



Sunrise

Friday, 20 October 2017

Rates: US reflationary spirits in the driving seat?

US Treasuries lost significant ground after the US Senate adopted a budget for the next fiscal year, clearing a crucial hurdle for tax reforms. Reflationary spirits could inflict more losses on US Treasuries given today's eco calendar. European investors might decide to take a wait-and-see attitude with next week's ECB meeting looming on the horizon.

Currencies: US senate vote 'saved' the dollar

The dollar stayed in the defensive yesterday. Interest rate differentials moved against the US currency despite the crisis in Catalonia. A budget vote in the US senate changed fortunes again in favour of the dollar. However, the gain of the dollar against the euro remains modest. EUR/GBP returned to the 0.90 barrier on poor UK eco data and little Brexit progress.

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 recovered from opening losses to the tune of 0.5% to end flat.** Nasdaq underperformed (-0.25%). **Overnight risk sentiment is positive** with Japan underperforming .
- **The US Senate's passage of the budget blueprint for the next fiscal year**, in a 51-49 vote primarily along party lines, **helps unlock a procedure that Republicans plan to use to rewrite the tax code with just GOP votes.**
- **European leaders rebuffed British PM May's pitch to revive stalled Brexit talks**, but German Chancellorl Merkel said she was confident negotiations would advance by **December.**
- **CIA director Pompeo warned** that North Korea could be just "months away" from developing **the ability to strike America** with a nuclear-armed ballistic missile.
- **Separatist campaign group the Catalan National Assembly** is calling on its supporters to pull cash from lenders including CaixaBank SA and Banco Sabadell SA between 8 am and 9 am today.
- **President Trump will support a bipartisan bill of health care only if it includes a series of conservative measures** that Republicans sought in their failed effort to repeal the Affordable Care Act.
- **Today's eco calendar** is extremely thin with only US existing home sales. The Q3 earnings season continues with GE, P&G,...

Rates

US Treasuries outperform Bunds

Investors shrug off Spanish crisis

	US yield	-1d
2	1,53	-0,03
5	1,99	-0,04
10	2,32	-0,03
30	2,86	-0,02

	DE yield	-1d
2	-0,73	-0,01
5	-0,31	0,00
10	0,40	0,00
30	1,25	0,00

Core bonds can't really profit from risk aversion

US Treasuries surprisingly outperformed German Bunds yesterday. Both performed well during European dealings on the back of equity weakness (PBOC governor Zhou warned of Minsky moment) and Spanish developments (Madrid initiated article 155). The Bund soon returned towards opening levels and any Spanish asset underperformance was rapidly undone as well, in line with previous days. Investors clearly think that the Spanish-Catalan stand-off won't spiral out of control. **US eco data printed very strong** with historically low jobless claims and a strong Philly Fed Business outlook, but it was only when US stock markets started reversing opening losses that US Treasuries also started sliding back. Minutes before the closing bell, Treasuries spiked again higher on headlines that Politico reported that Trump was leaning toward Powell for Fed chair.

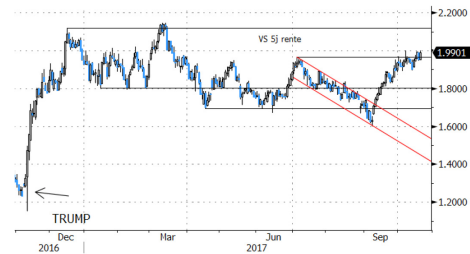
At the end of the day, US yields declined by 4 bps (5-yr) to 1.9 bps (30-yr). Changes on the German yield curve were limited between -0.1 bp (30-yr) and -0.9 bps (2-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany closed nearly unchanged with Portugal outperforming (-4 bps) and Greece underperforming (+5 bps).

