



Sunrise

Thursday, 18 May 2017

Rates: Risk sentiment remains key, positive for core bonds?

Risk sentiment will be key for trading with markets watching the latest developments in the Trump affaire. The US stock market correction probably has further to go. Risk aversion could support core bonds short term. The US Note future broke above 125-26+ resistance, suggesting return action to the contract high (126-20). 2.16% is key support for the 10-yr yield.

Currencies: USD Trump sell-off to slow?

Yesterday, the dollar was hit hard as the sell-off of risky assets weighed. Today, sentiment on risk remains the key driver for USD trading. If the equity sell-off slows, the dollar might enter calmer waters, at least temporary. Sterling traders will keep a close eye at the UK retail sales. Euro strength propelled EUR/GBP to the 0.86 big figure.

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 suffered their worst day in 8 months (-2%)** after political turmoil shook investors, with some fearing President Trump's ability to push through his pro-growth policies has been side-lined by the deepening political controversy. Losses in Asia are more contained overnight with Japan underperforming.
- Former FBI Director Robert Mueller III was appointed as **special counsel to oversee the federal investigation into Russia's alleged interference in the 2016 US presidential election.**
- **Japan has recorded its longest run of sustained economic growth since 2006** in a sign of its robust progress under Abenomics. Growth for Q1 2017 came in at an **annualised 2.2%**, marking 5 quarters of continuous output growth.
- **Growth in China's new home prices** slowed further in April when compared to a year prior, particularly among top-tier cities, but data also show price rises ramped up in month-on-month terms to the fastest pace since October.
- A Harris Interactive poll found **Macron's Republic on the Move party, together with allies, is set to win the largest share of the vote in the first round.** 32% of 4,600 registered voters questioned planned to vote for Macron's party, it said.
- **Australia's jobless rate fell to its lowest in four months in April, but the number of people with full-time work declined** - a mixed report that augurs poorly for a much-needed revival in wage growth and inflation.
- **Today's eco calendar** contains UK retail sales, US jobless claims and Philly Fed Business Outlook. ECB Draghi, Weidmann, Mersch, Lautenschlager, Nowotny and Fed Mester are scheduled to speak. Spain and France tap the market.

Rates

US political risk triggers flight to quality

US assets got whacked yesterday. Global core bonds profited fully from safe haven flows, as did gold, the yen and to a lesser extent the Swiss franc. Equities and other riskier assets hit the skids and registered heavy losses. US political risk took the upper hand amid empty eco calendars in EMU and the US. Media reported that President Trump asked former FBI-director Comey to back off the investigation into former National Security Adviser Flynn after the latter resigned. Late yesterday, a special prosecutor was appointed to run the FBI probe into Russian meddling in the US elections. A trip down memory lane with Nixon's resignation after Watergate and the failed impeachment procedure against Clinton. In both cases, a special prosecutor was assigned who played an important role in the process. It shouldn't go by definition the same way in Trump's case, but **Democrat/Republican resistance against Trump might increase further, possibly compromising his ambitious reform agenda.**

In a daily perspective, the US yield curve fell 5.2 bps (2-yr) to 10.1 bps (5-yr) lower. The German yield curve bull flattened with yields 2.6 bps (2-yr) to 5.8 bps (30-yr) lower. On intra-EMU bond markets, 10-yr yield spread changes versus Germany were nearly unchanged with Portugal and Italy outperforming (-3 bps) and Greece underperforming (+5 bps)..

Empty calendar, traders to eye ECB speakers tomorrow

US Initial claims are expected slightly higher, but we are more interesting in the **Philly Fed business outlook** for May. Consensus expects a slight decline of the headline index to 18.5 from 22 in April, which would be the third monthly decline, albeit after an unsustainable spike to an all-time record in February (43.8). If confirmed, it would leave the index still well above the 30-yr average (7). However, as earlier reported, the NY manufacturing confidence dropped in May unexpectedly below zero. **A bigger decline of the Philly Fed (than expected) would increase fears that the US economic growth may be worse than generally expected.** A negative surprise might have more impact than a positive one. In EMU, the **Minutes of the April ECB meeting will be published and 4 ECB governors speak**, including president Draghi, executive board members Lautenschlaeger, Mersch and Weidmann. Together with Praet and Constancio (tomorrow), they are the last ones scheduled before the next ECB meeting. **We suggested they might use the occasion to massage the markets in a certain direction ahead of the key June ECB meeting.** However, we are less sure now after yesterday's market turmoil and given the subjects of their speeches. Nevertheless, vigilance remains required. **Fed Mester, a hawk** who projected 4 rate hikes for 2017, speaks as well.

