



Sunrise

Wednesday, 01 March 2017

Rates: Fed paves way for March rate hike

A handful of Fed governors, including heavyweight NY Fed Dudley, said that the case for a March rate hike became very compelling. The market implied probability of a March move surged to 80% and pulled US Treasuries lower. US President Trump's speech before Congress turned out to be a non-event. We expect more selling pressure today.

Currencies: Trump doesn't help the dollar, but the Fed does

Yesterday evening Fed governors Williams and Dudley hinted that a March Fed rate hike has become ever more likely. The dollar started a gradual rebound. However, the upside momentum was hampered as President Trump failed to give any details on fiscal policy. Still, the US eco data and Fed rate expectations might support further USD gains.

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 opened weaker despite very strong US eco data** and failed to recover losses ahead of Trump's speech. **Japan outperforms** in Asia on the back of a weaker yen as the prospect of an imminent Fed rate hike propels USD.
- **Several Fed governors jolted markets into higher expectations for a March rate hike (80% probability)**, with comments that suggested they are worried about waiting too long in the face of pending economic stimulus from Washington.
- **President Trump** turned from the ominous language that characterized his campaign as he delivered **an impassioned plea for Congress** to capitalize on a political uprising and unite behind major overhauls of health care and tax laws.
- **The ECB said it will test euro zone banks on their resilience to sharp changes in interest rates**, simulating scenarios from sudden monetary tightening to the lending freeze that followed Lehman Brothers' collapse.
- **China's factory activity (PMI's) expanded faster than expected in February** as domestic and export demand picked up, adding to signs that the global economy is regaining momentum even as fears grow of a surge in trade protectionism.
- **Australia's economy bounced back to robust growth in the fourth quarter of last year (1.1% Q/Q)**, fuelled by a jump in corporate profits linked to rising commodity prices, a surge in exports and higher household spending.
- **Today's eco calendar heats up** with manufacturing PMI/ISM's in the EMU, UK and US. Germany (CPI) and the US (PCE) publish inflation data, the BoC decides on its policy, Germany taps the market and the Fed releases the Beige Book.

Rates

US Treasuries sell off as Fed closes in on a rate hike

Core bonds initially traded uneventful yesterday, as investors stayed side-lined ahead of Trump's speech before Congress. However late in the US session, several Fed governors, in what seemed to be a concerted action, stepped up and made an effort to convince markets that the Fed may raise its rates at the March meeting. NY Fed Dudley, who is a typical dove and a close companion of chairwoman Yellen said that *"the case for monetary policy tightening has become a lot more compelling"*. He added that regardless of uncertainties surrounding the timing, size and composition of future fiscal policy, it **will be in a supportive direction**. The risks on the eco outlook **are tilted on the upside**. The Fed must tighten in a slow and gradual manner, but **moving up rates early will help to prevent the economy from overheating so that the expansion can continue**. Regional Fed governors, **Harker and Kaplan**, both FOMC voters, reiterated their previous hawkish comments that March was on the table. Finally, **San Francisco Fed Williams**, another close ally of chairwoman Yellen said that a **March rate hike is a "serious consideration"** as full employment has been reached nation-wide. The market surrendered after this salvo of bullets and pushed the **odds of a March rate hike up to 80%. The market implied probability of 3 rate hikes in 2017 is now 54%, a cycle high**. Tonight, **Fed governor Brainard speaks**. She is one of the most dovish FOMC members. She recently shifted already to the more hawkish side.

In a daily perspective, Fed talk about the March hike bear flattened the curve with yield 6.6 bps (2-yr) to 1.2 bps (30-yr) higher. German yields added 0.6 bps (5-yr) to 2.6 bps (30-yr), largely catching-up with Monday's late evening US Treasury sell-off and not yet discounting late US selling. **On the intra-EMU bond markets**, peripheral bond spreads were little changed with Italy outperforming (-6 bps), following a 7 bps decline on Monday. France no longer outperformed.

