



Sunrise

Tuesday, 26 September 2017

Rates: Will risk sentiment continue to support core bonds?

Core bonds profited yesterday of renewed sabre rattling between North Korea and the US, giving the profit taking on shorts more impetus. Today's data will be largely ignored at the expense of the risk sentiment. There might be some more correction, but we still are in a sell-on-uptick modus, also as oil prices are moving higher.

Currencies: EUR/USD and EUR/GBP are nearing significant support levels

Yesterday, sentiment on the euro obviously turned less positive after the German election even as the impact on other markets was modest. A risk-off correction also weighed more on the euro than on the dollar. Eco data probably won't be decisive for FX trading today. If EUR/USD drops below 1.1823, the recent correction might have further to go.

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** were hard hit by North Korean threats, but recovered quite well limiting daily losses. NASDAQ lost more ground. Asian equities trade marginally lower.
- **Brent crude oil has risen above \$59 a barrel to its highest in more than two years**, lifted by fast-growing demand and a threat to Iraqi Kurdistan's crude exports as the autonomous region holds a referendum on independence
- **The U.S. has gamed out four or five scenarios on how the crisis with North Korea will be resolved, and "some are uglier than others,"** McMaster said. U.S. officials dismissed as "absurd" N-K Ri Yong Ho's comment that Trump's UN speech amounted to a declaration of war.
- **NY Fed Dudley** signalled one more hike this year, calling factors holding down prices temporary, while **Chicago's Fed Evans and Minneapolis Fed Kashkari** said tightening before seeing signs of wage and price pressure would be a mistake.
- **The ECB is not scared of tapering QE**, ECB Coeure said. The board member said any exit will be careful and "in light of the price stability mandate."
- **Iraq's parliament voted to ban Kurdish** crude exports, take back control of disputed oil fields and demanded troops be sent to Kurdistan-controlled territory after Monday's non-binding independence referendum. **Turkish President Erdogan** hinted at shutting off oil exports and at a military response.
- **Today's calendar** contains US New Home sales, consumer confidence and the Richmond Fed survey. Focus will though be on geopolitical issues, and on the manifold Fed and ECB speakers.

Rates

No risk off after German election, but after N-K sabre rattling

The German election surprise didn't trigger safe haven flows on core bond markets and peripheral spreads barely widened. European equities traded stable while the decline of EUR/USD was technically irrelevant. ECB and Fed talk also failed to give distinct direction. However, in mid-US session, risk off sentiment flared up all of a sudden up after more war talk from North Korea (see news). Equities nosedived and core bonds jumped higher, while peripheral spreads widened. US equities made a partial comeback later in the session, but core bonds held on to good daily gains. In a daily perspective, US yields fell between 0.8 bp (2-yr) to 3 bps (10 yr), while German yields dropped between 2.7 bps (30-yr) and 4.7 bps (10-yr). On intra-EMU bond markets, 10-yr yield spreads versus Germany widened 5 bps (Spain/Italy) to 6 bps (Port./Greece).

Not German election results, but N-Korean war talk triggers risk off rally

Spread widening periphery

	US yield	-1d
2	1.42	-0.01
5	1.83	-0.03
10	2.22	-0.03
30	2.76	-0.02

Busy US calendar

Focus today will be on the US economic data, Fed speakers including Yellen, ECB speakers Praet and Liikanen and fresh supply.

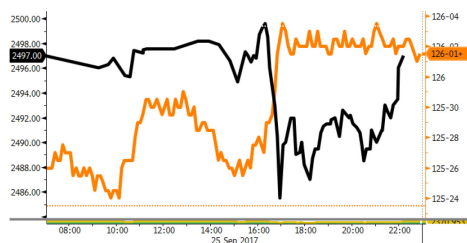
US New Home sales surprised on the downside in July, dropping 9.4% M/M (571K annualised). They are notoriously volatile and consequently we expect a sharp rebound in August. Underlying housing demand is strong with a solid economy and lack of existing homes for sale. The market expects a rebound to 590K (3.3%), but risks are on the upside. Consumer confidence (Conference board) was near a cyclical high in August (122.9). However, the hurricanes and their effect on gasoline prices suggest a decline in September. That should be a temporary effect though as the labour market remains in healthy shape and equities are flirting with all-time highs. So, the market reaction on a weaker September figure (consensus 119.5) should be sanguine. Given the uncertainties about the impact of the hurricanes, it is difficult to assess the extent of the decline. The Richmond Fed survey is expected to show stable conditions.

