Sunrise

Wednesday, 20 September 2017

Rates: Flattening US yield curve on Fed verdict?

We expect the FOMC to announce the start of its BS run-off, hang on the 2017/2018 rate projections (1-3) and potentially lower its neutral rate forecast. That would cause a flattening of the US yield curve. The front end of the US yield curve will in this scenario rise further as the market implied probability of a 2017 rate hike currently stands at 53%.

Currencies: Will Fed help to put a floor under the dollar?

Today's Fed policy assessment might be key for the dollar. The start of reducing the BS will probably give the dollar only limited additional interest rate support short-term. The new Fed dots will signal substantial additional rate rises to come. In theory this should be USD positive, but will the FX market believe the Fed more than it did until now?

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 stock markets eked out small gains yesterday (+0.1%)** in an uneventful session. **Overnight, Asian risk sentiment is mixed but changes remain small.**
- **Trump warned that America would "totally destroy" North Korea** if forced to defend itself or its allies, as the US president used his debut address to the UN general assembly to issue stark threats to a "wicked few" oppressive regimes.
- **Theresa May will offer a €20B Brexit payment to the EU** when she lays out her divorce strategy Friday, according to the FT. She hopes it will break a three-month deadlock over negotiations and allow talks to include a future trade deal.
- Shipments of cars and electronics in August drove up **Japan's exports** at the **fastest pace in nearly 4 years** (18.1% Y/Y), evidence that overseas demand is strong enough to support healthy economic growth. Imports rose 15.2% Y/Y.
- **Iraq's oil minister said OPEC and other crude producers were considering extending or even deepening a supply cut** to curb a global glut, while a report showed a smaller-than-expected increase in U.S. inventories.
- **Two key US senators said they had reached a pact on the parameters of a critical budget resolution,** removing an obstacle on the complex path towards Republican-led tax cuts.
- **Today's calendar** contains UK retail sales, US existing home sales and a German 30-yr Bund auction. However, these will all be overshadowed by tonight's FOMC meeting and press conference by chair Yellen.

Rates

Core bonds end narrowly mixed

Trump's war talk doesn't spark safety bid

FOMC decisions today paralyzed investors yesterday.

	US yield	-1d
2	1,40	0,01
5	1,83	0,01
10	2,24	0,02
30	2,81	0,02

	DE yield	-1d
2	-0,69	0,00
5	-0,27	-0,01
10	0,45	0,00
30	1,26	0,00

Core bonds end mixed in a in wait-and-see session.

The Bund managed to close marginally higher in a session of tight, uneventful, trading. The contract nevertheless broke a seven sessions losing streak. Investors ignored the only eco data of importance, a strong German ZEW economic sentiment. **A Reuters article** based on "sources" said ECB policy makers disagree on the fate of the APP programme. It's unclear what conclusion to draw from it, but it might have been behind the single move (up) for the day. Afterwards, the Bund lost most of the gains as US Treasuries slid marginally lower. **The war talk of president Trump at the UN** surprisingly brought no support for bonds. **In a daily perspective,** US yields rose by 0.5 bps (2-yr) to 1.8 bps (30-yr). German yields rose up to 0.4 bps (2-yr), but fell up to 0.7 bps (5yr) further out the curve. **On intra-EMU bond markets,** 10-yr yield spread changes versus Germany were small with Italy and Spain outperforming (-2-to-3 bps).

Existing Home sales will be ignored

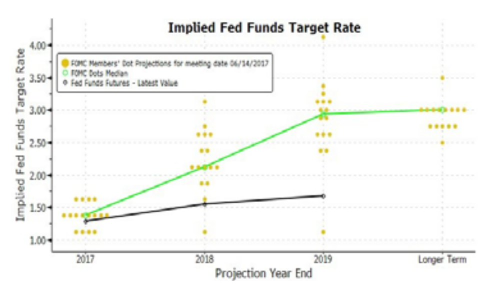
Fed to start balance sheet tapering

What about the dots?