US ISM, PCE deflators and German inflation key

German HICP inflation is expected to have risen to 2.1% Y/Y in February from 1.9% Y/Y in January, a psychological issue in Germany. We have **no reasons to distance ourselves from consensus**, but an upward surprise would increase chances that also EMU HICP surprises on the upside and moves to 2% Y/Y. US **ISM manufacturing confidence** is expected to have risen marginally in February to 56.2 from 56 previously. Given that all regional surveys surprised on the upside, **we expect a much stronger ISM** (57/58?). The PCE (consumption) and PI (income) are expected to have risen 0.3% M/M each. **Attention might go to the PCE deflator and core deflator**. The headline is expected to have risen to 2% Y/Y from 1.6% Y/Y in January. In that case, the FOMC could formally say that the inflation target is reached. Core PCE is expected to have stabilized at 1.7% Y/Y.

Fed "pre-announces" March rate hike

US curve bear steepens

US yield supports now out of danger

	US yield	-1d
2	1,28	0,09
5	1,96	0,10
10	2,41	0,06
30	3,01	0,03

	DE yield	-1d
2	-0,90	0,03
5	-0,57	0,01
10	0,21	0,01
30	0,99	0,03

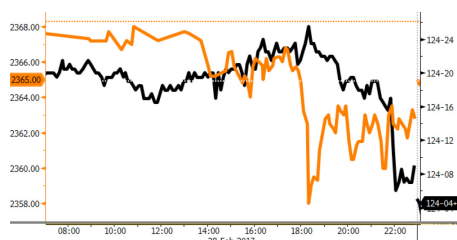
German inflation to rise

Upside risks US ISM

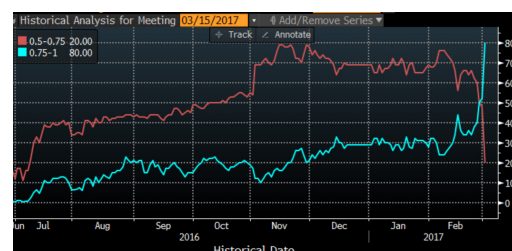
Will PCE deflator hit 2%?

Weidmann and again Kaplan speak

Beige Book to confirm acceleration growth pace, setting stage for rate hike



T-Note future (black) & S&P future (orange) (intraday): Dull session until Fed speakers come to the fore. T-Note future dives.



Odds for Fed March rate hike (80%): Complete turnaround on comments Dudley/Williams

ain vanilla German Bund auction?

R2	168,93	-1d
R1	166,84	
BUND	165,67	-0,40
S1	163,13	
S2	161,31	

The German Finanzagentur taps the on the run 10-yr Bund (€3B 0.25%

Feb2017). It's already the second German auction this week, which is highly exceptional, after yesterday's strong Schatz auction. Total bids at the previous 4 Bund auctions averaged €5.34B. The Bond on offer traded rather stable in ASW-spread terms going into the auction, but it sits rather cheap on the German curve. **We expect a plain vanilla auction.**

Probability of March rate hike hits 80%

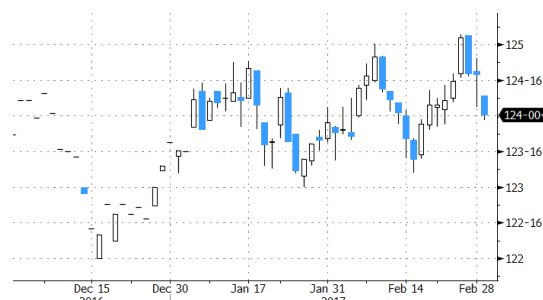
Overnight, most Asian stock markets trade slightly positive with Japan outperforming on the back of a weaker yen. The US Note future remains near the lows reached in the wake of hawkish Fed comments. We expect a lower opening for the Bund as well.

