



Sunrise

Friday, 15 September 2017

Rates: Markets show signs of habituation to North-Korean tensions

The downside in US Treasuries was blocked yesterday by a new North-Korean threat despite a hawkish signal of the BoE and higher-than-expected US CPI data. The missile threat was put into practice overnight, but markets show signs of habituation. The past week's extreme safe haven flows didn't materialize, suggesting that US eco data will prime today!

Currencies: Will US data be strong enough to lift the dollar beyond first resistance?

A further rise in core yields and of the dollar was blocked by geopolitical tensions yesterday. The dollar failed to clear first important resistance against the euro and the yen. Will today's US data be strong enough to do the job? Sterling might remain well bid as the BoE signaled a rate hike yesterday.

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	⬇

- **The market reaction to the latest missile test by North Korea was muted this morning**, with investors largely shrugging off news that a missile launched by Pyongyang had once again overflowed Japan. **Asian stocks trade mixed**.
- **US secretary of state Rex Tillerson has called on China and Russia to take "direct actions of their own" against North Korea** following Pyongyang's missile test on Friday that flew over northern Japan.
- **Theresa May will attempt to break the Brexit impasse with a speech next week in Florence** setting out her plans for a transition deal that is seen in London as the "key" to addressing Brussels' concerns about a €30B budget hole.
- While the Bank of Canada's inflation targeting regime has worked well, **the central bank is open to alternatives** and wants to communicate in a way that avoid unproductive volatility, **deputy governor Wilkins** said.
- **Top congressional Republicans signaled that they wouldn't be pressured into enacting an immigration framework** reached between President Trump and top Democrats.
- **EU finance ministers discuss deepening of economic and monetary ties**, developing a capital-markets union and tax matters today in Tallinn. EC Juncker will also push for the creation of a regional finance and economy minister post.
- **Today's calendar heats up in the US** with Empire Manufacturing, retail sales, industrial production and University of Michigan consumer confidence. ECB Nouy, ECB Lautenschläger and BoE Vlieghe are scheduled to speak.

Rates

Losses on CPI/BoE erased by North Korea

Global core bonds initially lost ground as the Bank of England signalled “some withdrawal of monetary stimulus is likely to be appropriate over the coming months” and after higher-than-expected US CPI data. Reports in Japanese newspapers about a possible near term North-Korean missile launch erased most of core bond losses via safe haven flows. Eventually, both the Bund and the US Note future ended near opening levels.

Higher US CPI lifts 2017 Fed rate hike expectations

	US yield	-1d
2	1,36	0,01
5	1,78	0,01
10	2,18	0,00
30	2,76	-0,02

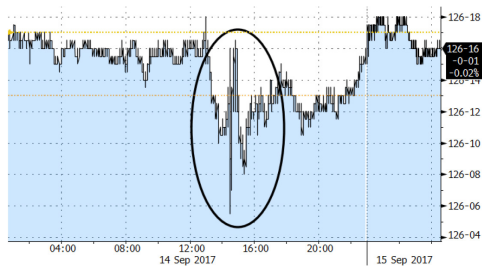
At the end of the session, German yields increased by 0.3 bps (2-yr) to 1.2 bps (5-yr & 10-yr). Changes on the US yield curve varied between +1.4 bps (2-yr) and -1.9 bps (30-yr). The front end of the curve underperformed as the market implied probability of a 2017 Fed rate hike moved back above 50% for the first time since early July. On intra-EMU bond markets, 10-yr yield spread changes versus Germany ranged between -2 bps and +1 bp with Greece slightly outperforming (-4 bps).

US eco calendar heats up

Attention turns to the US today. Yesterday’s market reaction after stronger US inflation readings proves markets willingness to adapt current dovish positions going into next week’s Fed meeting. US headline retail sales are expected to increase by 0.1% M/M following July’s impressive 0.6% M/M gain. The underlying trend in consumer spending remains positive, suggesting some upside risks. Gas station sales will be lifted by evacuations for hurricanes while auto sales could be more depressed. The August US empire manufacturing index is forecast to decline from a 3-yr high at 25.2 to 18. Some setback in this notoriously volatile indicator is likely. US industrial production is expected to increase by 0.1% M/M, mainly driven by manufacturing production. The aggregate hours worked by production related factory workers increased by a sharp 0.8% in August. Risks are on the upside of expectations. Finally, Michigan consumer confidence is expected to decline from 96.8 to 95. The indicator remains near multi year highs despite this small forecasted setback. Markets could be more sensitive to the forward-looking inflation components in the report.

