



Wednesday, 19 December 2018

Rates: All eyes on the Fed

US Treasuries heavily outperformed German Bunds yesterday with oil prices losing almost 5%. Today's Fed meeting is key. Markets expect tonight's hike to be the final one this cycle. The Fed will offer a contrasting view in its dot plot. Bear flattening of the US yield curve should be the logical market reaction. If not, the Fed has a credibility issue.

Currencies: Will Fed unlock EUR/USD stalemate?

The dollar lost slightly further ground as interest rate differentials moved against the US currency going into the Fed policy meeting. The Fed is expected to deliver some kind of dovish rate hike. Will Powell and Co be able to convince markets that (current & projected) rate hikes won't kill growth, preventing further USD losses?

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 closed flat (S&P 500) to 0.5% higher (Nasdaq). Opening gains (+1%) melted away as another drop in the oil price weighed down the energy sector.** Asian bourses are mixed this morning with China and Japan underperforming.
- **Oil prices dropped further with Brent crude below \$56/barrel (-4.5%).** API said that US crude inventories rose last week, putting the effectiveness of production cuts further in doubt with investors worried about global demand as well.
- The **National Bank of Hungary** kept its policy rate unchanged, but **no longer thinks that maintaining loose monetary conditions is necessary** with core inflation expected to pick-up. EUR/HUF fell from 323.5 towards 322.
- **Italian officials said that Rome has a technical agreement with EU officials on next year's budget (2.04% of GDP deficit target)** which needs to be ratified later today. Italy would avoid sanctions over its spending plans thanks to the deal.
- **Senate GOP leaders are preparing a short-term bill to avoid a partial government shutdown** as early as this weekend with the White House signalling readiness to drop its demand for \$5bn to pay for a border wall.
- **US Treasury Secretary Mnuchin said that the US and China are planning face-to-face January meetings to negotiate a trade war truce.** Both countries' vice ministers held discussions by phone this morning.
- **Today's economic calendar** contains the final Fed meeting of the year. A 25 bps rate hike is discounted, but how will new forecasts look like? UK CPI, US existing home sales and a speech by ECB Hansson are second tier events.

Rates

All eyes on the Fed

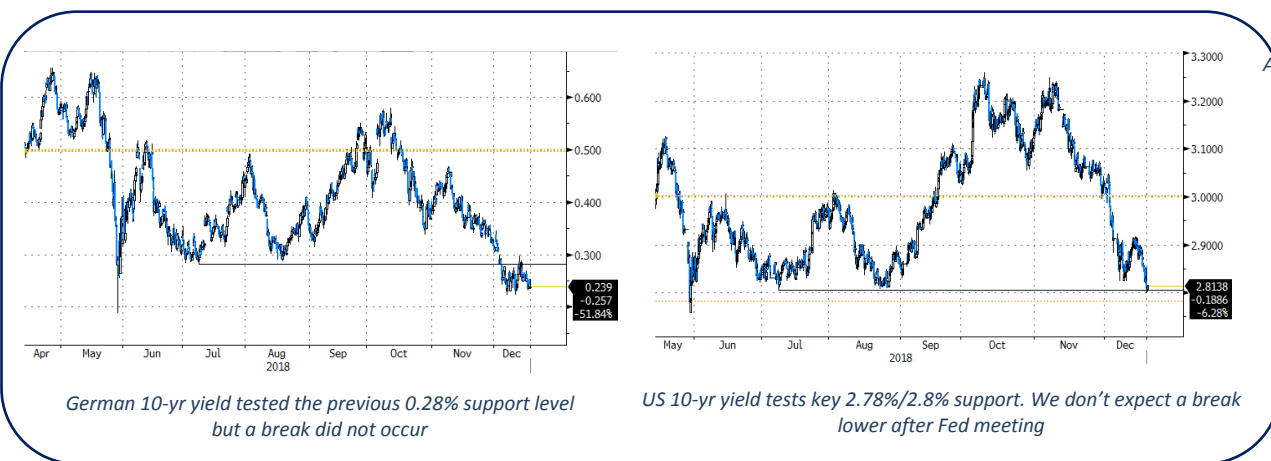
	US yield	-1d
2	2,64	-0,05
5	2,64	-0,05
10	2,82	-0,04
30	3,07	-0,05

	DE yield	-1d
2	-0,61	0,00
5	-0,29	0,00
10	0,24	-0,01
30	0,85	-0,02

Global core bonds gained ground yesterday with US Treasuries heavily outperforming German Bunds. European equities still moved south with losses varying between 0.25%-1.0%. The sell-off in US equities came to a halt. US indices opened higher, but eventually **remained near their multi-month lows as oil prices suffered another huge setback and as investors brace tonight's Fed policy decision.** The US yield curve moved substantially lower with changes ranging between -4.0 bps (10-yr) to -4.9 bps (2-yr). The second straight bull steepening adds evidence to investors discounting a rate cut as the next policy move following tonight's anticipated Fed hike. The German yield curve flattened with changes varying between -2.3 bps (30-yr) to +0.3 bps (2-yr). Closer to home, **Belgian PM Charles Michel offered his resignation yesterday after his opposition tabled a no confidence vote** as Michel's government lost majority over a migration dispute. Belgium's King Filip is keeping the decision under consideration. The most probable outcome is that PM Michel will chair a government of current affairs up until the national elections of May'19. We don't expect any specific OLO underperformance.