FOMC to start BS run-off and keep 2017 dot

We expect the FOMC to announce the start of its balance sheet tapering (as of Oct. 1?). In June, the FOMC announced how the tapering would proceed. Monthly re-investments will initially decline by $6 bn of maturing US Treasuries and $4 bn of maturing MBS. These amounts will be raised "automatically" every quarter (by $6 bn and $4 bn) until they hit full pace after one year ($50 bn/month combined). **We don't expect the decision to have a major impact on long term bonds, as it was extensively communicated to the markets.** That may change when the programme gathers speed. **Regarding the Fed's dot plot,** we don't see changes in the median dot for 2017 (still one rate hike) and for 2018 (3 extra hikes). It would take four governors to lower their dot before the median dot drops. Of course, chances are high that some governors lower their dot which might be considered as dovish. **Chances of a downward revision of the 2019 median dot (2.5 extra rate hikes) and the long run median dot (3%) are high.** We think the FOMC has little incentive to signal now that its expected rate cycle will still be more shallow than recently indicated. Financial conditions have actually eased since the start of the year despite two rate increases. Long term yields dropped about 40 basis points, the dollar weakened about 10% and the equities are 11.7% (S&P) to 19.8% (Nasdaq) higher. **Whether the Fed effectively raises rates in December remains uncertain.** The debt ceiling issue will likely be again on the table and the economic data won't give a clear-cut picture with storm-related disruptions in September/October. Anyway, inflation should show signs of rising again.

T-Note future (black) & Bund future (orange) (intraday): Bund rises in early afternoon (ECB?), but slides lower together with US Treasuries in mid-US session



June Fed dot plot: How many governors will have lowered their dots. Will it have effect on median dot?

R2	163,43	-1d
R1	161,66	
BUND	161,09	0,15
S1	160,49	
S2	160,5	

German 30-yr Bund auction

The German Finanzagentur launches a new 30-yr Bund (€2B 1.25% Aug2048). Total bids at the previous long term Bund auction averaged only €1.5B. We expect weak demand today as well, unless Germany is willing to pay a heavy new issue premium.

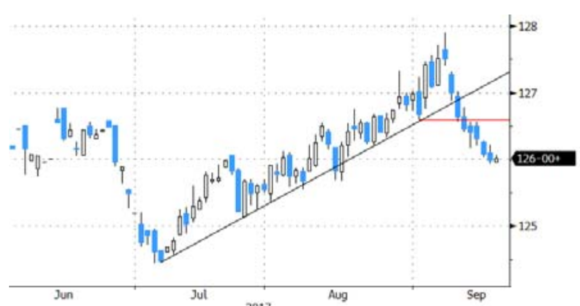
Flattening US yield curve on Fed verdict?

Asian risk sentiment is mixed overnight, but differences remain small despite US president hawkish rhetoric vs North Korea. The US Note future trades a tad higher, but we expect a neutral opening for the Bund.

Today's EMU/US eco calendar will be overshadowed by the FOMC meeting. Since the beginning of last week, core bond markets lost significant ground, scaling back too dovish bets against monetary policy normalisation. **We expect the FOMC to announce the start of its BS run-off, hang on the 2017/2018 rate projections (1-3) and potentially lower its neutral rate forecast. That would cause a flattening of the US yield curve.** The front end of the US yield curve will in this scenario rise further as the market implied probability of a 2017 rate hike currently stands at 53%. The impact on the longer end of the curve is less straightforward. Despite the correction higher last week, the 10-yr yield remains rather low in absolute terms even if the Fed lowers its neutral rate dote. Can this mean that it is already discounted? In that case, we expect only small moves at the longer end of the US curve.

From a technical point of view, US yields recaptured lost support levels and even broke out of their downward trend channels. Speculation in the run-up to the October ECB meeting (slowdown in monthly purchases and extension APP; start policy normalisation) should cap the topside of the Bund which lost first support at 161.66, ending the uptrend since the start of summer.

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



US Note future: Does longer end already discount lower neutral rate by Fed despite correction lower?

Currencies

Will Fed put a floor under the dollar?

R2	1,2225	-1d
R1	1,2167	
EUR/USD	1,1994	0,0040
S1	1,1662	
S2	1,1311	

USD trading remained technical in nature yesterday as investors counted down to tomorrow's FOMC decision. Data were second tier and had little impact on trading. USD/JPY set a new ST top, but reversed gains later. EUR/USD traded close to mostly slightly below 1.20.

