



Sunrise

Friday, 10 November 2017

Rates: Unusual correlation between stocks/bonds unlikely to persist

Tension on Asian stock markets eased overnight, but we think that the equity correction has further to go from a technical point of view. If so, it remains a strange combination to see both core bonds and stocks sell-off simultaneously. The end of the refinancing operation, doubts on US tax reforms and the weekend ahead generally favour some cautiousness as well.

Currencies: USD in the defensive as tax bill might undershoot expectations

Yesterday, there were some strange correlations on global markets, including the FX market. For new, we assume that the overall context is slightly negative for the dollar. A risk-off decline of USD/JPY might be less pronounced than is usually the case. The euro might remain relatively well supported. Brexit headlines might remain slightly GBP-negative.

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 corrected around 0.5% lower yesterday.** They tried to erase opening weakness which spread from Asia/Europe, but failed on headlines that the US Senate aims to delay tax reforms. **Asian markets are mixed overnight** with Japan underperforming and China outperforming.
- **Senate Republicans' proposal to rewrite the tax code breaks significantly with the one crafted by the House GOP** confronting party leaders with dozens of differences to reconcile and little time before the year-end deadline.
- **The House Ways and Means Committee approved revisions to the GOP tax legislation** that trimmed the bill's cost while providing more tax relief to owners of partnerships, limited liability companies and other so-called pass-throughs.
- **The EU is demanding Britain accept that Northern Ireland may need to remain inside the European customs union and single market** after Brexit in order to avoid "a hard border on the island of Ireland".
- **Australia's central bank has sliced its forecasts for core inflation** which is seen lurking under its long-term target band for another two years, a strong signal that interest rates won't rise for a long time to come.
- **The ECB can tighten monetary policy more decisively once inflation is on a clear path towards the target**, leaving behind its gradualist approach, Governing Council member **Lane** told German business newspaper Boersen-Zeitung.
- **Today's eco calendar** contains UK industrial production and University of Michigan consumer confidence. Barnier and Davis hold a press conference on Brexit talks. ECB Mersch is scheduled to speak.

Rates

Bund sells off in risk-off climate

Bund sells off despite risk aversion

US Treasuries outperform as US Senate republicans want to delay tax reforms

Global core bonds lost ground yesterday with German Bunds significantly underperforming US Treasuries. US Treasuries escaped the sell-off as US Senate Republicans seem to be willing to delay tax reforms into next year. The overall disappointing performance of core bonds was at odds with risk aversion on European stock markets (follow-up on Tuesday's bearish engulfing and yesterday's Asian volatility), peripheral bond markets and, to a lesser extent, FX markets. US indices opened on a weak footing and, but managed to erase most of the additional intraday losses into the close. The eco calendar, central bank speeches and events provided less of an explanation for yesterday's Bund weakness. **Technical factors offered an explanation**, but it goes a long way to exclusively pinpoint yesterday's move to failed tests of support levels in the German 5-yr yield (-0.4%) and 10-yr yield (+0.3%).

| | US yield | -1d |
|----|----------|-------|
| 2 | 1,63 | -0,01 |
| 5 | 2,03 | 0,00 |
| 10 | 2,34 | 0,01 |
| 30 | 2,83 | 0,02 |

The US Treasury concluded its refinancing operation with a mixed \$15 bn 30-yr Bond auction. The auction stopped through the 1:00 PM bid side and the bid cover was a little bit weak. Bidding details were very average.

| | DE yield | -1d |
|----|----------|------|
| 2 | -0,75 | 0,01 |
| 5 | -0,35 | 0,03 |
| 10 | 0,38 | 0,05 |
| 30 | 1,27 | 0,06 |

At the end of the day, the German yield curve bear steepened with yields 1 bp (2-yr) to 6.1 bps (30-yr) higher. The US yield curve steepened as well with yield changes ranging between -1.1 bp (2-yr) and +2.4 bps (30-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany widened up to 2 bps.

Very thin eco calendar

Today's eco calendar remains uninspiring with only University of Michigan consumer confidence for November. Consensus expects a small increase in both the headline, from 100.7 to 100.9, and expectations, from 90.5 to 91, components of the report. Both indices trade near/at decade-highs. ECB Mersch is scheduled to speak, but probably won't touch on monetary policy.



German Bund future (black) & Dax index (orange) (intraday): unusual correlation. Both selling off.



