



Sunrise

Monday, 24 October 2016

Rates: Sentiment-driven trading; limited outperformance periphery?

DBRS confirmed Portugal's investment grade rating and Spanish Socialists decided to no longer block PM Rajoy's bid to form a minority government. Those events could trigger limited outperformance on peripheral markets, but the outcomes were probably largely discounted. Today's focus turns to EMU PMI's and Fed speakers, but we doubt their relevance for trading.

Currencies: dollar extends broad-based rebound

On Friday, the dollar extended its uptrend as policy divergence between the Fed and most other central banks was expected to stay in place. The trade-weighted dollar trades at a multi-month top. EUR/USD declines beyond the 1.09 barrier. Today, the eco calendar is thin. The US currency might maintain in recent gains.

Calendar

Headlines

S&P	→
Eurostoxx50	→
Nikkei	→
Oil	→
CRB	→
Gold	→
2 yr US	→
10 yr US	→
2 yr EMU	→
10 yr EMU	→
EUR/USD	↓
USD/JPY	→
EUR/GBP	→

- **US equities** closed narrowly mixed on Friday. Asian stocks were mostly higher as mainland China shares jumped on coal producers.
- **Spain's political stalemate is about to end.** The Socialist Party leadership opted to abstain in a second confidence vote, giving acting Prime Minister Rajoy enough votes to form a minority government and take office for a second term. A confidence vote is imminent.
- **Banks in the U.K. will start relocating operations out of the country by year-end**, months before formal talks to leave the EU begin, the head of the **British Bankers Association** wrote in an Observer commentary.
- **Iraq balked at joining OPEC's plan to limit supply**, saying it should be exempt from production cuts because of its war with Islamic militants. Brent trades modestly down at \$51.54/barrel.
- The **EU is preparing a rewrite of international capital requirements** as part of a growing effort to soften the blow of regulations on struggling banks. The European Commission is debating ways of softening the rule's impact on trading in derivatives and short-term funding markets.
- **Philips reported third quarter earnings** which beat expectations although the Dutch group is not resting on its laurels in the coming weeks, despite the successful spin-off of its lighting business over the summer.
- The preliminary **Japanese manufacturing PMI** produced a reading of 51.7 in October, up from 50.4 previously, the 2th consecutive month of expansion. The Sep. trade surplus expanded as the contraction of especially exports slowed.
- Today's eye-catcher is the **EMU PMI** that will give a snapshot of the health of the economy in October. **Fed governors on duty** are expected to remain silent on the monetary policy outlook.

Rates

Bund consolidates after mini post-ECB correction

On Friday, global core bonds traded uneventful in a session devoid of eco data, events and central bank speeches. In a daily perspective, changes on the German yield curve ranged between +0.4 bps (2-yr) and 1.8 bps (30-yr) Changes on the US yield curve varied between +0.4 bps (2-yr) and -2 bps (10-yr/30-yr). The US 10-yr and 30-yr yields faced difficulties holding above key resistance levels at 1.75% and 2.5% respectively, suggesting that the downside in the US Note future (129-26 area) is a tough nut to crack as well.

On intra-EMU bond markets, 10-yr yield spreads ended nearly unchanged (-2 bps-to +1 bp). After closure, rating agency DBRS confirmed the Portuguese BBB- rating (stable outlook). It's the only rating agency that gives Portugal an investment grade. That's enough to qualify for purchases under the ECB's PSPP programme. Portuguese bond markets anticipated such a decision and outperformed in the past weeks. Therefore, we don't expect a sustained rally following this decision. "The rating reflects Portugal's euro zone membership and its adherence to the EU economic governance framework, which helps foster credible macroeconomic policies," DBRS said in a statement. "However, Portugal faces significant challenges, including elevated levels of public sector debt (133%), low potential growth, ongoing fiscal pressures, and high corporate sector indebtedness." Fitch affirmed Italy's BBB+ rating but lowered the outlook to negative from stable. In Fitch's view, Italy's track record of repeated delay and back-loading of fiscal consolidation reduces credibility. It forecasts somewhat larger budget deficits at 2.4% of GDP in 2017 and 1.7% in 2018 and expects the debt to GDP ratio to increase slightly to 132.8% in 2016 and 133.3% in 2017. Spanish Socialists' decided supporting a minority PP-government via abstention at the confidence vote, which ends the 10-month political deadlock. Spanish bonds traded rather stable this year despite the political crisis, so the impact today could be muted.