Asian equity markets opened mixed this morning with China and Japan underperforming. Japanese equities moved lower amid a disappointing IPO for Softbank Group's Japanese telecom business, while the Japanese 10y bond yield surged higher after slipping to within striking distance of zero percent. US Treasury Secretary Mnuchin said face-to-face negotiations with China are planned for January, while both VP's spoke already on the phone.

Today's eco calendar is richly filled with UK consumer inflation data, US existing home sales and ECB's Hansson speaking. **All will fall in the shade of the Fed meeting tonight.** With a 25 bps rate hike already discounted, investors will eye the 'dot plot' that forecasts the future policy rate. A 'hawkish hike', where they forecast 3 rate hikes for 2019, will lift the short end of the US yield curve (bear flattening), causing a further inversion between the 2- and 5-yr yield. **Investors are currently very soft positioned, not pricing in any rate hikes for 2019. We think this is exorbitant** and suspect that even a 'dovish hike', where the dot plot displays 2 rate hikes for 2019, will evoke markets to move in the similar direction. The magnitude of the moves will be lower of course. From a risk point of view, this is the more preferable outcome. The US 10-yr yield approaches 2.78%/2.8% key support, but we don't expect a break lower.



German 10-yr yield tested the previous 0.28% support level but a break did not occur

US 10-yr yield tests key 2.78%/2.8% support. We don't expect a break lower after Fed meeting

Currencies

R2	1,1815	-1d
R1	1,1621	
EUR/USD	1,1361	0,0013
S1	1,1187	
S2	1,1119	

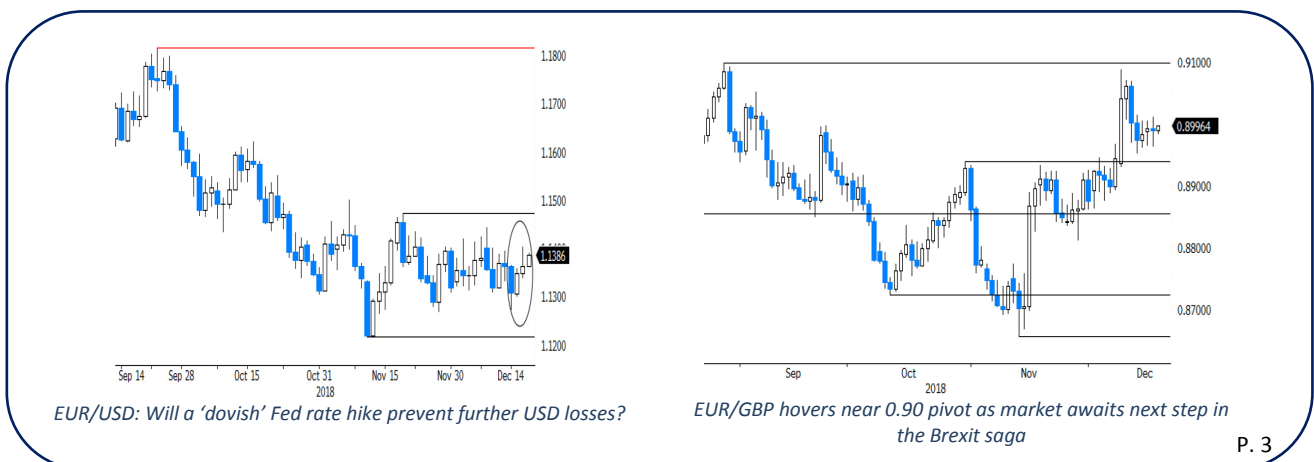
R2	0,93067	-1d
R1	0,91	
EUR/GBP	0,8989	-0,0003
S1	0,8700	
S2	0,862	

Will Fed unlock recent EUR/USD stalemate?

EUR/USD was well bid **yesterday morning**, but the US dollar regained modest ground later. The German IFO-indicator was slightly weaker than expected, but this was apparently discounted after last week's poor EMU PMI's. EUR/USD was also supported by narrowing US/EMU interest rate differentials. US equity volatility eased compared to previous days. The intraday decline in US yields slowed (albeit temporarily), providing some breathing space for the dollar. Still, US yields finished near intraday lows (oil-related?). The dollar lost modest ground in a daily perspective. EUR/USD closed at 1.1361 (from 1.1348). USD/JPY finished at 112.52 (from 112.83). **Asian markets** are trading mixed, but China and Japan are declining after a better start. Chinese officials and US Treasury secretary Mnuchin indicate that **trade talks continue**. More meetings are planned for January. This news doesn't really help to comfort investors for now. The dollar remains slightly in the defensive. EUR/USD is trading in the 1.1385 area. USD/JPY hovers in the 1.12.20/60 area.

