



Sunrise

Friday, 15 December 2017

Rates: Trading expected to shift in lower gear

Today's eco calendar is thin with only US empire manufacturing and industrial production. We don't expect them to influence trading. With the final key events of the year behind us, volumes will probably slow to a trickle. That could cause some erratic moves in coming days.

Currencies: USD trading to shift into year-end modus

Strong EMU/US eco data and a mixed ECB message failed to give clear guidance for EUR/USD trading yesterday. In the end, the topside in EUR/USD still looks rather well protected given divergent guidance from the ECB and the Fed. The fate of the US tax bill remains a wildcard for USD trading going into the end of the year.

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 up to 0.4% lower yesterday. Most Asian indices record losses as well this morning with China underperforming (-1%).**
- President Trump's drive to win passage of a sweeping Republican tax bill in the US Congress hit potential obstacles as **two more Republican senators insisted on changes, joining a list of lawmakers whose support is uncertain.**
- **EU leaders applauded British PM May for her work so far on Brexit**, assuring her at a summit in Brussels that sufficient progress has been made to allow Britain to move on to the next stage of leaving the union.
- The Canadian dollar recovered its vim on Thursday after **Bank of Canada** governor Poloz said **the central bank is growing "increasingly confident" that the economy will need less stimulus over time.**
- **Business conditions in Japan improved still further in the fourth quarter** as the Bank of Japan's Tankan index registered the best quarter for the country's big manufacturers in eleven years.
- A new dissenter on the **Bank of Japan** board calling for more stimulus has prompted the BOJ to adjust its communications **to flag risks of additional easing**, according to people familiar with the central bank's discussions.
- **Today's eco calendar** contains US industrial production data and empire manufacturing. ECB Nowotny and Rimsevic are scheduled to speak.

Rates

Core bonds weather the “storm”

Global core bonds ended near opening levels yesterday. Given developments of the last 48 hours, the Bund and US Note future have shown quite resilient.

First, the Fed as anticipated continued its tightening cycle on Wednesday night while also leaving the 2018 (3 hikes) and 2019 (2 hikes) scenarios in place. The December hike was discounted, but the 2018/2019 path isn't. Second, EMU (December PMI survey) and US data (November retail sales; weekly jobless claims) printed very strong and confirm both economies' momentum. Finally, the ECB kept policy unchanged, but significantly upgraded its growth outlook. Dovishness on inflation prevailed though. [Click here for an extended review of yesterday's policy meeting.](#)

In a daily perspective, the German yield curve flattened with yield changes ranging between +3.1 bps (2-yr) and -2.5 bps (30-yr). Changes on the US yield curve were quite similar, varying between +3.7 bps (2-yr) and -2.1 bps (30-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany narrowed up to 2 bps with Spain (-5 bps), Portugal (-6 bps) and Greece (-15 bps) outperforming.

Today's EMU eco calendar is empty apart from speeches by ECB Nowotny and Rimcevics. Both gentlemen speak at national events, suggesting they'll refrain from commenting on monetary policy. If they nevertheless do so, you could expect some hawkish counterweight to yesterday's dovish Draghi comments. ECB monetary hawks remain a minority on the board though, limiting their market moving potential at this stage. **The US eco calendar contains December empire manufacturing and November industrial production.** The empire manufacturing index is expected to show a small decline from 19.4 to 18.7. Industrial production is forecast to normalize at 0.3% M/M following a post-storm rebound in October (0.9% M/M).

Core bonds show resilience given Fed, ECB and eco data

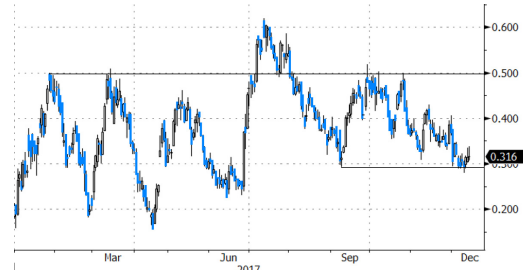
Flattening curves with underperformance front end

	US yield	-1d
2	1,81	0,04
5	2,15	0,03
10	2,35	0,01
30	2,72	-0,02

	DE yield	-1d
2	-0,71	0,03
5	-0,34	0,01
10	0,32	0,00
30	1,13	-0,02



German Bund (intraday): ECB-meeting was a non-event



German 10-yr yield bounced off 0.3% support this week. We expect a return higher in the range into yearend.

