Wednesday, 07 March 2018

Rates: Cohn's resignation vs hawkish comments by Fed Brainard

The US Note future gapped open higher overnight on White House economic adviser Cohn's resignation and on rumours of more US tariffs against China. The move is countered by a shift in tone of dovish Fed governor Brainard who favours a faster rate hike cycle than before. Tomorrow's ECB meeting could subdue today's session.

Currencies: trade war angst continues to weigh on the dollar

Today, uncertainty on the US trade policy will remain the key factor for global FX trading. For now, the issue is a negative for the dollar. At the same time, Fed speak and US eco data stay USD supportive, but are ignored for now. FX traders will also look forward to tomorrow's ECB meeting. Will the ECB be soft enough to prevent further EUR/USD gains?

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 closed up to 0.5% higher (Nasdaq) yesterday. **Risk sentiment deteriorated overnight** after economic adviser Cohn's resignation and on rumours of more US tariffs against China.
- **Gary Cohn will resign from the White House as President Trump's top economic adviser,** days after Mr. Trump surprised his senior staff by announcing steel and aluminum tariffs that Mr. Cohn had opposed.
- **Washington-based Fed governor Brainard;** one of the central bank's most ardent doves, sounded optimistic about the US economy's outlook and **suggested the pace of monetary policy tightening may need to accelerate.**
- **The Trump administration is considering clamping down on Chinese investments in the US** and imposing tariffs on a broad range of its imports to punish Beijing for its alleged theft of intellectual property, according to sources.
- **Opponents of Brexit are looking into whether Britain could postpone its exit from the EU** to give lawmakers and voters more time to weigh up whether they really want to leave.
- **Australia's economic growth slowed last quarter (0.4% Q/Q)** as bad weather hit exports, though government spending and a revival in household consumption helped the country extend its 26-yr run without recession.
- **Today's eco calendar contains US ADP employment.** Fed Bostic and Dudley are scheduled to speak and the Fed releases its Beige Book. The Bank of Canada is expected to keep policy rates unchanged at 1.25%. Germany taps the market.

Rates

	US yield	-1d
2	2,25	0,01
5	2,63	0,01
10	2,89	0,01
30	3,13	0,00

	DE yield	-1d
2	-0,55	0,01
5	0,03	0,03
10	0,68	0,03
30	1,33	0,02

Cohn's resignation vs hawkish Fed governor Brainard

Global core bonds traded mixed yesterday. German Bunds underperformed US Treasuries with European political event risk (SPD vote, Italian elections) out of the way. The rejected test of 0.62% support on Friday and on Monday triggered additional technical Bund selling. Both the Bund and the US Note future took an extra intraday hit on headlines of a potential Korean denuclearization, but the Note future eventually rebounded to close nearly unchanged. German yields rose by 0.7 bps (2-yr) to 3.2 bps (10-yr). The US yield curve bear flattened with yield changes varying between +1.2 bps (2-yr) and flat (30-yr). On intra-EMU bond markets, peripheral yield spreads vs Germany narrowed 3 to 8 bps with Italian BTP's shrugging off the election outcome.

The US Note gapped open higher overnight after White House top economic adviser Cohn put in his resignation on a dispute over president Trump's decision to impose tariffs on steel and aluminum. It causes uncertainty about the future economic agenda. Simultaneously, headlines hit the screen suggesting more US tariffs against China might be in the cards, intensifying trade war fears. The US Note future is gradually slipping away though as the Asian trading session advances following comments by Fed Brainard. She is one of the dovish members on the FOMC board, but suggested a faster pace of rate hikes as the US economy enjoys tailwinds (fiscal policy + accelerating global growth).

We expect a stronger opening for the Bund because of overnight risk aversion, but don't expect much follow-up gains ahead of tomorrow's ECB meeting and given strong support in the German 10-yr yield (0.62%; 157.43/69 resistance in Bund). The ECB will probably delay a change to its communication strategy to April. The US eco calendar contains ADP employment change (+200k expected), speeches by Fed governors Bostic and Dudley and the Fed's Beige Book. **Voting Fed governor Bostic is part of the dovish camp in favour of slow tightening. It would be an important signal if he shows a similar shift as Fed Brainard overnight which could cause an underperformance of the front end of the US yield curve today. We think that the new Fed dot plot will show the shift in thinking in the Fed with a higher estimate for the neutral rate and risks for a faster hike cycle.**

Technically, the trading band for the US 10-yr yield is 2.64%-3.05%. The German 10-yr yield's trading band is 0.62%-1.06%. **A move to the downside could be used to set up new short positions.**

US Note future (intraday, this week): gap open this morning as US trade debacle triggered the resignation of economic advisor Cohn

German 10-yr yield: failed test of 0.62% support

Currencies

R2	1,2598	-1d
R1	1,2555	
EUR/USD	1,2404	0,0068
S1	1,2165	
S2	1,2055	

R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8932	0,0025
S1	0,8690	
S2	0,8657	

Trade war debate continues weighing on USD

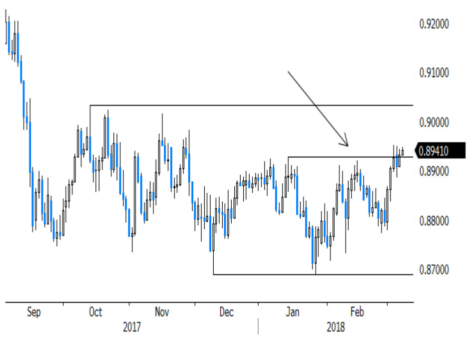
Yesterday, USD dollar selling eased temporary as markets hoped that senior Republicans could convince Trump to avoid a trade war. Around noon, South Korean officials declared that North Korea was prepared to talk about denuclearization. **Risky assets jumped and so did USD/JPY and EUR/JPY. The EUR/JPY short-squeeze also propelled EUR/USD** above the 1.24 level. Later in the session, the decline of the yen slowed as markets tried to assess the meaning of the Korean headlines. USD/JPY closed the day at 106.13. EUR/USD finished at 1.2414.

