

Friday, 23 March 2018

Rates: US 10-yr yield tests important support

An intensification of the equity sell-off could generate more safe haven flows into core bonds. The nature of the stock market root suggests though that this link might break at one stage (eg if China reduces US Treasury purchases). The US 10-yr yield tests 2.8% support. We don't expect a break, but wait until after the weekend to enter short bond positions.

Currencies: Trade war a tentative USD negative?

The dollar didn't suffer much from yesterday's risk-off correction. However, further USD/JPY losses might also affect other USD cross rates. Still we expect EUR/USD to hold the established consolidation pattern. EUR/GBP is rebounding back higher in the 0.87 big figure after a downside test following the BoE's policy decision was rejected.

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 lost huge ground (-2.5% to -3%)** after US president Trump came through with his pledged trade offensive against China. **Main Asian equity indices lose even more ground overnight (-3% to -5%).**
- **China fired a retaliatory shot against the US**, announcing planned tariffs against American goods and saying it is readying more actions against the Trump administration's proposed penalties on Chinese exports.
- **US President Trump has replaced his national security adviser HR McMaster with foreign policy hawk John Bolton**, an explosive appointment that signals a further lurch to the right and points to a White House in turmoil. (FT)
- **The US Senate passed a \$1.3 tn spending bill**, acting to avert a government shutdown with less than 24 hours to spare and bringing to a close a messy negotiating process over the sprawling measure.
- **The BoJ's preferred inflation measure, the national CPI excluding fresh food, accelerated in February in line with forecasts from 0.9% Y/Y to 1% Y/Y.** Headline inflation rose to 1.5% Y/Y.
- **OPEC members will need to continue coordinating with Russia and other non-OPEC oil-producing countries on supply curbs in 2019** to reduce global oil inventories to desired levels, Saudi Arabian Energy Minister al-Falih said.
- **Today's eco calendar** contains US durable goods orders. Fed governors Bostic, Kashkari, Kaplan and Rosengren are scheduled to speak. The EU Summit continues with discussion on global trade developments.

Rates

US 10-yr yield tests important support

	US yield	-1d
2	2,28	-0,03
5	2,60	-0,05
10	2,82	-0,06
30	3,06	-0,06

	DE yield	-1d
2	-0,60	-0,02
5	-0,07	-0,05
10	0,53	-0,06
30	1,17	-0,05

Core bonds eked out substantial gains yesterday, but it wasn't because of follow-up buying after Wednesday's evening FOMC meeting. **The new upleg started in Europe following a batch of disappointing PMI's** (2nd month in a row though still at lofty levels) **and accelerated as stock markets heavily sold off in the run-up to US President Trump's tariff announcement against China.** Main US indices closed up to 3% lower. The US yield curve bull flattened with yields 2.6 bps (2-yr) to 5.9 bps (10-yr) lower. German yields declined by 1.6 bps (2-yr) to 6.3 bps (10-yr). 10-yr yield spread changes vs Germany widened up to 2 bps with Portugal (+6 bps) and Greece (+14 bps) underperforming. **S&P gives an update on the Spanish rating tonight (BBB+, pos. outlook).** The limited impact of the Catalan crisis and Spain's outstanding economic performance, **suggest that a one-notch upgrade is likely** in line with Fitch earlier this year. Anticipation can cause some Spanish outperformance today in the peripheral spectrum.

Asian stock markets lose up to 5% overnight. Apart from the escalating trade conflict, US President Trump replaced his national security advisor by **another foreign policy hawk.** The US Note future slightly extends gains, while the yen profits from safe haven flows on currency markets. The US 10-yr yield tests important support around 2.8%. We expect a stronger opening for the Bund.

