



Sunrise

Wednesday, 31 May 2017

Rates: Investors side-lined ahead of key US releases tomorrow and on Friday?

Today's market remains well-filled. We mainly focus EMU inflation. Risks, if any, are on the downside of consensus, but markets should be prepared after the slightly larger setbacks in German and Spanish inflation yesterday. We hold a rather neutral view with investors probably side-lined ahead of key US eco releases tomorrow and on Friday.

Currencies: Sterling remains in the defensive as election uncertainty mounts

The dollar and the euro are captured in some kind of balance of mutual softness. A soft EMU inflation figure might be slightly negative for the euro, but probably won't change the broader picture. Sterling might remain under pressure as opinion polls indicate that it isn't 100% sure that PM May's conservative party will secure a majority in the June election.

Calendar

Headlines

- **US stock markets ended up to 0.25% lower.** Main indices flat-lined after a softer opening. **Overnight**, most Asian bourses eke out small gains with Japan underperforming.
- **Federal Reserve Governor Brainard said soft inflation could cause her to reassess the path forward for monetary policy** should it linger, even as the global economic outlook brightens and US growth looks poised to rebound.
- **Growth in activity at China's manufacturers was unchanged in May**, with the official PMI remaining at the lowest level since September (51.2), but defying expectations of a drop. **The non-manufacturing PMI rose from 54 to 54.5.**
- **British PM May's Conservative Party risks falling short of winning an overall majority of seats in parliament** in a national election on June 8, The Times newspaper said, quoting research by **polling firm YouGov.**
- The **Reserve Bank of New Zealand** said risks at home and abroad to the country's financial system had receded in recent months, but it remained **wary of any rise in house prices or global protectionism.**
- **The Pentagon conducted a successful test of a system designed to shoot down an intercontinental ballistic missile**, US defence officials said, a demonstration that came amid rising tensions over North Korea's nuclear weapons program.
- **Today's eco calendar heats up** containing EMU CPI, EMU unemployment rate, Chicago PMI and US pending home sales. ECB governors Coeure, Visco, Lautenschlaeger and Fed Kaplan speak. The Fed releases its Beige Book.



Rates

US Treasuries outperform German Bunds

Global core bonds had an uneventful trading session yesterday, shrugging off a batch of eco data (mostly softer in EMU and in line with consensus in US). **US Treasuries nevertheless outperformed German Bunds.** The US outperformance was partly due to Monday's US close (Memorial Day). Comments by **Washington-based Fed governor Brainard** helped US Treasuries as well. She remains convinced that it will likely be appropriate soon to adjust the Federal funds rate and start shrinking the balance sheet, but if soft inflation data persist it could lead her to reassess the appropriate rate path further out. The subdued inflation marks a stark contrast with conditions on the US labour market. **At the end of the day**, the US yield curve dropped 1 bp (2-yr) to 3.7 bps (10-yr) lower. Changes on the German yield curve ranged between -0.6 bps (10-yr) and +1 bp (2-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany narrowed up to 2 bps with Portugal outperforming (-4 bps) and Greece underperforming (+8 bps).

EMU/US eco data ignored

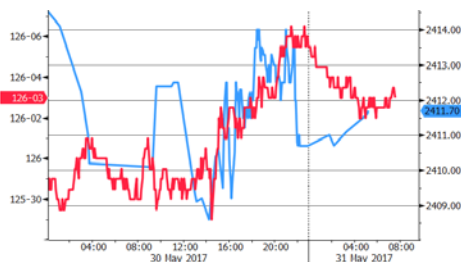
Fed Brainard warns on soft inflation



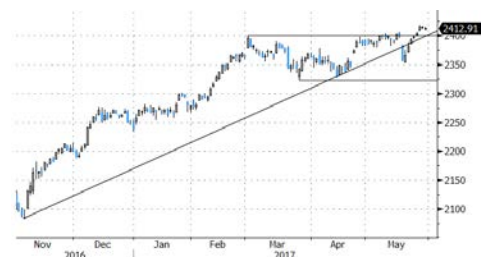
How big is the setback in EMU inflation?