Eco calendar won't play a role of importance

Today's eco calendar is unattractive with only US existing home sales. US housing data recently showed signs of peaking. Consensus expects a 0.9% M/M decline in September. This data series won't impact trading though. Cleveland Fed Mester speaks on global regulatory structure. **After US close, Fed chairwoman Yellen talks on monetary policy since the financial crisis.** It's probably one of the last speeches before the black period kicks in. Yellen has on several occasions suggested that the US central bank should continue its gradual rate hikes. A December rate hike is largely discounted, so markets will only react if she changes her mind which we deem unlikely.



US Note future (orange) & S&P future (black)(intraday):US Treasuries lose ground as equities recover from opening weakness



US 5-yr yield about to move north of 2% for the first time since March

US inflationary spirits in the driving seat?

R2	163,43	-1d
R1	162,19	
BUND	162,01	0,10
S1	160,49	
S2	159,80	

Asian stock markets trade positive with Japan underperforming (flat). US Treasuries lost significant ground while the dollar profited after the US Senate adopted a budget for the next fiscal year, clearing a crucial hurdle for tax reforms. We expect some spill over effects in the Bund in the opening.

Eco data and central bankers won't impact trading today. The Catalan-Madrid stand-off escalated to a new phase, but investors remain very calm. It's hard to tell which card investors will play today. The US Senate's budget approval could spark the reflation trade, weighing on core bonds with an underperformance of US Treasuries. European investors might decide to take a wait-and-see attitude though with next week's ECB meeting looming on the horizon. Risk sentiment on stock markets is a wildcard for trading with main indices showing some signs of vulnerability. Profit taking on stock markets ahead of the weekend could in this scenario underpin core bonds.

Technically, the German Bund broke above the 162 mark, implying a full retracement towards the contract high. European election outcomes (Germany, Austria, Catalonia) and ECB rumours caused outperformance vs the US Note future. **We hold a sell-on-upticks strategy in the US Note future (entry around 126), but put it on hold for the Bund ahead of the ECB meeting.**



German Bund: Counting down to ECB meeting



US Note future: Consolidation pattern still in place

Currencies

Dollar saved by US Senate vote

Euro outperformed despite Spain suspending Catalan regional powers

(Temporary) risk-off weighed on the dollar

Dollar rebounds on tax reform hopes

Asian markets trade mixed despite US optimism

Eco calendar is very thin

The 'fall-out' from the US budget plans will be an important driver for USD trading today

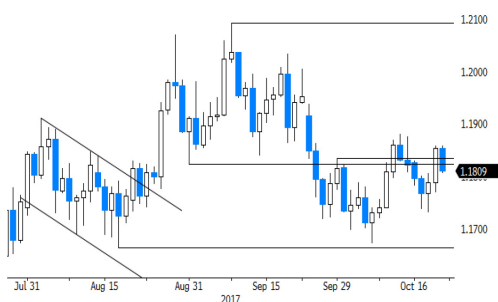
All eyes were on Spain yesterday. EUR/USD spiked lower as the Spanish government initiated the process of suspending the regional powers of the Catalan government. However, the euro decline was almost immediately reversed. EUR/USD even moved in positive territory. A tentative global risk-off sentiment caused US Treasuries to outperform German bunds, reducing the interest rate differential in favour of the euro. EUR/USD finished the session at 1.1852 (from 1.1787). USD/JPY closed the day at 112.54.

Overnight, the US Senate adopted a fiscal 2018 resolution which is an important step for a tax overhaul further down the road. The approval triggered a rebound in US bond yields and supported the dollar. USD/JPY jumped north of 113. EUR/USD returned to the 1.18 area. The hope on a US tax reform also propelled US equity futures. **The impact on Asian equity markets is diffuse and modest.** The Hong Kong market reverses part of yesterday's late session decline. Japanese indices are little changed despite the rise of USD/JPY. Investors look forward to the outcome of the Japanese parliamentary elections to be held this weekend. **The Kiwi dollar declined further below 0.70 after the formation of a government with Labour and the New Zealand first party.**

The eco calendar is extremely thin today. There are no important data in EMU. US the existing homes sales (September) will only be of intraday significance for USD trading, at best. **Fed's Yellen will give a lecture on 'Monetary policy since the Financial crisis' after the US close.** We don't expect the Fed chair to change her view on the Fed's policy action in the near future.

