



## Sunrise

**Tuesday, 19 September 2017**

### Rates: Eyes remain on the Fed

Core bonds lost slightly more ground yesterday in thin trading conditions. Today's eco calendar contains eco data with little market moving potential, especially ahead of the FOMC. We expect neutral trading within small ranges. Since last week, market reduced dovish bets, making the technical picture and positioning more neutral.

### Currencies: Sterling rebound runs into resistance

The dollar showed no clear trend yesterday. Yen weakness remains the key trend among the major currency cross rates. Today's eco calendar probably won't inspire big directional USD bets going into tomorrow's FOMC policy announcement. The easiest part of the sterling rally on recent hawkish BoE comments is apparently behind us.

### 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 stock markets closed with limited gains (+0.2%)** in a session devoid of eco data with investors waiting tomorrow's FOMC meeting. **Overnight, most Asian bourses lose slightly ground with Japan outperforming** (yen weakness).
- **BoE Carney** said Brexit is undermining the UK's supply capacity, making it harder for the economy to grow without generating inflationary pressures. That's one reason why **the BoE may need to hike rates in the coming months**.
- **The Bank of Canada will pay close attention to how the economy responds to both higher interest rates and a stronger CAD**, and remains data-dependent as it looks ahead to further decisions on interest rates, BoC Lane said.
- **Senate Republicans are considering writing a budget that would allow for up to \$1.5 trn in tax cuts over the next decade**, said people familiar with the discussions. Budget talks are continuing and no final decision has been reached.
- **Theresa May** has moved to tighten her grip on the UK's disjointed Brexit operation, **shaking up her negotiating team and dismissing efforts by her foreign secretary**, Boris Johnson, to push her towards a hard exit.
- **Hurricane Maria barrelled into the eastern Caribbean as a Category 5 storm**, ripping roofs from homes, knocking out electricity on the island of Dominica and threatening others in the region already ravaged by Hurricane Irma.
- **Today's calendar** contains German ZEW investor sentiment, US housing starts and building permits.

# Rates

## Modest steepening curves

### Portugal profits from S&P rating upgrade

|    | US yield | -1d  |
|----|----------|------|
| 2  | 1,39     | 0,01 |
| 5  | 1,82     | 0,02 |
| 10 | 2,23     | 0,03 |
| 30 | 2,79     | 0,03 |

|    | DE yield | -1d  |
|----|----------|------|
| 2  | -0,69    | 0,01 |
| 5  | -0,26    | 0,01 |
| 10 | 0,46     | 0,02 |
| 30 | 1,26     | 0,03 |

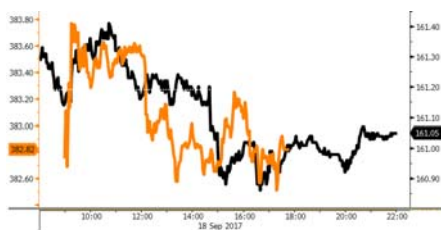
## Core bonds modestly down in follow through selling

Core bonds hovered sideways during much of yesterday's session, nor eco data nor other items figured on the calendar. During the afternoon session, core bonds slid suddenly lower on some big orders. The Bund initially underperformed US Treasuries, but while Bunds soon travelled again sideways, the US Treasuries very gradually lost some more ground. Yesterday's price action was uneventful, given also the low volumes traded, but signalled that the downward correction in core bonds is not over yet.

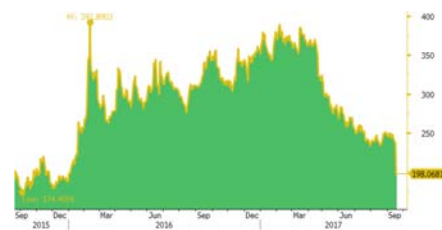
In a daily perspective, changes on the US yield curve ranged between +1.4 bps (2-yr) and +2.9 bps (30-yr), while German yields traded 0.8 bps (2-yr) to 3.2 bps (30-yr) higher, steepening the curves. On intra-EMU bond markets, 10-yr yield spreads narrowed across the board (3-4 bps for Italy and Spain). Portuguese bonds profited fully from the rating upgrade by S&P to investment grade (BBB-). The 10-yr yield spread versus Germany dived 39 bps.

## Light calendar, before FOMC concludes tomorrow

September German ZEW economic confidence survey is expected little changed compared to August. As German equities recovered in September, we have no reasons to distance us from consensus. Anyway, market reactions on the release are mostly modest at best. In the US, housing starts and permits are expected respectively slightly higher and slightly lower in August, but no rebound from weak July figures. Sales look to have peaked, but no such sign yet from permits, which urges for caution in interpreting the housing market.



Bund future (black) & EuroStoxx (orange) (intraday): Bund loses some ground mainly in afternoon session but all in all uneventful session



Portuguese-German 10-yr yield spread plunges below 200 bps for the first time since early 2016, as S&P upgrades rating.