Consolidation in German & US bond markets

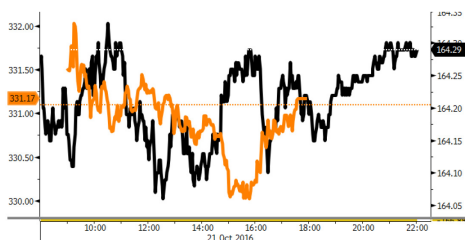
Portugal keeps its investment grade (DBRS)

Fitch lowers Italy BBB+ outlook to negative, while upgrading Cyprus to BB-

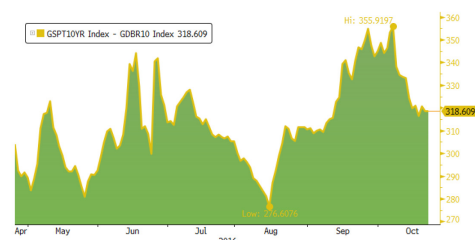
S&P upgrades France's AA outlook to stable

	US yield	-1d
2	0,8316	0,0041
5	1,2429	-0,0098
10	1,7295	-0,0175
30	2,477	-0,0099

	DE yield	-1d
2	-0,6670	-0,0040
5	-0,5020	0,0010
10	-0,0010	0,0000
30	0,6129	0,0205



Bund future (black) and EuroStoxx (orange) intraday: Sideways trading Bund and equities leading to a nearly unchanged finish



German-Potuguese 10-yr yield spread: Sharp narrowing in past weeks in anticipation that Portugal kept its investment grade. That is now confirmed, limiting the scope for more lasting gains short term

EMU PMI's eye-catcher today

In EMU, attention goes to the October PMI's. The composite indicator is expected to have increased slightly to 52.8 from 52.6 previously. During the first three quarters of the year, the composite PMI averaged around 53. In August and September the index twice fell by 0.3. We expect the downmove to have stopped in October with a composite again close to 53. Especially, Germany should contribute to the advance as the recent fall in the German PMI looks too big. The

Upside surprise EMU PMI?

IFO is actually higher than three months ago after a strong jump in the last month. So, maybe **some small risks on the upside for the overall EMU PMI**. Levels around 53 point to ongoing modest economic growth.

Heavy supply; Belgium starts with small OLO auction

R2	166,36	-1d
R1	164,41	
BUND	164,36	0,0700
S1	163	
S2	162,56	

Belgium's debt agency kicks off this week's EMU bond supply by tapping the on the on run 10-yr OLO 77 (1% Jun2026), on the run 15-yr OLO 75 (1% Jun2031) and off the run 30-yr OLO 71 (3.75% Jun2045) for a combined €1.5-1.8B. The amount on offer is relatively small as Belgium is already well-funded this year. They raised €32.89B of the upwardly revised OLO funding target (€36.5B) with two auctions left. The bonds didn't cheapen in the run-up to the auction in ASW spread terms and trade normal on the Belgian curve. Tomorrow, the **Finnish Treasury** sells up to €1B 15-yr bonds (0.75% Apr2031). On Wednesday, the **German Finanzagentur** holds a small Bobl auction (€3B 0% Oct2021) and the **Portuguese debt agency** taps the off the run OT (3.85% Apr2021) for €0.75-1B. On Friday, **Italy** concludes with a BTP auction. This week's supply will be supported by a €26B French redemption. **The US Treasury starts its end-of-month refinancing operation** tomorrow with \$26B 2-yr Note auction. On Wednesday, they hold a \$15B 2-yr FRN and a \$34B 5-yr Note auction and it concludes Thursday with a \$28B 7-yr Note auction.