R2	165,18	-1d
R1	163,67	
BUND	163,45	-0,04
S1	161,49	
S2	159,78	

Trading expected to shift in lower gear

Most Asian stock markets lose ground overnight with China underperforming (-1%).

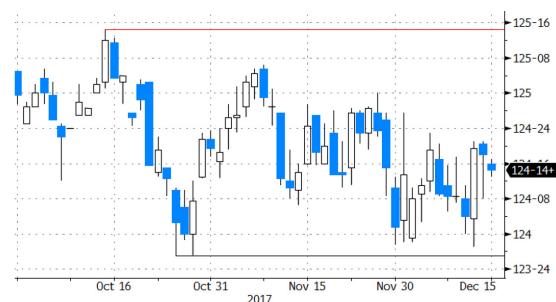
The US Note future nevertheless trades with a small downward bias. Several dollar crosses also point in different directions, giving no strong indication for the start of dealings. The Bund could marginally profit from a weaker European equity opening.

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Technically, the US Note future trades in the 123-27/125-14+ sideways range. In yield terms, we eye a test of 2.47% into year-end. The Fed remains on path to hike rates three times next year and that's not yet completely discounted. US tax reforms will probably get a green light before the end of the year, moving attention to an infrastructure plan early 2018. The **German Bund** set a new contract high earlier this week, but this wasn't confirmed by a drop of the German 10-yr yield below 0.3%. **We don't anticipate such move and suggest putting short positions around current levels. Strong present and expected growth warrants such move. We think that the ECB will have to change its guidance on APP and interest rates in 2018, acknowledging these developments.**



German Bund (March contract!): New contract high, but break wasn't confirmed with move of German 10y yield below 0.3%. We don't expect that to happen and suggest putting up short positions



US Note future (March contract): within sideways range. Heading for test of downside?

Currencies

USD/JPY and EUR/USD show mixed picture

USD/JPY and USD/EUR go separate ways on mixed news flow

Asian equities fall prey to modest profit taking

BOJ Tankan survey indicates further economic rebound

Dollar shows no clear trend

Eco calendar modestly interesting

US politics/tax bill remain a wild card

Trading to develop in thin market conditions

R2	1,2225	-1d
R1	1,2092	
EUR/USD	1,1778	-0,0048
S1	1,1554	
S2	1,1331	

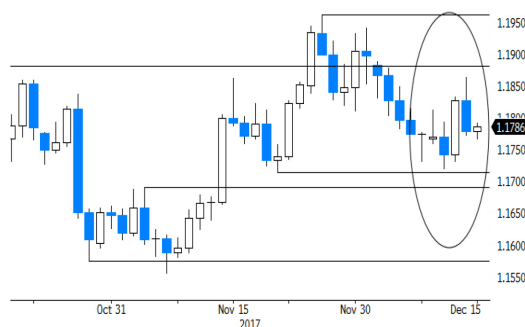
There was plenty of eco and central bank news yesterday. Initially, no theme was able to give USD trading a clear direction. Eco data were strong both in the US and in EMU. The ECB brought a mixed signal with a sharp upward revision for its growth forecast but with inflation still expected to rise only very gradually. Finally EUR/USD drifted back south below the 1.18 barrier as EMU yields declined more than US ones. The pair closed the session at 1.1778, reversing part of the post-Fed rise. At the same time, USD/JPY traded with a negative bias (cautious risk-off, lower core yields). The pair finished at 112.39.