Stronger than expected US retail sales and industrial production?

	DE yield	-1d
2	-0,72	0,00
5	-0,31	0,01
10	0,41	0,01
30	1,22	0,01



US Note future (intraday): Test downside on BoE/CPI erased by North Korean threat



Odds of another 2017 Fed rate hike (blue) exceed odds of unchanged rate policy for the first time since early July

US Treasuries sensitive to stronger US eco data?

R2	165,83	-1d
R1	164,00	
BUND	161,56	-0,16
S1	161,37	
S2	160,5	

Asian stock markets trade mixed overnight while the US Note future and Japanese yen fail to gain ground on the North Korea missile launch. The tepid market reaction suggests some habituation from a market point of view to the North Korean missile tests. We expect a neutral opening for the Bund as well.

Today's eco calendar heats up in the US. Data will be key for trading unless European markets do react to the North Korean ICBM test (risk aversion). We don't think they will do so. **Risks to US eco data releases are on the upside for the two most important reports (retail sales and industrial production).** Yesterday's post-CPI move shows willingness to react. **Therefore, we think that there is more downside with US Treasuries underperforming German Bunds.** Short covering ahead of the weekend could eventually limit losses. Speeches by ECB Nouy and Lautenschläger are wildcards for trading.

From a technical point of view, US yields recaptured lost support levels and even broke out of their downward trend channels (eg 5-yr & 30-yr). It means that we entered a consolidation phase ahead of the September 20 FOMC meeting, especially if supported by the data. The market implied probability of 2017 Fed rate hike exceeds 50% for the first time since early July, compared with 35% at the end of last week. It still seems too dovish according to us. The FOMC will normally also give the green light at its September meeting for balance sheet tapering in Q4 2017.

Speculation in the run-up to the October ECB meeting (a slowdown in monthly asset purchases and extension APP; start policy normalisation) should cap Bund gains. The Bund tests first support at 161.66



German Bund: Draghi delays key decisions to October. Speculation on APP announcement should cap gains.. First support under test.



US Note future: Risk sentiment improved and ended uptrend since start of Summer. Stronger US eco data can inflict more losses ahead of FOMC meeting.

Currencies

Will US data help USD to overcome first resistance?

Dollar rebound blocked as North Korean threat countered USD supportive economic data

The dollar couldn't extend gains yesterday even as the interest rate context and the data were initially supportive. Core yields rose after the BoE signalled a rising probability on a rate hike and a higher-than-expected US CPI. Headlines that North Korea was preparing a new missile test in the direction of Japan blocked further USD-gains. The dollar almost immediately reversed post-CPI gains and returned to the levels seen earlier in the session. EUR/USD finished the session at 1.1919 (from 1.1885 on Wednesday). USD/JPY closed at 110.24 (from 110.49).

Asian equities show muted reaction to new North Korea missile launch

Overnight, North Korea indeed launched a new missile over Japan's Northern Island Hokkaido. However, the multiple North Korean actions have a 'diminishing impact' on markets. There were some jitters in regional equity indices and in USD/JPY as the headlines on the test flashed on the screens. However, any risk-off reaction was much more limited than at previous occasions. Asian equities currently mostly show limited losses. Japan even trades in positive territory. USD/JPY spiked briefly below 110 but trades again in the 110.40 area. The EUR/USD chart hardly shows any ripples. The pair trades just north of 1.19. That said, the geopolitical noise still prevents USD/JPY and EUR/USD to clear first key levels respectively at 110.95 and 1.1823.