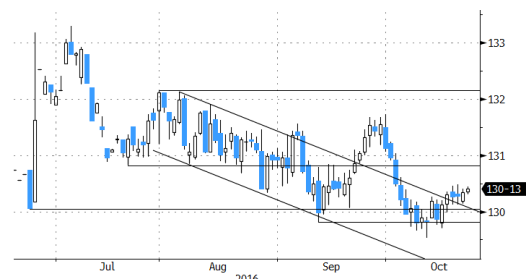
Sentiment-driven trading at start of the week?

Overnight, Asian risk sentiment is positive with China outperforming (+1.5%). Oil prices (Brent crude drops from \$52/b to \$51.5/b) and US Note future (slightly higher) send a different signal.

Today's eco calendar contains EMU PMI data and several Fed speakers. Risks for the composite PMI are on the upside of expectations, but it's been a very long while since EMU eco data affected trading. Fed speakers' (Dudley, Bullard, Evans, Powell) views are well known and probably also irrelevant for trading. **The trading session will be sentiment-driven**, but we don't expect much more corrective action higher in the Bund. ECB president Draghi said that the ECB will deliver key policy guidance in December. QE won't last forever, but also won't stop immediately after March 2017, suggesting that the central bank has a tapering scenario in mind. We expect the Bund to remain in the sideways trading range (163 area – 165.63). **The US 10-yr and 30-yr yields faced difficulties holding above key resistance levels at 1.75% and 2.5% respectively**, suggesting that the downside in the US Note future (129-26 area) is a tough nut to crack as well. **On intra-EMU bond markets, we expect only limited outperformance of Portuguese and Spanish bonds.**



German Bund: Correction away from 163 support as Draghi signals that the QE-programme won't stop immediately after March 2017



US Note future: Extensively tested the downside, but break didn't occur and US 10-yr yield back below 1.75%.

Currencies

R2	1,1366	-1d
R1	1,1123	
EUR/USD	1,0876	-0,0029
S1	1,0826	
S2	1,0711	

USD extends rebound on further policy divergence.

Asian markets start week on a positive footing

The dollar remains well bid

Yuan trades near multi-year lows

EMU PMI to confirm gradual rebound. Impact on the euro show be limited.

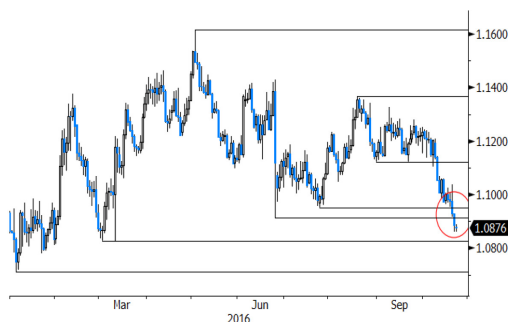
Dollar to holds strong

USD remains in the driver's seat

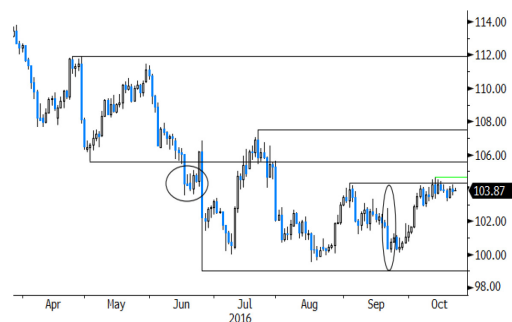
On Friday, in absence of macro data to guide trading the dollar remained in favour. EUR/USD declined further after breaking the post-Brexit low as markets expected an extending of APP beyond March 2017. EUR/USD closed the session at 1.0884 (from 1.0929 on Thursday). USD/JPY lagged the overall USD rally as global investor sentiment was a bit fragile. The pair finished the day at 103.80 (from 103.95).

