



## Sunrise

Thursday, 02 March 2017

### Rates: EMU CPI and Friday's Yellen speech negative for core bonds

Dovish Fed governor Brainard joined the recent Fed chorus, hinting at a near term rate hike. Ahead of Yellen's speech tomorrow evening, we expect US Treasuries to remain under downward pressure. The correction lower in the Bund can continue as well, especially if EMU CPI hits the psychological 2%-mark today.

### Currencies: USD extends gains on rate hike expectations, but no USD euphoria

Yesterday, USD investors adapted positions to rising chances of a March rate hike. The USD gains were substantial, but not excessive. Both EUR/USD and USD/JPY didn't break major technical levels. Today, some consolidation might be on the cards as there are no important data in the US. EUR/GBP is nearing a first technical 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 and global equities soared**, as data reinforced expectations that a Fed rate hike is imminent. Investors see that as a sign of strengthening economic growth. Asian stocks advance modestly despite a buoyant WS yesterday.
- **EU states could regain control over matters ranging from regional development to consumer protection**, Jean-Claude Juncker, has suggested, setting out ideas to shore up the bloc after Brexit.
- **Fed governor Brainard, a dove, said that the Fed should be prepared to increase its benchmark interest rate "soon"** as the job market pushes closer to full employment and inflation moves towards the central bank's target.
- The kiwi dollar pared some of its losses after **RBNZ Governor Wheeler** said risks to interest rate moves are equally balanced. NZD/USD trades now around 0.7132.
- **UK PM May suffered a defeat on her draft Brexit law** after the Lords rebuffed a government plea to leave it intact. It voted in favour of an amendment that protects the right of EU nationals to remain living in the UK after Brexit.
- **Brent oil dropped to \$56/barrel** from \$57/barrel after EIA data showed US crude stockpiles rose to a record. **Gold spot** (1246.90\$/ounce) recovered in US trading to snap two days of declines, but slid lower overnight on Fed Brainard.
- **Today, the market calendar slows down** with only EMU inflation as key economic release ECB Lautenschlaeger speaks after European closure, while France and Spain tap the markets.

# Rates

## Dudley's comments echo through markets; strong data

*US Treasuries lose more ground on perspective of higher rates, confirmed by strong data*

*US curve bear steepens sharply*

*German yields sharply higher*

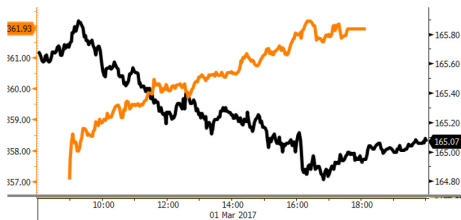
*Peripherals and semi-core outperform*

Global core bonds lost more ground yesterday with markets adapting further to NY Fed governors Dudley's comments just before the closing bell on WS Tuesday. The influential Fed governor paved the way for a March 15 rate hike. We expect vice-chair Fischer and chairwoman Yellen to seal the deal in public speeches on Friday. **The market implied probability of a 25 bps rate hike increased from less than 40% at the end of last week to 84% currently. Higher than expected German inflation (2.2% Y/Y), strong bourses** (sign that higher rates are appropriate), a stronger dollar and a catch-up move with Tuesday evening brought Bund losses in line with US Treasury losses. The **US PCE deflator** increased from 1.6% y/y to 1.9% y/y in January, just below 2% y/y consensus, but nearly hitting the Fed's inflation target. The **US manufacturing ISM** sky-rocketed to 57.7 (56), the highest since August 2014 with bright sub-indices, confirming the acceleration of growth and keeping US Treasuries at daily lows.

	US yield	-1d
2	1,29	0,00
5	1,99	0,03
10	2,46	0,05
30	3,07	0,06

	DE yield	-1d
2	-0,83	0,07
5	-0,50	0,07
10	0,28	0,07
30	1,08	0,09

**In a daily perspective**, the US yield curve shifted 2.4 bps (2-yr) to 6.5 bps (10-yr) higher. **From a technical point of view, the US 2-yr yield reached a minor new cycle high north of 1.3%, but couldn't sustain above and closed at 1.29%. The US 10-yr yield (now 2.45%) moves in a tearing rush from 2.3% support to 2.52/2.55% resistance. Contrary to yesterday, the US curve now bear steepened.** The German yield curve slightly bear steepened with yields 7.2 bps (2-yr) to 8.7 bps (30-yr) higher. The shorter end reacts on a further easing of political tensions and the unwinding of the long overdone rally. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany narrowed up to 5 bps for Spain, Belgium and France. French Republican president candidate Fillon vowed to stay in the race even now he's charged with misuse of public funds, which only raises the chances of the current centrist presidential candidate, Macron, the markets' favourite.