Major Asian equities indices mostly trade in negative territory showing losses between 0.5% and 1.0%. The closely watched large manufacturing index in the Q3 Japan Tankan report rose from 22 to 25, the highest level in 11 years. Other sub-indices also suggest an improvement in the broader economic performance including a tightening labour market and tentative signs of price rises. For now this is not enough for markets to expect that the BOJ will change its ultra-easy monetary policy in the foreseeable future. USD/JPY trades in the 112.15 area, near the post-Fed low. Uncertainty on the fate of the US tax bill might play a role. EUR/USD trades sideways in the 1.1785 area.

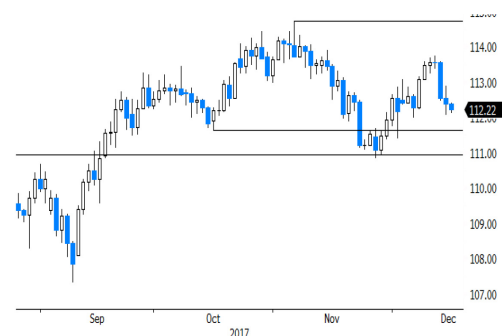
There are no important data Europe today. The US Empire manufacturing survey and November production data will be published. NY manufacturing confidence is expected to ease slightly further off very high levels reached over the previous months. US production growth is expected to ease to 0.3% after strong October data. These data are usually only of intraday significance for trading.

With most key eco data and key central bank meetings out of the way, FX markets will gradually shift to year-end modus. Declining market liquidity will result in more erratic trading. Markets will keep a close eye on the final outcome of the US tax debate. An agreement, even if 'imperfect', might still be slightly positive for the dollar. The combined position of the Fed (ongoing policy normalisation) and the ECB (ongoing soft inflation assessment) in theory should cap any sustained EUR/USD gains for now. We maintain the working hypothesis that a break beyond the 1.1961 resistance will be difficult except in case of negative (political) news from the US.

Technical picture. EUR/USD set a post-ECB low mid-November, but the USD's momentum wasn't strong enough. EUR/USD settled in a directionless consolidation pattern in the 1.17/19 area.



EUR/USD: Fed nor ECB were able to unlock recent stalemate



USD/JPY: topside test rejected. Struggles to prevent further losses

The outcome of the ECB and Fed meetings were not able to push EUR/USD out of the recent tight consolidation pattern. A return below 1.1713 would signal an improvement in the ST USD momentum. Next support comes in at 1.1554 (November low). **USD/JPY's momentum** deteriorated early November, dropping below the 111.65 neckline. No aggressive follow-through selling occurred though. Over the previous two weeks, the pair rebounded, calling off the downside alert and returning to **the 110.84/114.73 range**. **We amended our ST bias from negative to neutral. We maintain the view that a sustained break north of 115 will remain difficult.**

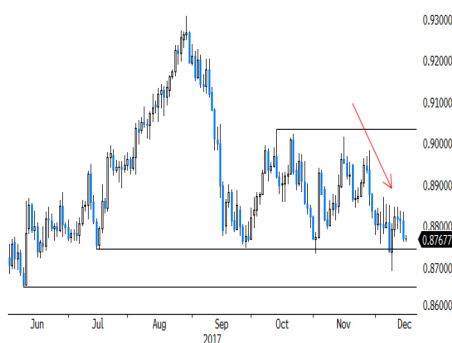
R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8770	-0,0043
S1	0,8690	
S2	0,8657	

Sterling gains, but within established ranges

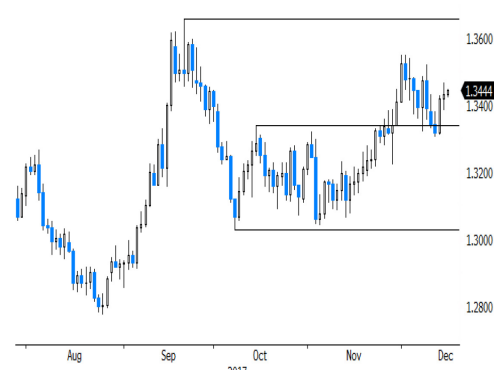
Yesterday, UK November retail sales beat the consensus by a wide margin, but had only a temporary positive impact on sterling. **The BoE as expected left is policy unchanged.** The Bank saw last week's Brexit deal as **reducing the chances of disorderly UK departure**. However, the BoE also saw **tentative signs that the economy might be slowing into the yearend**. There were no specific indications that the BoE considers a next rate hike in the near/foreseeable future. Sterling developed a directionless trading pattern for most of the day. Sterling finally captured a better bid later in the session. The EU supporting PM May's efforts to make progress on Brexit might have been an sterling positive. A cautious EUR/USD decline also weighed on EUR/GBP". EUR/GBP finished the day at 0.8770. Cable closed at 1.3431.