There are only second tier eco data in the US and Europe **today**. The EU and Italy are close to a budget agreement. If finalised, it might remove a euro negative factor. However, the Fed policy decision will be the all-decisive factor. **The Fed is expected to deliver some kind of 'dovish' rate hike**. Investors' focus will be on the Fed dots and chairman Powell's assessment at the press conference. Of late, the dollar lost substantial interest rate support as markets sharply reduced expectations on 2019 Fed rate hikes. **Will Powell be able to convince markets that (recent and projected) Fed rate hikes won't kill growth?** The dollar in general and EUR/USD in particular showed an indecisive trading pattern lately. We are not convinced this will change after today's Fed decision. A perceived too hawkish Fed will cause more global market volatility and further flatten the US yield curve. However, is such a risk-off context supportive for the euro with EMU growth also slowing? A moderate tone from the Fed might ease growth concerns. In this respect, the scenario of a rate hike, dots signalling 2 instead of 3 2019 rate hikes and less strict Fed forward guidance, shouldn't be too bad for the dollar.

EUR/GBP hovered sideways close to, mostly slightly below the 0.90 mark as there was little 'new' news on Brexit **yesterday**. UK price data (CPI) and CBI order data will be published today. Data had little impact on sterling trading of late. Still, soft inflation data might be a slightly sterling negative going into tomorrow's BoE meeting.





Calendar

Wednesday, 19 December		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	1.6%
14:30	Current Account Balance (3Q)	-\$25.0b	-\$101.5b
16:00	Existing Home Sales Total/MoM (Nov)	5.20m/-0.4%	5.22m/1.4%
20:00	FOMC Rate Decision	2.25%/2.50%	2.00%/2.25%
Canada			
14:30	CPI NSA MoM/YoY (Nov)	-0.4%/1.8%	0.3%/2.4%
14:30	CPI Core - Median YoY% (Nov)	--	2.0%
Japan			
00:50	Trade Balance Adjusted (Nov)	-¥492.2bA	-¥302.7b
00:50	Imports/Exports YoY (Nov)	12.5%/0.1%A	19.9%/8.2%
UK			
10:30	CPIH YoY (Nov)	2.1%	2.2%
10:30	CPI MoM/YoY (Nov)	0.2%/2.3%	0.1%/2.4%
10:30	CPI Core YoY (Nov)	1.8%	1.9%
10:30	RPI MoM/YoY (Nov)	0.1%/3.2%	0.1%/3.3%
10:30	PPI Input NSA MoM/YoY (Nov)	-2.8%/5.0%	0.8%/10.0%
10:30	PPI Output NSA MoM/YoY (Nov)	0.0%/3.0%	0.3%/3.3%
10:30	PPI Output Core NSA MoM/YoY (Nov)	0.2%/2.3%	0.3%/2.4%
10:30	House Price Index YoY (Oct)	3.4%	3.5%
12:00	CBI Trends Total Orders (Dec)	6	10
12:00	CBI Trends Selling Prices (Dec)	8	9
EMU			
11:00	Construction Output MoM/YoY (Oct)	--/--	2.0%/4.6%
Germany			
08:00	PPI MoM/YoY (Nov)	-0.1%/3.1%	0.3%/3.3%
Belgium			
15:00	Business Confidence (Dec)	-0.9	0.4
Sweden			
09:00	Economic Tendency Survey (Dec)	106.3	106.7
Events			
19DEC	European Commission meets to consider Italy's budget and may discuss starting EDP		
19DEC	Chinese leaders begin annual economic policy-setting meeting		
10:00	ECB's Hansson speaks about outlook for Estonia, euro area		
20:30	Fed's Powell Holds Press Conference Following FOMC Decision		

10-year	Close	-1d	2-year	Close	-1d	Stocks	Close	-1d	
US	2,82	-0,04	US	2,64	-0,05	DOW	23675,64	82,66	
DE	0,24	-0,01	DE	-0,61	0,00	NASDAQ	6783,912	30,18	
BE	0,74	-0,02	BE	-0,53	-0,01	NIKKEI	20987,92	-127,53	
UK	1,28	0,01	UK	0,75	0,01	DAX	10740,89	-31,31	
JP	0,04	0,02	JP	-0,15	0,00	DJ euro-50	3040,13	-23,52	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,03	2,74	1,23	Eonia	-0,3660	-0,0020	Libor-1	2,4696	0,0000
5y	0,25	2,73	1,33	Euribor-1	-0,3690	0,0000	Libor-3	2,8036	0,0000
10y	0,85	2,84	1,47	Euribor-3	-0,3110	0,0000	Libor-6	2,9046	0,0000
				Euribor-6	-0,2380	-0,0010			
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1361	0,0013	EUR/JPY	127,84	-0,19	CRB	174,42	-3,50	
USD/JPY	112,52	-0,31	EUR/GBP	0,8989	-0,0003	Gold	1253,60	1,80	
GBP/USD	1,2639	0,0015	EUR/CHF	1,1277	0,0009	Brent	56,26	-3,35	
AUD/USD	0,7181	0,0002	EUR/SEK	10,3043	0,0249				
USD/CAD	1,3466	0,0059	EUR/NOK	9,9212	0,1086				

Data Source : Bloomberg

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