



## Sunrise

Thursday, 23 February 2017

### Rates: French election fever temporary out of the way?

Bayrou's shout out to Macron might ease French election fever short term and trigger some spread narrowing. On core bond markets, the Bund could return some of yesterday's impressive gains, also as the Bund rally ran into 165.48 resistance, the 62% retracement level of the Oct-Dec decline. Today's eco calendar isn't really inspiring for trading.

### Currencies: Euro decline slows as French political tensions ease

Yesterday, the euro reversed initial steep losses as French centrist candidates join forces, avoiding further fragmentation. Today, the eco calendar is thin. Some consolidation on the recent wild (euro) swings might be on the cards. However, we don't see a change of trend, yet. EUR/GBP again failed to break the 0.8450 support in a sustainable way.

### 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 equities closed a tightly traded session narrowly mixed. Asian equities are slightly lower** with some notorious exceptions, like India which ekes out small gains.
- **Many FOMC voting members** "continued to see only a modest risk of a scenario where unemployment rate would substantially undershoot its longer-run level and inflation pressures would increase significantly," **the Minutes said**.
- **Fed governor Powell** said, after the release of the minutes, **that a rate increase may be appropriate in the near future if the economy stays on track**.
- **Greece doesn't need a debt haircut at the moment**, IMF Lagarde said, adding that debt restructuring and interest rate cuts on bailout loans were necessary. She thinks that Greece was complying more with IMF demands, suggesting the IMF will officially participate in the third bail-out.
- US Treasury Secretary Mnuchin praised the **strong dollar as a reflection of confidence in the U.S. economy**, telling the WSJ that it was "a good thing".
- **Dissenting BOJ member Takahide Kiuchi** warned that raising the bank's bond yield target near-term would be problematic as inflation remains well below its 2% goal.
- Today's **eco calendar is uneventful**, but comments of ECB Praet and Fed Kaplan are wild cards. The US finishes its refinancing operation with a 7-yr Note auction while Italy issues linkers and zero bond.

# Rates

## Political uncertainties still drive of EMU bond markets

Core bonds modestly higher

French election news affected trading.

Some relief for France and peripherals as Bayrou supports Macron in election

	US yield	-1d
2	1,22	-0,02
5	1,91	-0,03
10	2,41	-0,04
30	3,03	-0,03

	DE yield	-1d
2	-0,88	-0,02
5	-0,53	-0,04
10	0,28	-0,02
30	1,08	-0,05

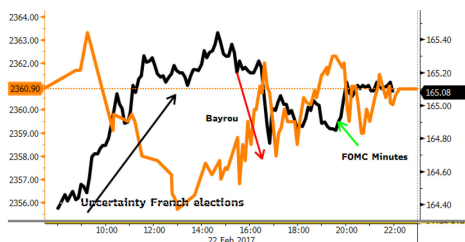
Yesterday, global core bonds gained modestly ground with German Bunds outperforming US Treasuries. Bund gains were out of proportion given yesterday's events, but are probably related to election uncertainty in France. The Bund ignored a strong German IFO. On EMU bond markets, yields declined with France initially underperforming. However in late afternoon, Bayrou offered an alliance to Macron in the presidential race to stop Le Pen, suggesting he is not running for president. This increases the presidential chances of the centrist Macron and diminishes those of Le Pen. On the news, German-French yield spreads declined, the Bund returned some of its gains and the euro reversed losses versus the dollar. These moves suggest that political uncertainty was the main trading driver yesterday, even as Bund gains might have been out of proportion also for technical reasons. Finally, bond auctions included a horrible 30-yr Bund, a strong 15-yr Spanish syndication and a soft 5-yr US Note. Oil prices lost \$1/barrel and supported bonds at the margin. In a daily perspective, the German yield curve shifted 2.1 bps (2-yr) to 3.3 bps (5-yr) lower. US yields dropped up to 1.6 bps, slightly helped by the FOMC Minutes. On intra EMU-bond markets, 10-year yield spread changes versus Germany ranged between -4 bps and -6 bps with Spain and Greece lagging.

