-chair, said that recent market turmoil didn't alter her mildly hawkish views on monetary policy. On intra-EMU bond markets, 10-yr yield spread changes versus Germany widened 1 bp with the periphery underperforming (+6 bps for Portugal, Spain and Italy; +11 bps for Greece).

The US Note future continues trading with an upward bias this morning as yen strength remains a theme. USD/JPY briefly fell below 107, to the lowest level since the end of 2016. Collateral damage on Asian bourses remains limited, putting the traditional market correlations once more to the test. We expect a somewhat stronger opening for the Bund.

Today's eco calendar heats up in the US with the key CPI release and retail sales. Inflation is expected to slow to 1.9% Y/Y (from 2.1% Y/Y) for the headline index and to 1.7% Y/Y (from 1.8% Y/Y) for the core measure. Monthly readings are expected to print at 0.3% and 0.2% respectively. **The current (modest) comeback of core bonds could gain some momentum in case of a below or at consensus outcome. We doubt that core bond sellers will come out in strength on a higher reading in the current fragile risk-off climate.** US retail sales are forecast to show a 0.2% monthly advance, but activity data are at this moment less important than price data.

Short term, we favour more consolidation, but strong growth momentum, rising inflation (expectations) and the global turn towards monetary policy normalization are structurally negative factors for core bonds medium term.

US and German yields cleared resistance levels earlier this year and moved towards next targets. The trading band for the US 10-yr yield is 2.64%-3.05%. Correction towards the lower bound could be used to put up short positions in the Note future. The German 10-yr yield's trading band is 0.62%-1.06%.



German Bund future: decline takes a breather on in fragile risk climate



US Note future: room for more short term gains after US CPI data

Currencies

USD/JPY drops below key 107.32 support!

R2	1,2643	-1d
R1	1,2537	
EUR/USD	1,2352	0,0060
S1	1,1713	
S2	1,1554	

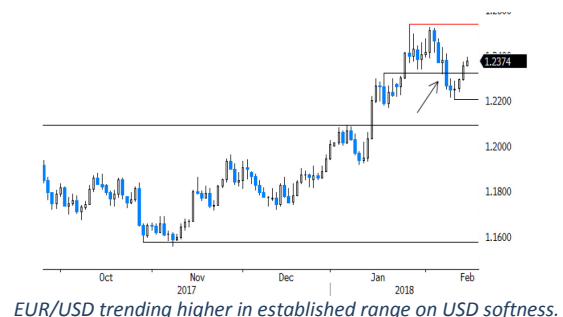
R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8891	0,0006
S1	0,8690	
S2	0,8657	

USD weakness prevailed yesterday, driven by a **sharp USD/JPY decline**. The pair dropped from the 108.75 area to fill bids below 107.50 before European noon. The USD/JPY decline weighed also on other USD cross rates. EUR/USD trended higher in the 1.23 figure. We didn't see a clear trigger for this yen-driven repositioning, but it created uncertainty on European equity markets. The USD decline slowed after a strong US NFIB confidence and 'hawkish' comments from Fed's Mester (no impact yet from recent turmoil), but USD sentiment remained weak. EUR/USD closed at 1.2352. USD/JPY finished at 107.82.

Overnight, most Asian equities indices are in positive territory in line with WS. Several markets are heading for a holiday period (Lunar New Year) starting tomorrow. **Japan underperforms as the rise of the yen continues. USD/JPY dropped below the 107.32 support, reaching the lowest level since November 2016.** Japan Q1 GDP was soft (0.5% Q/Qa), but domestic spending OK. For now, there are **few comments from Japanese officials on the rise of the yen**. The USD/JPY slide still weighs on other USD cross rates. EUR/USD trades in the 1.2375 area. EUR/JPY is nearing the key 132/131 support area.

Today, Q1 GDP releases in Germany, Italy and EMU are interesting, but the focus for global trading will be on the **US CPI**, and to a lesser extent US retail sales. Headline CPI is expected to ease from 2.1% Y/Y to 1.9% (core from 1.8% to 1.7%). **The dollar probably needs above consensus inflation to change fortunes for the better. We also keep an eye at the strange combination of yen-strength and at the same time relative equity resilience (in Asia ex-Japan and in the US).** How long will this pattern persist? **Technically**, EUR/USD consolidates between 1.2165 and 1.2537. The pair dropped below 1.2323/35 support but follow-through price action was modest. Next support at 1.2165 looks far away for now. We assume that current USD weakness won't push EUR/USD beyond the 1.2537 top yet.