A global risk off context, partially inspired by tensions in Catalonia weighed more on the dollar than on the euro yesterday as interest rates in the US declined more than in EMU. **Overnight fortunes changed again in favour of the dollar as US yields jumped higher on the approval of a 2018 budget resolution in the US Senate.** The rise in US yields and a constructive risk sentiment support the dollar overnight. **The gains of the dollar against the euro remain modest.** EUR/USD still trades north of 1.18. We see room for some further USD gains today. **However, the price action earlier this week indicated that it wasn't that easy for the dollar to gain ground against the euro even if the move was supported by a favourable interest rate differential.** The day-to-day picture of USD/JPY is improving and the pair is nearing the recent highs. Investors will look out for the outcome of the Japanese elections. The prospect of the continuation of Abenomics (including an easy monetary policy) might be a slightly negative for the yen.

R2	1,2225	-1d
R1	1,2167	
EUR/USD	1,1852	0,0065
S1	1,1662	
S2	1,1311	



EUR/USD: Holding tight ranges, despite plenty of 'event risk'



USD/JPY extends gains on higher core yields and risk-on sentiment

From a technical point of view, EUR/USD dropped below the 1.1823/ 1.2070 consolidation pattern, but no real test of the **1.1662 support occurred**. Last week, the pair even returned (temporary?) above the **1.1823 previous range bottom**, which was disappointing for EUR/USD bears. We maintain a cautious sell-on upticks bias. However, the pair needs to drop below 1.1670/62 support to really give comfort to EUR/USD bears. **The USD/JPY momentum was constructive in September**. The pair regained 110.67/95 (previous resistance), a short-term positive. The 114.49 correction top is the next important resistance. Sentiment improved again this week, but we still assume that a break beyond 114.49 will be difficult.

