



Thursday, 20 June 2019

Rates: Fed paves the way for rate cuts

The Fed's dovish message confirmed market expectations of rate cuts going forward, albeit not to the same extent as investors currently discount. US yields tanked nonetheless with the US10y 2.01% under heavy pressure. Both the ECB and the Fed are likely to reverberate through global bond markets today, limiting any yield upside in the short term.

Currencies: EUR/USD rebounds as Fed rate cut hope counterbalances ECB easing bias

The dollar was sold yesterday as the Fed signaled to be prepared to start substantial rate cuts soon, if necessary to protect the economy from current uncertainties. For now, the dollar might develop some kind of an asymmetric reaction function, with negative US data outweighing strong ones. Sterling traders look out whether the BoE will leave its tightening bias.

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 eke out gains after the Fed signalled rate cut(s) ahead. The Nasdaq outperformed (+0.42%). **Asian markets** are propelled higher with China as a clear outperformer (+2-3%).
- The **Fed** kept its policy unchanged, but now holds **a clear easing bias**. Rate cuts are coming unless we'll see a dramatic improvement in eco data. **7 out of 17 governors already insist on a 50 bps rate cut this year**.
- The **Bank of Japan** kept its monetary policy unchanged this morning. BoJ governor **Kuroda** delivers a press conference later today and **is expected to signal an easing bias as well**.
- **RBA governor Lowe** said that the possibility of lower interest rates remains on the table as spare capacity persists. He also called on the government for action **on fiscal stimulus**.
- **Rory Stewart** is **eliminated in the Tory leadership contest**. **Boris Johnson's lead** extended by 17 votes to 143 as 4 contestants enter the final two rounds of voting before the two leaders go head-to-head in a full party member ballot..
- **New Zealand's economy grew by 0.6% Q/Q and 2.5% Y/Y** in the first quarter. Details showed **weakness in consumer spending** and the services sector with construction filling the gap.
- Today's eco calendar contains weekly jobless claims and Philly Fed Business Outlook. **The Norges Bank and Bank of England decide on monetary policy**. Spain & France tap the bond market.

Rates

Fed paves the way for monetary easing

	US yield	-1d
2	1.74	-0.13
5	1.73	-0.07
10	2.02	-0.04
30	2.50	-0.01

	DE yield	-1d
2	-0.74	0.03
5	-0.64	0.05
10	-0.29	0.00
30	0.29	0.02

The Fed walked the talk yesterday after its chair Powell signaled readiness to act earlier this month. **The US central bank left rates stable** (although Bullard dissented, voting for a 25 bp rate cut) **but paved the way for rate cuts in the future**. The FOMC’s description of the US economy was less optimistic than in May as “cross currents reemerged”. Increased uncertainties about the outlook and muted inflation pressures warrant close monitoring of incoming data. **The Fed pledged to “act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2% objective”**. This marked a clear shift from a neutral (“patient”) to a dovish stance which is backed by the central bank’s June forecasts. Growth projections barely changed vs. March but inflation is now expected to hit the 2% target only by the end of the policy horizon (2021). The new dot plot does not pencil in a rate cut before 2020 yet, but 2019 is a close call with 7 out of 17 governors expecting a 50 bps lower policy rate by the end of the year. The FOMC wants to wait and see how the identified risks weigh on the outlook. Powell said they did not engage yet on the size of a possible cut but could act “promptly” if needed, leaving open the case for both a 25 and 50 bps. Although the expected rate path is still a long way from what markets discounted ahead of the Fed, US yields suffered severe losses. They feel comfort in the Fed’s dovish signal. The yield curve bull steepened with changes between -13 bps (2y) and -4 bp (10y). Markets now take a July rate cut for granted. Asian markets are profiting from the Fed’s dovish tilt. China outperforms with gains up to 2.5%. US yields are extending yesterday’s losses. The US10y yield slips below 2% (-4 bps). Losses for the shorter end of the curve are more limited. Japanese yields (-0.16% for 10y) suffer spill-over effects even as the BoJ left rates unchanged. Today’s economic calendar (jobless claims, Philly Fed business outlook) provides markets with little inspiration. **Both the ECB and the Fed will continue to reverberate through global bond markets**. We expect the Bund to open higher in the wake of the Fed policy meeting yesterday, but don’t forecast outsized gains. The test of key support in the US 10-yr yield is ongoing.

Long term view: The onus of the ECB is back on potential easing measuring including revamping asset purchases or cutting rates. The German 10-yr yield sets a new all-time low. There’s no trigger available at this stage to escape the lows, let alone negative territory. The Fed opened the door for cutting rates. The US 10-yr yield is currently below, but still testing 2.01%. A break would point to more losses. The next high profile support is situated around 1.77% (76% Fibonacci retracement). There’s probably little room for a rebound unless eco data start improving.



Fed’s new dot plot now hints at one rate cut happening in 2020, but with clear easing bias already this year.

US2y yield tanks 13bps as the Fed opened the door for cutting rates if eco outlook deteriorates further.

Currencies

R2	1.1533	-1d
R1	1.1448	
EUR/USD	1.1226	0.0032
S1	1.1110	
S2	1.0864	

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8881	-0.0033
S1	0.8500	
S2	0.8314	

Dollar declines as Fed is close to cutting rates

The dollar traded with a tentative negative bias ahead of the Fed decision. The Fed left rates unchanged but **is closely monitoring whether uncertainties that are weighing on the economy will call for policy accommodation in the near term**. The dots indicate that the case for rate cuts later this year is building within the FOMC. Even a 50 bp rate cut in a not that distant future is possible. **US yields and the dollar declined further**. On the dollar, Fed's Powell repeated that the Treasury is responsible for FX. The Fed doesn't target the dollar. EUR/USD closed at 1.1226, well off the intraday peak. USD/JPY finished at 108.10.