Upside risks US New Home sales

Consumer confidence weaker due to hurricanes.

Many Fed & ECB speakers

	DE yield	-1d
2	-0.71	-0.03
5	-0.30	-0.05
10	0.40	-0.05
30	1.24	-0.03



T-Note future (orange) & EuroStoxx (black) (intraday): Main trigger of Monday's move were not the German elections, but new N-K war talk in mid US session



Brent oil spikes higher and breaks through upper boundary of sideways channel. Some impact may have been due to the Turkish threat to shut Kurdish crude shipments

Regarding central bankers, ECB Draghi and Coueré yesterday eve talked about the recovery, inflation and policy. We retain that they are optimistic on the recovery and are increasingly confident that inflation will rebound. They are not afraid of the QE exit, but can't afford hasty moves on monetary policy and want to keep as much stimulus as needed. Regarding the future size of the ECB balance sheet, Draghi said it is hard to say now.

Today, ECB Praet and Liikanen take the stage, but after yesterday's speech of Draghi, we expect no new insights that are market moving. NY Fed Dudley defended yesterday the Fed's rate path including another rate hike in December as he sees low inflation as mainly due to temporary factors. Today, we hear the views of Fed Brainard (dove), Bostic (centr) and Mester (hawk), but the main attention goes to Yellen (after European close). She speaks on inflation, uncertainty and monetary policy. Interesting, but it is unlikely she comes to another conclusion on policy than last week when she gave her post-FOMC press conference.

Germany, Italy and the US to sell bonds

Today, the German Finanzagentur holds a €4B 2-yr Schatz auction (0% Sep2019). German auctions usually go sluggish, but the 2-yr Schatz auctions most of the time do okay. We expect the Schatz auction to be plain vanilla. The German election results and geopolitical concerns together with the natural interest of central banks should be positives for the auction. The US starts its end-of-month refinancing operation with a \$26B 2-yr Note auction. It trades in the when issued market at 1.435%, which should be attractive after the recent rise, even as more rate hikes are on the horizon.

Core bonds to correct somewhat higher?

Overnight, risk sentiment improved cautiously. Asian equities are slightly negative, but not much different from WS closure. USD/JPY is little changed, but at yesterday's lows. Gold is strong, but additional gains are small and oil ekes out some more gains after yesterday's spike that broke key resistance. US Treasuries are little changed. So, risk sentiment is more neutral, but remains an issue. We expect the Bund to open neutral too.

Today's eco calendar contains US new home sales, consumer confidence and Richmond Fed business survey. The home sales may rebound, but risks are for a weaker consumer confidence and Richmond business confidence, albeit due to hurricane effects and higher gasoline prices. All in all markets shouldn't be driven by these releases. A plea of Fed speakers are wildcards (see above). Geopolitical issues like North-Korean threats & US verbal responses and the Kurdish independence referendum combined with the Turkish reaction may keep risk sentiment fragile. Higher oil prices aren't currently a main driver for core bonds. In such an environment, there might be room for some further profit on short positions in the German Bunds and US Treasuries. However, given the upcoming normalization of the ECB policy and the continuation of the Fed policy, the upside for core bonds may be limited and an easing of geopolitical tensions may turn the focus back to the central bankers, the economy and maybe oil prices.