Today's eco calendar remains well-filled. May EMU inflation is expected to soften from 1.9% Y/Y to 1.5% Y/Y for the headline reading and from 1.2% Y/Y to 1.0% Y/Y for the core measure. Spanish and German inflation recorded a slightly bigger than expected fall in CPI yesterday, suggesting that risks, if any, are tilted to the downside of expectations. **Market should be prepared though, indicating little impact on trading.** Slower inflation would warrant ECB President's Draghi's seemingly lack of urgency to start normalizing monetary policy. Rumours on Reuters suggested earlier week that the central bank would start with changing its forward guidance by dropping the easing bias. **The EMU unemployment rate is expected to continue its steady downward trend** with a decline from 9.5% to 9.4% in April, which would be the lowest level since March 2009. **US eco data include Chicago PMI and pending home sales.** The volatile Chicago PMI is forecast to marginally decline from 58.3 to 57 in May. Ahead of ADP employment, manufacturing ISM (tomorrow) and Payrolls (Friday) and given that a June Fed rate hike is completely discounted, we don't expect today's second tier US eco data to influence dealings.

ECB Coeure, Visco Lautenschlaeger and Fed Kaplan are today's scheduled central bank speakers. Topics of speeches by Visco and Lautenschlaeger suggest that they won't touch on monetary policy. ECB Coeure comments on Greece and could impact the Greek bond market ("Greece: a comeback to financial markets?"). Dallas Fed Kaplan spoke earlier this week in favour of two more rate hikes in 2017.



S&P future (blue) and T Note future (red) (intraday): US Treasuries gain marginally ground in US dealings



S&P 500 remains near all-time high



Inflation key, but investors won't lose their nerves

Overnight, Asian stock markets gain some ground with Japan underperforming. Chinese PMI's stabilized (manufacturing) and improved (non-manufacturing). The US Note future returns some of yesterday's limited gains, but **we expect a neutral opening for the Bund**.

Today's market calendar remains well-filled (see above). We mainly focus EMU inflation. Risks, if any, are on the downside of consensus. Investors' current framework ahead of key ECB (June 8) and Fed (June 14) policy meetings is one of subtle changes in EMU (embracing underlying growth momentum, dropping easing bias in forward guidance) and a new 25 bps rate hike in the US. Therefore markets will probably be most sensitive to hawkish surprises in EMU and dovish ones in the US. This week's backloaded eco calendar suggests that investors' won't rush into hurried conclusions though. **We have a neutral view for today**. Sentiment on EMU bond markets is a wildcard for trading. Italian early election jitters and Greek debt relief talk could spoil sentiment for BTP's and GGB's. Corrections on stock markets could support core bonds via safe haven flows.

Technically, we expect the Bund to stay in a range defined between 160 (recent sell-off low) and 162.15/49 (recent highs/gap) even if we tested the upside earlier this week in extremely low volume trading. **The US Note future remains near the contract high (126-13) which could be used to enter new short position, given that** we're on the brink of another Fed rate hike and the balance sheet tapering is nearing.



German Bund: Range-trading in 160-to-162.15/49 band preferred. First test upside in thin trading conditions



US Note future (September contract!!!): 126-10/13 resistance could be used to enter new short positions

Currencies

Initial selling pressure on the euro erased

Mediocre US data weighed on the US currency later in the session



Eco calendar is well filled, but impact on USD trading might be limited

Euro and dollar feel mutual softness

Different themes guided trading in the major FX cross rate yesterday. Euro weakness prevailed early in the session as markets pondered whether EMU political risk (Italy/Greece) would again become an issue for trading. However, the euro found its composure even as EMU data were slightly softer than expected. US data were also mixed to slightly softer than expected, putting the dollar again in the defensive later in US dealings. EUR/USD closed the session at 1.1186. USD/JPY even finished the day below the 111 mark (110.85).

Overnight, Asian markets show again a diffuse picture. Chinese equities opened strong as investors return after holidays. Early gains were supported by better than expected China PMI's, but the gains are evaporating. Japan underperforms. USD/JPY is holds in the 111 area. End of month USD buying from US importers is said to prevent a further decline, for now. EUR/USD drifts south in tight 1.1190/65 range.

The eco calendar is again well filled today. The EMU headline CPI is expected to decline from 1.9% Y/Y to 1.5% Y/Y in May. The core measure is expected to soften to 1.0%. The EMU unemployment rate is expected to decline further from 9.5% to 9.4. In the US, the volatile Chicago PMI (expected 57.0 from 58.3) and the pending home sales will be published.