Impact on USD/JPY limited and short-lived

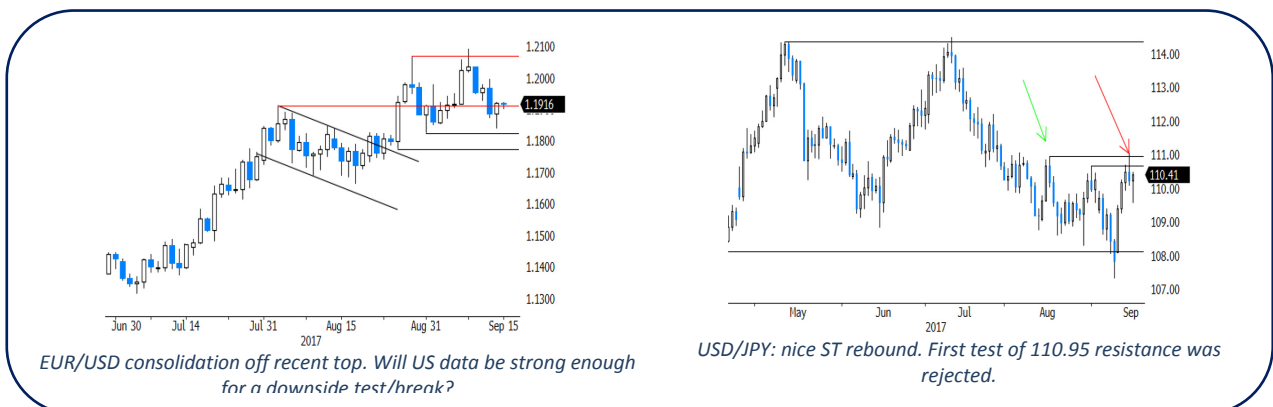
EUR/USD unmoved

R2	1,2225	-1d
R1	1,2167	
EUR/USD	1,1919	0,0034
S1	1,1662	
S2	1,1311	

Today's EMU calendar only contains the trade balance which is no market mover. The US calendar is again interesting with the Empire manufacturing survey, retail sales, industrial production and consumer confidence from the U of Michigan. The consensus expects a limited setback for the confidence data (NY manufacturing and Michigan,). Retail sales growth is expected to slow after a strong August figure. In general, we think that expectations on the US data are no that high. Positive surprises are especially possible in retail sales and production.

US activity data in focus

Geopolitics remains a wildcard



Of late, global factors were the main driver for the dollar. Regarding the data, the focus of FX markets was more on price data rather than on activity data. Even so, if yesterday's slightly higher than expected CPI would be followed by a set of decent activity data, it should solidify a ST floor for the dollar going into next week's Fed meeting. Yesterday, USD/JPY and EUR/USD tested/came closer to first technically significant resistance/support at respectively 110.67/95 and 1.1823. A break /real test was blocked by the North Korea headlines. Will today's US eco data be able to do the job? Clearing these levels in a sustainable

way would call off the USD negative momentum short-term. However, if the break doesn't succeed today, it would be disappointing for USD bulls.

Global context. The euro remained strong last week even as the ECB delayed communication on APP tapering till October and as Draghi kept a soft tone.

Markets apparently took the view that ECB normalisation will come anyway. At the same time, the dollar lost further interest rate support as global uncertainty kept US yields on a downward trajectory. Finally, the decline in US yields and of the dollar had gone far enough given recent US eco data, which remained fairly good. **A technical correction occurred this week.** The dollar in the first place needs an improvement in global sentiment and higher yields. US data might become noisy due to the impact of the hurricanes and can cloud the Fed's outlook and complicate a USD rebound. **In this context, we want more confirmation that the recent bottoming out process in US yields and in the dollar might be the start of more sustained USD gains. We keep a close eye on how the test of first important technical levels turns out (cf supra).** A break of EUR/USD below 1.1823 would open the way to the 1.1662 correction low. We remain cautious on a sustained upside break in USD/JPY .

BoE rate hike signal propels sterling

Yesterday, the Bank of England voted 7-2 to leave its policy rate unchanged. However, the BoE clearly signalled that the recent up-tick in inflation can no longer be ignored if eco data continue to come in as expected. A rate hike in the coming months is very well possible. Sterling started a new upleg. EUR/GBP declined more than one big figure and fell below the 0.89 big figure. Cable also set a new ST top in the 1.34 area.

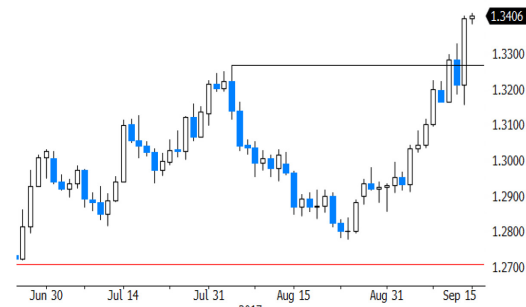
There are no important UK eco data today. **However, BoE's Vlieghe will give a speech. He is a well-known dove.** We don't expect that he will be able to change to market repositioning after yesterday's clear message from the BoE Minutes. After yesterday's jump of sterling, quite some good news should gradually be discounted. Even so, we don't row against the sterling positive tide yet. The EUR/GBP correction might still go a bit further.