*Bund (black) & EuroStoxx (orange) (intraday): Risk-on as Trump speech and Fed likely rate move are considered growth friendly.*



*US 10-yr yield (long term). Yield test key support (neckline potential triple top), but rebounds on strong growth and expected rate hike(s)*

*Euro area inflation to reach 2%*

*EMU unemployment to stabilize at 9.6% cyclical low*

*Will ECB Lautenschlaeger keep talking hawkish, supported by rising inflation?*

## EMU inflation and Lautenschlaeger in focus today

The main economic release is the **EMU HICP inflation** for February. The market expects a 0.2%-point increase to 2% Y/Y for the headline figure and a 0.9% stabilization of the core. Given the recent increase in consensus estimate and taken into account other national inflation data, we side with expectations meaning that the 2% ECB target will be reached, a psychologically important event. Of course, core inflation will stick close to 0.9% Y/Y. **The headline inflation number, together with strong eco data, nevertheless increases chances that the ECB will prematurely dial back its asset purchases during H2 of 2017. Regarding central bankers, ECB Lautenschlaeger, a hawk, speaks after closure. She recently**

said "I am thus optimistic that we can soon turn to the question of an exit from quantitative easing" She is a loner inside the dovish Executive Committee.

### France and Spain tap market

R2	168,93	-1d
R1	166,84	
<b>BUND</b>	<b>164,96</b>	<b>-0,71</b>
S1	163,13	
S2	161,31	

**The French Treasury taps the on the run 10-yr OAT (0.25% Nov2026), 20-yr OAT (1.25% May2036) and 50-yr OAT (1.75% May2066) for a combined €6-7B.** ASW spreads of the bonds on offer narrowed in the run-up to the auctions and the bonds are slightly expensive on the French curve. They still trade with an "election discount" though. Nevertheless, we expect a decent auction given that calm returned to the French bond market as Macron became the clear frontrunner in the French presidential election race. **The Spanish debt agency taps the on the run 5-yr Bono (0.4% Apr2022) and 10-yr Obligacion (1.5% Apr2027) for €3-4B.** The bonds on offer traded stable in the run-up to the auction, but are also slightly expensive on the Spanish curve. We expect plain vanilla demand. Additionally, the Spanish debt agency raises €0.5-1B via inflation-linked bonds.

### No rebound for core bonds ahead of Yellen

**Overnight**, most Asian stock markets trade positive but sentiment is less ebullient than in Europe and the US yesterday. China underperforms (-0.5%). The US Note future remains near yesterday's lows as dovish and influential Washington-based Fed governor Brainard joined the chorus that a rate hike is imminent. We expect a neutral opening for the Bund.

**Today's eco calendar only contains EMU CPI, which is expected to hit the ECB's 2% inflation target and will generate a lot of media attention and might be negative for the Bund today. In light of this week's hawkish Fed comments and the surge of the market implied probability of a March Fed rate hike (from 50% to 84%), we don't expect US Treasuries to rebound ahead of speeches by Fed Fischer and Yellen (tomorrow) who will probably seal the deal ahead of the Fed's blackout period. Technically, the US 2-yr yield tests the cycle high (1.3%), while the 10-yr yield bounced off key support (2.3%), suggesting more upside.**

**The German 10-yr yield tested similar support around 0.17%/0.2%.** Recent developments in Greece and France improved sentiment on EMU bond markets. **Longer term, we hold our bearish view also for Bunds as we expect a new "calibration" of the ECB's QE programme in H2 2017.**



German Bund: Selling pressure via US Treasuries, strong bourses and rising inflation. 10yr yield bounced off key support



US Note future (June contract!!!): Rising probability March rate hike pulls US Treasuries lower

# Currencies

## Dollar propelled by March rate hike bets

*Dollar extends rebounds as USD embraces rate hike expectations*

On Wednesday, the rising probability of a March Fed rate hike propelled the dollar. The US currency (and equities) ignored that US president Trump failed to give details on his economic and fiscal plans. The US Manufacturing ISM was very strong, but at the time of the publication, the dollar had already reached the intraday highs. USD/JPY finished the session at 113.73 (from 112.77). The rise of the dollar against the euro was more modest. EUR/USD closed the day at 1.0547.

*USD holding near the recent highs as Fed's Brainard supports a rate hike 'soon'.*

**Overnight**, Fed's Brainard joined the chorus of Fed speakers advocating a rate hike "soon". The comments caused a limited further dollar uptick early in Asia. However, FX and interest rate markets have largely discounted a March rate hike. USD/JPY hovers sideways in the 114 area, near the recent highs. EUR/USD stabilizes in the 1.0535 area. Most Asian equities show modest gains (except for mainland China), that fall shy though with WS euphoria yesterday. The more modest risk sentiment might slow further USD gains.