## Thin calendar with ECB Praet & Fed Kaplan wildcards?

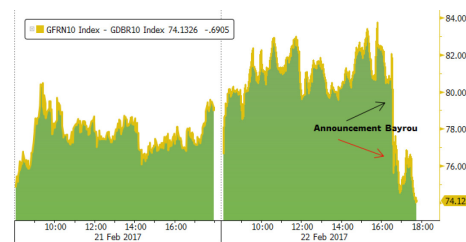
Eco data no driver for markets today?

ECB Praet & Fed Kaplan speak

The euro area eco data are second tier (final Q4 German GDP, French INSEE business confidence and Italian retail sales). Also US economic data have only minor potential market impact. We listen closely to the speech of ECB Praet, especially as tensions inside euro area markets flare up amid political uncertainty. Will he give some comments on the deviation of the capital key as measure for sovereign bond purchases as mentioned in the latest ECB meeting accounts? Atlanta Fed Lockhart retires at the end of the month and is unlikely to speak about the policy outlook. Dallas Fed Kaplan is a moderate hawk and last said "we should be removing accommodation sooner rather than later."



Bund future (black) & S&P future (orange) (intraday): Risk off pushes Bund much higher, but Bayrou decreased uncertainty



German-French 2-yr yield spread drops sharply as Bayrou supports Macron in election, diminishing chances of a Le Pen victory

## FOMC Minutes: Too early to act?

The FOMC Minutes said that many FOMC voting members "continued to see only a modest risk of a scenario in which the unemployment rate would substantially undershoot its longer-run level and inflation pressures would increase significantly". "Most participants", meaning a majority, continued to

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see *“heightened uncertainty”* around the size, timing and composition of fiscal and other government policies and their impact on the economy. *“They thought some time would likely be required for the outlook to become clearer”*. Many Fed officials see a hike as being appropriate *“fairly soon”*, but this does not necessarily imply March. While the situation changed in the meantime with stronger growth and somewhat higher inflation, it looks that it is still too early to hike rates in March, unless there would be a huge surprise from the payrolls report. The Fed doesn’t feel they are behind the curve, they still see risks and are unsure about the fiscal plans. **These are arguments to wait for somewhat longer, maybe the May or June meeting, before increasing rates.** The market implied probability of a March hike stands at 34%, which is too low to hike if the Fed doesn’t want to surprise. US Treasuries gained some ground and the dollar weakened a tad upon the release.

### Slightly disappointing 5-yr Note auction

The US Treasury continued its end-of-month refinancing operation with a mixed \$13 2-yr FRN and a slightly disappointing \$34B 5-yr Note auctions. The latter stopped slightly above the 1:00 PM bid side and the auction bid cover (2.29) was the smallest since July. Bidding details showed a good direct bid, but disappointing indirect and dealer bids. Today, the Treasury ends its supply operation with a **\$28B 7-yr Note auction**. Currently, the WI trades at 2.23%.

R2	166,84	-1d
R1	165,48	
<b>BUND</b>	<b>164,99</b>	<b>0,61</b>
S1	163,13	
S2	161,31	

### Sting out of French election fever short term?

**Overnight**, most Asian stock markets trade slightly lower, but sentiment isn’t really risk-off. The US Note future and Brent crude stabilize, suggesting a neutral opening for the Bund.