German Dax: correction time

Unusual correlation unlikely to hold

| | | |
|-------------|--------|-------|
| R2 | 165,18 | -1d |
| R1 | 163,43 | |
| BUND | 162,44 | -0,82 |
| S1 | 160,49 | |
| S2 | 159,80 | |

Asian stock markets trade mixed currently with China outperforming (+0.5%) and Japan underperforming (-0.8%). There's no continuation of yesterday's sudden volatility which triggered an equity correction. The US Note future cedes some ground, suggesting a weaker opening for the Bund as well.

Today's eco calendar remains uninspiring. **We expect trading to be sentiment-driven and technical in nature.** Tensions on Asian stock markets eased overnight, but we think that the equity correction has further to go from a technical point of view. If so, it remains a strange combination to see both core bonds and stocks sell-off simultaneously. The end of the refinancing operation, doubts on US tax reforms and the weekend ahead generally favour some cautiousness as well. While recent moves on core bond markets fit in our sell-on-upticks strategy, we don't take it for granted yet that the core bond sell-off will continue at yesterday's pace.

We have a longer term US Treasury negative bias and would short the Note future for return action towards the 124-06 low. Also for the Bund we favour a sell-on-upticks (around 163.43), targeting 160.24. Support levels in yield terms played their role (German 5y: -0.4%, 10y: 0.3%). Underlying growth momentum remains very strong in EMU and warrants higher (LT) rates.



German Bund: Near key resistance. Prefer a sell-on upticks around 163.43, but watch out for temporary support from weak stock markets



US Note future: bottoming out after failed test key support. Sell-on-upticks near 125-25+

Currencies

Dollar ceded slightly ground on US tax plan

Yesterday, the safe have yen gained only modestly from the uptick in global volatility

Late in the session the dollar declined after the release of details of the Senate tax plan

USD/JPY holds in the mid 113 area even as Japanese equities stay under pressure

Dollar remains in the defensive as US tax bill might be less stimulating than expected

Eco calendar remains thin

Global markets will continue to set the tone for USD trading.

Global markets were spooked by an unexpected uptick of volatility on equity markets yesterday. At the same time, Bunds and, to a lesser extent Treasuries, came under pressure. The dollar and the euro both received interest rate support, despite the equity correction. This prevented a meaningful gain of the usual safe havens (Japanese yen, Swiss franc). Later in the session, the dollar ceded ground as more details on the Senate tax plan were aired. EUR/USD finished the session at 1.1642 (from 1.1595). USD/JPY finished the session at 113.47.

Overnight, most Asian equity indices show modest losses. China outperforms. Japan underperforms again. The yen maintains yesterday's gains, but the Japanese currency doesn't profit from the additional equity losses overnight. EUR/USD holds near yesterday's closing levels in the 1.1650 area. So, the US currency remains slightly in the defensive. The RBA expects underlying inflation to remain below its inflation target band till early 2019. This suggest that a policy rate hike isn't on the cards anytime soon. AUD/USD (currently 0.7685 area) trades within reach of the recent lows, but there are few additional losses.

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Global markets (including FX) showed some unusual links yesterday. The global risk-off sentiment/rise in volatility coincided with a rise in core (especially German) yields. This rise in German (and to a lesser extent in US yields) supported the euro and the dollar against the usual FX safe havens. Uncertainty, on the tax bill was a negative for the dollar. **Today, the Michigan consumer confidence might be slightly supportive for the dollar. However, the focus of markets is elsewhere.** Yesterday's price action suggests that the developments in core interest rate markets are currently more important for trading in the major FX cross rates rather than global risk sentiment. Regarding the latter, it isn't sure that the sell-off will continue, but we assume that equity enthusiasm has cooled a bit short-term. This will probably remain a negative for USD/JPY even as the pace of the decline might be less pronounced than is usually the case. The absolute low level of German/European interest rates makes that the euro will probably receive interest rate support in case of a risk-off correction. Uncertainty on the US tax plan might be slightly USD negative, too.

| | | |
|---------|--------|--------|
| R2 | 1,188 | -1d |
| R1 | 1,169 | |
| EUR/USD | 1,1642 | 0,0047 |
| S1 | 1,1511 | |
| S2 | 1,1331 | |



EUR/USD: euro rebounds on higher EMU yields, despite risk-off



USD/JPY: risk-off weighs, but less than usual

In this context we change our day-to-day bias for EUR/USD from negative to neutral. For now, there are also no indications of selling pressure on EUR/JPY due to the global risk-off sentiment.

