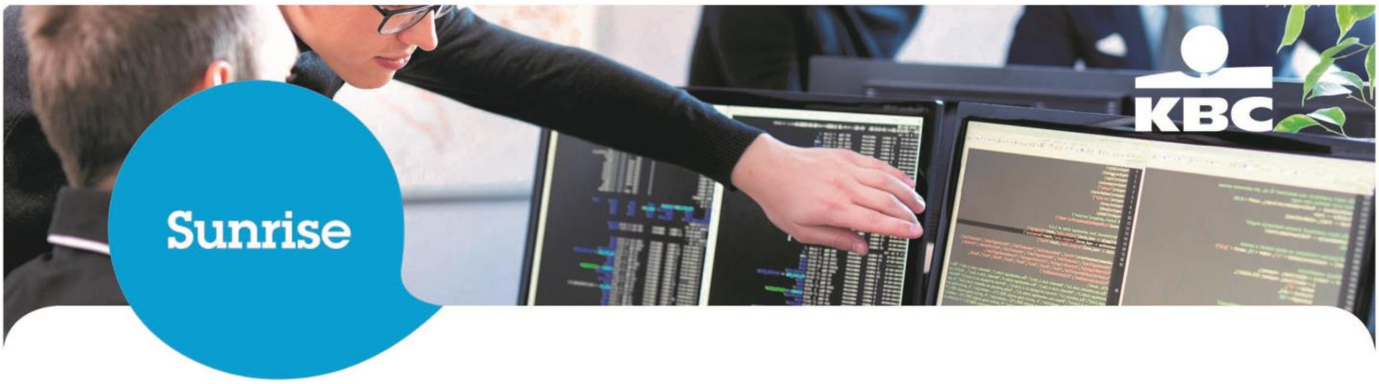



**Friday, 17 May 2019**

## Rates: China's disinterest brings risk-off back on the table

The risk relief on financial markets yesterday proves short-lived as Chinese media signaled a lack of interest for China to continue trade talks with the US. Core bonds resume the upward trend this morning and are set to profit further from a deteriorating sentiment. The University of Michigan consumer confidence is today's sole eye catcher on the eco calendar.

## Currencies: dollar received interest rate support, but for how long?

The dollar succeeded broad-based gains, supported by higher US yields. The move was supported by good US data and a rebound of equities. This morning, the odds for the dollar to get additional interest rate support look rather small as uncertainty on the trade war persists. USD/JPY is most vulnerable. The picture for EUR/USD is more mixed.

## 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 rebounded around 1% yesterday. **Risk sentiment sours again overnight with Chinese stocks down 2% and gains for US Treasuries and the Japanese yen** as China threatens to walk away for US talks.
- **Chinese media signal little willingness from the government to continue trade talks with the US** under the current tariff threat. They also report that the administration will **step up stimulus to defend the local economy.**
- **Swedish deputy central bank governor Floden said he was unhappy with the slide of the Swedish krone** against other major FX rates. It's something the central bank will take into consideration for setting its policy.
- Washington Fed-based governor Brainard said that the Federal Reserve should be **prepared to allow for an inflation overshoot** (without raising interest rates) to more credible demonstrate its commitment to the 2%-goal.
- **The US has cut tariffs on Turkish steel from 50% to 25%.** The US President lifted this import levy last year over a row about the detention of a US pastor. There's no reaction in EUR/TRY this morning.
- **UK PM May said she would set out the timetable of her resignation** after UK Parliament holds its 4th vote on Brexit legislation, whether it passes or not. The vote is expected in early June.
- **Today's economic calendar** contains University of Michigan consumer confidence. Fed Clarida and Williams are scheduled to speak. EU Finance Ministers meet in Brussels.

# Rates

## China's disinterest brings risk-off back on the table

| | US yield | -1d |
|---|---|---|
| 2 | 2.19 | 0.03 |
| 5 | 2.15 | 0.02 |
| 10 | 2.39 | 0.02 |
| 30 | 2.83 | 0.01 |

| | DE yield | -1d |
|---|---|---|
| 2 | -0.65 | 0.01 |
| 5 | -0.52 | 0.00 |
| 10 | -0.10 | 0.00 |
| 30 | 0.53 | 0.01 |

**Global core bonds lost ground yesterday with US Treasuries underperforming German Bunds.** The risk-off rally of late eased as US President Trump was said to delay his decision to impose auto tariffs by 6 months, avoiding trade disputes with important partners (the EU, Japan). European equity markets edged higher, weighing on core bonds. Solid US eco data lifted sentiment further. Weekly jobless claims fell from 228k to 212k, close to multi-decade lows, while building permits and housing starts both rose in April. The Philly Fed Business Outlook increased from 8.5 to 16.6 in May, although the details were less outstanding than the headline number suggests. US Treasuries edged lower. **The US yield curve bear flattened with yield changes in the range of +1.4 bps (30-yr) to +3.3 bps (2-yr). The German yield curve was only modestly lifted with gains up to +0.9 bps (30-yr).** Peripheral spreads over the German 10-yr yield tightened with Greece (-9 bps) and Italy (-7 bps) outperforming.