Today's eco calendar contains US durable goods orders and speeches by 4 Fed governors. The most interesting Fed speech is the one from Atlanta Fed Bostic, who is a voter in favour of 2-3 rate hikes in 2018. These items probably won't impact trading in light of recent events. All eyes remain on stock markets. **An intensification of the sell-off could generate more safe haven flows into core bonds.** The nature of the stock market root suggests though that **this link might break at one stage.** If China responds for example by reducing or halting US Treasury purchases, it might backfire (US Treasury sell-off instead of safe haven buying), especially with the prospect of increasing US twin deficits. **We won't row against the tide yet, but keep a close eye on the link.** In any case, the **underperformance of the US Note future against the Bund can continue.**

After the Fed meeting, we advocated **corrective action in the US 10-yr yield towards 2.8%. The test is currently ongoing. We don't anticipate a break lower, but won't set-up new short positions with too much uncertainty looming ahead of and during the weekend.** The German 10-yr yield fell below 0.62% support after the ECB meeting, suggesting a technical correction towards 0.46%-0.48% support (gap open/62% retracement).



German 10-yr yield: technical correction should halt around 0.46%-0.48% area



US 10-yr yield tests first support at 2.8%.

Currencies

R2	1,2598	-1d
R1	1,2555	
EUR/USD	1,2302	-0,0036
S1	1,2165	
S2	1,2055	

R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8727	0,0002
S1	0,8690	
S2	0,8657	

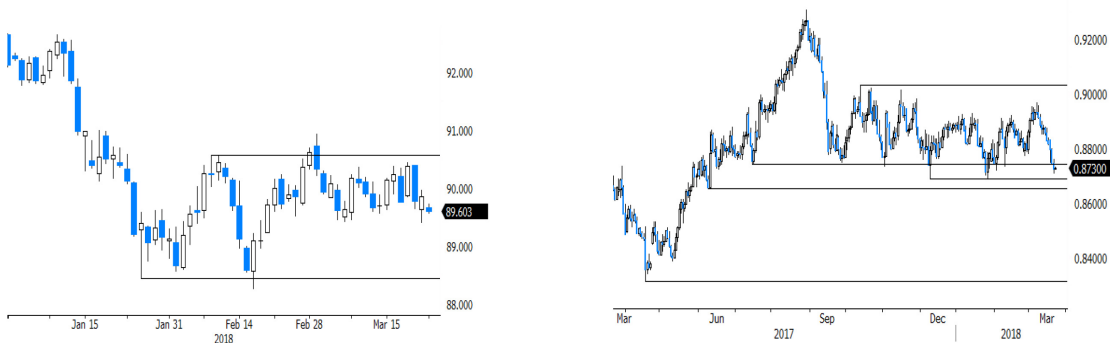
Trade war escalation: a tentative USD negative?

USD bulls were a bit **disappointed after the FOMC meeting, but** dollar selling eased soon as markets realized that policy normalization remains firmly in place. **EMU PMI's again missed the consensus by a big margin, capping potential euro gains.** After an initial spike, EUR/USD drifted lower in the 1.23 big figure. Later, risky assets sold off as US president Trump ordered to impose tariffs on Chinese imports. This was quite neutral for EUR/USD. The pair closed the day at 1.2302. The yen jumped sharply higher with USD/JPY closing at 105.28 and EUR/JPY at 129.52

The equity sell-off accelerated overnight with major regional indices losing up to 5% even as the first reaction of China (considering tariffs on imports worth \$3 bn) can be seen as rather moderate. USD/JPY declined further (currently 114.80). Japanese inflation was in line with consensus (1.5%Y/Y headline, 1.0% core) ,but that wasn't the focus of markets. The dollar declines slightly against the euro (EUR/USD 1.2335).