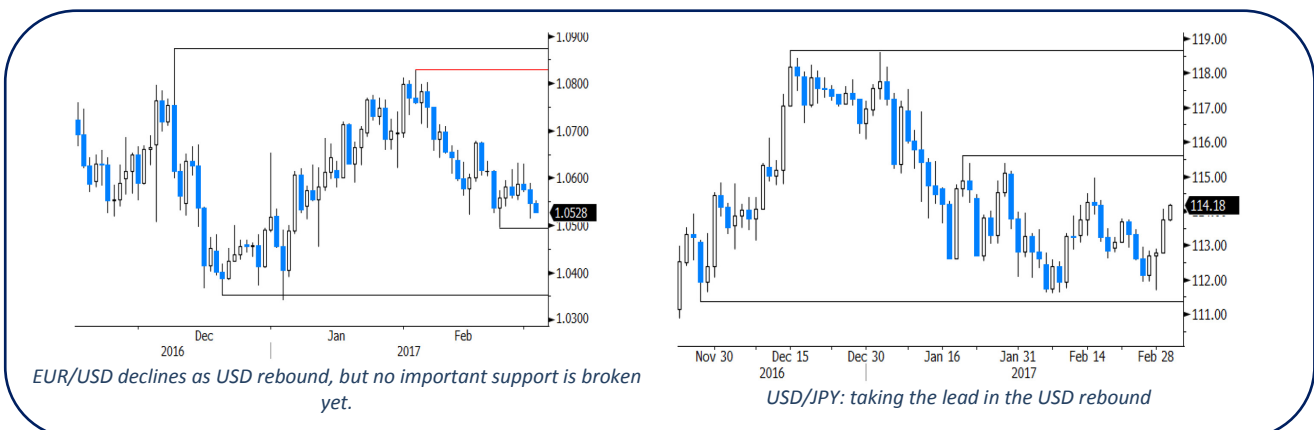
*EMU inflation reaching the 2% target unlikely to change EUR/USD picture*

**Today**, the market expects the February EMU HICP inflation to increase from 1.8% to 2.0% Y/Y. So, the ECB target might be reached. The core is expected stable at a rather low 0.9%. **The headline inflation number, together with strong eco data, increases chances that the ECB will prematurely dial back its asset purchases in H2 of 2017.** Regarding central bankers, ECB Lautenslaeger, a hawk, will speak after closure. Yesterday, USD investors adapted positions for a March Fed rate hike. The continuation of the risk rally was also slightly USD positive. The trade-weighted dollar gained about 1% since to the start of the rebound Tuesday. This is a good gain, but shows no USD euphoria. Especially the decline of EUR/USD was moderate. The market was probably still a bit 'euro short' due to recent uncertainty on France. **Today, we expect some consolidation on yesterday's rally.** (no important US data. 2% EMU inflation in theory could be slightly supportive for the euro). **At the same time, the dollar is well supported in a context of rising global yields.** Equities remain a wildcard. A correction could cause some modest USD profit taking, but for now there is no clear sign that the reflation trade might change course.

*US eco calendar is thin*

*Equities remain a wildcard*

R2	1,1145	-1d
R1	1,0874	
EUR/USD	1,0527	-0,0027
S1	1,0341	
S2	1,0000	



**Global context.** The dollar corrected lower since the start of January, but bottomed early February **supported by Trump’s tax promise. Underlying euro weakness due to political uncertainty** in the area was a factor too. Over the previous days the **focus shifted from US fiscal policy to the Fed talk, preparing markets for a rate hike in the near future. We assume EUR/USD 1.0874 to be a solid resistance and favour a sell EUR/USD on upticks approach. 1.0494 is first intermediate support ahead of the 1.0341 correction low. The downside test of USD/JPY is also rejected.** USD/JPY 111.60/111.16 (Range bottom/38% retracement of the 99.02/118.66 rally) remains key support. On the topside 114.96 is a first point of reference. So, USD sentiment is constructive, but for now both EUR/USD and USD/JPY haven’t broken any important technical level yet.

### EUR/GBP nearing first (minor) resistance

R2	0,8645	-1d
R1	0,8592	
EUR/GBP	0,8575	0,0042
S1	0,8304	
S2	0,8117	

**Yesterday,** the UK manufacturing PMI declined more than expected, but **Sterling hardly reacted. Even so, there were tentative signs of underlying sterling softness, as EUR/GBP lost hardly ground despite the EUR/USD decline.** Around noon, sterling selling intensified. Uncertainty on the outcome of the Brexit vote in the House of Lords added to sterling caution. Later in the session the Upper House indeed voted for a change in PM May’s Brexit law. The vote probably won’t change the government’s Brexit roadmap in a profound way. Even so, it illustrates that the Brexit process is facing plenty of hurdles. Sterling lost gradually further ground. EUR/GBP finished the day at 0.8579. Cable dropped below the 1.23 level, mostly on USD strength.