Today's eco calendar heats up with US manufacturing ISM, PCE deflator and German CPI. Risks for the ISM are on the upside of expectations, while US PCE and German CPI are expected to hit 2% (inflation target ECB and Fed), which will generate a lot of media attention. **In light of yesterday's hawkish Fed comments and the surge of the market implied probability of a March Fed rate hike (from 50% to 80%), we expect more downside for US Treasuries with underperformance vs German Bunds.** Influential Fed governors Brainard (tonight), Fischer (Friday) and Yellen (Friday) will probably seal the deal ahead of the Fed's blackout period. **Technically, the US 2-yr yield tests the cycle high (1.3%), while the 10-yr yield bounced off key support (2.3%).**

The German 10-yr yield reached similar support around 0.17%/0.2%. The test is still ongoing, but we don't anticipate a break lower. Recent developments in Greece and France improved sentiment on EMU bond markets. **Collateral scarcity and other technical factors might be at play though and interfere with positive underlying growth and inflation dynamics. Longer term, we hold our bearish view also for Bunds.**



German Bund: EMU worries push Bund above 164.90 and 165.48 resistance. In yield terms, 0.17%/0.20% is key support



US Note future (June contract!!!): Rising probability March rate hike pulls US Treasuries lower

Currencies

Dollar propelled by March rate hike bets

Dollar late session rebound as Fed governors signal March rate hike.

R2	1,1145	-1d
R1	1,0874	
EUR/USD	1,0554	-0,0042
S1	1,0341	
S2	1,0000	

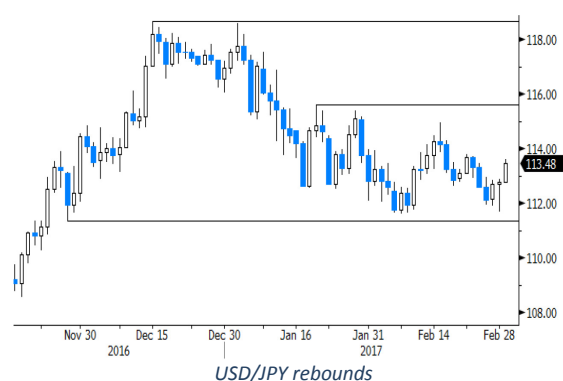
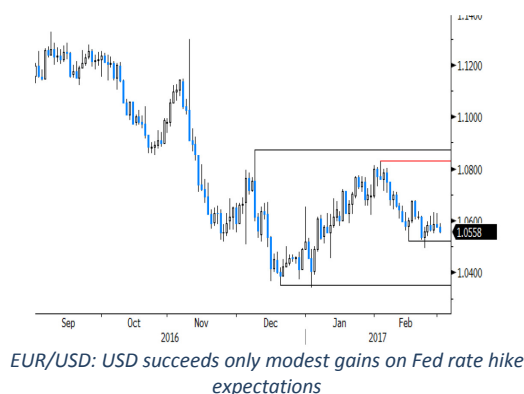
USD extends gains on rate hike hope

Trump Testimony a non-event for USD trading.

On Tuesday, USD trading was confined to tight ranges ahead of US president Trump's testimony before Congress. However, it didn't take till the Trump testimony for the dollar to catch a renewed bid. Late in the US session, Fed governors Williams and Dudley gave strong hints on a March rate hike, as the Fed is reaching its goals on inflation and unemployment. The dollar reversed the intraday losses against the euro and the yen. EUR/USD finished the session at 1.0576. USD/JPY closed the day at 112.77. The gains were modest, as investors might still have been cautious to place big USD bets ahead of the Trump speech.

Overnight, the focus was on the testimony of US president Trump. The US president hardly gave any specifics on the budget, tax cuts or on any other economic topic. Even so, **the dollar extended its gains**. The Trump speech was USD disappointing, but investors adapted positions on the rising likelihood of a March Fed rate hike. USD/JPY trades in the 113.50 area. **BOJ member Sato said that the BOJ could raise the Target for the 10-year bond yield before the 2% target is reached. For now**, his comments didn't help the yen. USD strength prevails. Even so, the USD gains against the euro are modest. EUR/USD is changing hands in the mid 1.05 area. Australian Q4 growth was reported at a strong 1.1% Q/Q and 2.4%. AUD/USD spiked temporary to the 0.77 area, but the move was soon reversed on overall USD strength (currently 0.7670).