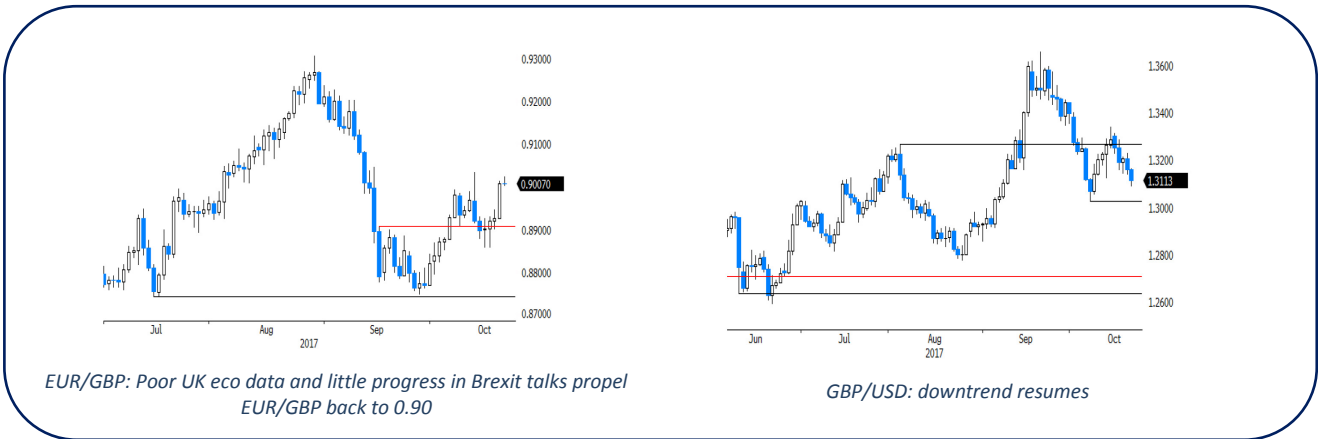
EUR/GBP returns to 0.90 barrier

R2	0,9415	-1d
R1	0,9307	
EUR/GBP	0,9007	0,0081
S1	0,8743	
S2	0,8657	

UK retail sales fell by 0.8% M/M in September, reversing a rise of 0.9% the previous month. The report suggested that there is little room for the BoE to raise its policy rate beyond a sole rate hike in November. **This prospect of little additional interest rate support weighed further on sterling yesterday**. EUR/GBP spiked to the **0.8990 area and held close to that level for the remainder of the session**. At the EU summit, German Chancellor Merkel indicated that both parties in the EU-Brexit talks should move so that a deal on the divorce can be reached by the end of the year. However, there were no concrete steps. **The statement didn't help sterling much**. EUR/GBP even closed the session north of 0.90 (0.9006). Cable finished the day at **1.3159**.

Monthly UK budget data will be published today. However, we don't expect this data series to have a lasting impact on sterling trading. The UK currency remains in the defensive this morning, both against the euro and the dollar. Recent eco data reinforced investors' feeling that any interest rate support for sterling in the near future will be very limited. At the same time, there is no noticeable progress in the Brexit talks. **We hold on to the view that any upside of sterling will be difficult**. We look to buy EUR/GBP on dips.

EUR/GBP staged a strong uptrend from April till late August to set a top at 0.9307. Rising UK inflation data and hawkish BoE comments reinforced a sterling rebound, but **this rebound has run its course**. EUR/GBP supports at 0.8743 and 0.8652 proved difficult to break. **The recent rebound above 0.89 improved the ST technical picture of EUR/GBP**, but for now there were no convincing follow-through gains. **EUR/GBP 0.9026 is 50% retracement of the recent countermove**.



Calendar

Friday, 20 October		Consensus	Previous
US			
16:00	Existing Home Sales / MoM (Sep)	5.30m/-0.9%	5.35m/-1.7%
Canada			
14:30	CPI NSA MoM / YoY (Sep)	0.3%/1.7%	0.1%/1.4%
UK			
10:30	Public Sector Net Borrowing (Sep)	5.7b	5.1b
10:30	PSNB ex Banking Groups (Sep)	6.5b	5.7b
EMU			
10:00	ECB Current Account SA (Aug)	--	25.1b
Germany			
08:00	PPI MoM / YoY (Sep)	0.1%/2.9%	0.2%/2.6%
Events			
Q4 Earnings	GE (before market), P&G (13:00),...		
20:00	Fed's Mester Speaks on Global Regulatory Structure		

10-year	Close	-1d	2-year	td	-1d	Stocks	Close	-1d	
US	2,32	-0,03	US	1,53	-0,03	DOW	23163,04	5,44	
DE	0,40	0,00	DE	-0,73	-0,01	NASDAQ	6605,067	-19,15	
BE	0,66	0,00	BE	-0,58	-0,01	NIKKEI	21457,64	9,12	
UK	1,28	-0,04	UK	0,42	-0,02	DAX	12990,1	-52,93	
JP	0,08	0,01	JP	-0,13	0,01	DJ euro-50	3602,08	-17,57	
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>-1d</u>	<u>-2d</u>
3y	-0,07	1,89	0,89	Eonia	-0,3600	0,0000	Libor-1	1,2389	0,0000
5y	0,22	2,04	1,04	Euribor-1	-0,3730	0,0000	Libor-3	1,3626	0,0000
10y	0,85	2,30	1,32	Euribor-3	-0,3290	0,0000	Libor-6	1,5506	0,0000
				Euribor-6	-0,2740	0,0000			
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1852	0,0065	EUR/JPY	133,38	0,26	CRB	184,07	0,08	
USD/JPY	112,54	-0,40	EUR/GBP	0,9007	0,0081	Gold	1290,00	7,00	
GBP/USD	1,3159	-0,0046	EUR/CHF	1,1571	0,0001	Brent	57,23	-0,92	
AUD/USD	0,7878	0,0032	EUR/SEK	9,6323	0,0341				
USD/CAD	1,2485	0,0018	EUR/NOK	9,4011	0,0183				

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