# Sunrise

**Wednesday, 28 June 2017**

## Rates: Draghi steps up to the plate

Markets will further digest ECB president Draghi's comments. Can "deflationary replaced by reflationary forces" become the new "whatever it takes"? We recommend a sell-on-upticks strategy in the Bund. On EMU bond markets, it could mark an end to the long-term narrowing trend.

## Currencies: EUR/USD and EUR/GBP testing key resistance levels

A combination of hawkish comments from ECB's Draghi and negative (political) headlines from the US propelled EUR/USD for an extensive test of the 1.1300/66 resistance. A break would be significant from a technical point of view. Euro sentiment is strong, but an equity correction remains a wildcard for global FX trading. EUR/GBP is also testing the 2017 top.

## 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 | ↗ |

- **Wall Street was knocked hard** in the wake of a delay to a US healthcare reform vote in Senate, the IMF's US growth forecast downgrade, a tech sell-off (Nasdaq -1.5%) and Fed Yellen's warning of "somewhat rich" asset valuations. **Asian stock markets** manage to limit losses overnight.
- **Energy stocks rose as the broadly weaker tone of the dollar helped oil prices** extend their recent rally from multi-month lows. **Gold also benefited from a weaker dollar overnight,** though still not recovered from the fat-finger sell off.
- The **Chinese yuan surged** for a second day **amid speculation of central bank intervention.** Meanwhile the **euro rose on ECB Draghi's more hawkish tone** with EUR/USD now around 1.135 and EUR/JPY just above 127. ECB's Constancio confirmed in an interview that Draghi's speech was in line with policy.
- A **new cyberattack similar to WannaCry** has reached Asia after spreading from Europe to the US overnight, hitting businesses, port operators and government systems.
- In a CNBC interview, **Bank of Canada's Poloz said rate cuts have done their job** and **stated that excess capacity seems close to being used up.** This shows that the BoC is coming closer to changing its monetary policy towards hiking.
- A **trio of Fed officials**, including Chair Yellen, **pointed (although very cautiously) to the potential overvaluation of assets.** This could mean that financial stability is gaining some interest in the monetary policy decision mix.
- The **eco calendar is thin with only US pending home sales, EMU M3 money supply and a US 7-yr Note auction.** Today is also the final day of the ECB forum in Sintra.

# Rates

## Disarray in bond land, as Draghi prepares policy turn

*Draghi surprises markets and leaves Bunds with huge losses*

*Strong US eco data and comments of Yellen went almost unnoticed*

*Peripheral bonds held up surprisingly well*

| | US yield | -1d |
|---|---|---|
| 2 | 1,37 | 0,04 |
| 5 | 1,84 | 0,06 |
| 10 | 2,21 | 0,07 |
| 30 | 2,77 | 0,05 |

| | DE yield | -1d |
|---|---|---|
| 2 | -0,56 | 0,06 |
| 5 | -0,24 | 0,12 |
| 10 | 0,37 | 0,13 |
| 30 | 1,17 | 0,11 |

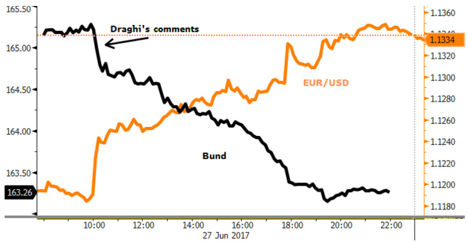
**ECB president Draghi surprised traders and investors yesterday as he explained how the ECB could gradually unwind its non-conventional stimulus measures.** It was clearly a turnaround of the ECB president, who sounded optimistic on growth, even if he remained very cautious and suggested that policy changes should be very gradually and depending on improving dynamics in the economy. *"As the economy continues to recover, a constant policy stance will become more accommodative, and the central bank can accompany the recovery by adjusting the parameters of its policy instruments -- not in order to tighten the policy stance, but to keep it broadly unchanged."* **Mario Draghi repeated that the governing council needs to be patient in letting inflation pressures build, but his remarks should nevertheless be considered as an early signal that policy will be adapted with a formal announcement of tapering likely at the September meeting.** Of course, the economy and inflation should evolve as expected. Other news went to the background and didn't impact trading. **US consumer confidence and Richmond Fed manufacturing** were strong and stronger than expected. **Philly Fed Harker** repeated his previous comments. **Chairwoman Yellen** covered a lot of issues, but didn't come back on her post FOMC comments. The **US 5-year Note auction** was a little weak.