Over the previous days, the dollar and the euro were captured by a balance of mutual weakens. US eco data couldn't convince. Fed speakers confirmed the case for a June rate hike, but further rate hikes might be delayed if inflation eases further. On the EMU side of the story, the ECB also maintains a soft tone. The ECB's case is supported by soft EMU inflation data. EMU political event risk lingers in the background. **We don't expect today's data to be a game-changer for EUR/USD trading. If anything, a below consensus EMU CPI might be slightly negative for the euro.** For now, corrections on the equity markets remain modest, but if sentiment turns risk-off, we think that it will also be a slightly euro negative (via EUR/JPY). **In a daily perspective, we assume that the 1.1205/1.1268 area will be tough resistance for the euro.**



EUR/USD: markets await key US eco data later this week



USD/JPY: downside pressure persists. Test of the 110.24 correction low might be on the cards

Of late, the dollar traded soft. US data were a bit disappointing, markets turned more cautious on Trump's pro-growth agenda and US yields declined, keeping the dollar in the defensive. At the same time, the euro profited of reduced political risk on the region.

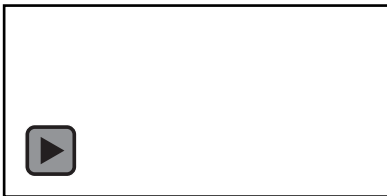
Last week, there were tentative signs that the dollar decline could slow. Is enough USD softness discounted? This week's payrolls and manufacturing ISM might be important in this assessment. At the same time the euro positive momentum is also fading.

Technical picture

The USD/JPY rebound ran into resistance early May. A mini-sell-off pushed the pair back below the 112.20 previous top and made the short-term picture negative. Return action lower in the 108.13/114.37 range is possible.

Earlier this month, it looked that EUR/USD could revisit 1.0821/1.0778 support (gap). However, poor US data and political upheaval finally propelled EUR/USD north of the 1.1023 range top. The pair reached a short-term correction top at 1.1268. The correction top at 1.1300/1.1366 is next resistance. USD sentiment will have to be extremely negative to clear this hurdle short-term. Further ST EUR/USD gains might become tough. A return below 1.1023 would indicate that the upside momentum has eased.

Growing uncertainty on a May victory weighs on sterling

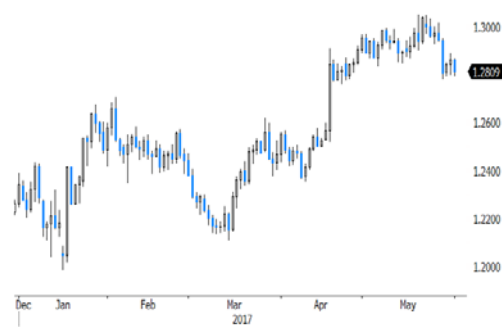


Sterling selling eased (temporary) yesterday morning, digesting recent substantial losses after opinion polls indicated that that the lead of the conservative party in parliamentary election could be much smaller than assumed of late. EUR/GBP dropped to the 0.8655 area. Cable touched an intraday top in the 1.2885/90 area. However, sterling momentum dwindled again during the US trading session as political uncertainty lingered. There were no important eco data in the UK yesterday. EUR/GBP closed the session at 0.8699. Cable finished the day at 1.2859.

Overnight, a YouGov poll suggested that the conservative party is at risk to lose its majority in Parliament. Cable dropped to the 1.28 area. EUR/GBP rebounded well north of 0.87. GfK consumer confidence unexpectedly improved from -7 to -5, but this hardly helped sterling. Later today, the UK money Supply and lending data will be published, but they will be of second tier importance for sterling trading. The focus will remain on politics. The YouGov poll has a big margin of error, but won't go unnoticed on European/UK markets this morning. Yesterday, it looked that the EUR/GBP rally was ripe for a pause as selling pressure on sterling eased and as the euro was in the defensive. One day later, fortunes have changed again. A retest of the 0.8750 correction top might be on the cards, especially if uncertainty on the outcome of the June 8 election grows further. There is no reason to row against the sterling negative tide. Next resistance comes is 0.8788.



EUR/GBP nears recent highs as election uncertainty grows



GBP/USD: sterling extends decline off 1.30 area as political uncertainty weighs.