## Fed to start balance sheet tapering

### What about the dots?

Regarding tomorrow's FOMC meeting, we expect the FOMC to announce the start of its balance sheet tapering (as of Oct. 1?). In June, the FOMC announced how the tapering would proceed. Monthly re-investments will initially decline by \$6 bn of maturing US Treasuries and \$4 bn of maturing MBS. These amounts will be raised "automatically" every quarter (by \$6 bn and \$4 bn) until they hit full pace after one year (\$50 bn/month combined). We don't expect the decision to have a major impact on long term bonds, as it was extensively communicated to the markets. That may change when the programme gathers speed.

Regarding the Fed's dot plot, we don't see changes in the median dot for 2017 (still one rate hike) and for 2018 (3 extra hikes). It would take four governors to lower their dot before the median dot drops. Of course, chances are high that some governors lower their dot which might be considered as dovish. Chances of a downward revision of the 2019 median dot (2.5 extra rate hikes) and the

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**long run median dot (3%) are high.** We think the FOMC has little incentive to signal now that its expected rate cycle will still be more shallow than recently indicated. Financial conditions have actually eased since the start of the year despite two rate increases. Long term yields dropped about 40 basis points, the dollar weakened about 10% and the equities are 11.7% (S&P) to 19.8% (Nasdaq) higher. **Whether the Fed effectively raises rates in December remains uncertain.** The debt ceiling issue will likely be again on the table and the economic data won't give a clear-cut picture with storm-related disruptions in September/October. Anyway, inflation should show signs of rising again.

## Eyes remain on the Fed

|             |        |       |
|-------------|--------|-------|
| R2          | 163,43 | -1d   |
| R1          | 161,66 |       |
| <b>BUND</b> | 160,94 | -0,25 |
| S1          | 160,49 |       |
| S2          | 160,5  |       |

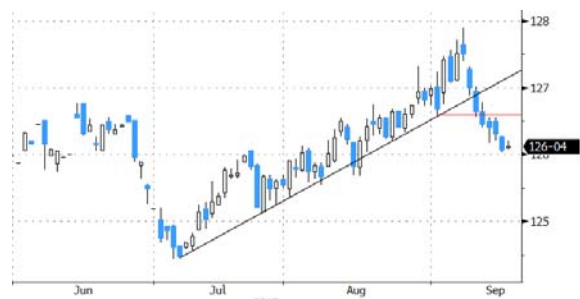
**Risk sentiment on Asia is slightly negative overnight** with small losses for most equity indices and small gains for the US Note future. USD/JPY is the exception to the rule with more JPY losses. We expect a neutral to slightly higher opening for the Bund.

**Today's EMU/US eco calendar remains thin with German ZEW and US housing starts & building permits. Those indicators mostly have little market moving potential and that's especially the case ahead of tomorrow's FOMC meeting.** Since the beginning of last week, core bond markets lost significant ground, scaling back too dovish bets against monetary policy normalisation. **With markets now positioned more neutral, we expect sideways trading ahead of the Fed. We expect the FOMC to hang on the 2017/2018 rate projections (1-3) while potentially lowering its neutral rate forecast. That would cause a flattening of the US yield curve.**

**From a technical point of view, US yields recaptured lost support levels and even broke out of their downward trend channels.** Since last Friday, the market implied probability of a 2017 Fed rate hike trades back above 50% (first time since early July). Markets positioning remains too soft in the medium/long term, according to us. The FOMC will normally give the green light at its September meeting for balance sheet tapering in Q4 2017. **That's negative for US T's long term. Speculation in the run-up to the October ECB meeting (slowdown in monthly purchases and extension APP; start policy normalisation) should cap the upside of the Bund which lost first support at 161.66, ending the uptrend since the start of summer.**



German Bund: Draghi delays key decisions to October. Speculation on APP announcement should cap gains. First support broken



US Note future: Risk sentiment improved and ended uptrend since start of summer. Repositioning ahead of the Fed over?

# Currencies

## Yen weakness prevails. Dollar trades mixed

|         |        |        |
|---------|--------|--------|
| R2      | 1,2225 | -1d    |
| R1      | 1,2167 |        |
| EUR/USD | 1,1954 | 0,0009 |
| S1      | 1,1662 |        |
| S2      | 1,1311 |        |

*Asian equities ex-Japan show modest losses*

*Yen fighting an uphill battle*

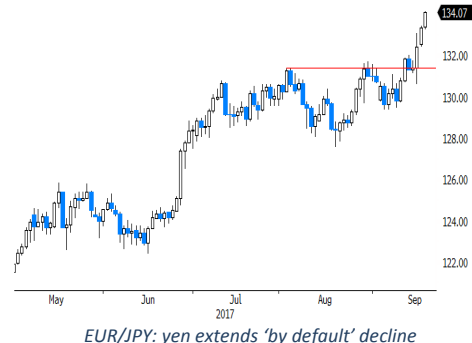
*EUR/USD stays fairly well bid*

Yesterday, technical considerations drove USD trading in the absence of hard news. Core yields traded with a slight upward bias. This rise weighted on the yen with USD/JPY and EUR/JPY breaking through key resistance (recent highs). There was no directional impact on EUR/USD. The pair hovered in the mid 1.19 area. The pair finished the day at a1.1954. USD/JPY closed the session at 111.57.