**Sentiment is mixed across Asia.** While the threat of US auto tariffs has most likely been put on the back burner for now, the US-Sino trade spat continues. This morning, Chinese state media signalled a lack of interest to continue trade talks with the US under the current threat to escalate tariffs and the absence of "sincerity" on the US side of negotiations. Core bonds resume the upward trend.

**The trade story could shift to the background with the EU and Japan most likely excluded from Trump's trade crusade.** We wait and see whether investors are willing to continue yesterday's risk rally. China signalling a lack of interest in resuming trade talks is probably shifting investors already back to risk-off, further supporting core bonds. The eco calendar is not expected to offer much guidance for trading today. In the US, the University of Michigan sentiment for May gets released and is expected to stabilize after last month's decline to 97.2. The EMU releases last month's new car registrations and a final reading of April CPI's. EU finance ministers meet in Brussels, while Fed governors Williams and Clarida are wildcards.

**Long term view: markets concluded that the ECB missed out on this cycle.** They even start pondering the possibility of an additional deposit rate cut. The downtrend in the German 10-yr remains in place so far. **Regarding Fed policy, markets are now largely discounting a Fed rate cut by December.** The US 10-yr yield earlier this month temporary returned above the lower bound of the previous 2.5%-2.79%. However, the cycle low (2.34% is again on the radar).

*German 10-yr yield: downward trend remains in place and is back at the lows of 2016.*

*US 10-yr yield: Risk-off rally is set to continue and puts cycle low (2.34%) back on the radar.*

# Currencies

| | | |
|---|---|---|
| R2 | 1.1815 | -1d |
| R1 | 1.1621 | |
| **EUR/USD** | 1.1174 | -0.0027 |
| S1 | 1.1110 | |
| S2 | 1.0864 | |

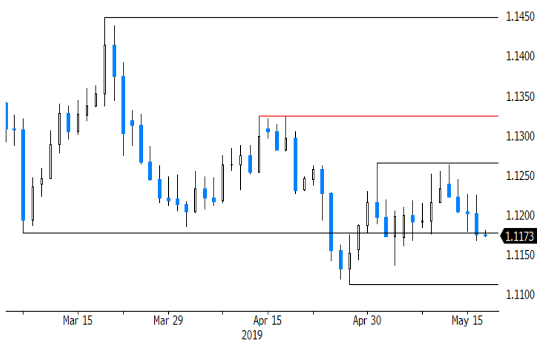
| | | |
|---|---|---|
| R2 | 0.93067 | -1d |
| R1 | 0.91 | |
| **EUR/GBP** | 0.8732 | 0.0011 |
| S1 | 0.8500 | |
| S2 | 0.8314 | |

## USD gains on rate support, but for how long?

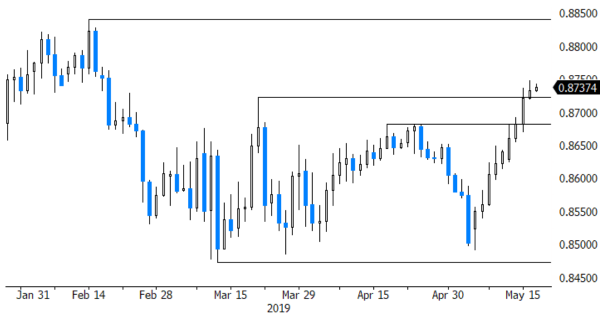
EUR/USD initially hovered in a tight range in the 1.12 area yesterday as markets pondered the consequences of recent developments in the trade war saga. Risk sentiment improved in the run-up to the US session. US eco data were better than expected. US yields rose. A wider US-German yield spread finally tilted the balance in favour of the dollar. EUR/USD dropped below 1.12 to close the session at 1.11.74. USD/JPY also profited from the equity rally and closed at 109.85.