Overnight, Asian equities trade in positive territory with Chinese equities outperforming, even as the yuan declines further and as capital outflows rise. The off-shore yuan trades near the historic lows. The CNY trades at 6.7736, the weakest level in more than six years. Its decline is mostly due to USD weakness, but it also helps the Chinese economy to regain competitiveness. In a broader perspective, the dollar is holding strong, with the trade-weighted dollar reaching the highest level since February. EUR/USD trades in the 1.0865 area; near the recent lows. USD/JPY stabilizes in a tight range close just below the 104 area. Japan September trade data were better than expected, but had no noticeable impact on currency trading;

Today, in EMU attention goes to the October **PMI's**. The composite indicator is expected to have increased slightly to 52.8 from 52.6 previously. During the first three quarters of the year, the composite PMI averaged around 53. In August and September the index twice fell by 0.3. We expect the downmove to have stopped in October with the **composite index again close to 53**. Especially, Germany should contribute to the advance as the recent fall in the German PMI looks too big. The IFO is actually higher than three months ago after a strong jump in the last month. So, maybe there is a **upside risk for the overall EMU PMI. We expect the impact of the PMI's on Euro trading to be limited**. In the US there are only second tier eco data on the agenda. The deal between AT&T and Time Warner might be slightly supportive for equity sentiment and dollar.



EUR/USD: dollar extends gains beyond 1.0952/13 support



USD/JPY holds near the recent highs, but no sustained break

At the end of last week, the dollar extended its rebound as markets saw ongoing policy divergence between the Fed and the ECB after the ECB press conference. December Fed rate hike expectations put a solid floor for the US currency.

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The euro declines as the ECB is expected to maintain a loose policy beyond March 2017 (no abrupt end to APP). Most other major central banks will probably lag the Fed on the way to policy normalisation. This insight isn't new. **The dollar rally won't continue forever, but for now interest rate support causes by default USD buying.** There is no reason to row against the USD positive tide, especially not in EUR/USD.

From a technical point of view, EUR/USD finally dropped below 1.0952/13 support. If confirmed, the break would be a further USD positive and open the way to next intermediate support (1.0822/1.0711). USD/JPY struggles to break north of 104.32/64. A break would paint a double bottom formation on the charts with targets in the 108/109 area. We stay cautious on sustained USD/JPY gains beyond the 104.32/65 resistance especially as global volatility/uncertainty would intensify.

Sterling enters calmer waters, for now

R2	0,9142	-1d
R1	0,9027	
EUR/GBP	0,8909	0,0001
S1	0,8725	
S2	0,8589	

On Friday, moves of sterling were modest. Some 'minor' issues triggered a gradual, temporary intraday decline of sterling. BAT's bid for the outstanding shares of Reynolds was slightly negative for sterling (especially against the dollar). Mid-morning, the monthly UK public finance data added to the sterling-sceptical sentiment. The budget deficit was substantially wider than expected and questions whether the government has room to support the economy in case of an economic setback due to Brexit. The budget data reinforced the intraday sterling decline. The fragile risk sentiment and negative headlines on the Brexit process coming from the EU summit didn't help sterling neither. **EUR/GBP touched an intraday top in the 0.8940 area, but the pressure on sterling eased later in the session. The pair closed the session at 0.8900 (from 0.8920). Cable finished the day at 1.2234, all in a tight sideways range.**

During the weekend, there were press headlines on Banks preparing scenario's to move part of their activity out of the UK. For now, the negative impact on sterling is limited. Later today, CBI trends total orders will be published. A stabilisation (-5) is expected. We expect the impact of the report to be only of intraday significance. Sterling entered calmer waters last week. This process might continue short term. The UK currency even rebounded slightly **as markets assume that more Parliamentary involvement will reduce the risk of a hard Brexit. However, we don't expect this rebound to go far. We look to sell sterling on more pronounced up-ticks**



EUR/GBP: sterling decline slows, at least for now.