**Overnight**, Asian equities trades with modest losses. Japan outperforms on catching up to do after yesterday's holiday and yen weakness. **PM Abe is rumoured to call snap parliamentary elections. Markets assume that a continuation of the current policy also includes an extension of the ultra-loose BOJ policy. This is an additional negative for the yen.** The yuan extends its recent decline. EUR/USD maintains a cautious upward bias (1.1975 area). There is no indication of broad-based USD strength going into tomorrow's FOMC decision. The trade-weighted dollar (91.86) is going nowhere.

**Today the eco calendar is again only modestly interesting. The September German ZEW economic confidence survey is expected little changed from August.** As German equities recovered in September, we have no reasons to distance us from consensus. The **market reaction to the release is mostly modest at best.** In the US, **housing starts and permits** are expected respectively slightly higher and slightly lower in August. Sales look to have peaked, but no such sign yet from permits, which urges for caution in interpreting the housing market. **Markets will look forward to an tomorrow's Fed decision.** For an in extenso analysis see the fixed income part of the this report. The focus will be on the reduction of the balance sheet, but the 'dots' are important too. We expect the 'median dots' for December 2017 and for 2018 to remain unchanged. If so, it might be slightly supportive for the dollar. The speech of Trump before the UN and the US tax reduction debate are wild cards.

**Last week's** cautious USD rebound (due to positive risk sentiment) was not convincing as soft US data created a mixed dollar context. Despite disappointing US data, core yields (in the US and EMU) extended their rise, suggesting that markets don't expect an overly soft FOMC. This might prevent further USD losses going into the FOMC policy meeting.



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We did start the week with a neutral bias on the dollar. EUR/USD hovers in a sideways consolidation pattern between 1.1823 and 1.2070. It was disappointing for EUR/USD bears that last week's correction didn't reach this range bottom.

More confirmation is still needed that the recent bottoming out process in US yields and in the dollar might be the start of more sustained USD gains (against the euro).

The day-to-day momentum in USD/JPY is more constructive. The yen trades weak across the board. USD/JPY regained the 110.67/95 previous resistance. This a short-term positive. EUR/JPY shows a similar positive picture. So, the yen might stay under pressure at least until the next event risk pops up.

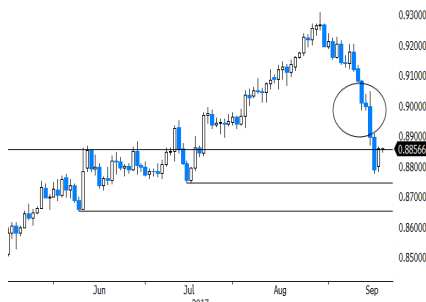
### GBP rebound losing steam

|         |        |        |
|---------|--------|--------|
| R2      | 0,9415 | -1d    |
| R1      | 0,9307 |        |
| EUR/GBP | 0,8857 | 0,0068 |
| S1      | 0,8743 |        |
| S2      | 0,8657 |        |

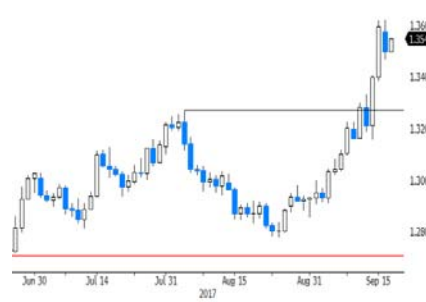
After a week of very strong gains on hawkish BoE talk, sterling finally fell prey to modest profit taking yesterday. Investors holding sterling longs took some chips off the table. BoE governor Carney confirmed recent BoE communication that chances of a rate hike have risen, even as Brexit contains plenty of risks for the UK economy. The speech of the BoE governor didn't help sterling anymore though. It fell even prey to more profit taking. EUR/GBP closed the session at 0.8856. Cable finished the day at 1.3495.

Technical considerations will probably prevail today as the calendar is empty. Markets will continue to look forward to PM May's Brexit speech Friday. The sterling rally clearly lost momentum yesterday. We look out whether/how soon sterling can return to the recent correction top. If that move fails, the easiest part of the BoE rate hike rebound might be behind us.