From a technical point of view, EUR/USD dropped below 1.1670/62 support, the subsequent follow-through price action occurred very slow. Still the pair dropped to a new post-ECB low on Tuesday. A sustained break would confirm that the recent EUR/USD uptrend is broken. EUR/USD 1.1423 (38% retracement of 2017 rise) is the next downside target on the charts. USD/JPY's momentum was positive in past months. The pair regained 110.67/95 resistance and tested the 114.49 MT range top, but the attempt failed. A sustained break would improve the technicals. We remain cautious to preposition for further USD/JPY gains. This week's price action remains unconvincing.

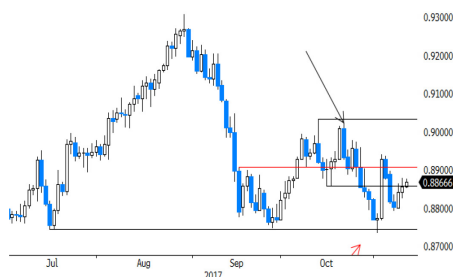
| | | |
|---------|--------|--------|
| R2 | 0,9307 | -1d |
| R1 | 0,9033 | |
| EUR/GBP | 0,8856 | 0,0016 |
| S1 | 0,8743 | |
| S2 | 0,8657 | |

Brexit continues to dominate GBP trading

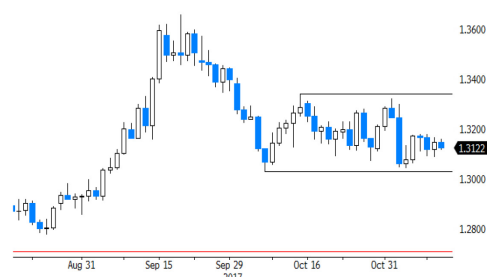
Sterling felt additional selling pressure yesterday. There were no important economic data in the UK. Investors kept a close eye on the next round of official Brexit negotiations that started in Brussels. EU negotiators were said to maintain a very cautious approach as they tried to ponder the consequences of the political turmoil in the UK. The overall risk-off context is usually a negative for sterling, too. EUR/GBP closed the session at 0.8856 (from 0.8840). Cable finished the session at 1.3145. The pair received some support from overall USD weakness.

The UK September production data, the trade balance and the NIESR GDP estimate will be published today. Production is expected to rise at a modest pace (0.3% M/M). The trade deficit is expected to narrow after a bad figure the previous month. We don't expect the data to bring additional negative news for sterling. Markets will be more focused on the Brexit negotiations in Brussels. Press headlines suggest that the negotiations on the border between Ireland and Northern Ireland are more difficult than previously expected. This might be a slightly additional negative for sterling. A risk-off context also doesn't help sterling. So, we maintain a cautious upward bias for EUR/GBP.

MT technical: Sterling rebounded in September as the BoE prepared markets for a rate hike. This rebound ran into resistance as markets anticipated that any rate hikes would be very gradual and limited. This view was confirmed at last week's BoE policy meeting. EUR/GBP currently trades in a 0.8733/0.9033 consolidation range. A downside test of this range was rejected last week. We maintain the view that the 0.8733 -0.8652 support area will be tough to break in a sustainable way. A EUR/GBP buy-on-dips approach is favoured. EUR/GBP 0.9023/33 is the first important resistance.



