



Sunrise

Monday, 03 July 2017

Rates: Will the sell-off take a pause or will strong US data hit especially US bonds?

The US ISM could be stronger than expected today, but traders might be hesitant to react ahead of tomorrow's holiday. We do expect strong US labour market data later this week, which might give US Treasuries the lead in the global sell-off. German bonds face tough resistance. A sell-on-upticks might therefore be appropriate, unless a break occurs.

Currencies: US data to help the dollar

US data will be key this week. Today, the US manufacturing ISM is expected at a decent level. An upward surprise might restore confidence on the US recovery and on the dollar. If so, last week's EUR/USD top might become a first resistance.

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 stocks closed Friday with slight gains** (S&P 500 at +0.15%). **Asian stock markets continue on this path** as they also struggle to gain traction in early trading.
- **Japanese PM Abe's Liberal Democratic Party suffered an historic defeat** in an election in Tokyo (losing half of its seats), signalling trouble ahead for the Abe, who has suffered from slumping support because of a favouritism scandal.
- **Japan's Tankan survey of business conditions** at Japan's large manufacturers **jumped to 17 in Q2 from 12 in Q1**, besting a median forecast of 15. Business conditions also improved more than predicted for SME manufacturers
- The **Japanese Nikkei-Markit PMI increased to 52.4 in June from 52 in May**. Manufacturers upped their purchasing activity on new orders and higher production requirements. Employment rose too.
- The **China Caixin-Markit manufacturing PMI rose to 50.4 in June after falling into contraction in May** (49.6 in May, consensus of 49.8). Growth in output and new orders rose marginally, while employment continued to contract.
- **China and Hong Kong have launched a bond trading link that allows foreign fund managers to trade in China's \$9 trillion government, agency and corporate debt markets** without the need for an onshore account.
- The **eco-calendar's most interesting releases are the UK's manufacturing PMI, the US manufacturing ISM and the Eurozone unemployment rate**.

Rates

Bear steepening German curves continues, but in the US the belly underperformed

Repositioning on hawkish central bank talk is not finished

Peripherals oasis of calm

	US yield	-1d
2	1.38	0.01
5	1.90	0.04
10	2.30	0.04
30	2.85	0.02

	DE yield	-1d
2	-0.57	-0.01
5	-0.21	0.01
10	0.47	0.01
30	1.27	0.02

Upside risks US ISM

Later this week, US labour market data in the driver's seat

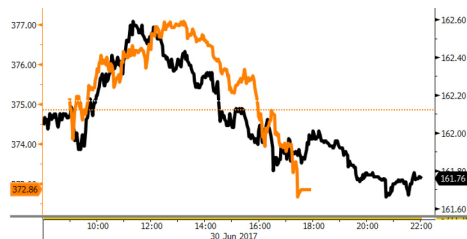
Will Praet try to turn the bearish bond sentiment?

Lousy attempt of core bonds to correct higher fails

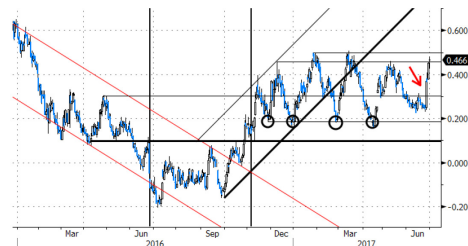
Core bonds markets lost again, albeit modest to moderate ground on Friday, as a lousy attempt to correct higher failed. US Treasuries now underperformed German Bunds. An attempt to correct higher was blocked around European noon, pulling core bonds lower. At the same time, European equities lost their initial gains and even closed lower. The dollar stabilized and was unable to profit from widening yield differentials. Oil continued its gradual recovery but was a sideshow for other markets. **Quarter end demand for bonds was washed away by repositioning flows out of bonds. Hawkish comments by ECB Lautenschlager**, who argued in favour of policy normalisation and suggested that the communication should be adjusted accordingly, could have played a role in the renewed selling. EMU (CPI) and US (PCE) inflation didn't directly influence dealings. Core EMU inflation rose unexpectedly to 1.1% Y/Y, while the US PCE deflator fell to 1.4% Y/Y from 1.7% Y/Y. **All in all, most inflation outcomes were near consensus though.** US investors ignored personal income and spending data, a very strong Chicago PMI and an upwardly revised Michigan consumer sentiment as they were preparing for a **long weekend**. US markets are closed next Tuesday for the 4th of July holiday, suggesting low activity on Monday despite the release of the manufacturing ISM.