Overnight, Gary Cohn announced to resign as President Trump's top economic adviser. He disagrees with Trump's foreign trade policy. **The announcement revived the risk-off trade.** Fed Brainard (a dove) hinted that tailwinds to the economy could lead to a faster rate hike path. However, the focus for (FX) trading remains on US trade policy as US president Trumps still intends to defend US interests by protectionist measures. USD/JPY dropped to the mid 105 area. EUR/USD is hovering near 1.2425 even as EUR/JPY came off yesterday's top.

The US trade balance and the ADP labour market report will be published today. Several Fed members speak and the central bank publishes the Beige Book. Of late, most Fed members, even the doves, were optimistic on growth and US data were OK. **In theory, this is USD supportive. However, the market's focus is on the US trade policy.** The 'trade issue' is weighing on the dollar, but **tomorrow's ECB meeting is also in play**. We expect the ECB to make only limited changes to its communication (if any) as inflation stays low. **However, will a 'soft' ECB be enough to prevent further EUR/USD gains, as the dollar stays under pressure?** For now, we assume the ECB to be soft enough for EUR/USD to hold the 1.2155/1.26 trading range. Of course, US political event risk makes the dollar vulnerable short-term.

Yesterday, there was **plenty of diplomatic action** between EU and UK policy makers at different levels. However, for now, there is no break-through on key pending issues. Especially financial services are a hot topic. This debate will probably continue today as the EU is expected to publish its starting text for the next round of the negotiations. EUR/GBP hovers near 0.8930/50 resistance. Swings in EUR/GBP remain modest, but the day-to-day momentum of sterling is again deteriorating.

EUR/USD rebounds higher in the consolidation range as US trade policy weighs on the dollar.



EUR/GBP: sterling again in the defensive as Brexit noise weighs

Calendar

Wednesday, 7 March		Consensus	Previous
US			
13:00	MBA Mortgage Applications (Mar 2)	--	2.7%
14:15	**ADP Employment Change (Feb)**	**200k**	**234k**
14:30	Trade Balance (Jan)	-$55.0b	-$53.1b
Canada			
16:00	**Bank of Canada Rate Decision**	**1.25%**	**1.25%**
UK			
09:30	Halifax House Prices MoM & 3Mths/Year (Feb)	0.4%/1.6%	-0.6%/2.2%
EMU			
11:00	Gross Fix Cap QoQ (4Q)	1.1%	1.1%
11:00	Govt Expend QoQ (4Q)	0.3%	0.2%
11:00	Household Cons QoQ (4Q)	0.6%	0.3%
11:00	GDP SA QoQ / YoY (4Q F)	0.6%/2.7%	0.6%/2.7%
China			
	Foreign Reserves (Feb)	$3160.00b	$3161.46b
Events			
01:00	**Fed's Brainard to Speak in New York**		
02:30	Fed's Kaplan Speaks at Energy Conference		
11:30	Germany to Sell €4bn 0% 2023 Bonds		
14:00	**Fed's Bostic Speaks on the Economic Outlook**		
14:20	Fed's Dudley Speaks in Puerto Rico		
20:00	**US Federal Reserve Releases Beige Book**		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	2,89	0,01		US	2,25	0,01	DOW	24884,12	9,36
DE	0,68	0,03		DE	-0,55	0,01	NASDAQ	7372,007	41,30
BE	0,96	0,02		BE	-0,51	0,01	NIKKEI	21252,72	-165,04
UK	1,52	0,03		UK	0,82	0,01	DAX	12113,87	23,00
JP	0,05	-0,01		JP	-0,16	0,01	DJ euro-50	3357,86	2,54
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	0,09	2,65	1,20	Eonia	-0,3650	-0,0030			
5y	0,47	2,77	1,39	Euribor-1	-0,3710	-0,0010	Libor-1	1,7017	0,0000
10y	1,10	2,90	1,63	Euribor-3	-0,3270	0,0000	Libor-3	2,0349	0,0000
				Euribor-6	-0,2710	0,0010	Libor-6	2,2293	0,0000
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1,2404	0,0068		EUR/JPY	131,64	0,63	CRB	196,76	0,09
USD/JPY	106,13	-0,07		EUR/GBP	0,8932	0,0025	Gold	1335,20	15,30
GBP/USD	1,3888	0,0039		EUR/CHF	1,1668	0,0074	Brent	65,79	0,25
AUD/USD	0,7829	0,0064		EUR/SEK	10,179	-0,0118			
USD/CAD	1,2876	-0,0088		EUR/NOK	9,6466	0,0011			

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