Asian equities mixed bias ahead of the Fed

Yen remains weak

EUR/USD tries to regain 1.20 barrier

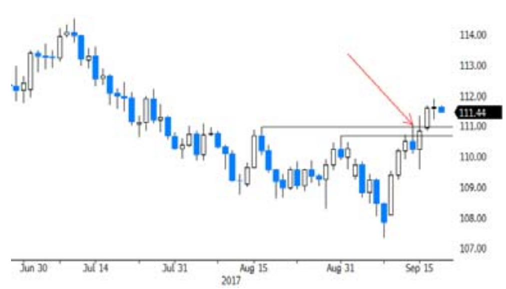
Overnight, Asian equities are narrowly mixed after WS closing at again new record levels. **Japan August trade data were stronger-than-expected, but doesn't change to broader picture going into tomorrow's BOJ policy announcement.** The BOJ is largely expected to keep course, lagging the normalisation process in other major economies. **This prospect weighs on the yen, especially if rates in the US or Europe would rise further.** The overall picture for the dollar stays unchanged. USD/JPY holds in the mid 111 area, within reach of the ST correction top. The dollar continues to trade weak against the euro. EUR/USD tries to regain the 1.20 barrier. EUR/JPY trades near the highest levels since December 2015.

Eco calendar uneventful

FX traders look forward to the FOMC decision

Today, the eco data (German PPI, US existing home sales) will be largely ignored as investors will forward to **the Fed policy decision.** For an in depth preview of the Fed decision, see the fixed income part of this report. The start of the reduction of the balance sheet is a symbolic step in the normalisation process. The move was extensively pre-announced and the initial impact on market liquidity is limited. **In this context, the new Fed rate dots might be more important for the dollar.** We don't see changes in the median dot for 2017 (one additional hike) and for 2018 (3 extra hikes), but **chances of a downward revision of the 2019 median dot (2.5 extra rate hikes) and the long run (3%) are high.** The Fed's ongoing intention to normalize policy should be USD supportive given that hardly any further tightening is discounted. **However, are there reasons for the market to believe the Fed more after today's meeting than it did till now?** For that to happen, the Fed dots probably need 'confirmation' from good eco data and higher inflation. **We won't get that today. In this context, the defuse/fragile picture for the dollar might persist for some time. We assume more USD consolidation near the recent lows, maybe with room for some modest USD gains, but we dare not anticipate on it.**

EUR/USD: nearing correction top ahead of the FOMC decision .



USD/JPY remains well bid, mostly on yen weakness

From a technical point of view EUR/USD hovers in a ST consolidation pattern between 1.1823 and 1.2070. It was disappointing for EUR/USD bears that last week's correction didn't reach the range bottom. **More confirmation is needed**

that the recent bottoming out process in US yields and in the dollar might be the start of more sustained USD gains (against the euro).

The day-to-day momentum in **USD/JPY** is more constructive. The yen trades weak across the board. USD/JPY regained the 110.67/95 previous resistance. This a short-term positive. EUR/JPY shows a similar positive picture. So, the yen might stay under pressure at least until the next event risk pops up.

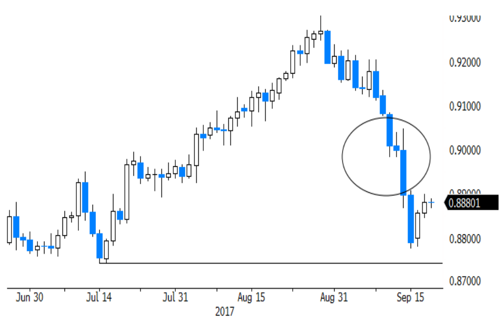
UK retail sales in focus

R2	0,9415	-1d
R1	0,9307	
EUR/GBP	0,8881	0,0024
S1	0,8743	
S2	0,8657	

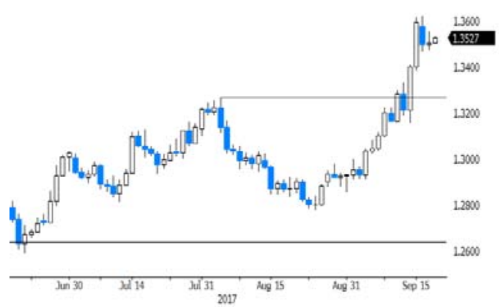
Sterling traded with a slightly negative intraday yesterday following a sharp rally last week, when the BoE warned that it was likely to raise its policy rate in the coming months. **BoE governor Carney confirmed that view on Monday, but sterling started to lose ground.** The political bickering between UK PM May and UK Foreign Secretary Johnson was also a slight sterling negative. EUR/GBP closed the session at 0.8881 (from 0.885). Cable hovered around the 1.35 pivot.