Today, German HICP inflation is expected to have risen to 2.1% Y/Y in February from 1.9% Y/Y, a psychological issue in Germany. We join the consensus, but an upward surprise would increase chances for the EMU inflation to reach 2%. In US, the **ISM manufacturing confidence** is expected to have risen to 56.2 from 56. Recent surveys put the risk for an upward surprise (57/58?). The PCE (consumption) and PI (income) are expected to have risen 0.3% M/M each. **Attention might go to the PCE deflators**. The headline is expected to have risen to 2% Y/Y from 1.6%. In that case, the FOMC could formally say that the inflation target is reached. **Of late, the focus for USD trading was on US fiscal policy (Trump speech). However, at this stage, it is the Fed talk that really matters**. The probability of a March Fed rate hike has risen to 80%. The rise in short-term US yields should be USD supportive. The first reaction of EUR/USD to the rise in Fed rate hike expectations is modest. Even so, **in this context we can't but the start the day with a USD positive bias**. The Fed rate expectations should outweigh the disappointment on any details on fiscal policy from president Trump.



Global context. The dollar corrected lower since the start of January, but bottomed out three weeks ago **supported by Trump's tax promise. Underlying euro weakness due to political uncertainty** in the area is a factor too. Recent Fed comments were also USD supportive. Initially, it had little impact on yields and on the dollar. However this might change as chances on a March rate hike are sharply rising. **We see 1.0874 as solid resistance and favour a sell EUR/USD on upticks approach. 1.0494 is first intermediate support. The downside test of USD/JPY was rejected.** USD/JPY 111.60/111.16 (Range bottom/38% retracement of the 99.02/118.66 rally) remains key support. We keep a USD positive bias longer term, as the dollar might still get additional interest support if the Fed continues its normalisation process.

EUR/GBP drifting north of 0.85

R2	0,8645	-1d
R1	0,8592	
EUR/GBP	0,8534	0,0011
S1	0,8304	
S2	0,8117	

Yesterday, sterling traded again with a tentatively negative bias. EUR/GBP drifted further north of 0.85. Cable hovered in the lower half of the 1.24 big figure for most of the day.. At a hearing before lawmakers, new MPC member **Charlotte Hogg** faced tough questions on monetary policy, including the management of the stock of assets on the BoE's balance sheet. Her assessment and tolerance on the inflation overshoot sounded rather dovish. In the press, the Scottish PM kept the door open for a second 'indyref', as she was unhappy on the way PM May handles the EU views of Scotland. In both cases, the impact on sterling trading was limited. EUR/GBP closed the session at 0.8543. Cable finished the day at 1.2380.

Today, the UK manufacturing PMI is expected little changed at 55.8. Markets will keep an eye at the Brexit vote in the House of lords. UK May might lose the vote for an amendment over the rights of EU citizens living in the UK. A negative outcome might complicate the Brexit timetable. The headlines might be slightly GBP negative. The overall context of USD strength will also affect sterling trading. That said, we have the impression that sterling sentiment has softened a bit of late. So, it is difficult for cable to outperform EUR/USD as is often the case with USD strength. **Early last week**, the euro sell-off pushed EUR/GBP to the 0.84 area, but a sustained break lower didn't occur. There is currently no clear driver for sterling trading. **Longer term, we have a sterling negative view, as the Brexit will negatively impact the UK economy. We maintain a neutral bias on sterling short-term.**



EUR/GBP: drifting higher from the recent lows, but to sustained trend.



GBP/USD topside test rejected. USD strength to prevail.

