

Monday, 17 June 2019

Rates: Inflation expectations are drifting away

Market based inflation expectations (5y5y forward) slid another 5 bps, with the EMU gauge at an all-time low and the US one below 2% for the first time since 2016. Core bond trading could be somewhat subdued this week ahead a dovish expected FOMC meeting on Wednesday.

Currencies: EUR/USD pushed back in lower in the 1.1350/1.11 trading range

EUR/USD declined both on solid US retail sales last Friday, but also on markets speculation of further ECB easing. EUR/USD traders will continue to monitor this balance this week with the Sintra ECB forum and the Fed policy decision potentially bringing more clarity on the relative policy stance between the ECB and the Fed.

Calendar

Headlines

- Friday's intraday rebound in **US stock markets** snapped last minute, leaving the major indices in red. The Nasdaq underperformed (-0.52%). **Asian markets** are trading mixed with Hong Kong (+0.7%) outperforming.
- The Hong Kong government threw in the towel and suspended the controversial extradition bill.** An estimated 2m protesters took the streets again on Sunday however, demanding the bill's full withdrawal.
- Dominic Raab, a Conservative candidate, said **Parliament could be suspended in order to stop the House of Commons delaying Brexit again** if no deal has been struck in time (i.e. Oct. 31).
- Moody's cut Turkey's credit rating further into junk territory** (B1 from Ba3), citing risks of a balance of payment crisis and a government default. The rating agency added a negative outlook. The Turkish lira slid to EUR/TRY 6.65.
- The US Chamber of Commerce calls on Trump to reverse tariffs** imposed over the past years and urge the administration to reopen negotiations. According to the business group the levies can cost the US \$1tn over the next 10 years.
- Saudi Arabia said **OPEC+ will probably meet in the first week of July** and added that the **goal is to extend the production curbs** and balance the market before 2020. It expects a pick up of demand in the second half this year.
- Today's economic calendar** contains the US Empire Manufacturing index (June). ECB president Draghi kicks off the three-day ECB forum in Sintra (Portugal). Belgium taps the bond 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

Market based inflation expectations drifting away

	US yield	-1d
2	1.84	0.00
5	1.86	-0.01
10	2.08	0.02
30	2.60	-0.01

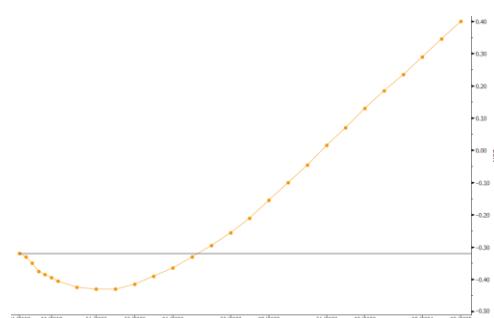
Core bonds lost part of Friday's gains following good (retail sales) to decent (production) US eco data. German Bunds outperformed US Treasuries. Market-based inflation expectations (5y5y forward inflation swap) fell another 5 bps to a record low for EMU (1.13%) and below 2% for the US (first time since 2016). German yields fell 1.1 bp (5-yr) to 3.4 bps (30-yr). The German 10-yr yield set a new all-time low at -0.27%. Changes on the US yield curve varied between +0.5 bps (2-yr) and -1.5 bps (30-yr). 10-yr yield spread changes vs Germany ranged between -3 bps (Spain) and +2 bps (Greece).

	DE yield	-1d
2	-0.69	-0.02
5	-0.60	-0.01
10	-0.26	0.00
30	0.32	-0.03

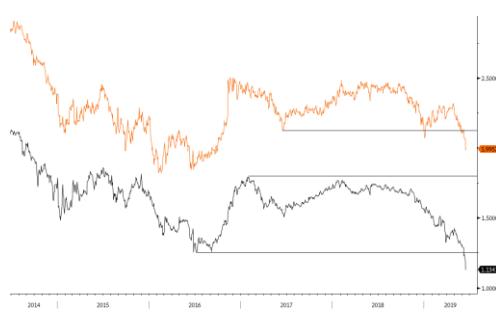
Asian stock markets are mixed this morning. Core bonds cede some additional ground. Several ECB hotshots stroke a soft tone. ECB Coeure warned about bleak market indications about the global economic health and reiterated Draghi's readiness to act if downside risks materialize. He specifically mentioned the option of cutting rates further in which case they would have to consider the impact on the financial sector. **The Euribor 3-month forward curve sits below -0.4% in 2020, discounting a 10 bps deposit rate cut.** ECB VP de Guindos said that the central bank would add stimulus in case inflation expectations become de-anchored. Currently that's not (yet?) the case, he argues, referring to the discrepancy between market measures and eg survey based expectations.

Core bond trading could start subdued this week in the run-up to Wednesday's Fed meeting. Today's eco calendar contains US Empire manufacturing business sentiment. Consensus expects a reversal of the May jump (11 from 17.8). **The Belgian debt agency taps 4 OLO's (0.5% Oct2024, 0.9% Jun2029, 1.9% Jun2038 & 2.15% Jun2066) for a combined €2.7-3.2bn.** Currently, the debt agency already completed 65% of this year's stated €28bn OLO funding need. **We don't expect difficulties after the ECB's soft outlook probably floored bond prices. ECB President Draghi gives opening remarks at the central bank's Sintra conference. His speech is a wildcard.**

The European central bank missed out on the previous cycle regarding monetary normalization. The onus is back on potential easing measuring including revamping asset purchases or cutting rates. The German 10-yr yield reached a new all-time low. **The Fed is aware of downside eco risks and seems to be ready to cut policy rates as an insurance to keep the economic expansion going.** We eye a first rate cut in September, followed by another one in December. The US 10-yr yield tested 2.06%. A break didn't occur. **There's probably little room for rebound ahead of the FOMC meeting. The end of June G-20 Summit** is this month's other high profile event.