Today, there are no important eco data in the UK. The EU will formally approve that the second phase of the Brexit negotiations can start as enough progress has been made in the separation topics. The approval might support a temporary positive sterling momentum, but we don't expect any sterling rebound to go far. The next phase of the Brexit negotiations will remain very tough, UK PM May faces political hurdles at home and there is no indication that the BoE will take additional action anytime soon. In this context we see little room for a protracted sterling rebound.

Recent developments pushed EUR/GBP lower in the 0.8690/0.9033 consolidation pattern. EUR/GBP tested 0.8693 support (62% retracement), but the test was rejected. Next support comes in at 0.8653. We assume that the 0.8653/90 area won't be easy to break short-term. **We hold a neutral bias on EUR/GBP short-term.** We consider a return to the bottom of this range as an opportunity to reduce sterling long exposure against the euro.



EUR/GBP: sterling momentum improves slightly, but within established range



GBP/USD: decline slows partially on USD softness

Calendar

Friday, 15 December		Consensus	Previous
US			
14:30	Empire Manufacturing (Dec)	18.7	19.4
15:15	Industrial Production MoM (Nov)	0.3%	0.9%
15:15	Capacity Utilization (Nov)	77.2%	77.0%
15:15	Manufacturing (SIC) Production (Nov)	0.3%	1.3%
Japan			
00:50	Tankan Large Mfg Index / Outlook (4Q)	A: 25/19	22/19
00:50	Tankan Large Non-Mfg Index / Outlook (4Q)	A: 23/20	23/19
00:50	Tankan Large All Industry Capex (4Q)	A: 7.4%	7.7%
00:50	Tankan Small Mfg Index / Outlook (4Q)	A: 15/11	10/8
00:50	Tankan Small Non-Mfg Index / Outlook (4Q)	A: 9/5	8/4
EMU			
11:00	Trade Balance SA (Oct)	24.3b	25.0b
Events			
10:00	ECB's Nowotny Presents Austrian GDP Outlook		
11:00	ECB's Rimsevics speaks in Riga press conference		

10-year	Close	-1d	2-year	td	-1d	Stocks	Close	-1d	
US	2,35	0,01	US	1,81	0,04	DOW	24508,66	-76,77	
DE	0,32	0,00	DE	-0,71	0,03	NASDAQ	6856,525	-19,27	
BE	0,51	-0,01	BE	-0,60	0,00	NIKKEI	22553,22	-141,23	
UK	1,17	-0,04	UK	0,45	-0,03	DAX	13068,08	-57,56	
JP	0,05	0,00	JP	-0,16	0,00	DJ euro-50	3556,22	-25,53	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,07	2,10	0,89	Eonia	-0,3620	-0,0020	Libor-1	1,4770	0,0000
5y	0,20	2,20	1,04	Euribor-1	-0,3710	0,0000	Libor-3	1,5885	0,0000
10y	0,79	2,35	1,26	Euribor-3	-0,3310	-0,0020	Libor-6	1,7558	0,0000
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1778	-0,0048	EUR/JPY	132,37	-0,72	CRB	184,22	0,85	
USD/JPY	112,39	-0,15	EUR/GBP	0,8770	-0,0043	Gold	1257,10	8,50	
GBP/USD	1,3431	0,0011	EUR/CHF	1,1650	-0,0006	Brent	63,31	0,87	
AUD/USD	0,7666	0,0029	EUR/SEK	9,9392	-0,0105				
USD/CAD	1,2797	-0,0020	EUR/NOK	9,7738	-0,0720				

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