German curve flattens

US yields sharply lower

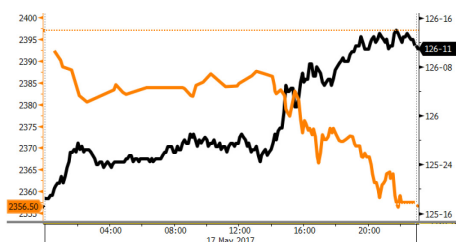
Peripheral spreads calm

| | US yield | -1d |
|----|----------|-------|
| 2 | 1,27 | -0,01 |
| 5 | 1,77 | -0,04 |
| 10 | 2,24 | -0,05 |
| 30 | 2,92 | -0,04 |

| | DE yield | -1d |
|----|----------|-------|
| 2 | -0,70 | -0,04 |
| 5 | -0,35 | -0,04 |
| 10 | 0,37 | -0,04 |
| 30 | 1,20 | -0,05 |

Philly Fed survey only key release

Many ECB speakers, but will they massage markets ahead of meeting?



T-Note future (black) and S&P future (orange) intraday: While risk off sentiment was still weak in Asia and Europe, it snowballed in the US leading to a major equity correction.



S&P: Sharp correction, but technical picture not yet fatally damaged. The March low at 2322 is the line in the sand as a break would mean the sideways range is broken. Yesterday's downday filled two gaps and fell below 50 d average. Sell-on-upticks?

| | | |
|-------------|--------|------|
| R2 | 163,99 | -1d |
| R1 | 162,49 | |
| BUND | 161,24 | 0,56 |
| S1 | 158,73 | |
| S2 | 158,28 | |

Spain and France tap market

The French treasury sells the on the run 3-yr OAT (0% Feb2020) and 5-yr OAT (0% May2022) for a combined €6.5-7.5B. The bonds on offer cheapened slightly in ASW spread terms going into the auction and sit rather cheap on the French curve. We expect good demand. Additionally, the French Treasury will try to raise €1.5-2B via inflation-linked bonds. **The Spanish debt agency taps the on the run 3-yr Bono (1.15% Jul2020), on the run 10-yr Obligacion (1.5% Apr2027) and two off the run Obligacions (4.8% Jan2024 & 5.9% Jul2026) for a total amount of €4-5B.** The Jul2020 and Apr2027 bonds are somewhat expensive on the Spanish curve, while the Jul2026 bonds is attractive. We expect plain vanilla demand.

Risk sentiment remains key; positive for core bonds?

Overnight, trading calmed after yesterday's slaughter on US equity markets (-2%). Main Asian indices lose around 0.5% with Japan underperforming (-1.5%) on the back of yen strength. The US Note future trades with a small downward bias, while gold prices level near yesterday evening's highs. We expect a neutral opening for the Bund, but don't take the market calm for granted.

Today's eco calendar contains only US weekly jobless claims and Philly Fed Business Outlook which probably won't impact trading. ECB speakers are wildcards, but topics of most of their speeches suggests that they won't touch upon monetary policy. Nevertheless, we look for clues going into a potentially key June meeting.

Risk sentiment will be key for trading with markets watching the latest developments in the Trump affaire. The US stock market correction probably has further to go. **Risk aversion could support core bonds short term, in absence of other trading factors. The US Note future broke above 125-26+ resistance, suggesting return action to the contract high (126-20). In yield terms, 2.16% is key support for the 10-yr yield. Given that** we're on the brink of another Fed rate hike (June 14), such rally of bonds **could be interesting to set up new short positions.**



German Bund: Waiting new impetus ahead of ECB meeting



US Note future: Trump affaire gets grip on trading, lifting US Treasuries short term

Currencies

Dollar suffered as Trump risk-off trade intensified.

| | | |
|---------|--------|--------|
| R2 | 1,13 | -1d |
| R1 | 1,1172 | |
| EUR/USD | 1,1141 | 0,0036 |
| S1 | 1,0778 | |
| S2 | 1,0341 | |

Dollar touch minor new correction lows overnight.

The intensity of the Trump sell-off eases, at least for now.

Eco calendar remains thin

ECB speakers are a wildcard.

Will the Trump-sell-off slow down?

Turmp-driven USD decline to slow?

On Wednesday, the dollar sold off after articles, based on internal FBI memo of former director Comey, accused Donald Trump to influence and possible obstruct an FBI investigation against his former security adviser. The dollar initially still held near Asian lows, but the sell-off accelerated during the US session with US equities falling off a cliff. USD/JPY lost more than two big figures to close the session at 110.83. The decline of the dollar against the euro was more modest as EUR/JPY selling weighed. Still EUR/USD set a new recovery top and closed session at 1.1159.