From a technical point of view, EUR/GBP cleared 0.8854/80 resistance (top end June), opening the way for a protracted August rebound. The move was the result of euro strength. Simultaneously, UK price data were soft enough to keep the BoE side-lined. Recent price data amended this story and the ST-trend reversal of sterling was confirmed/reinforced by yesterday's BoE comments. Medium term, we maintain a **EUR/GBP buy-on-dips approach as we expect the combination of relative euro strength and sterling softness to persist. However, the prospect of some withdrawal of policy stimulus probably has put a solid floor for sterling ST term. We let the current correction do its job, before selling sterling versus the euro.**

R2	0,9415	-1d
R1	0,9307	
EUR/GBP	0,8896	-0,0102
S1	0,8743	
S2	0,8657	



EUR/GBP: BoE rate hike signal accelerates GBP-rebound



GBP/USD: breaking higher on BoE rate hike talk

Calendar

Friday, 15 September		Consensus	Previous
US			
14:30	Empire Manufacturing (Sep)	18.0	25.2
14:30	Retail Sales Advance MoM (Aug)	0.1%	0.6%
14:30	Retail Sales Ex Auto MoM (Aug)	0.5%	0.5%
14:30	Retail Sales Ex Auto and Gas (Aug)	0.3%	0.5%
14:30	Retail Sales Control Group (Aug)	0.3%	0.6%
15:15	Industrial Production MoM (Aug)	0.1%	0.2%
15:15	Capacity Utilization (Aug)	76.8%	76.7%
15:15	Manufacturing (SIC) Production (Aug)	0.4%	-0.1%
16:00	U. of Mich. Sentiment (Sep P)	95.0	96.8
16:00	U. of Mich. Current Conditions (Sep P)	--	110.9
16:00	U. of Mich. Expectations (Sep P)	--	87.7
16:00	U. of Mich. 1 Yr Inflation (Sep P)	--	2.6%
16:00	U. of Mich. 5-10 Yr Inflation (Sep P)	--	2.5%
16:00	Business Inventories (Jul)	0.2%	0.5%
EMU			
11:00	Trade Balance SA (Jul)	24.0b	22.3b
11:00	Labour Costs YoY (2Q)	--	1.5%
Events			
08:00	ECB's Nouy Speech in Finland		
10:15	ECB's Lautenschlaeger Speaks in Tallinn		
10:50	BoE Vlieghe Speaks in London		

10-year	Close	-1d	2-year	td	-1d	Stocks	Close	-1d	
US	2,18	0,00	US	1,36	0,01	DOW	22203,48	45,30	
DE	0,41	0,01	DE	-0,72	0,00	NASDAQ	6429,084	-31,10	
BE	0,70	0,01	BE	-0,55	0,00	NIKKEI	19909,5	102,06	
UK	1,23	0,09	UK	0,38	0,09	DAX	12540,45	-13,12	
JP	0,02	-0,03	JP	-0,14	-0,02	DJ euro-50	3526,48	3,34	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,07	1,71	0,82	Eonia	-0,3590	-0,0010			
5y	0,20	1,87	1,03	Euribor-1	-0,3710	0,0020	Libor-1	1,2344	0,0000
10y	0,86	2,15	1,33	Euribor-3	-0,3290	0,0000	Libor-3	1,3200	0,0000
				Euribor-6	-0,2720	0,0000	Libor-6	1,4558	0,0000
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1919	0,0034	EUR/JPY	131,4	0,08	CRB	183,31	0,43	
USD/JPY	110,24	-0,25	EUR/GBP	0,8896	-0,0102	Gold	1329,30	1,30	
GBP/USD	1,3399	0,0188	EUR/CHF	1,1479	0,0019	Brent	55,47	0,31	
AUD/USD	0,8005	0,0019	EUR/SEK	9,522	-0,0291				
USD/CAD	1,2165	-0,0007	EUR/NOK	9,3829	0,0178				

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