Sunrise

Wednesday, 06 December 2017

Rates: Commodity sell-off could hurt risk sentiment

Risk sentiment deteriorates in Asia this morning with Japan losing up to 2%. Yesterday's commodity sell-off continues on Asian exchanges and gains traction cross markets. Spillover to Europe could lift core bonds via safe haven flows. Trading was lackluster so far this week with investors unwilling to front run on Friday's payrolls and next week's Fed meeting.

Currencies: Risk-off correction to slow further USD gains

The dollar profited slightly from the protracted rise in US ST yields yesterday. Especially EUR/USD drifted gradually lower. However, the US rebound was blocked later in the session by a risk-off correction. This correction continues this morning in Asia. USD/JPY remains vulnerable. The jury is still out, but USD/EUR looks more resilient.

Calendar

Headlines

- **US stock markets ended around 0.4% lower yesterday. Asian risk sentiment deteriorated with Japan losing up to 2%.** Asian commodity markets catch up with yesterday's sell off in mainly industrial metals.
- **UK PM May is facing a revolt from inside her Cabinet** over her plan to keep UK regulations aligned with the EU after Brexit, a split that threatens to undermine her hopes of breaking the deadlock in negotiations.
- **Donald Trump plans to recognise Jerusalem as the capital of Israel** and will announce plans to move the US embassy there from Tel Aviv, defying fears among counterparts in the Middle East and elsewhere that such a move would threaten efforts to broker peace.
- **Australia's economy expanded by 0.6% Q/Q in Q3** (vs 0.7% Q/Q expected) thanks to a long-awaited jump in business investment, though marked weakness in household spending cast a cloud over the outlook for growth.
- **Chicago Fed Evans questioned whether the Fed is really in a hurry to raise rates.** "What if we just decided to wait until the middle of the year and if we saw inflation pick up, then we could do something?"
- **BoJ board member Masai advocated sticking with ultra-easy monetary policy** due to uncertainty over how fast inflation will rise, while warning that the central bank should remain on guard against the possible side-effects.
- **Today's eco calendar** contains US ADP employment and Bank of Canada's interest rate decision. ECB Mersch is scheduled to speak and Germany taps the market.

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	→

Rates

Core bonds settled in sideways range

	US yield	-1d
2	1,82	0,01
5	2,13	0,00
10	2,35	-0,02
30	2,73	-0,03

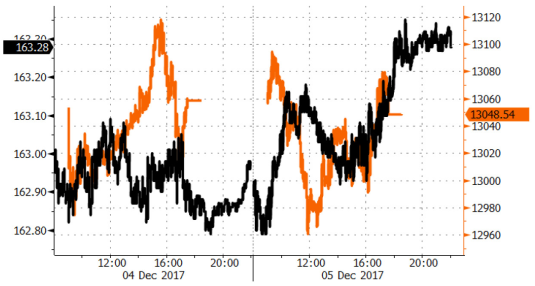
Global core bonds settled in a narrow sideways range yesterday, similar to Monday. Second tier EMU eco data and a disappointing, but still very strong, non-manufacturing ISM didn't influence trading. European stock markets lost slightly ground while Brent crude hovered around $62.5/barrel. Industrial metals sold off, triggered by copper, but didn't drew attention from other markets. During US dealings, focus turned to politics but markets shruged off the uncertainty for now. House and Senate members hope to streamline their US tax reform proposals before the end of the year, special prosecutor Mueller's investigation into alleged Russian ties with Trump's presidential campaign widens, a new debt ceiling (Dec 08) comes closer and US President Trump want to recognize Jerusalem as Israel's capital.

Flattening US yield curve continues

In a daily perspective, the German yield curve shifted 2.3 bps (10-yr) to 2.9 bps (30-yr) lower. The US yield curve flattened with yield changes ranging between +1.2 bps (2-yr) and -3.3 bps (30-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany ranged between -3 bps (Ireland) and +2 bps (Spain) with Greece outperforming (-55 bps). Yesterday was the first trading day for five new bonds that were issued as part of €25.5 bn debt swap which occurred last week. The swap is a way to build a more normal yield curve and an entry point to market funding next year.