**The Bund** was relentlessly sold from Draghi's comments into the close and **ultimately shed a massive 189 ticks to 163.26, painting a bearish double top on the chart** amid high volumes. **The US Note future** followed the Bund lower, but limited the daily losses to 16/32. It touched the previous low, but a break didn't occur.. **In a daily perspective,** German yields increased 5.9 bps (2-yr) to 12.5 bps (10-yr), while US yields added 3.7 bps (2-yr) to 6.8 bps (10-yr). **On the intra-EMU bond markets,** yield spreads versus Germany were small Italy that underperforming (+4 bps) ahead of supply and Greece outperforming (-6 bps).

## Thin calendar

*Second tier releases*

**The eco calendar contains mostly second tier releases with little market moving potential.** That's the case for June French consumer confidence (upward risk in the wake of the elections?), Italian June HICP (suggesting another month of declining headline inflation?),US wholesale inventories (neutral) and US pending home sales (rebound following back-to-back declines in March/April?). The **trade balance deficit** is expected to have fallen slightly in May, but the Q2 trade deficit will nevertheless surpass Q1 deficit, suggesting a negative contribution to Q2 GDP. **EMU M3 money supply** data should show ongoing expansion of M3 around 5% and a slow recovery of the bank lending.




*Bund future (black) & EUR/USD (orange): Draghi's turnaround wakes markets from hibernation*


*German 10-yr yield propelled higher in sideways range.*

| | | |
|---|---|---|
| R2 | 165,93 | -1d |
| R1 | 165,55 | |
| **BUND** | 162,96 | -1,39 |
| S1 | 161,68 | |
| S2 | 160,17 | |

## US concludes end-of-month refinancing operation

**The US Treasury continued its end-of-month refinancing operation with a soft $34B 5-yr Note auction.** The auction stopped with a moderate tail and the bid cover (2.33) was the lowest since February. Bidding details showed decent indirect and direct bids, but a disappointing dealer bid. The US Treasury ends its refinancing operation tonight with a $13B 2-yr FRN auction and a **$28B 7-yr Note auction**. The WI of the latter trades currently around 2.045%.

## Draghi steps up to the plate

**Most Asian stock markets lose marginally ground overnight with China underperforming (**-0.5%). Losses remain modest given WS's correction lower (Nasdaq underperforming; -1.5%). Brent crude extends its modest correction higher, while the US Note future trades with a small downward bias. We expect a neutral opening for the Bund.

**Today's eco calendar** only contains second tier US eco data while Fed Williams already spoke recently. Markets will further digest ECB president Draghi's comments. **Can "deflationary replaced by reflationary forces" become the new "whatever it takes"?** We recommend **a sell-on-upticks strategy in the Bund** with markets further positioning towards the next step in the ECB's normalisation process (unwinding asset purchases). Technically, the German 2-yr yield broke above important resistance (-0.63%/-0.60%), painting a multiple bottom formation on the charts. On EMU bond markets, it could mark an end to the long-term narrowing trend. US yields rose to a lesser extent yesterday, but the 10-yr yield followed the 5-yr yield and settles back above key support. We also support **a sell-on-upticks strategy in US Treasuries** as markets are too dovish positioned given the Fed's future tightening intentions.

**The (US) equity market correction and Trump's legislative problems could play an impeding role in our strategy short term.**


*German Bund: Sell-on-upticks. Bearish double top formation in place*


*US Note future: Sell-on-upticks, but equity correction & US legislative process could hinder our strategy short term*

# Currencies

## Draghi propels euro. Yellen fails to help the dollar

*EUR/USD shines on Draghi comments/negative US headlines*

*USD/JPY gains moderately on higher core yields*

**The stalemate in USD trading ended yesterday, as ECB's Draghi said the economic improvement could lead to a gradual ECB policy change. The euro jumped higher. Later on, the dollar was sold as the IMF downgraded its US growth forecast and the vote on the US health care bill was delayed. EUR/USD jumped north of 1.13. Fed's Yellen repeated her intention to continue a gradual rate hike path, but it couldn't help the dollar, at least not against the euro. EUR/USD closed the day at 1.1339. USD/JPY behaved differently. The rise in core yields and sharp gains in EUR/JPY pushed USD/JPY beyond the 112.13 resistance even as US equities came under pressure. The pair closed the session at 112.35.**

*EUR/USD testing correction top*

*Equity correction caps USD/JPY gains.*

**This morning,** Asian equities trade with modest losses as the sell-off in the tech sector in the US continues to weigh. At the same time, yields remain under upward pressure, while oil struggles to continue its recent rebound. EUR/USD is holding near the rally highs, currently trading in the 1.1347 area. USD/JPY tries to sustain north of 112, but the momentum eases as correction of tech equities tends to support the yen.