Calendar

Wednesday, 1 March		Consensus	Previous
US			
14:30	Personal Income (Jan)	0.3%	0.3%
14:30	Personal Spending (Jan)	0.3%	0.5%
14:30	PCE Deflator MoM / YoY (Jan)	0.5%/2.0%	0.2%/1.6%
14:30	PCE Core MoM / YoY (Jan)	0.3%/1.7%	0.1%/1.7%
15:45	Markit US Manufacturing PMI (Feb F)	54.5-	54.3
16:00	ISM Manufacturing (Feb)	56.2	56.0
16:00	Construction Spending MoM (Jan)	0.6%	-0.2%
Canada			
16:00	Bank of Canada Rate Decision (Mar 1)	0.50%	0.50%
Japan			
00:50	Capital Spending YoY (4Q)	A 3.8%	-1.3%
01:30	Nikkei Japan PMI Mfg (Feb F)	A 53.3	53.5
China			
02:00	Non-manufacturing PMI (Feb)	A 54.2	54.6
02:00	Manufacturing PMI (Feb)	A 51.6	51.3
02:45	Caixin China PMI Mfg (Feb)	A 51.7	51.0
UK			
01:01	BRC Shop Price Index YoY (Feb)	A -1%-	-1.7%
08:00	Nationwide House PX MoM / NSA YoY (Feb)	0.2%/4.1%	0.2%/4.3%
10:30	Markit UK PMI Manufacturing SA (Feb)	55.7	55.9
10:30	Net consumer credit (Jan) £B	£1.4B	£1B
10:30	Mortgage approvals (Jan)	68.5K	67.9K
10:30	Money Supply M4 MoM / YoY (Jan)	--/--	-0.5%/6.2%
EMU			
10:00	Markit Eurozone Manufacturing PMI (Feb F)	55.5	55.5
Germany			
14:00	CPI MoM / YoY (Feb P)	0.6%/2.1%	-0.6%/1.9%
14:00	CPI EU Harmonized MoM / YoY (Feb P)	0.6%/2.1%	-0.8%/1.9%
France			
09:50	Markit France Manufacturing PMI (Feb F)	52.3	52.3
Italy			
09:45	Markit/ADACI Italy Manufacturing PMI (Feb)	53.5	53.0
10:00	GDP Annual YoY (2016)	1%	0.8%
10:00	Deficit to GDP (2016)	2.4%	2.6%
Spain			
09:15	Markit Spain Manufacturing PMI (Feb)	55.8%-	55.6
Norway			
09:00	Manufacturing PMI (Feb)	51.7	51.4
Sweden			
08:30	Swedbank/Silf PMI Manufacturing (Feb)	60	62.0
Events			
00:50	Fed's Bullard Speaks in Washington		
02:30	BOJ Sato speaks in Tokushima		
03:00	US president Trump addresses joint Congress		
09:30	Riksbank Publishes Minutes from February Meeting		
11:30	Germany to Sell €3B 0.25% 2027 Bonds		
14:30	ECB Weidmann speaks in Ljubljana		
19:00	Fed's Kaplan Speaks in Dallas		
20:00	U.S. Federal Reserve Releases Beige Book		

10-year	td	-1d		2-year	td	-1d		Stocks	td	-1d
US	2,41	0,06		US	1,28	0,09		DOW	20812,24	-25,20
DE	0,21	0,01		DE	-0,90	0,03		NASDAQ	5825,438	-36,46
BE	0,71	0,01		BE	-0,56	0,01		NIKKEI	19393,54	274,55
UK	1,15	0,00		UK	0,10	0,01		DAX	11834,41	11,74
JP	0,07	0,02		JP	-0,25	0,02		DJ euro-50	3319,61	10,31
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	td	-1d
3y	-0,10	1,82	0,62	Eonia	-0,3450	0,0120				
5y	0,08	2,07	0,77	Euribor-1	-0,3710	0,0000		Libor-1	0,7844	0,0039
10y	0,67	2,40	1,15	Euribor-3	-0,3300	-0,0010		Libor-3	1,0546	0,0006
				Euribor-6	-0,2390	-0,0010		Libor-6	1,3613	0,0006
Currencies	td	-1d		Currencies	td	-1d		Commodities	td	-1d
EUR/USD	1,0554	-0,0042		EUR/JPY	119,82	0,76		CRB	190,62	0,74
USD/JPY	113,53	1,17		EUR/GBP	0,8534	0,0011		Gold	1244,10	-10,70
GBP/USD	1,2368	-0,0064		EUR/CHF	1,0645	-0,0026		Brent	56,51	0,43
AUD/USD	0,766	-0,0021		EUR/SEK	9,5634	-0,0270				
USD/CAD	1,3315	0,0139		EUR/NOK	8,8665	0,0044				

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