**Today’s eco calendar is thin with only weekly jobless claims. Speeches by ECB Praet, Fed Lockhart and Fed Kaplan are wildcards for trading. Core bond trading will likely remain technically and sentiment-driven. Bayrou’s support to Macron might take the sting out of French presidential election fever short term and give the Bund some relief after yesterday’s astonishing rally, which ended with a failed test of 165.48 resistance (62% retracement of Oct-Dec decline). On intra-EMU bond markets, it could trigger some spread narrowing as also short-term developments in Greece are advantageous.**



German Bund: EMU worries push Bund above 164.90 resistance with a test of the 62% retracement level (165.48)



US Note future: new test of 125-09/16 resistance failed. Yellen’s testimony & strong data cap the topside and suggest move lower in range ahead of Trumps’ fiscal stimulus plans

# Currencies

## Euro sell-off slows, at least temporary.

*Euro reversed initial losses as tensions on France eased*

*Fed minutes don't support further USD gains*

*Asian equities show modest losses*

*USD shows no clear trend*

*Eco calendar uneventful*

*EUR/USD decline might slow ST as tensions on France ease*

Yesterday, euro weakness due to political uncertainty dominated FX trading. The euro sold off even as regional data (IFO) were strong. EUR/USD dropped temporary below 1.05. The decline of EUR/JPY also weighed on USD/JPY. Later, uncertainty on France eased as centrist Bayrou supported independent candidate Macron, avoiding further fragmentation and diminishing the risk of a Le Pen victory. The euro rebounded. Later, the Fed minutes didn't provide concrete evidence on a March rate hike and weighed slightly on the dollar. EUR/USD rose further to close the session at 1.0558. USD/JPY finished at 113.31.

**Overnight**, most Asian equity indices show modest losses. Yen cross rates made quite some big swings yesterday and the yen trades still rather strong. This is a slightly negative for regional markets. Even so, Japanese/regional equities reversed part of the earlier losses. USD/JPY is trading in the 113.25 area. EUR/USD is little changed in the 1.0560 area.

**Today, EMU eco data are second tier** (final Q4 German GDP, French INSEE business confidence and Italian retail sales). **US data have also limited potential to move USD.** The January Chicago National Activity Index is expected flat (versus 0.14 previously). Initial claims have been very low in past weeks and no change is expected. We listen closely to the **speeches of ECB Praet**, especially as **tensions in EMU markets flared up. Atlanta Fed Lockhart speaks but retires** at the end of the month. Dallas Fed Kaplan is a moderate hawk. **Over the previous days**, French election worries fuelled uncertainty on European markets and weighed on the euro. **The political uncertainty in France eased a bit after centrist Bayrou support centrist candidate Macron.** Uncertainty might easily return later on, but in a day-to-day perspective, it might ease pressure on the euro. **Even so, we don't expect the EUR/USD rebound go far.** Markets await Trump's fiscal plan and its impact on Fed thinking. A decent fiscal easing (tax cuts/spending) should be USD supportive. However, we don't see much pro-USD prepositioning yet. **If there is no high profile news on France or on US fiscal policy, some consolidation in EUR/USD and USD/JPY is likely, with equities guiding the intraday moves.**

R2	1,1145	-1d
R1	1,0874	
<b>EUR/USD</b>	<b>1,0556</b>	<b>0,0028</b>
S1	1,0341	
S2	1,0000	