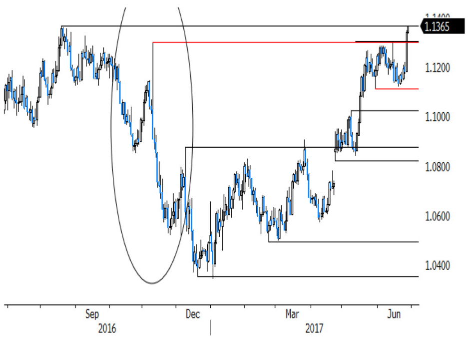
*Eco calendar is thin*

*Euro remains in pole position*

*Equity correction is a wildcard for FX trading.*

**Today,** the eco calendar is again thin. There are only second tier eco data in Europe, while in the US, the trade balance and inventory data won't affect USD trading. **Investors will ponder the impact of yesterday's comments/events and will also keep a close eye at the final day of the ECB forum in Sintra, with comments from ECB's Draghi, BOJ's Kuroda and former Fed president Bernanke.** It's is too early to firmly conclude that the global policy normalisation has started, but tentative signs of such process are multiplying. **Even so, investors focus primarily on adapting positions to the ECB change of tone. The euro should remain well supported short-term. Will EUR/USD be able to take out the 1.1366 resistance?** The FX reaction to a further equity correction is a less straightforward. For now, USD/JPY and EUR/JPY are supported by higher core yields, but this pattern probably won't continue in case of a more protracted equity correction. In this context we stay cautious on further USD/JPY gains, despite the recent good performance. The euro is currently favoured over the dollar. Short-term there is no reason to row against the euro positive tide. However, we are not convinced on the safe haven characteristics of the euro in case of a protracted global risk-off correction. We continue to keep a close eye at EUR/JPY. A reversal in this cross rate at some point might also cap the topside of EUR/USD.

| | | |
|---|---|---|
| R2 | 1,1428 | -1d |
| R1 | 1,13 | |
| **EUR/USD** | 1,1339 | 0,0157 |
| S1 | 1,0839 | |
| S2 | 1,0778 | |




*EUR/USD: 1.1300/66 resistance under heavy strain on Draghi comments and negative US headlines*


*USD/JPY: tests 112.13 resistance on rise in core yields*

## Technical picture: USD still confined to tight ranges

**Early May, EUR/USD failed to break below the 1.0821/1.0778 support (gap).** Poor US data and US political upheaval propelled EUR/USD to a test of the 1.1300 area going into the FOMC decision, but the test was rejected. Yesterday, a combination of hawkish ECB comments and negative US headlines pushed EUR/USD for an intensive test of the 1.1300/66 resistance are. The test is ongoing. A sustained break would be significant from a technical point of view and could open the way to the 1.1616/1.1714 LT correction tops A return below 1.12 (STMA) would be a first indication that the euro rally is easing. A drop below 1.1119 would call off the downward alert.

**The USD/JPY rally** ran into **resistance** in early May and the pair returned lower in the 108.13/114.37 range. The post-Fed USD rebound pushed the pair beyond a first minor resistance at 110.81. The pair yesterday regained the **112.13 correction top, but the test is ongoing . A break would improve the ST-picture.** Even so, were remain cautious on further USD/JPY gains as equity volatility tends to rise.

## EUR/GBP retests 2017 top

**Yesterday,** the Draghi comments sent EUR/GBP-well north of 0.88, but there were also modest positive spill-over effects on cable. In the financial stability report, **the BOE warned on easing credit standards for consumer credit.** The bank increased the cyclical capital buffer from June 2018. **The measures is a kind of monetary tightening and might make a rate hike (slightly) less probable.** Especially EUR/GBP remained well bid after the financial stability report and closed the session at 0.8863. Cable profited from a soft dollar and closed the day at 1.2814.

| | | |
|---|---|---|
| R2 | 0,8881 | -1d |
| R1 | 0,8866 | |
| **EUR/GBP** | 0,8848 | 0,0058 |
| S1 | 0,8383 | |
| S2 | 0,8314 | |

This morning, the only release of the day, Nationwide UK House prices rose more than expected, but without market impact. So, sterling trading will be driven by global factors (euro strength) and by political/Brexit headlines. The news flow on UK politics remains diffuse, at best and the euro is in good shape. So, there is no reason to row against the EUR/GBP uptrend. A negative risk sentiment, if it would continue, is also more negative for sterling than for the euro.