After the FOMC meeting, we concluded that US Treasuries re-entered a sell-on-upticks phase after the Fed confirmed its view on 2017/2018 interest rate policy. A December rate hike isn't fully discounted yet. Short term though, we still expect some correction higher. We hold a sell-on-upticks view in the Bund as well as the ECB's normalisation process slowly takes off. From a technical point of view, both the Bund and the US Note future fell below uptrend lines (early September) since the start of summer, making the picture neutral from bullish.

R2	163.43	-1d
R1	161.66	
BUND	161.84	0.81
S1	160.49	
S2	160.50	



German Bund: Draghi delays key decisions to October. Speculation on APP announcement could inflict more losses, but ST gains on geopolitical risks



US Note future: Hawkish Fed inflicts more losses on US Treasuries. Correction higher possible on stretched move, but sell-on-upticks

Currencies

Will EUR/USD drop below 1.1823 support?

German election and a risk-off repositioning weigh on the euro.

The yen outperformed

Risk-off trade slows in Asia

EUR/USD and USD/JPY still near yesterday's lows.

Will German election outcome erode the recent positive sentiment on the euro?

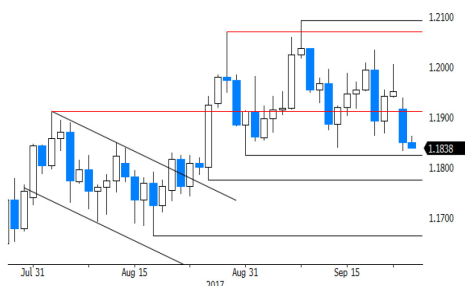
Yesterday, the focus for FX trading turned from the dollar to the euro. The German election outcome might complicate intra-EMU cooperation. EUR/USD settled in a gradual intraday downtrend. The pair dropped below 1.19. ECB Draghi mentioned the recent rise of the euro as a source of volatility/uncertainty. Later on a new exchange of hostile comments between North Korea and the US made investors look for safe havens. The risk-off triggered a simultaneous decline of USD/JPY, EUR/USD and EUR/JPY. USD/JPY finished the session at 111.73. EUR/USD close the day at 1.1848. A real test of the 1.1823 support didn't occur.

Yesterday's risk-off trade in the US also leaves its traces in Asian overnight. Major Asian equity indices show minor losses. USD/JPY hovers in the mid 111 area, near yesterday's low. However, yesterday's motive, additional fiscal spending ahead of the snap elections, doesn't support the yen anymore. EUR/USD stabilizes in the mid 1.18 area. Oil jumped sharply higher yesterday and maintains its gains this morning (Brent 59.40 \$/p), but there is no obvious (invers) link with the dollar.

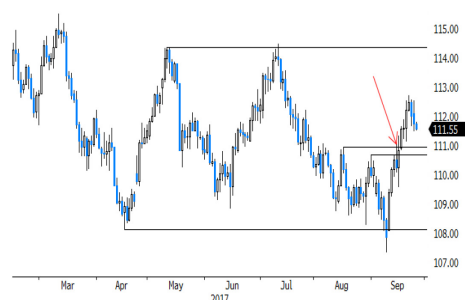
Today, the eco calendar is well filled with US economic data, Fed speakers including Yellen and ECB speakers Praet and Liikanen. US New Home sales declined sharply in July (-9,4% M/M). They are notoriously volatile and we expect a significant rebound in August. Consumer confidence (Conference board) was near a cyclical high in August (122.9). However, the hurricanes and higher gasoline prices suggest a decline in September. The market reaction on a weaker figure (consensus 119.5) should be modest. CB speakers are a wildcard. However, Yellen probably will hold the line of last week's press conference. We don't expected ECB's Praet to bring key new elements on the ECB policy debate at this stage.

Yesterday, the uncertain political consequences of the German election outcome for Germany and for Europe weighed slightly on the euro. Contrary to what was the case of late, a flaring up of risk-off sentiment this time weighed more on the euro than on the dollar. So, there are tentative signs that market sentiment turned less euro friendly. Today's eco data probably won't be a big help for the dollar. However, question remains whether global sentiment (cautious risk-off) and/or CB talk will sustain a further euro correction. We have the impression that yesterday's trends (simultaneous decline of USD/JPY, EUR/USD and EUR/JPY) might go somewhat further. A break of EUR/USD below 1.1823 could inspire a further technical repositioning.