**Today, the UK construction PMI** is expected to decline slightly from 52.2 to 52.00. The report is not so important for markets, but a negative surprise, after yesterday’s miss in the manufacturing measure, might be slightly sterling negative. **There will also be headlines on the rejection of the Brexit Bill.** Sterling sentiment has softened a bit of late. It was/is difficult for cable to outperform EUR/USD as is often the case with USD strength. **Early last week,** the euro sell-off pushed EUR/GBP to the 0.84 area, but a sustained break lower didn’t occur. EUR/GBP is currently nearing a first resistance at 0.8592. A break would suggest a further loss of momentum of sterling. **Longer term, we have a sterling negative view, as the Brexit will negatively impact the UK economy.**



EUR/GBP: nearing a first resistance at 0.8592.



P/USD topside test rejected. USD strength prevails but some sterling softness is also at work.

# Calendar

Thursday, 2 March		Consensus	Previous
<b>US</b>			
14:30	<b>Initial Jobless Claims</b>	245K-	244k
14:30	Continuing Claims	2065K--	2060k
<b>Canada</b>			
14:30	Quarterly GDP Annualized (4Q)	2.0%	3.5%
<b>Japan</b>			
00:50	Monetary Base YoY (Feb)	A 21.4%--	22.6%
00:50	Loans & Discounts Corp YoY (Jan)	-A 2.73%-	2.81%
<b>UK</b>			
10:30	Markit/CIPS UK Construction PMI (Feb)	52.0	52.2
<b>EMU</b>			
11:00	<b>CPI Estimate YoY (Feb)</b>	<b>2%</b>	<b>1.8%</b>
11:00	<b>CPI Core YoY (Feb A)</b>	<b>0.9%</b>	<b>0.9%</b>
11:00	PPI MoM / YoY (Jan)	0.6%/3.2%	0.7%/1.6%
11:00	<b>Unemployment Rate (Jan)</b>	<b>9.6%</b>	<b>9.6%</b>
<b>Germany</b>			
08:00	Import Price Index MoM / YoY (Jan)	0.5%/5.5%	1.9%/3.5%
<b>Italy</b>			
10:00	Unemployment Rate (Jan P)	12%	12.0%
<b>Belgium</b>			
11:00	Unemployment Rate (Jan)	--	7.6%
<b>Spain</b>			
09:00	GDP QoQ / YoY (4Q F)	0.7%/3%	0.7%/3.0%
09:00	Unemployment rates ('000s) (Feb)	4.6-	57.3
<b>Norway</b>			
08:00	Retail Sales W/Auto Fuel MoM (Jan)	1.4%	-2.1%
<b>Events</b>			
00:00	<b>Fed's Brainard Speaks at Harvard</b>		
20:30	ECB Lautenschlaeger speaks in London		
10:30	Spain to Sell Bonds (0.4% Apr 2022 1.5% Apr2027 bond, 0.3% IL Nov 2021)		
11:50	France to Sell Bonds (0.25% 2026 OAT, 1.25% 2036 OAT & 1.75% 2066 OAT)		



10-year	td	-1d		2-year	td	-1d		Stocks	td	-1d
US	2,46	0,05		US	1,29	0,00		DOW	21115,55	303,31
DE	0,28	0,07		DE	-0,83	0,07		NASDAQ	5904,029	78,59
BE	0,74	0,03		BE	-0,53	0,03		NIKKEI	19564,8	171,26
UK	1,19	0,04		UK	0,11	0,01		DAX	12067,19	232,78
JP	0,07	0,00		JP	-0,26	-0,02		DJ euro-50	3390,2	70,59
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	td	-1d
3y	-0,08	1,84	0,65	Eonia	-0,3500	-0,0050				
5y	0,10	2,09	0,82	Euribor-1	-0,3720	-0,0010		Libor-1	0,7889	0,0044
10y	0,71	2,43	1,20	Euribor-3	-0,3290	0,0010		Libor-3	1,0640	0,0094
				Euribor-6	-0,2370	0,0020		Libor-6	1,3749	0,0136
Currencies	td	-1d		Currencies	td	-1d		Commodities	td	-1d
EUR/USD	1,0527	-0,0027		EUR/JPY	120,2	0,38		CRB	191,27	0,65
USD/JPY	114,18	0,65		EUR/GBP	0,8575	0,0042		Gold	1245,40	1,30
GBP/USD	1,2276	-0,0092		EUR/CHF	1,0644	-0,0001		Brent	56,15	-0,36
AUD/USD	0,7652	-0,0008		EUR/SEK	9,5404	-0,0230				
USD/CAD	1,3356	0,0041		EUR/NOK	8,8753	0,0088				

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