Calendar

Wednesday, 31 May		Consensus	Previous
US			
15:45	Chicago Purchasing Manager (May)	57.0	58.3
16:00	Pending Home Sales MoM / NSA YoY (Apr)	0.4%/--	-0.8%/0.5%
Canada			
14:30	Quarterly GDP Annualized (1Q)	4.2%	2.6%
Japan			
01:50	Industrial Production MoM / YoY (Apr P)	A: 4%/5.7%	-1.9%/3.5%
06:00	Vehicle Production YoY (Apr)	A: 16.3%	4.5%
07:00	Housing Starts YoY (Apr)	A: 1.9%	0.2%
07:00	Construction Orders YoY (Apr)	A: -0.2%	1.1%
07:00	Small Business Confidence (May)	A: 48.9	48.6
China			
03:00	Manufacturing PMI (May)	A: 51.2	51.2
03:00	Non-manufacturing PMI (May)	A: 54.5	54.0
UK			
01:01	GfK Consumer Confidence (May)	A: -5	-7
01:01	Lloyds Business Barometer (May)	A: 27	47
01:01	BRC Shop Price Index YoY (May)	A: -0.4%	-0.5%
10:30	Net Consumer Credit (Apr)	1.5b	1.6b
10:30	Mortgage Approvals (Apr)	66.0k	66.8k
10:30	Money Supply M4 MoM / YoY (Apr)	--/--	0.3%/6.6%
EMU			
11:00	Unemployment Rate (Apr)	9.4%	9.5%
11:00	CPI Estimate YoY (May)	1.5%	1.9%
11:00	CPI Core YoY (May A)	1.0%	1.2%
Germany			
08:00	Retail Sales MoM / YoY (Apr)	0.3%/2.2%	0.1%/2.3%
09:55	Unemployment Change (000's) (May)	-15k	-15k
09:55	Unemployment Claims Rate SA (May)	5.7%	5.8%
France			
08:45	CPI EU Harmonized MoM / YoY (May P)	0.1%/1.1%	0.1%/1.4%
Italy			
10:00	Unemployment Rate (Apr P)	11.6%	11.7%
11:00	CPI EU Harmonized MoM / YoY (May P)	-0.2%/1.6%	0.8%/2.0%
Belgium			
11:00	Unemployment Rate (Apr)	--	6.9%
15:00	GDP SA QoQ / YoY (1Q F)	--/--	0.5%/1.5%
Events			
09:20	ECB's Coeure Speaks in Frankfurt		
10:30	Governor Visco Speaks at Bank of Italy Holds Annual Meeting		
14:00	Fed's Kaplan Speaks in New York		
14:30	ECB's Lautenschlaeger Speaks in Berlin		
20:00	U.S. Federal Reserve Releases Beige Book		

10-year	<u>td</u>	<u>-1d</u>		2-year	<u>td</u>	<u>-1d</u>		Stocks	<u>td</u>	<u>-1d</u>
US	2,22	-0,02		US	1,29	0,00		DOW	21029,47	-50,81
DE	0,29	-0,01		DE	-0,71	0,01		NASDAQ	6203,189	-7,01
BE	0,65	-0,02		BE	-0,56	0,02		NIKKEI	19650,57	-27,28
UK	0,99	-0,02		UK	0,08	-0,01		DAX	12598,68	-30,27
JP	0,05	0,01		JP	-0,15	0,02		DJ euro-50	3561,22	-17,73
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>		USD	<u>td</u>	<u>-1d</u>
3y	-0,07	1,65	0,58	Eonia	-0,3610	0,0000		Libor-1	1,0447	0,0000
5y	0,16	1,85	0,74	Euribor-1	-0,3730	-0,0010		Libor-3	1,2018	0,0000
10y	0,77	2,16	1,09	Euribor-3	-0,3290	0,0000		Libor-6	1,4138	0,0000
				Euribor-6	-0,2540	0,0000				
Currencies	<u>td</u>	<u>-1d</u>		Currencies	<u>td</u>	<u>-1d</u>		Commodities	<u>td</u>	<u>-1d</u>
EUR/USD	1,1166	0,0052		EUR/JPY	123,93	0,61		CRB	181,33	-0,68
USD/JPY	110,99	0,03		EUR/GBP	0,8722	0,0049		Gold	1263,50	-6,50
GBP/USD	1,2803	-0,0012		EUR/CHF	1,0897	0,0004		Brent	51,52	-0,67
AUD/USD	0,7451	0,0008		EUR/SEK	9,7622	0,0433				
USD/CAD	1,3453	-0,0021		EUR/NOK	9,4418	0,0463				

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