GBP/USD: consolidation

Calendar

Monday, 24 October		Consensus	Previous
US			
14:30	Chicago Fed Nat Activity Index (Sep)	-0.13	-0.55
15:45	Markit US Manufacturing PMI (Oct P)	51.5	51.5
Japan			
01:50	Trade Balance Adjusted (Sep)	A: ¥349.0b	¥408.4b
01:50	Exports YoY (Sep)	A: -6.9%	-9.6%
01:50	Imports YoY (Sep)	A: -16.3%	R-17.2%
02:30	Nikkei Japan PMI Mfg (Oct P)	A: 51.7	50.4
07:00	Supermarket Sales YoY (Sep)	A: -3.2%	-2.9%
07:00	Leading Index CI (Aug F)	A: 100.9	101.2
07:00	Coincident Index (Aug F)	A: 112.0	112.0
UK			
12:00	CBI Trends Total Orders (Oct)	-5	-5
12:00	CBI Trends Selling Prices (Oct)	--	5
12:00	CBI Business Optimism (Oct)	--	-47
EMU			
10:00	Markit Eurozone Manufacturing PMI (Oct P)	52.7	52.6
10:00	Markit Eurozone Services PMI (Oct P)	52.4	52.2
10:00	Markit Eurozone Composite PMI (Oct P)	52.8	52.6
Germany			
09:30	Markit/BME Germany Manufacturing PMI (Oct P)	54.4	54.3
09:30	Markit Germany Services PMI (Oct P)	51.5	50.9
09:30	Markit/BME Germany Composite PMI (Oct P)	53.3	52.8
France			
09:00	Markit France Manufacturing PMI (Oct P)	50.0	49.7
09:00	Markit France Services PMI (Oct P)	53.0	53.3
09:00	Markit France Composite PMI (Oct P)	52.8	52.7
Events			
07:00	Philips earnings		
08:30	BoE Minouche Shafik speaks in HK		
11:00	Euro Area Second Quarter Government Deficit / Debt		
11:30	Belgian OLO auction (1% 2026, 1% 2031, 3.75% 2045)		
12:00	ECB Hansson speaks in Tallin		
15:00	Fed's Dudley Speaks at U.S. Treasury Market Event in New York		
15:05	Fed's Bullard Speaks on Economy, Monetary Policy in Arkansas		
18:15	ECB's Nowotny Speaks at University Event in Vienna		
19:30	Fed's Evans Speaks in Chicago		
20:00	Fed's Powell Speaks at New York Fed Event on Treasury Market		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS		-1d
US	1,73	-0,02	US	0,83	0,00	DOW	18146	18145,71
DE	0,00	-0,01	DE	-0,67	0,00	NASDAQ	for Exch - NQI	#VALUE!
BE	0,23	-0,04	BE	-0,66	0,00	NIKKEI	17220	17219,89
UK	1,08	-0,01	UK	0,23	0,02	DAX	10710,73	10710,73
JP	-0,05	0,01	JP	-0,23	0,02	DJ euro-50	3078	3077,65

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	Eonia EUR	-0,348	0,001
3y	-0,167	1,118	0,626	Euribor-1	-0,37	Libor-1 USD	0,26	0,26
5y	-0,064	1,250	0,734	Euribor-3	-0,31	Libor-3 USD	0,40	0,40
10y	0,384	1,552	1,042	Euribor-6	-0,21	Libor-6 USD	0,56	0,56

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0876	-0,0028	EUR/JPY	112,95	-0,26		189,3951	1265,3	51,6
USD/JPY	103,87	0,02	EUR/GBP	0,8909	-0,0002	-1d	0,62	1,32	0,38
GBP/USD	1,2203	-0,0033	EUR/CHF	1,0811	-0,0038				
AUD/USD	0,7622	-0,0014	EUR/SEK	9,7019	0,01				
USD/CAD	1,3345	0,0103	EUR/NOK	8,9854	0,03				

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