Today, the UK August retail sales take centre stage. A very modest rise of 0.2% M/M and 1.2% is expected A soft figure questions the viability of the recent hawkish BoE speak. However, the BoE is temporary giving more weight on prices than on activity data**. Even so, the sterling rally might lose further momentum in case of a poor report.** Markets will also look forward to PM's Brexit speech. A more conciliatory PM May would be a ST sterling positive. **The recent GBP rebound is losing momentum. Even so, we look out whether sterling can return to the recent correction top (EUR/GBP low). If that move fails, the easiest part of the sterling rebound might be behind us.**

EUR/GBP made an impressive uptrend since April and set a new MT top at 0.9307 late August on the back 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 reinforced by recent BoE hawkish comments. Medium term, we maintain a **EUR/GBP buy-on-dips approach as we expect the mix of relative euro strength and sterling softness to persist. However, the prospect of (limited) withdrawal of BOE stimulus put a solid floor for sterling ST term. We look out how far the current correction has to go. EUR/GBP is nearing support at 0.8743 and 0.8652, which we consider difficult to break. We start looking to buy EUR/GBP on dips.**



EUR/GBP: GBP-rebound rebound slows



GBP/USD: running into resistance?

Calendar

Wed, 20 September		Consensus	Previous
US			
16:00	Existing Home Sales / MoM (Aug)	5.46m/0.4%	5.44m/-1.3%
20:00	**FOMC Rate Decision (Upper Bound)**	**1.25%**	**1.25%**
20:00	**FOMC Rate Decision (Lower Bound)**	**1.00%**	**1.00%**
Japan			
01:50	Trade Balance Adjusted (Aug)	A: ¥367.3b	¥363.1b
01:50	Exports YoY (Aug)	A: 18.1%	13.4%
01:50	Imports YoY (Aug)	A: 15.2%	16.3%
UK			
10:30	Retail Sales Ex Auto Fuel MoM / YoY (Aug)	0./1.4%	0.5%/1.5%
10:30	Retail Sales Inc Auto Fuel MoM / YoY (Aug)	0.2%/1.1%	0.3%/1.3%
Germany			
08:00	PPI MoM / YoY (Aug)	0.1%/2.5%	0.2%/2.3%
Events			
11:30	Germany to Sell €2B Aug2048 Bonds		
20:30	**Press conference Fed Chairwoman Yellen**		

10-year	Close	-1d	
US	2,24	0,02	
DE	0,45	0,00	
BE	0,72	-0,01	
UK	1,33	0,03	
JP	0,03	-0,01	
IRS	EUR	USD	GBP
3y	-0,05	1,76	0,91
5y	0,23	1,92	1,08
10y	0,89	2,21	1,40
Currencies	Close	-1d	
EUR/USD	1,1994	0,0040	
USD/JPY	111,59	0,02	
GBP/USD	1,3503	0,0008	
AUD/USD	0,801	0,0052	
USD/CAD	1,2292	0,0001	

2-year	td	-1d
US	1,40	0,01
DE	-0,69	0,00
BE	-0,52	0,01
UK	0,41	-0,01
JP	-0,13	0,00
EUR	-1d	-2d
Eonia	-0,3610	0,0020
Euribor-1	-0,3730	0,0000
Euribor-3	-0,3300	-0,0010
Euribor-6	-0,2720	-0,0010
Currencies	Close	-1d
EUR/JPY	133,85	0,50
EUR/GBP	0,8881	0,0024
EUR/CHF	1,1548	0,0052
EUR/SEK	9,5381	0,0208
EUR/NOK	9,353	-0,0098

Stocks	Close	-1d
DOW	22370,8	39,45
NASDAQ	6461,323	6,68
NIKKEI	20310,46	11,08
DAX	12561,79	2,40
DJ euro-50	3531,18	4,44
USD	-1d	-2d
Libor-1	1,2361	0,0000
Libor-3	1,3250	0,0000
Libor-6	1,4744	0,0000
Commodities	Close	-1d
CRB	182,58	-1,16
Gold	1310,60	-0,20
Brent	55,14	-0,34

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