The Fed-inspired risk rally continues in Asia this morning. China outperforms. Japan underperforms. The BOJ left its policy unchanged, but the Bank is coming under growing pressure to join the easing stance of the ECB and the Fed. USD/JPY dropped further (currently near 107.65). A further slide in US yields is supporting EUR/USD (1.1265 area).

The yuan also strengthens against an overall weaker dollar (USD/CNY 6.8675). RBA's Lowe said that it wasn't unrealistic to expect a further rate cut and called for fiscal stimulus, too. The gain of the Aussie dollar against the USD is modest. (AUD/USD 0.6890).

Today, there are few data in Europe. In the US, the jobless claims and the Philly Fed business outlook are not the most high profile data series, but any signs of weakness might weigh on the dollar.

Earlier this week, euro weakness prevailed as Draghi signalled further ECB easing. **The Fed at least restored the balance of softness**, as it showed to be close to cutting rates soon if necessary. Any Fed action is still data-dependent. Even so, we see an asymmetrical reaction function for the dollar, with the US currency being more sensitive to negative rather than to positive news.

EUR/USD support at 1.1180/1.1107 looks solid. EUR/USD probably entered a buy-on-dips pattern for return action higher in the 1.1180/1.1350 trading range.

EUR/GBP lost gradually further ground yesterday and closed below the 0.89 handle. Boris Johnson becoming the next UK PM looks more or less discounted. Today, the UK calendar is well filled with the **retail sales and the BoE policy decision**. Markets will closely monitor whether the BoE keeps its guidance for gradual rate hikes. The market already for quite some time sees this call as unlikely, but the BoE might wait till the August inflation report the chance its assessment. Even so, The BoE shifting to a more neutral bias might be a (modest negative) for sterling.



EUR/USD rebounds as prospect for substantial Fed rate cuts (more than) counterbalances ECB's easing bias



EUR/GBP: sterling trading are looking out whether BoE will already leave its tightening bias today.

Calendar

Thursday, 20 June		Consensus	Previous
US			
14:30	Current Account Balance (1Q)	-\$124.3b	-\$134.4b
14:30	Initial Jobless Claims	220k	222k
14:30	Philadelphia Fed Business Outlook (Jun)	10.4	16.6
14:30	Continuing Claims	1680k	1695k
Japan			
	BOJ Policy Balance Rate	-0.10%A	-0.10%
	BOJ 10-Yr Yield Target	0.00%A	0.00%
07:30	All Industry Activity Index MoM (Apr)	0.70%	-0.40%
08:00	Machine Tool Orders YoY (May F)	--	-27.30%
09:00	Convenience Store Sales YoY (May)	--	1.30%
20JUN-25JUN	Supermarket Sales YoY (May)	--	-1.00%
UK			
10:30	Retail Sales Ex Auto Fuel MoM/YoY (May)	-0.40%/2.50%	-0.20%/4.90%
10:30	Retail Sales Inc Auto Fuel MoM/YoY (May)	-0.50%/2.70%	0.00%/5.20%
13:00	Bank of England Bank Rate	0.75%	0.75%
EMU			
16:00	Consumer Confidence (Jun A)	-6.5	-6.5
Belgium			
15:00	Consumer Confidence Index (Jun)	--	-5
Norway			
10:00	Deposit Rates	1.25%	1.00%
Events			
20JUN	Fourth Conservative Party leadership ballot (tentative)		
20JUN	EU heads of state hold two-day meeting to appoint new leaders for EU institutions		
08:30	ECB Governing Council member Rehn Speaks in Brussels		
09:30	ECB's Luis de Guindos to speak in city of Santander		
10:00	ECB Publishes Economic Bulletin		
10:45	Spain to Sell Bonds		
11:50	France to Sell I/L Bonds		
12:00	ECB's Enria Speaks in Dubli		
19:00	US to Sell USD15 Bln 5-Year TIPS		
22:00	BOE Governor Carney gives annual Mansion House Speech		

	<u>Close</u>	<u>-1d</u>		<u>2-year</u>	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	2.02	-0.04		US	1.74	-0.13	DOW	26504	38.46
DE	-0.29	0.00		DE	-0.74	0.03	NASDAQ	7987.323	33.44
BE	0.13	0.00		BE	-0.63	0.03	NIKKEI	21462.86	128.99
UK	0.87	0.00		UK	0.62	0.03	DAX	12308.53	-23.22
JP	-0.17	-0.03		JP	-0.23	-0.02	DJ euro-50	3454.7	1.81
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	-0.35	1.71	0.88	Eonia	-0.3790	-0.0110			
5y	-0.20	1.74	0.92	Euribor-1	-0.3910	-0.0030	Libor-1	2.3829	0.0000
10y	0.22	1.96	1.05	Euribor-3	-0.3360	-0.0140	Libor-3	2.3866	0.0000
				Euribor-6	-0.2990	-0.0230	Libor-6	2.2980	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	1.1226	0.0032		EUR/JPY	121.36	-0.04	CRB	175.43	-0.66
USD/JPY	108.1	-0.35		EUR/GBP	0.8881	-0.0033	Gold	1348.80	-1.90
GBP/USD	1.2639	0.0081		EUR/CHF	1.1161	-0.0037	Brent	61.82	-0.32
AUD/USD	0.6881	0.0004		EUR/SEK	10.6551	-0.0182			
USD/CAD	1.328	-0.0097		EUR/NOK	9.7728	-0.0160			

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