Overnight, Asian equity losses are more modest than in the US. Japanese indices are losing about 1.5% as yen strength bites. USD/JPY touched a correction low near 110.55 and trades currently in the 111.20 area. It looks that the acute sell-off phase is easing. Japanese Q1 growth was marginally strong than expected (2.2% Q/Qa), but had limited impact on yen trading. EUR/USD shows a similar picture. The pair touched a minor top around 1.1172 and trades in the 1.1150 area. The Australian April labour market report was better than expected. **The Aussie dollar rebounds further off the recent lows. AUD/USD trades around 0.7460**

Today, the eco calendar only contains the US initial jobless claims and the May Philly Fed business outlook. For the Philly Fed, a slight decline to 18.5 from 22 is expected. A negative surprise might have more impact than a positive one, as it might raise further doubts on the strength of the US economy. Various ECB members will speak including Draghi. However, it is not clear whether they will elaborate on market sensitive issues. The risk-off sentiment might make them reluctant to address the issue of policy normalization. So, global risk sentiment will dominate USD trading.

We think that US equities entered a short-term sell-on-upticks environment and that US (10-year) yields might revisit the recent lows. **This scenario suggests that the dollar might remain in the defensive. That said, we consider yesterday's USD correction as aggressive.** So, if the equity and core yields decline slows, the dollar decline might do so too. Yesterday's price action indicates that the outright risk-off is extremely negative for USD/JPY. The impact on EUR/USD is more modest. Even more, a protracted risk-off correction might raise questions on the ECB's intention to start policy normalization in the near future. **So, the upside of EUR/USD might become more difficult, even if sentiment on risk remains negative due to US political uncertainty.**



EUR/USD: euro breaks topside of the ST range as US political uncertainty weighs on the dollar



USD/JPY: hammered as Trump-risk-off trade intensifies

Technical picture.

The USD/JPY rebound ran into resistance last week. Till Tuesday, it was no more than a correction, but yesterday's sell-off and the re-break below the previous top at 112.20 aborted the uptrend and made the short-term picture negative. Return action lower in the 108.13/114.37 range is likely.

Last week, it looked that EUR/USD could revisit the 1.0821/1.0778 support (gap). However, Friday's US data and political uncertainty finally propelled EUR/USD north the 1.1023 range top, improving the technical picture. **The correction top at 1.1366 is the next resistance. We think that USD sentiment will have to be extremely negative to clear this hurdle short-term. Further ST EUR/USD gains might become tougher.**

| | | |
|---------|--------|--------|
| R2 | 0,8881 | -1d |
| R1 | 0,8854 | |
| EUR/GBP | 0,8600 | 0,0014 |
| S1 | 0,8314 | |
| S2 | 0,8304 | |

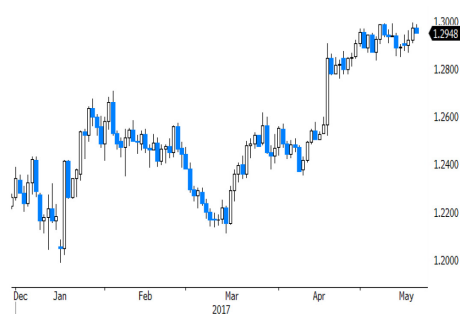
EUR/GBP tests 0.86 big figure

The **April UK labour market report was solid, but wage growth was again the missing link.** Real wage growth even became negative due to rising inflation. **Sterling's reaction was limited. Chance are low that the BoE will raise its policy rate any time soon as long as low wage growth is at risk to further slow UK spending/growth.** EUR/GBP touched an intraday top of 0.8615 early in Europe and settled in the upper half of the 0.85 big figure for most of the day, supported by the ongoing bid in EUR/USD. The pair close the session at 0.8604. USD weakness kept cable near the recent top, but a real test of 1.30 didn't occur.

Today, the April UK retail sales will be published. Sales are expected to rebound (1.1% M/M and 2.1% Q/Q) after a sharp decline in March. Technical factors might have been in play. The odds are for a good report, but for sterling there is still an asymmetrical risk. After recent indications that higher prices are weighing on spending, a negative figure will probably have more impact than a positive surprise. The price action in the euro and the dollar will also remain important. **Of late, the positive sterling sentiment eased and euro strength prevailed in EUR/GBP trading.** The pair developed a bottoming out pattern with 0.84/0.8330 as a solid bottom. The breach of 0.8509/31 (previous ST tops) improved the technical picture. For now, we don't row against the EUR/GBP uptrend **even as the euro rebound might slow short-term.** Longer term, Brexit remains potentially negative for sterling.