US eco calendar well filled this week

The attention turns this week to the **US eco data, which we expect to show renewed vigour after the lacklustre performance of late.** EMU data are less important with today's final June manufacturing PMI and the unemployment rate. The former shouldn't show big revisions, while the latter is expected unchanged. The EMU unemployment rate is on a firm downside trend, which suggests some downside risks, but even if correct, markets won't react too hefty. **In the US, the manufacturing ISM** for June is important. The index is at decent levels (54.9 in May), but we **see risks to the upside of consensus** (55.2 in June), as all regional surveys surprised on the upside and as a weaker dollar and strong global growth should benefit US firms. **St-Louis Fed Bullard** spoke many times in recent weeks and shouldn't affect markets anymore. The **closure of US markets tomorrow** may affect the reaction on the ISM, either by ignoring it or by reacting too heavily as the market will already be thinner.



Bund future (black) and EuroStoxx 600 (orange) lousy attempt of Bund to correct higher fails, dragging equities down too.



German 10-yr yield: approaches main resistance at 0.5%. If US eco data surprise and US yields go higher, we might see a break. However, ECB speakers may try to avoid a further rise of yields

Further out this week in the US, the **labour market data** will be of paramount interest. **We see upward risks.** The **Minutes of the FOMC meeting** might be interesting to get a better take on the start of the balance sheet tapering and on the different value the Fed attributes to stronger labour market on the one hand and lower inflation on the other hand.

It might impact thinking on the sequence between tapering and rate increase on the one hand and on the chances, as such, for another rate hike this year. **In EMU**, data are less important, but after the bond sell off, **it will be interesting whether ECB speakers will try to change market views on the outlook for policy**. The news article based on three ECB sources that the market had misunderstood the words of Mario Draghi didn't carry far. **ECB Praet, speaks on Tuesday and Thursday**. Will he try to turn bond market sentiment around?

Will US Treasuries take over lead in sell-off?

R2	165.93	-1d
R1	165.55	
BUND	161.74	-0.30
S1	161.68	
S2	160.17	

Asian equities trade narrowly mixed despite stronger Japanese Tankan business sentiment and Chinese Caixan manufacturing PMI (cf headlines). **PM Abe's party lost heavily in Tokyo elections, weakening its position**. **Brent oil** trades higher after the contract roll, but is stable overnight. **The dollar gains modestly** across the board while **the US T-Note continues its slide and is about 6/32 lower, suggesting a weak opening for the Bund**.

Regarding European bond trading, we don't think the final EMU manufacturing PMI or the unemployment rate will affect bonds much. This means that the morning session will be **dominated by sentiment, which turned bearish last week**. **In the afternoon, the US ISM may surprise on the upside**, which is a bond negative. Of course, it should be put into the perspective of **tomorrow's closure of US markets**.

We hold our sell-on-upticks strategy as markets reposition for a new stage in the global monetary cycle: policy normalisation. The peak of central bank dovishness is behind us. It will be interesting to see whether US Treasuries lose more ground (on ISM or sentiment) and maybe take over the lead from German bonds in the sell-off phase. Of course, the closure of US markets tomorrow may keep many investors side-lined. Later this week though, we see strong labour market data and maybe hawkish FOMC Minutes. That should be another opportunity for US Treasuries to test the downside. There is still some scope before key support looms (see graph). **This is different for the Bund, which arrived at key support levels** (see graph below) and 0.50% 10-yr yield resistance. **Such key technical levels are often not easy to take out in a first attempt**. Therefore, we still prefer a sell-on-upticks strategy. Should the break occur, repositioning may get on another leg with strong stop-loss selling. The current repositioning and the Fed Yellen's credibility (subdued inflation is temporary) might hamper any sustainable gains. Any spike higher could be used in our **sell-on-upticks strategy in US Treasuries** as markets are positioned too dovish given the Fed's future tightening intentions.



German Bund: Sell-off pushed the Bund for a first test of the 161.68 support (neckline double top) & 161.58 (62% retracement). No break occurred, but risks remain (cf. 0.50% 10-yr yield resistance)



US Note future: First signs of fragilizing technical picture as uptrendline is broken and small double top formation (125-08 is target & 38% retracement). Key support though at 124-12.

Currencies

EUR/USD and USD/JPY little changed on the day despite slightly wider rate differentials and US equities holding up rather well

R1	1.15	
EUR/USD	1.1426	-0.0014
S1	1.0839	
S2	1.0778	

Upside risks US ISM

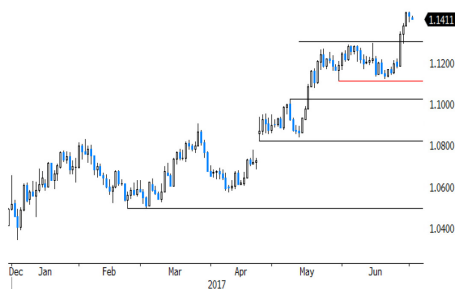
Uneventful EMU calendar

US data to help the dollar?