EUR/USD: rebounds off recent lows on Bayrou comments



USD/JPY: off the recent lows, rebound shows no strong momentum

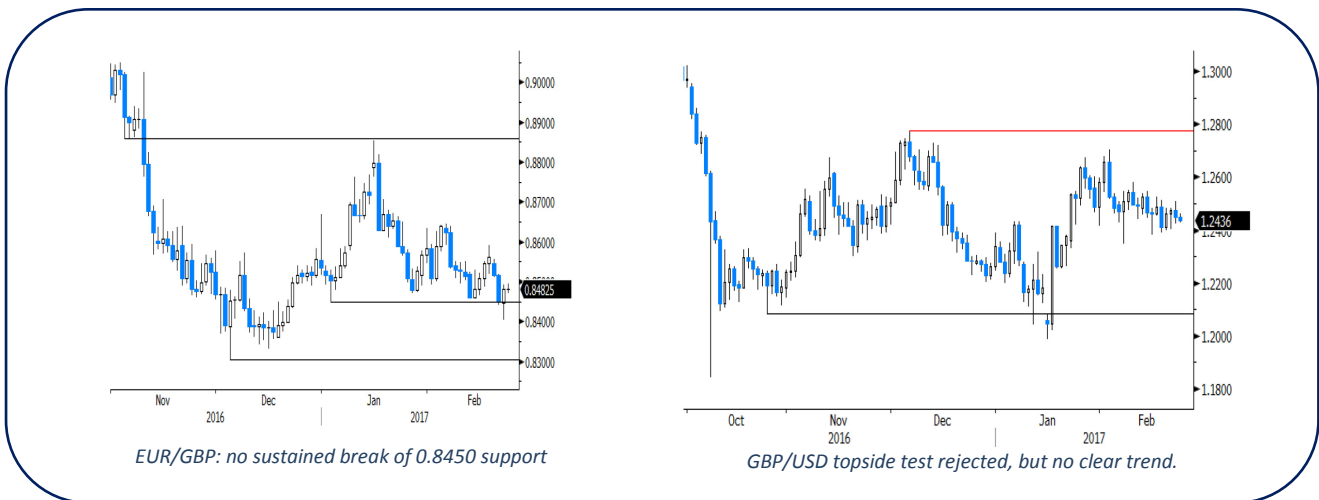
**Global context.** The dollar corrected lower since the start of January as the Trump reflation trade slowed down. **Two weeks ago, the dollar bottomed out, supported by Trump’s tax promise. Underlying** euro weakness due to political uncertainty in the area is a factor too. **We see 1.0874 as solid resistance and favour a sell EUR/USD on upticks approach. The downside test of USD/JPY was rejected.** USD/JPY 111.16 (38% retracement of the 99.02/118.66 rally) remains a key support. The comments of Yellen before Congress (and of other Fed members) were USD supportive, but had little lasting impact on yields. We keep a USD positive bias, but remain more cautious on the upside potential of USD/JPY compared to USD/EUR.

**EUR/GBP: again no sustained break of 0.8450 support**

R2	0,8645	-1d
R1	0,8592	
EUR/GBP	0,8488	0,0061
S1	0,8304	
S2	0,8117	

Euro weakness pushed EUR/GBP further below the 0.8450 support. The pair touched an intraday low just north of 0.84. Some ST consolidation kicked in. **The details of the UK Q4/2016 GDP painted a mixed picture and weighed on sterling.** EUR/GBP initially rebounded to the 0.8440/50 area. Later in the session, the pair was further supported by the post-Bayrou rebound of EUR/USD. EUR/GBP closed the session at 0.8481. Cable finished the day at 1.2450. Sterling trading was dominated by the gyrations in the euro cross rates. Even so, yesterday’s price action should have disappointed sterling bulls.

**Today, UK CBI Retail/Distributive trades reports** will be published. Usually, the FX market doesn’t react much to the data and so the report won’ be a game-changer. However, the CBI data are interesting after recent very poor ONS retail sales data. We especially look for the market reaction in case of a poor report. **EUR/GBP recently hovered in a tight range north of the 0.8450 support.** Sterling sentiment softened slightly as a BoE rate hike is still very far away. Yesterday, a (temporary) acceleration of the euro sell-off pushed EUR/GBP temporary to the 0.84 area, but a sustained break of the 0.8450 level again didn’t occur. **Longer term, we have a sterling negative view as the Brexit will negatively impact the UK economy.** However, this is no issue at this stage. Euro weakness prevails. A sustained break below **0.8450 would open de way for a return to the EUR/GBP 0.8304 correction low, the next key support. We maintain a neutral bias on sterling short-term. Both EUR/GBP and cable show no clear trend.**