EUR/GBP: jumps north of ST range top



GBP/USD is holding a tight range just below 1.30. Sterling fails to profit from USD softness

Calendar

| Thursday, 18 May | | Consensus | Previous |
|------------------|---|------------------|-------------------|
| US | | | |
| 14:30 | Initial Jobless Claims | 240k | 236k |
| 14:30 | Continuing Claims | 1950k | 1918k |
| 14:30 | Philadelphia Fed Business Outlook (May) | 18.5 | 22.0 |
| Japan | | | |
| 01:50 | Housing Loans YoY (1Q) | A 3.3% | 3.1% |
| 01:50 | GDP SA QoQ (1Q P) | A 0.5% | 0.3% |
| 01:50 | GDP Annualized SA QoQ (1Q P) | A 2.2% | R 1.4% |
| 01:50 | GDP Deflator YoY (1Q P) | A -0.8% | R 0% |
| 01:50 | GDP Private Consumption QoQ (1Q P) | A 0.4% | 0.0% |
| 01:50 | GDP Business Spending QoQ (1Q P) | A 0.2% | R 1.9% |
| UK | | | |
| 10:30 | Retail Sales Ex Auto Fuel MoM / YoY (Apr) | 1.0%/2.6% | -1.5%/2.6% |
| 10:30 | Retail Sales Inc Auto Fuel MoM / YoY (Apr) | 1.1%/2.1% | -1.8%/1.7% |
| France | | | |
| 07:30 | ILO Unemployment Rate (1Q) | A 9.6% | 10.0% |
| 07:30 | Mainland Unemp. Change 000s (1Q) | A -115K | -31k |
| 07:30 | ILO Mainland Unemployment Rate (1Q) | A 9.3% | 9.7% |
| Events | | | |
| 03:30 | China April Property Prices | | |
| 09:00 | ECB Governing Council's Weidmann speaks in Frankfurt on payment symposium | | |
| 09:50 | ECB Executive Board member Mersch speaks in Frankfurt on Vision 2020 | | |
| 10:30 | Spain to Sell 1.15% 2020, 4.8% 2024, 5.9% 2026 & 1.5% Apr2027 | | |
| 10:50 | France to Sell 0% 2020 & 0% 2022 Bond (+ inflation-linked) | | |
| 13:30 | ECB Minutes of the April meeting | | |
| 14:30 | ECB Board member Mersch speaks in Frankfurt (Government borrowers forum) | | |
| 14:45 | ECB's Lautenschlaeger Speaks in Berlin | | |
| 14:50 | ECB's Nowotny Speaks in Vienna | | |
| 19:00 | ECB's Draghi Speaks in Tel Aviv (Conferral of Doctot Philosophiae Honoris Causa) | | |
| 19:15 | Fed's Mester Speaks on Economy and Monetary Policy | | |

| 10-year | <u>td</u> | <u>-1d</u> | | 2-year | <u>td</u> | <u>-1d</u> | | Stocks | <u>td</u> | <u>-1d</u> |
|------------|------------|------------|------------|------------|------------|------------|--|-------------|-----------|------------|
| US | 2,24 | -0,05 | | US | 1,27 | -0,01 | | DOW | 20606,93 | -372,82 |
| DE | 0,37 | -0,04 | | DE | -0,70 | -0,04 | | NASDAQ | 6011,236 | -158,63 |
| BE | 0,79 | -0,04 | | BE | -0,51 | -0,02 | | NIKKEI | 19553,86 | -261,02 |
| UK | 1,07 | -0,06 | | UK | 0,12 | -0,02 | | DAX | 12631,61 | -172,92 |
| JP | 0,05 | 0,00 | | JP | -0,15 | 0,01 | | DJ euro-50 | 3584,83 | -57,06 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| 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 | -0,05 | 1,62 | 0,61 | Eonia | -0,3590 | 0,0080 | | Libor-1 | 0,9991 | -0,0017 |
| 5y | 0,17 | 1,83 | 0,76 | Euribor-1 | -0,3710 | 0,0000 | | Libor-3 | 1,1812 | 0,0017 |
| 10y | 0,79 | 2,17 | 1,13 | Euribor-3 | -0,3310 | 0,0000 | | Libor-6 | 1,4204 | -0,0022 |
| | | | | Euribor-6 | -0,2510 | -0,0010 | | | | |
| | | | | | | | | | | |
| Currencies | <u>td</u> | <u>-1d</u> | | Currencies | <u>td</u> | <u>-1d</u> | | Commodities | <u>td</u> | <u>-1d</u> |
| EUR/USD | 1,1141 | 0,0036 | | EUR/JPY | 123,91 | -0,94 | | CRB | 183,24 | 1,11 |
| USD/JPY | 111,23 | -1,20 | | EUR/GBP | 0,8600 | 0,0014 | | Gold | 1259,70 | 16,70 |
| GBP/USD | 1,2954 | 0,0021 | | EUR/CHF | 1,0924 | 0,0005 | | Brent | 52,06 | 0,77 |
| AUD/USD | 0,7463 | 0,0032 | | EUR/SEK | 9,7397 | 0,0037 | | | | |
| USD/CAD | 1,3616 | 0,0022 | | EUR/NOK | 9,3902 | 0,0017 | | | | |

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