From a technical point of view, EUR/GBP cleared the 0.8854/80 resistance (top end June), opening the way for a protracted August rebound. The move was the result of euro strength. Simultaneously, UK price data were soft enough to keep the BoE side-lined at the August meeting. Recent price data amended this story and the ST-trend reversal of sterling was reinforced by recent BoE comments. Medium term, we maintain a EUR/GBP buy-on-dips approach as we expect the mix of relative euro strength and sterling softness to persist. The prospect of withdrawal of BOE stimulus put a solid floor for sterling ST term. We look out how far the current correction has to go. EUR/GBP is nearing next support at 0.8743 and 0.8652. We start looking to buy EUR/GBP on dips.



EUR/GBP: GBP-rebound slows



GBP/USD: running into resistance?

# Calendar

| Tuesday, 19 September |                                     | Consensus   | Previous    |
|-----------------------|-------------------------------------|-------------|-------------|
| <b>US</b>             |                                     |             |             |
| 14:30                 | Housing Starts / MoM (Aug)          | 1174k/1.7%  | 1155k/-4.8% |
| 14:30                 | Building Permits / MoM (Aug)        | 1220k/-0.8% | 1230k/-3.5% |
| 14:30                 | Import Price Index MoM / YoY (Aug)  | 0.4%/2.2%   | 0.1%/1.5%   |
| <b>EMU</b>            |                                     |             |             |
| 11:00                 | Construction Output MoM / YoY (Jul) | --/--       | -0.5%/3.4%  |
| 11:00                 | ZEW Survey Expectations (Sep)       | --          | 29.3        |
| <b>Germany</b>        |                                     |             |             |
| 11:00                 | ZEW Survey Current Situation (Sep)  | 86.2        | 86.7        |
| 11:00                 | ZEW Survey Expectations (Sep)       | 12          | 10.0        |
| <b>Belgium</b>        |                                     |             |             |
| 15:00                 | Consumer Confidence Index (Sep)     | --          | 2           |
| <b>Events</b>         |                                     |             |             |
| 03:30                 | RBA Sept. Rate Meeting Minutes      |             |             |

| 10-year    | Close  | -1d     |      | 2-year     | td      | -1d     | Stocks      | Close    | -1d    |
|------------|--------|---------|------|------------|---------|---------|-------------|----------|--------|
| US         | 2,23   | 0,03    |      | US         | 1,39    | 0,01    | DOW         | 22331,35 | 63,01  |
| DE         | 0,46   | 0,02    |      | DE         | -0,69   | 0,01    | NASDAQ      | 6454,639 | 6,17   |
| BE         | 0,73   | 0,02    |      | BE         | -0,53   | 0,00    | NIKKEI      | 20317,93 | 408,43 |
| UK         | 1,30   | -0,01   |      | UK         | 0,42    | -0,05   | DAX         | 12559,39 | 40,58  |
| JP         | 0,03   | 0,01    |      | JP         | -0,14   | -0,01   | DJ euro-50  | 3526,74  | 11,19  |
|            |        |         |      |            |         |         |             |          |        |
|            |        |         |      |            |         |         |             |          |        |
| IRS        | EUR    | USD     | GBP  | EUR        | -1d     | -2d     | USD         | -1d      | -2d    |
| 3y         | -0,05  | 1,76    | 0,90 | Eonia      | -0,3630 | -0,0030 |             |          |        |
| 5y         | 0,23   | 1,91    | 1,11 | Euribor-1  | -0,3730 | -0,0020 | Libor-1     | 1,2372   | 0,0000 |
| 10y        | 0,89   | 2,20    | 1,36 | Euribor-3  | -0,3290 | 0,0000  | Libor-3     | 1,3239   | 0,0000 |
|            |        |         |      | Euribor-6  | -0,2710 | 0,0000  | Libor-6     | 1,4711   | 0,0000 |
|            |        |         |      |            |         |         |             |          |        |
|            |        |         |      |            |         |         |             |          |        |
| Currencies | Close  | -1d     |      | Currencies | Close   | -1d     | Commodities | Close    | -1d    |
| EUR/USD    | 1,1954 | 0,0009  |      | EUR/JPY    | 133,35  | 0,93    | CRB         | 183,73   | -0,32  |
| USD/JPY    | 111,57 | 0,74    |      | EUR/GBP    | 0,8857  | 0,0068  | Gold        | 1310,80  | -14,40 |
| GBP/USD    | 1,3495 | -0,0099 |      | EUR/CHF    | 1,1496  | 0,0031  | Brent       | 55,48    | -0,14  |
| AUD/USD    | 0,7958 | -0,0044 |      | EUR/SEK    | 9,5173  | -0,0002 |             |          |        |
| USD/CAD    | 1,2291 | 0,0093  |      | EUR/NOK    | 9,3628  | -0,0147 |             |          |        |

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