	DE yield	-1d
2	-0,73	-0,03
5	-0,36	-0,03
10	0,32	-0,02
30	1,12	-0,03

Today's eco calendar is thin with only November US ADP employment change. Consensus expects net job growth of 190k (from 235k in October), which would be another sign of ongoing labour market strength. **ECB Mersch is scheduled to speak.** He recently sounded in favour of the German-France ECB push to tie total monetary policy to the inflation outlook instead of just APP, suggesting a change in forward guidance. **The German Finanzagentur holds a Bund auction (€2 bn 0.5% Aug2027).** Total bids at the previous 4 Bund auction averaged €3.65 bn, suggesting that the very small tap should be covered even if we don't expect a big improvement in demand.



German Bund (black) & Dax (orange) intraday this week: sideways action

Copper future: Yesterday's sell-off a warning signal?

Commodity sell-off could hurt risk sentiment

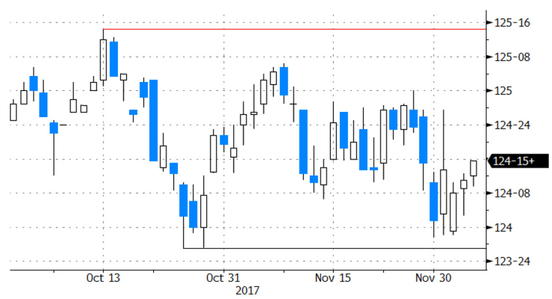
R2	165,18	-1d
R1	163,67	
BUND	163,41	0,19
S1	161,49	
S2	159,78	

Risk sentiment deteriorates in Asia this morning with Japan losing up to 2%. Yesterday's commodity sell-off continues on Asian exchanges and gains traction cross markets. Trump's intentions to recognize Jerusalem as capital if Israel threatens to stir the Middle East region. Dovish comments from Chicago Fed Evans, who is a voter next week, could be used as a reason to take some profit on the giant repositioning at the front end of the US yield curve since September. The combination of these 3 items supports the US Note future overnight and suggest a higher opening for the Bund as well.

The main item on today's agenda is the ADP employment report which is expected confirm strength on the US labour market. In theory, that's negative for US treasuries, but we don't expect a strong reaction. The commodity sell-off (industrial metals) affects Asian stock markets and could trigger risk aversion in Europe as well, lifting core bonds via safe haven flows. Some investors might remain side-lined though ahead of payrolls (Friday) and next week's Fed meeting. **The front end of the US yield curve (short future in oversold conditions), discounts already two rate hikes for 2018 going into next week's FOMC meeting.** We expect the new dot plot to show the Fed's determination to hike rates 3 times next year. **Rate markets are for the first time in the current tightening cycle (rapidly) catching up with FOMC forecasts.**

Technically, US Treasuries will probably trade in the 123-27 to 125-14+ range going forward (March 2018 contract!). This corresponds with a 2.3%-2.47% band in yield terms. The **German Bund** set a new contract high, but this wasn't confirmed by a drop of the German 10-yr yield below 0.3%. **We don't anticipate such move and suggest putting short positions around current levels. Strong current and expected growth and the ECB's slow normalisation process warrant such move.**

German Bund (March contract!): New contract high, but break needs to be confirmed with move of German 10y yield below 0.3%. We don't expect that to happen.



US Note future (March contract!): sideways ahead of key Fed meeting next week. How will the 2018 dot plot look like?!

Currencies

Risk-off correction to cap further USD gains?

Dollar initially trended cautiously higher yesterday, supported by rising ST US yields

Rebound stalled as sentiment turned risk-off

There were few data with market moving potential yesterday. US ST yields rose further, widening the interest rate differential in favour of the dollar. Of late, the dollar often ignored the guidance from interest rate markets, but this time it helped the US currency to some cautious gains. The US non-manufacturing ISM was slightly softer than expected. It didn't hurt the dollar much, but the US currency lost slightly ground later as equities turned again negative. EUR/USD closed the session at 1.1826. USD/JPY finished at 112.60.