**From a technical point of view,** EUR/GBP is again testing the 0.8854/66 area (2017 top). The BoE debate on a rate hike caused some volatility recently, but wasn't able to support sustained sterling gains against the euro. A break of the 2017 top would open the way to the 0.90 area. **A return below the 0.8655 correction low would indicate easing pressure on sterling.** Such a break lower will be difficult. A **EUR/GBP buy-on-dips approach remains favoured.**


*EUR/GBP: testing key resistance at 0.8854/66*


*GBP/USD profits from dollar softness rather than USD strength*

# Calendar

| Wednesday, 28 June | | Consensus | Previous |
|---|---|---|---|
| **US** | | | |
| **14:30** | **Advance Goods Trade Balance (May)** | **-$66b** | **-$67.1b** |
| 14:30 | Wholesale Inventories MoM (May P) | 0.2% | -0.5% |
| 14:30 | Retail Inventories MoM (May) | -- | -0.3% |
| **16:00** | **Pending Home Sales MoM / NSA YoY (May)** | **1%/--** | **-1.3%/-5.4%** |
| **Japan** | | | |
| 07:00 | Small Business Confidence (Jun) | A 49.2 | 48.9 |
| **UK** | | | |
| 08:00 | Nationwide House PX MoM / NSA YoY (Jun) | 0.1%/1.9% | -0.2%/2.1% |
| **EMU** | | | |
| **10:00** | **M3 Money Supply YoY (May)** | **5.0%** | **4.9%** |
| **France** | | | |
| 08:45 | Consumer Confidence (Jun) | 103 | 102 |
| **Germany** | | | |
| 08:00 | Import prices (May) M/M Y/Y | -0.6%/4.6%- | 0.1%/6.1% |
| **Italy** | | | |
| 11:00 | CPI EU Harmonized MoM / YoY (Jun P) | 0%/1.4% | -0.1%/1.6% |
| **Spain** | | | |
| 09:00 | Retail Sales SA YoY (May) | 2.2% | 1.8% |
| **Events** | | | |
| | ECB forum in Sintra to conclude | | |
| 09:30 | Fed's Williams Speaks in Canberra | | |
| 15:30 | BOC Poloz speaks at ECB panel | | |
| **19:00** | **US to Sell $28B 7-yr Notes** | | |

| 10-year | Close | -1d | | 2-year | td | -1d | Stocks | Close | -1d |
|---|---|---|---|---|---|---|---|---|---|
| US | 2,21 | 0,07 | | US | 1,37 | 0,04 | DOW | 21310,66 | -98,89 |
| DE | 0,37 | 0,13 | | DE | -0,56 | 0,06 | NASDAQ | 6146,623 | -100,53 |
| BE | 0,72 | 0,12 | | BE | -0,49 | 0,06 | NIKKEI | 20130,41 | -94,68 |
| UK | 1,09 | 0,08 | | UK | 0,27 | 0,03 | DAX | 12671,02 | -99,81 |
| JP | 0,06 | 0,01 | | JP | -0,11 | 0,00 | DJ euro-50 | 3538,32 | -23,44 |
| IRS | EUR | USD | GBP | EUR | -1d | -2d | USD | -1d | -2d |
| 3y | -0,03 | 1,68 | 0,70 | Eonia | -0,3620 | 0,0000 | | | |
| 5y | 0,23 | 1,87 | 0,86 | Euribor-1 | -0,3730 | 0,0010 | Libor-1 | 1,2221 | 0,0000 |
| 10y | 0,82 | 2,18 | 1,20 | Euribor-3 | -0,3310 | 0,0000 | Libor-3 | 1,2948 | 0,0000 |
| | | | | Euribor-6 | -0,2730 | 0,0000 | Libor-6 | 1,4464 | 0,0000 |
| Currencies | Close | -1d | | Currencies | Close | -1d | Commodities | Close | -1d |
| EUR/USD | 1,1339 | 0,0157 | | EUR/JPY | 127,39 | 2,32 | CRB | 170,01 | 1,44 |
| USD/JPY | 112,35 | 0,49 | | EUR/GBP | 0,8848 | 0,0058 | Gold | 1246,90 | 0,50 |
| GBP/USD | 1,2814 | 0,0091 | | EUR/CHF | 1,0888 | 0,0016 | Brent | 46,65 | 0,82 |
| AUD/USD | 0,7583 | -0,0002 | | EUR/SEK | 9,7659 | 0,0150 | | | |
| USD/CAD | 1,3199 | -0,0045 | | EUR/NOK | 9,5487 | 0,0658 | | | |

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