US new home sales and durables are expected to rebound after a poor January reading. Several Fed governors speak. They might bring some insight on the internal dynamics during the FOMC meeting. **However, the focus will be on the next steps in the China-US trade war.** Trade tension had no big impact on the USD's performance yesterday (excl. USD/JPY). The dollar slightly underperforms this morning. **We keep a cautious approach on the dollar as long as the trade war dominates market highlights.** Even a widening of the USD-EUR interest rate differential maybe won't help the dollar. Underperformance of US Treasuries might be due to the wrong reasons (US risk premium, less buying of China). **USD/JPY remains most vulnerable.** At the same time, any further EUR/USD gains might be slowed by selling from EUR/JPY. **The trade war is a growing source of uncertainty, but for now we assume that the 1.2155-1.2555 trading range remains in place.**

EUR/GBP tested the 0.8688 downside barrier yesterday as two BoE members already voted for a rate hike. However, a sustained break didn't occur. EU leaders will approve the guidelines for further Brexit talks today. We don't expect big news for sterling. The risk-off context might also be slightly sterling negative (EUR/GBP supportive). A modest technical rebound after yesterday's EUR/GBP rejected downside test might be in the cards.



USD (Trade-weighted): no clear USD reaction to trade war escalation.

EUR/GBP: test 0.8688/52 support rejected

Calendar

Friday, 23 March		Consensus	Previous
US			
13:30	Durable Goods Orders (Feb P)	1.7%	-3.6%
13:30	Durables Ex Transportation (Feb P)	0.5%	-0.3%
13:30	Cap Goods Orders Nondef Ex Air (Feb P)	0.7%	-0.3%
13:30	Cap Goods Ship Nondef Ex Air (Feb P)	0.4%	-0.1%
15:00	New Home Sales / MoM (Feb)	624k/5.2%	593k/-7.8%
Japan			
00:30	Natl CPI YoY (Feb)	1.5%	1.4%
00:30	Natl CPI Ex Fresh Food YoY (Feb)	1.0%	0.9%
00:30	Natl CPI Ex Fresh Food, Energy YoY (Feb)	0.5%	0.4%
France			
08:45	Wages QoQ (4Q F)	--	0.1%
Spain			
09:00	PPI MoM / YoY (Feb)	--/--	0.2%/0.1%
Norway			
10:00	Unemployment Rate (Mar)	2.4%	2.5%
Events			
EU Summit			
13:10	Fed's Bostic Speaks on the Economic Outlook		
15:30	Fed's Kashkari Speaks in Moderated Q&A		
15:30	Fed's Kaplan Speaks in Austin, Texas		
23:59	Fed's Rosengren Speaks at International Research Forum		

10-year	Close	-1d	2-year	Close	-1d	Stocks	Close	-1d	
US	2,82	-0,06	US	2,28	-0,03	DOW	23957,89	-724,42	
DE	0,53	-0,06	DE	-0,60	-0,02	NASDAQ	7166,677	-178,61	
BE	0,82	-0,06	BE	-0,54	-0,01	NIKKEI	20617,86	-974,13	
UK	1,44	-0,09	UK	0,90	-0,02	DAX	12100,08	-209,07	
JP	0,03	-0,01	JP	-0,16	0,00	DJ euro-50	3348,19	-52,85	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	0,03	2,70	1,25	Eonia	-0,3680	-0,0010	Libor-1	1,8613	0,0000
5y	0,40	2,78	1,40	Euribor-1	-0,3710	-0,0010	Libor-3	2,2711	0,0000
10y	1,00	2,87	1,56	Euribor-3	-0,3290	0,0000	Libor-6	2,4342	0,0000
				Euribor-6	-0,2710	0,0010			
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,2302	-0,0036	EUR/JPY	129,52	-1,33	CRB	195,23	-0,79	
USD/JPY	105,28	-0,77	EUR/GBP	0,8727	0,0002	Gold	1333,20	5,90	
GBP/USD	1,4096	-0,0045	EUR/CHF	1,1677	-0,0042	Brent	68,91	-0,56	
AUD/USD	0,7693	-0,0072	EUR/SEK	10,1576	0,0607				
USD/CAD	1,2939	0,0036	EUR/NOK	9,5341	0,0382				

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