R2	1.2225	-1d
R1	1.2167	
EUR/USD	1.1848	-0.0103
S1	1.1662	
S2	1.1311	



German election and global risk-off push EUR/USD close to 1.1823 support



USD/JPY: risk-off finally puts the yen again in pole position.

From a technical point of view EUR/USD hovers in a consolidation pattern between 1.1823 and 1.2070. It was disappointing for EUR/USD bears that the recent correction didn't reach the range bottom. **More confirmation is needed that the bottoming out process in US yields and in the dollar might be the start of more sustained USD gains (against the euro). In case of a break, next support in EUR/USD comes in at 1.1774 and 1.1662**

The day-to-day momentum in **USD/JPY** was constructive recently, but it was in the first place due to yen weakness. USD/JPY regained the 110.67/95 previous resistance, a short-term positive. The 114.49 correction top is the next important reference. However, yesterday's price action suggests that this cross rate remains sensitive to changes in overall risk sentiment.

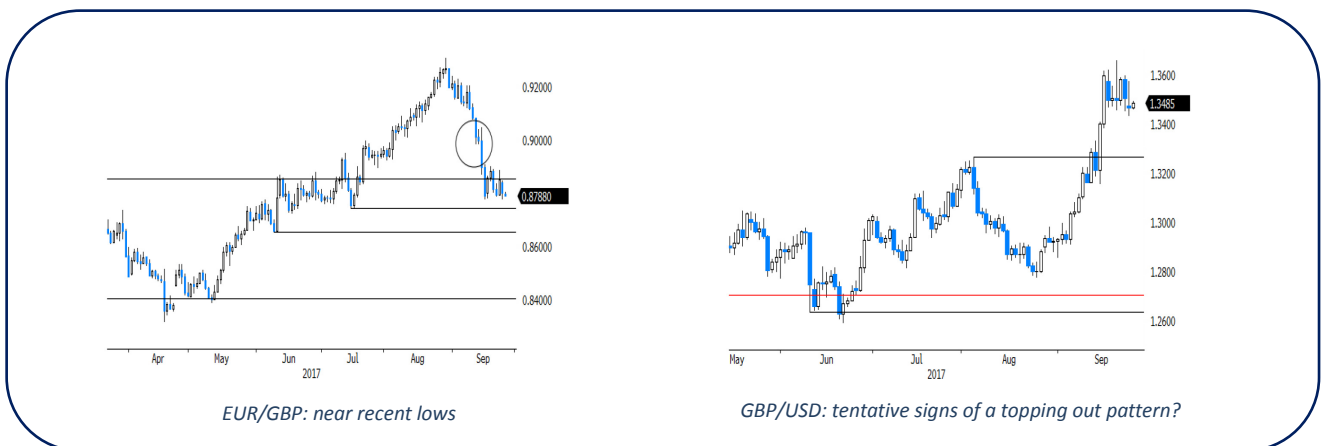
EUR/GBP: euro softness to inspire further losses?

Sterling trading was driven by global markets reaction to the German election results. The euro remained under pressure in early European dealings. EUR/GBP declined to the 0.8785 area. The rise of sterling temporary propelled cable, but finally the dollar outperformed the euro and sterling. **The German election outcome might complicate the Brexit negotiations.** It hasn't become easier for Merkel to make concessions. The risk-off correction (North-Korea) later in the session affected EUR/USD and cable in a similar way. Cable closed at 1.3466. EUR/GBP hovered with reach of the recent lows and close the session at 0.8798

Today, UK loans for housing are only of intraday significance. The formal Brexit negotiations restarted yesterday evening. There is no indication that a breakthrough on the stalemate is imminent. The EU wants progress on the conditions of the divorce, before considering talking on a new trade relationship. In theory this is negative for sterling, but the market focus isn't on the Brexit negotiations. **In line with the assessment on EUR/USD, we think that the euro sentiment has worsened after the German election. If so, the EUR/GBP correction might have some further to go.**