# Calendar

Thursday, 23 February		Consensus	Previous
<b>US</b>			
14:30	Chicago Fed Nat Activity Index (Jan)	0.00	0.14
<b>14:30</b>	<b>Initial Jobless Claims</b>	<b>240K</b>	<b>239k</b>
14:30	Continuing Claims	2068K	2076k
15:00	House Price Purchase Index QoQ (4Q)	--	1.5%
15:00	FHFA House Price Index MoM (Dec)	0.5%	0.5%
<b>Japan</b>			
00:50	PPI Services YoY (Jan)	A 0.5%	R0.5%
<b>UK</b>			
12:00	CBI Retailing Reported Sales (Feb)	2	-8
12:00	CBI Total Dist. Reported Sales (Feb)	24	26
<b>Germany</b>			
<b>08:00</b>	<b>GDP SA QoQ / WDA YoY (4Q F)</b>	<b>0.4%/1.7%</b>	<b>0.4%/1.7%</b>
08:00	Private Consumption QoQ (4Q)	0.3%	0.4%
08:00	Government Spending QoQ (4Q)	0.8%	1.0%
08:00	Capital Investment QoQ (4Q)	0.8%	0.0%
08:00	Construction Investment QoQ (4Q)	1.5%	0.3%
08:00	Domestic Demand QoQ (4Q)	0.6%	0.5%
08:00	Exports QoQ / Imports QoQ (4Q)	1.4%/1.8%	-0.4%/0.2%
08:00	GfK Consumer Confidence (Mar)	10.1	10.2
<b>France</b>			
08:45	Business Confidence (Feb)	104	104
<b>Italy</b>			
10:00	Retail Sales MoM / YoY (Dec)	0.2%/0.9%	-0.7%/0.8%
<b>Events</b>			
<b>09:55</b>	<b>ECB Praet speaks in London (also at 12:00 and 14:00)</b>		
11:00	Italy to Sell Bonds (2.5B zero coupon 2018, 0.1% IL 2022 and IL 2026 bonds)		
<b>14:35</b>	<b>Fed's Lockhart to Speak on His 10-Year Tenure at the Fed</b>		
19:00	US to Sell \$28B 7-yr Note auction		
17:00	Dallas Fed Kaplan speaks in Oklahoma (at 19:00 in Fort Worth)		
23:30	RBA's Lowe Testimony to Parliament Committee		

10-year	td	-1d		2-year	td	-1d		Stocks	td	-1d
US	2,41	-0,04		US	1,22	-0,02		DOW	20775,6	32,60
DE	0,28	-0,02		DE	-0,88	-0,02		NASDAQ	5860,625	-5,32
BE	0,78	-0,08		BE	-0,53	-0,04		NIKKEI	19371,46	-8,41
UK	1,20	-0,03		UK	0,09	-0,01		DAX	11998,59	31,10
JP	0,08	-0,01		JP	-0,27	-0,01		DJ euro-50	3339,27	-0,06
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	td	-1d
3y	-0,06	1,76	0,67	Eonia	-0,3600	-0,0040		Libor-1	0,7794	0,0022
5y	0,13	2,02	0,86	Euribor-1	-0,3710	-0,0010		Libor-3	1,0534	0,0033
10y	0,75	2,39	1,27	Euribor-3	-0,3300	-0,0010		Libor-6	1,3624	0,0053
				Euribor-6	-0,2390	-0,0010				
Currencies	td	-1d		Currencies	td	-1d		Commodities	td	-1d
EUR/USD	1,0556	0,0028		EUR/JPY	119,56	0,12		CRB	191,23	-0,82
USD/JPY	113,26	-0,19		EUR/GBP	0,8488	0,0061		Gold	1237,20	2,10
GBP/USD	1,2437	-0,0056		EUR/CHF	1,0667	0,0027		Brent	56,34	-0,48
AUD/USD	0,7693	0,0003		EUR/SEK	9,4771	0,0230				
USD/CAD	1,3149	0,0012		EUR/NOK	8,8314	0,0298				

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