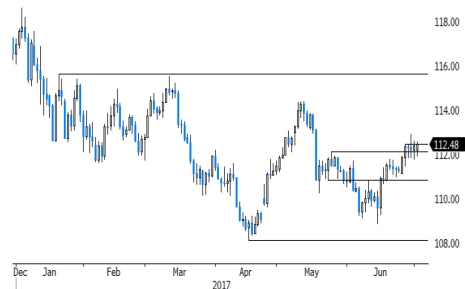
The strong three-day EUR/USD rally ran into resistance Friday, but there was also no real USD rebound. Yield differentials widened slightly in favour of the dollar. US equities outperformed European ones. EUR/USD closed at 1.1426 versus 1.1440 on Thursday. USD/JPY traded in a small band. The yen started strong, but USD/JPY closed with a small gain at 112.39 as US equities kept up well. Appetite to take additional positions was clearly missing, as it was the final the day of the quarter and as many US traders prepared for a long weekend with US markets closed for the 4th of July holiday tomorrow.

Overnight, Asian equities are trading mixed. The Japan Tankan business sentiment was stronger than expected (see headlines). The Caixin China manufacturing PMI also improved slightly. Decent regional data don't help the yen this morning. USD/JPY opened slightly in the red, but reversed the initial loss. A further rise in the oil price and a rise in US yields are supporting the dollar. USD/JPY trades in the 112.50 area. EUR/USD dropped slightly to the low 1.14 area and trades currently at 1.1415.

The attention turns this week to the US eco data. We expect an improvement after the lacklustre performance of late. EMU data are less important with today the final June manufacturing PMI and the unemployment rate. The US manufacturing ISM is expected to rise slightly, but we see risks to the upside of consensus. Further out this week the US labour market data will be of paramount interest. We see upward risks. The Minutes of the FOMC meeting might also be interesting to get a better take on the start of the balance sheet tapering and on the different value the Fed attributes to a strong labour market on the one hand and lower inflation on the other hand. The EMU data are less important, but after the bond sell off, it will be interesting whether ECB speakers will try to change market views on the outlook for policy.



EUR/USD Will good US data support the dollar and cap the EUR/USD rally?



USD/JPY: rebounding off the recent lows.

In a daily perspective, we look out whether the US ISM might be strong enough to help a USD rebound against the euro. A decent report, which we expect, should help a topping out process after the recent EUR/USD rally. In case of good US labour data, we see also room for a re-widening of the USD/EMU interest rate differential as the recent rise in German/EMU yields was quite impressive. That said, the dollar remains vulnerable in case of a negative surprise. We start the

week with a tentative USD-positive bias and look out whether last week's top in EUR/USD might become a more solid resistance. A decent US ISM and a constructive equity sentiment might also be a USD/JPY positive. However, it will be difficult to take out the recent top just below 113. For that to happen, as strong Payrolls report is probably needed.

Technical picture: USD looking for a bottom

A combination of hawkish ECB comments and weaker US eco data pushed EUR/USD last week above the 1.1300/66 resistance area with a new high at 1.1448. The next resistance is now the 1.15 area. Further out LT correction tops are coming in at the 1.1616/1.1714. A break would end the long consolidation period that followed the sharp decline of EUR/USD in 2014/early 2015. Such a key area will be difficult to break for now. A drop below 1.1119 would suggest the pair enters calmer waters.

The USD/JPY rally ran into **resistance** in early May and the pair returned lower in the 108.13/114.37 range. The post-Fed USD rebound pushed the pair the **112.13 correction top early this week, but there were no real follow-through gains, So, the break isn't confirmed yet. A break would improve the ST-picture.** Even so, were remain cautious on further USD/JPY gains.

Sterling extends rebound

On Friday, cable approached key 1.3044 resistance in Asia, but a real test didn't occur, sending GBP/USD temporary lower again. UK data made no difference: Outdated Q1 GDP was confirmed at a weak 0.2% Q/Q. Trading in Cable and EUR/GBP was mostly technical in nature. Some sterling short-covering prevailed at the end of the month/quarter. EUR/GGBP closed the session at 0.8771 (from 0.876). Cable finished the day on a strong bid at 1.3030.