Asian equities turn south after sell-off of copper

USD/JPY drops to the 112 area. EUR/USD rises only modestly

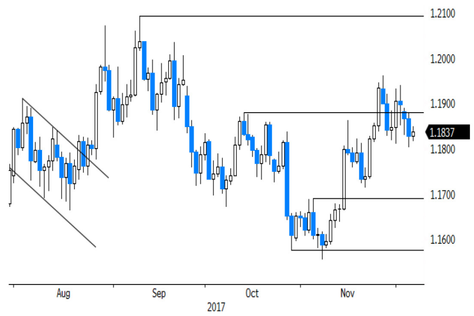
Aussie dollar suffers from commodity correction and soft GDP data

The US equity slide accelerated in Asia overnight. Commodity related stocks are taking the lead in the decline after a sell-off of copper yesterday. Losses on Asian markets vary from about 0.5% (India) to almost 2% (Japan). **The equity decline pressures US yields with modest impact on the dollar.** USD/JPY dropped to the low 112 area. EUR/USD is less affected and trades in the 1.1840 area. **Yesterday, the Aussie dollar profited from positive comments in the RBA statement.** Part of the gain was already undone yesterday (copper correction). **The reversal continued this morning as Australian Q3 GDP was slightly softer than expected** at 0.6% Q/Q and 2.8% Y/Y (0.7% Q/Q and 3.0% Y/Y was expected).

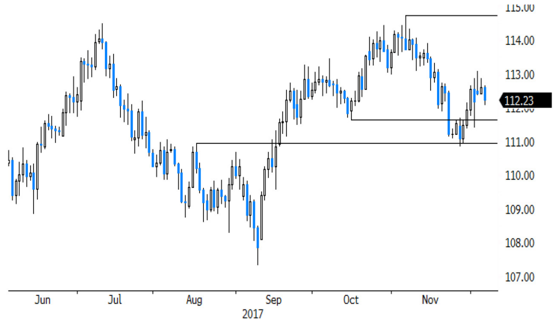
R2	1,2225	-1d
R1	1,2092	
EUR/USD	1,1826	-0,0040
S1	1,1554	
S2	1,1331	

Global sentiment probably remains the driver for USD trading short-term

There are few data with market moving potential in Europe or in the US today. **The ADP labour market report is the exception to the rule.** The consensus expects 190 000 net job growth in the US private sector (from 235 000 in October, probably still affected by the consequences of the hurricanes). We have no reason to take a different view from consensus. The expected job growth remains good, given that the US eco cycle has already advanced quite a long way. Of late, the reaction of the (FX) market to the ADP was mostly modest as the month-on-month correlation with the payrolls is not that tight.



EUR/USD: rally aborted, but no sustained downside correction yet



USD/JPY: rally slows. Technical picture turned neutral again

The dollar showed a mixed picture last week, rebounding against the yen but holding relatively soft against the euro. This week, there were tentative signs (especially yesterday) that the US currency could get a bit more support from the protracted rise in ST US yields (2-y US yield rising above 1.8%). Markets are gradually moving a bit more in the direction of the Fed guidance (dot-plot). For now, it didn't help the dollar that much. Even so, it should at least help to put a floor for the US currency as USD shorts are becoming ever more expensive.

Of course, this process might again be aborted if global markets fall prey to an outright risk-off correction. Even so, we have the impression that the topside in EUR/USD is becoming a bit tougher.

We still see no reason for EUR/USD **to rise beyond the 1.1961/1.20 area ahead of next week's Fed meeting, unless there comes high profile negative news from the US. USD/JPY reacted more to interest differentials of late, but the pair might be more vulnerable in case of a risk-off correction.**

From a technical point of view: EUR/USD set a post-ECB low mid-November, but dollar momentum wasn't strong enough. EUR/USD regained the 1.1880 MT correction top, opening the way for a full retracement to the 1.2092 top. A return below 1.1713 would signal that the rebound in EUR/USD is aborted. **For now, there is no clear technical signal. USD/JPY's momentum** deteriorated early November, dropping below the 111.65 neckline. No aggressive follow-through selling occurred though. Last week the pair succeeded a nice rebound, calling off the downside alert. **The pair again hovers in the 110.84/114.73 consolidation range. We amend our ST bias from negative to neutral.**

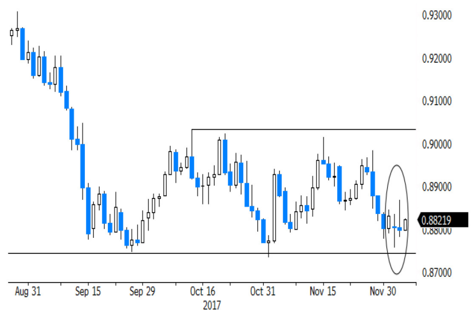
Sterling awaiting less diffuse news from Brexit

R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8797	-0,0006
S1	0,8743	
S2	0,8657	