Euribor 3month forward strip curve discounts 10 bp ECB deposit rate cut



Market based inflation expectations sliding away in EMU (black) and the US (orange)

Currencies

EUR/USD turning back south in 1.11/1.1350 range

R2	1.1533	-1d
R1	1.1448	
EUR/USD	1.1208	-0.0068
S1	1.1110	
S2	1.0864	

The dollar rebounded further on Friday as solid US data (including better than expected April/May US retail sales), made investors realize that already quite some dovishness is discounted ahead of Wednesday's Fed meeting. The rise in US yields was modest, but the dollar regained substantial further ground. At the same time, investors were **pondering the chances of further ECB easing if needed**. EUR/USD made a further step south closed at 1.1208 (from 1.1276). USD/JPY finished at 108.56.

This morning, most Asian equity markets are trading mixed, with Hong Kong outperforming. The dollar shows no clear trend. EUR/USD regains a few ticks (1.1215/20 area). USD/JPY is holding strong (108.60 area). The yuan (USD/CNY 6.9240) is holding near lows against the dollar. The Aussie dollar still struggles not to fall below the 0.6865 support area.

Today the focus will be on the US data. **The Empire manufacturing survey is expected to ease to 11 from 17.8** after a strong rebound last month. **The NAHB housing index** is expected to rise from 66 to 67. Today's data probably won't change the US eco picture in a profound way anymore ahead of the Fed meeting. This evening, ECB's Draghi will give an introduction at the Sintra ECB forum. Geopolitics including the US-China trade dispute remain a wild card, but apparently there is a period of temporary calm as parties involved are considering strategy options in the run-up to the G20 meeting.

Friday's EUR/USD correction marked the end of recent upside test, putting the pair back the 1.11/1.1350 ST range. Dollar bears first want clarity on how far the Fed has moved toward starting an easing cycle. At the same time, soft ECB talk continues to weigh on the euro, too. We assume order-driven technical trade in EUR/USD ahead of Wednesday's Fed meeting. EUR/USD is testing the 1.1200 intermediate support. A break below, might at least be as much a sign of deteriorating sentiment on the euro, more than outright USD strength. EUR/GBP hovered near the 0.89 level last Friday as investors awaited the next steps in the race for the leadership of the conservative party. At the TV-debate this weekend, contenders for the Conservative party leadership even discussed the option of limiting the room of manoeuvre of Parliament blocking a no-deal Brexit. **The debate suggest that uncertainty will persist, even after a new PM is put in place.** Of late, the decline of sterling slowed, but the rising chance of no-deal Brexit, probably prevents a sustained rebound short-term.

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8904	0.0006
S1	0.8500	
S2	0.8314	



EUR/USD pushed back lower in the 1.11/1.1350 range as markets ponder relative positioning between Fed and ECB

EUR/GBP: sterling decline slowed. Has EUR/GBP found a new ST equilibrium near 0.89?

Calendar

Monday, 17 June			Consensus	Previous
US				
14:30	Empire Manufacturing (Jun)		11.0	17.8
16:00	NAHB Housing Market Index (Jun)		67	66
22:00	Net Long-term TIC Flows (Apr)		--	-\$28.4b
22:00	Total Net TIC Flows (Apr)		--	-\$8.1b
Japan				
06:00	Tokyo Condominium Sales YoY (May)		-10.40%	-39.30%
UK				
01:01	Rightmove House Prices MoM/YoY (Jun)		0.30%A/0.00%A	0.90%/0.10%
EMU				
11:00	Labour Costs YoY (1Q)		--	2.30%
Events				
11:30	Belgium to Sell Bonds			
19:00	Draghi Gives Opening Remarks at ECB Forum in Sintra, Portugal			

	<u>Close</u>	<u>-1d</u>		<u>2-year</u>	<u>Close</u>	<u>-1d</u>		Stocks	<u>Close</u>	<u>-1d</u>
US	2.08	0.02		US	1.84	0.00		DOW	26089.61	-17.16
DE	-0.26	0.00		DE	-0.69	-0.02		NASDAQ	7796.659	-40.47
BE	0.16	0.00		BE	-0.60	-0.02		NIKKEI	21124	7.11
UK	0.85	0.00		UK	0.61	0.02		DAX	12096.4	-72.65
JP	-0.13	0.00		JP	-0.20	0.00		DJ euro-50	3379.19	-11.31
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>		USD	<u>-1d</u>	<u>-2d</u>
3y	-0.30	1.79	0.87	Eonia	-0.3680	-0.0070				
5y	-0.17	1.81	0.91	Euribor-1	-0.3780	-0.0020		Libor-1	2.3818	-0.0125
10y	0.25	2.01	1.05	Euribor-3	-0.3180	0.0000		Libor-3	2.4020	-0.0082
				Euribor-6	-0.2610	-0.0020		Libor-6	2.2774	-0.0410
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>		Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1.1208	-0.0068		EUR/JPY	121.69	-0.53		CRB	174.81	0.38
USD/JPY	108.56	0.18		EUR/GBP	0.8904	0.0006		Gold	1344.50	0.80
GBP/USD	1.2589	-0.0085		EUR/CHF	1.1196	-0.0011		Brent	62.01	0.70
AUD/USD	0.6872	-0.0043		EUR/SEK	10.6364	-0.0571				
USD/CAD	1.3414	0.0087		EUR/NOK	9.7706	-0.0178				

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