EUR/GBP: off recent low, but no sustained rebound, yet



GBP/USD: downside test rejected. Cable holds sideways consolidation pattern

Calendar

| Friday, 10 November | | Consensus | Previous |
|---------------------|--|------------------|------------------|
| US | | | |
| 16:00 | U. of Mich. Sentiment (Nov P) | 100.6 | 100.7 |
| 16:00 | U. of Mich. Current Conditions (Nov P) | -- | 116.5 |
| 16:00 | U. of Mich. Expectations (Nov P) | -- | 90.5 |
| 16:00 | U. of Mich. 1 Yr Inflation (Nov P) | -- | 2.4% |
| 16:00 | U. of Mich. 5-10 Yr Inflation (Nov P) | -- | 2.5% |
| Japan | | | |
| 00:50 | Money Stock M2 YoY (Oct) | A: 4.1% | 4.0% |
| 00:50 | Money Stock M3 YoY (Oct) | A: 3.5% | 3.4% |
| China | | | |
| 10NOV-15NOV | Money Supply M2 YoY (Oct) | 9.2% | 9.2% |
| 10NOV-15NOV | New Yuan Loans CNY (Oct) | 770.0b | 1270.0b |
| 10NOV-15NOV | Aggregate Financing CNY (Oct) | 1100.0b | 1820.0b |
| UK | | | |
| 10:30 | Industrial Production MoM / YoY (Sep) | 0.3%/1.9% | 0.2%/1.6% |
| 10:30 | Manufacturing Production MoM / YoY (Sep) | 0.3%/2.4% | 0.4%/2.8% |
| 10:30 | Construction Output SA MoM / YoY (Sep) | -0.9%/1.6% | 0.6%/3.5% |
| 10:30 | Visible Trade Balance GBP/Mn (Sep) | £12800 | £14245 |
| 10:30 | Trade Balance Non EU GBP/Mn (Sep) | £4500 | £5835 |
| 14:00 | NIESR GDP Estimate (Oct) | -- | 0.4% |
| France | | | |
| 08:45 | Industrial Production MoM / YoY (Sep) | 0.5%/3.1% | -0.3%/1.1% |
| 08:45 | Manufacturing Production MoM / YoY (Sep) | 0.8%/3.4% | -0.4%/1.1% |
| 08:45 | Wages QoQ (3Q P) | 0.3% | 0.4% |
| 08:45 | Private Sector Payrolls QoQ (3Q P) | 0.3% | 0.4% |
| Italy | | | |
| 10:00 | Industrial Production MoM / WDA YoY (Sep) | -0.4%/4.5% | 1.2%/5.7% |
| Belgium | | | |
| 10NOV-20NOV | Budget Balance YTD (Oct) | -- | -9.923b |
| Norway | | | |
| 08:00 | CPI MoM / YoY (Oct) | 0.3%/1.4% | 0.6%/1.6% |
| 08:00 | CPI Underlying MoM / YoY (Oct) | 0.2%/1.0% | 0.5%/1.0% |
| Events | | | |
| 13:30 | ECB's Mersch Speaks in Windsor, England | | |

| 10-year | Close | -1d | 2-year | td | -1d | Stocks | Close | -1d | |
|------------|--------|---------|------------|-----------|---------|-------------|----------|---------|--------|
| US | 2,34 | 0,01 | US | 1,63 | -0,01 | DOW | 23461,94 | -101,42 | |
| DE | 0,38 | 0,05 | DE | -0,75 | 0,01 | NASDAQ | 6750,053 | -39,07 | |
| BE | 0,62 | 0,06 | BE | -0,62 | 0,02 | NIKKEI | 22681,42 | -187,29 | |
| UK | 1,27 | 0,04 | UK | 0,48 | 0,02 | DAX | 13182,56 | -199,86 | |
| JP | 0,04 | 0,01 | JP | -0,18 | 0,02 | DJ euro-50 | 3612,5 | -42,54 | |
| | | | | | | | | | |
| IRS | EUR | USD | GBP | EUR | -1d | -2d | USD | -1d | -2d |
| 3y | -0,08 | 1,94 | 0,90 | Eonia | -0,3550 | 0,0010 | Libor-1 | 1,2461 | 0,0000 |
| 5y | 0,20 | 2,08 | 1,05 | Euribor-1 | -0,3710 | 0,0010 | Libor-3 | 1,4098 | 0,0000 |
| 10y | 0,84 | 2,32 | 1,33 | Euribor-3 | -0,3290 | 0,0000 | Libor-6 | 1,6016 | 0,0000 |
| | | | | Euribor-6 | -0,2760 | 0,0000 | | | |
| | | | | | | | | | |
| Currencies | Close | -1d | Currencies | Close | -1d | Commodities | Close | -1d | |
| EUR/USD | 1,1642 | 0,0047 | EUR/JPY | 132,1 | 0,07 | CRB | 191,87 | -0,02 | |
| USD/JPY | 113,47 | -0,40 | EUR/GBP | 0,8856 | 0,0016 | Gold | 1287,50 | 3,80 | |
| GBP/USD | 1,3145 | 0,0029 | EUR/CHF | 1,1571 | -0,0025 | Brent | 63,93 | 0,44 | |
| AUD/USD | 0,768 | 0,0002 | EUR/SEK | 9,7534 | 0,0360 | | | | |
| USD/CAD | 1,2683 | -0,0046 | EUR/NOK | 9,4668 | -0,0020 | | | | |

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