Today, the UK Manufacturing PMI is expected little changed at 56.3 from 56.7. This is still a healthy level and other UK data were not too bad of late. So, we assume that the report might be considered constructive in the markets. The past weakening of sterling is a positive for the UK manufacturing sector. **So, the report might support a further technical comeback of sterling.** The Brexit negotiations are on ongoing issue. Any progress on the rights of EU/UK citizens might suggested a less hard Brexit. **All in all, we see EUR/GBP staying below the key resistance of 0.8866/80** and cable's fate will depend on EUR/USD. If the cross would move higher, cable may test the 1.3048 resistance but a break looks unlikely.

From a technical point of view, EUR/GBP set a minor top north of the 0.8854/66 resistance (2017 top), but a sustained break didn't occur. Recent setbacks will probably block further gains ST. **A return below the 0.8655 correction low would indicate easing pressure on sterling.** Such a break lower will be difficult. A **EUR/GBP buy-on-dips approach remains favoured.**

R2	0.9142	-1d
R1	0.8881	
EUR/GBP	0.8771	-0.0025
S1	0.8383	
S2	0.8314	



EUR/GBP topside test rejected. A modes/temporary sterling comeback might be on the cards



GBP/USD near key resistance

Calendar

Monday, 3 July		Consensus	Previous
US			
16:00	ISM Manufacturing (Jun)	55.2	54.9
16:00	ISM Prices Paid (Jun)	58.5	60.5
16:00	ISM New Orders (Jun)	--	59.5
16:00	ISM Employment (Jun)	--	53.5
16:00	Construction spending (May (M/M))	0.3%	-1.4%
	Domestic car sales (June)	12.9M	12.84M
Japan			
01:50	Tankan Large Mfg Index / Outlook (2Q)	A 17/18	12/11
01:50	Tankan Large Non-Mfg Index / Outlook (2Q)	A 23/18	20/16
02:30	Nikkei manufacturing PMI (June) final	A 54.2	52
07:00	Consumer confidence (June)	43.9	43.6
China			
03:45	Caixin China PMI Mfg (Jun)	A 50.4	49.6
UK			
10:30	Markit UK PMI Manufacturing SA (Jun)	56.3	56.7
EMU			
10:00	Markit Eurozone Manufacturing PMI (Jun F)	57.3	57.3
11:00	Unemployment Rate (May)	9.3%	9.3%
Germany			
09:55	Markit/BME Germany Manufacturing PMI (Jun F)	59.3	59.3
France			
09:50	Markit France Manufacturing PMI (Jun F)	55.0	55.0
Italy			
09:45	Markit/ADACI Italy Manufacturing PMI (Jun)	55.3	55.1
10:00	Unemployment Rate (May P)	11.2%	11.1%
Belgium			
11:00	Unemployment Rate (May)	--	6.8%
Spain			
09:15	Markit Spain Manufacturing PMI (Jun)	55.6	55.4
Norway			
09:00	Manufacturing PMI (Jun)	54.5	54.3
Sweden			
08:30	Swedbank/Silf PMI Manufacturing (Jun)	60	58.8
Events			
10:30	Fed's Bullard Speaks at BoE Conference in London		

10-year	Close	-1d	2-year	td	-1d	Stocks	Close	-1d	
US	2.30	0.04	US	1.38	0.01	DOW	21349.63	62.60	
DE	0.47	0.01	DE	-0.57	-0.01	NASDAQ	6140.42	-3.93	
BE	0.80	0.02	BE	-0.47	0.00	NIKKEI	20055.8	22.37	
UK	1.26	0.01	UK	0.36	0.00	DAX	12325.12	-91.07	
JP	0.09	0.00	JP	-0.12	0.00	DJ euro-50	3441.88	-29.45	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	0.01	1.75	0.80	Eonia	-0.3500	0.0100	Libor-1	1.2239	-0.0033
5y	0.29	1.96	0.99	Euribor-1	-0.3730	0.0000	Libor-3	1.2992	0.0006
10y	0.91	2.28	1.35	Euribor-3	-0.3310	0.0000	Libor-6	1.4477	-0.0006
				Euribor-6	-0.2710	-0.0010			
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1.1426	-0.0014	EUR/JPY	128.4	0.06	CRB	174.78	2.89	
USD/JPY	112.39	0.21	EUR/GBP	0.8771	-0.0025	Gold	1242.30	-3.50	
GBP/USD	1.3025	0.0018	EUR/CHF	1.0950	0.0014	Brent	48.77	1.14	
AUD/USD	0.7689	0.0006	EUR/SEK	9.6322	-0.0565				
USD/CAD	1.2964	-0.0040	EUR/NOK	9.5372	-0.0568				

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