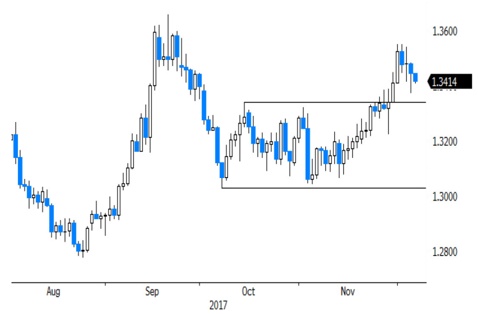
Monday's last minute failure to strike a separation deal on Brexit kept sterling in the defensive yesterday morning. The UK services PMI came out slightly softer than expected at 53.8 from 55.6 (55.00 was expected), but price indictors in the report rose quite sharply. **Sterling traded already off the recent lows at the time of the PMI release and regained some further ground late in the session. Markets apparently still hope that a deal can be reach in the near future even if the political signals from the UK remain very diffuse.** EUR/GBP closed the session at 0.8797. Cable **finished the day at 1.3443, but this move still reflected some USD strength.**

There are no important eco data in the UK today. So, **Brexit headlines/rumours will continue drive GBP trading.** The comments this morning at least suggest that **UK PM May has still plenty of work to do to convince hard-line Brexit supporters in her party and to meet the wishes of the DUP.** Sterling is slightly in the defensive this morning. Sterling traders remain reluctant to place big directional bets as the Brexit news flow might change minute by minute. An agreement is still possible ahead of next week's EU summit. However, given recent developments, we don't add sterling longs at this stage. More erratic trading might be on the cards unless there comes some real clarity on Brexit.

MT view/technical picture: A BoE driven sterling rebound ran into resistance early last month. Sterling declined again as markets anticipated that the rate cycle would be very gradual and limited. EUR/GBP trades in a 0.8733/0.9033 consolidation range. Brexit headlines cause day-to-day gyrations. **We changed our ST bias on EUR/GBP from positive to neutral mid-November.** The 0.9015/33 area might be tough to break short-term. In case of more positive news on Brexit, return action to the 0.8733 (or below) level is possible ST.



EUR/GBP: downside test rejected as separation deal is no done thing yet



GBP/USD: topside test rejected?

Calendar

Wed, 6 December		Consensus	Previous
US			
14:15	ADP Employment Change (Nov)	190k	235k
Canada			
16:00	Bank of Canada Rate Decision	1.00%	1.00%
Germany			
08:00	Factory Orders MoM / WDA YoY (Oct)	A: 0.5%/6.9%	1.2%/9.7%
09:30	Markit Germany Construction PMI (Nov)	--	53.3
Events			
11:30	Germany to Sell €2 bn 0.5% 2027 Bonds		
11:30	ECB Executive Board member Yves Mersch speaks in Frankfurt		

10-year	Close	-1d		2-year	td	-1d	Stocks	Close	-1d
US	2,35	-0,02		US	1,82	0,01	DOW	24180,64	-109,41
DE	0,32	-0,02		DE	-0,73	-0,03	NASDAQ	6762,213	-13,15
BE	0,50	-0,02		BE	-0,62	-0,02	NIKKEI	22177,04	-445,34
UK	1,26	-0,03		UK	0,49	-0,01	DAX	13048,54	-10,01
JP	0,06	0,01		JP	-0,14	-0,01	DJ euro-50	3570,57	-5,65
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,08	2,10	0,95	Eonia	-0,3240	-0,0050			
5y	0,19	2,20	1,10	Euribor-1	-0,3670	0,0010	Libor-1	1,3918	0,0000
10y	0,79	2,37	1,34	Euribor-3	-0,3260	0,0000	Libor-3	1,5085	0,0000
				Euribor-6	-0,2710	0,0010	Libor-6	1,6931	0,0000
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1,1826	-0,0040		EUR/JPY	133,16	-0,22	CRB	187,47	-1,22
USD/JPY	112,6	0,19		EUR/GBP	0,8797	-0,0006	Gold	1264,90	-12,80
GBP/USD	1,3443	-0,0037		EUR/CHF	1,1676	-0,0012	Brent	62,86	0,41
AUD/USD	0,7607	0,0009		EUR/SEK	9,8766	-0,1140			
USD/CAD	1,2691	0,0018		EUR/NOK	9,7713	-0,1159			

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