UK CPI printed slightly above consensus yesterday (headline 3.0%), but didn't help sterling. The report won't change the BoE's rate hike path. After a brief dip, EUR/GBP returned to the 0.89 area. **Today, there are no UK eco data.** EUR/GBP is trending higher in the 0.8690/0.9033 range, with intermediate resistance at 0.8930. We hold our view that the 0.8690 support won't be easy to break without big progress on Brexit.



Calendar

Wed., 14 February		Consensus	Previous
US			
14:30	CPI MoM / YoY (Jan)	0.3%/1.9%	0.2%/2.1%
14:30	CPI Ex Food and Energy MoM / YoY (Jan)	0.2%/1.7%	0.2%/1.8%
14:30	Retail Sales Advance MoM (Jan)	0.2%	0.4%
14:30	Retail Sales Ex Auto MoM (Jan)	0.5%	0.4%
14:30	Retail Sales Ex Auto and Gas (Jan)	0.3%	0.4%
14:30	Retail Sales Control Group (Jan)	0.4%	0.3%
14:30	Real Avg Hourly / Weekly Earning YoY (Jan)	--/--	0.6%/0.9%
16:00	Business Inventories (Dec)	0.3%	0.4%
Japan			
00:50	GDP SA QoQ (4Q P)	A: 0.1%	0.6%
00:50	GDP Annualized SA QoQ (4Q P)	A: 0.5%	2.2%
00:50	GDP Deflator YoY (4Q P)	A: 0.0%	0.2%
00:50	GDP Private Consumption QoQ (4Q P)	A: 0.5%	-0.6%
00:50	GDP Business Spending QoQ (4Q P)	A: 0.7%	1.0%
05:00	Tokyo Condominium Sales YoY (Jan)	A: 39.7%	-7.5%
EMU			
11:00	Industrial Production SA MoM / WDA YoY (Dec)	0.1%/4.2%	1.0%/3.2%
11:00	GDP SA QoQ / YoY (4Q P)	0.6%/2.7%	0.6%/2.7%
Germany			
08:00	GDP SA QoQ / WDA YoY(4Q P)	0.6%/3.0%	0.8%/2.8%
08:00	CPI EU Harmonized MoM / YoY (Jan F)	-1.0%/1.4%	-1.0%/1.4%
Italy			
10:00	GDP WDA QoQ / YoY (4Q P)	0.4%/1.7%	0.4%/1.7%
Sweden			
09:30	Riksbank Interest Rate	-0.500%	-0.500%
Events			
09:00	ECB's Weidmann Speaks in Frankfurt		
11:20	ECB's Mersch Speaks in Frankfurt		
11:30	Germany to Sell €1.5bn 2.5% 2044 Bonds		
12:20	ECB's Mersch, SNB's Zurbuegg Participate in Panel Discussion		

10-year	<u>Close</u>	<u>-1d</u>		2-year	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	2,83	-0,03		US	2,10	0,03	DOW	24640,45	39,18
DE	0,75	-0,01		DE	-0,57	0,01	NASDAQ	7013,51	31,55
BE	1,03	0,01		BE	-0,48	0,01	NIKKEI	21154,17	-90,51
UK	1,62	0,02		UK	0,70	0,01	DAX	12196,5	-86,27
JP	0,06	-0,01		JP	-0,15	-0,01	DJ euro-50	3340,93	-27,32
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>-1d</u>	<u>-2d</u>
3y	0,07	2,49	1,18	Eonia	-0,3620	0,0010			
5y	0,48	2,63	1,41	Euribor-1	-0,3690	0,0000	Libor-1	1,5875	0,0000
10y	1,14	2,84	1,68	Euribor-3	-0,3290	0,0000	Libor-3	1,8334	0,0000
				Euribor-6	-0,2760	0,0020	Libor-6	2,0486	0,0000
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>	Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1,2352	0,0060		EUR/JPY	133,18	-0,38	CRB	189,84	0,75
USD/JPY	107,82	-0,84		EUR/GBP	0,8891	0,0006	Gold	1330,40	4,00
GBP/USD	1,3894	0,0056		EUR/CHF	1,1550	0,0006	Brent	62,72	0,13
AUD/USD	0,7859	-0,0003		EUR/SEK	9,9158	0,0035			
USD/CAD	1,2592	0,0015		EUR/NOK	9,7356	0,0071			

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