EUR/GBP made an impressive uptrend since April and set a MT top at 0.9307 late August. **Recent UK price data amended the dynamics** and the reversal of sterling was reinforced by hawkish BoE 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 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.**

R2	0.9415	-1d
R1	0.9307	
EUR/GBP	0.8798	-0.0052
S1	0.8743	
S2	0.8657	



Calendar

Tuesday, 26 September		Consensus	Previous
US			
15:00	S&P CoreLogic CS 20-City MoM SA / YoY NSA (Jul)	0.29%/--	0.11%/5.65%
16:00	New Home Sales / MoM (Aug)	590k/3.3%	571k/-9.4%
16:00	Conf. Board Consumer Confidence (Sep)	119.5	122.9
16:00	Conf. Board Present Situation (Sep)	--	151.2
16:00	Conf. Board Expectations (Sep)	--	104.0
16:00	Richmond Fed Manufact. Index (Sep)	13	14
Japan			
01:50	PPI Services YoY (Aug)	A 0.8%	0.6%
UK			
10:30	UK Finance Loans for Housing (Aug)	41700	41587
Germany			
08:00	Import Price Index MoM / YoY (Aug)	-0.1%/2.1%	-0.4%/1.9%
France			
08:45	Business Confidence (Sep)	110-	109
Sweden			
09:30	PPI MoM / YoY (Aug)	--/--	0.6%/5.7%
Events			
00:30	Fed's Kashkari Speaks at Townhall in Grand Forks, North Dakota		
11:00	Italy to Sell Zero Coupon and Inflation-Linked Bonds		
11:30	Germany to Sell €4B 0% 2019 Bonds		
14:00	ECB's Praet chairs speech in Frankfurt (Good pension design)		
11:00	Bank of Finland's Liikanen Speaks at Conference in Lisbon (risk management for CB's)		
15:30	Fed's Mester Moderates Session NABE (global outlook)		
16:30	Fed's Brainard Speaks on Labor Market Disparities		
18:30	Fed's Bostic Speaks to the Atlanta Press Club (eco outlook & monetary policy)		
18:45	Yellen Speaks on Inflation, Uncertainty, and Monetary Policy		
19:00	US to Sell \$26B 2-yr Notes		

10-year	Close	-1d		2-year	td	-1d	Stocks	Close	-1d
US	2.22	-0.03		US	1.42	-0.01	DOW	22296.09	-53.50
DE	0.40	-0.05		DE	-0.71	-0.03	NASDAQ	6370.593	-56.33
BE	0.70	-0.04		BE	-0.55	-0.03	NIKKEI	20330.19	-67.39
UK	1.33	-0.02		UK	0.44	-0.01	DAX	12594.81	2.46
JP	0.03	0.00		JP	-0.14	-0.01	DJ euro-50	3537.81	-3.61
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0.07	1.79	0.90	Eonia	-0.3600	-0.0010	Libor-1	1.2383	0.0000
5y	0.21	1.92	1.07	Euribor-1	-0.3710	0.0010	Libor-3	1.3294	0.0000
10y	0.85	2.19	1.37	Euribor-3	-0.3290	0.0000	Libor-6	1.4968	0.0000
				Euribor-6	-0.2720	-0.0010			
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.1848	-0.0103		EUR/JPY	132.39	-1.45	CRB	184.61	1.04
USD/JPY	111.73	-0.26		EUR/GBP	0.8798	-0.0052	Gold	1311.50	14.00
GBP/USD	1.3466	-0.0038		EUR/CHF	1.1450	-0.0131	Brent	59.02	2.16
AUD/USD	0.7937	-0.0025		EUR/SEK	9.53	-0.0089			
USD/CAD	1.2371	0.0032		EUR/NOK	9.2618	-0.0602			

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