**This morning,** Asian markets are mixed with China underperforming. Yesterday's relative trade optimism is again questioned this morning as a China government related source questioned whether it is appropriate for China to continue trade talks under current threats from the US. At the same time, the comment suggested that China might step efforts to support growth. The yuan is ceding further ground. USD/CNY jumped above the 6.90 barrier this morning. USD/JPY touched the 110 area this morning, but reversed initial gains (currently at 109.65). EUR/USD hovers in the 1.1175 area. AUD/USD slipped below the 0.69 level as the country is headed for elections this weekend.
**Later today,** the EMU final April CPI (expected at 1.7% headline and 1.2% core) is published. In the US, the Michigan consumer confidence is expected to stabilize at a decent level. At the same time, **this morning's price action suggest that it won't be easy for the risk rally to continue.**

Over the previous days the dollar (temporary)?) outperformed the yen and the euro. **Yesterday, the dollar was supported by a rebound in US yields both due to good US eco data and a better risk sentiment.** Especially, the risk context suggests that **further USD interest rate support won't be that evident.** If so, it is in the first place a negative for USD/JPY. The picture for EUR/USD is more mixed. Selling pressure from EUR/JPY might make a EUR/USD rebound more difficult. Even so, we maintain the working hypothesis that the EUR/USD 1.1110 level won't be easy to break without real negative EMU news.
Sterling lost further ground yesterday as the debate on the **departure/ succession of UK PM May as leader of the conservative party continues.** The outcome of the process and its consequences for Brexit are highly uncertain and this continues to weigh on sterling. EUR/GBP settled above the 0.8723 previous ST range top. May will try a last attempt to get her deal approved early June, but markets are not convinced it will succeed. **Sterling will probably stay in the defensive.**




*EUR/USD: dollar rally to slow as rise in US yields might be temporary*




*EUR/GBP: sterling suffers from persistent political uncertainty*

# Calendar

| Friday, 17 May | | Consensus | Previous |
|---|---|---|---|
| **US** | | | |
| **16:00** | **U. of Mich. Sentiment (May P)** | **97.2** | **97.2** |
| 16:00 | U. of Mich. Current Conditions (May P) | 112.2 | 112.3 |
| 16:00 | U. of Mich. Expectations (May P) | 86.8 | 87.4 |
| 16:00 | U. of Mich. 1 Yr Inflation (May P) | -- | 2.50% |
| 16:00 | U. of Mich. 5-10 Yr Inflation (May P) | -- | 2.30% |
| **EMU** | | | |
| 08:00 | EU27 New Car Registrations (Apr) | -- | -3.90% |
| 11:00 | Construction Output MoM/YoY (Mar) | --/-- | 3.00%/5.20% |
| 11:00 | CPI Core YoY (Apr F) | 1.20% | 1.20% |
| 11:00 | CPI MoM/YoY (Apr F) | 0.70%/1.70% | 1.00%/1.40% |
| **Events** | | | |
| **17MAY** | **EU finance ministers meet in Brussels** | | |
| 14:00 | BOE's Alex Brazier speaks in London | | |
| **17:15** | **Fed's Williams Meets With Community Leaders (voter)** | | |
| **19:40** | **Clarida Speaks at `Fed Listens' Event in Philadelphia (vice-chair)** | | |
| **20:00** | **Fed's Williams Meets With Community Leaders (voter)** | | |

| 10-year | Close | -1d | | 2-year | Close | -1d | Stocks | Close | -1d |
|---|---|---|---|---|---|---|---|---|---|
| US | 2.39 | 0.02 | | US | 2.19 | 0.03 | DOW | 25862.68 | 214.66 |
| DE | -0.10 | 0.00 | | DE | -0.65 | 0.01 | NASDAQ | 7898.045 | 75.90 |
| BE | 0.40 | -0.01 | | BE | -0.52 | 0.00 | NIKKEI | 21250.09 | 187.11 |
| UK | 1.07 | 0.01 | | UK | 0.72 | 0.01 | DAX | 12310.37 | 210.80 |
| JP | -0.06 | 0.00 | | JP | -0.16 | 0.00 | DJ euro-50 | 3438.56 | 52.78 |
| | | | | | | | | | |
| IRS | EUR | USD | GBP | EUR | -1d | -2d | USD | -1d | -2d |
| 3y | -0.18 | 2.19 | 1.02 | Eonia | -0.3710 | -0.0030 | | | |
| 5y | -0.02 | 2.19 | 1.11 | Euribor-1 | -0.3660 | 0.0000 | Libor-1 | 2.4324 | 0.0000 |
| 10y | 0.44 | 2.35 | 1.27 | Euribor-3 | -0.3120 | -0.0010 | Libor-3 | 2.5251 | 0.0000 |
| | | | | Euribor-6 | -0.2370 | -0.0020 | Libor-6 | 2.5509 | 0.0000 |
| | | | | | | | | | |
| Currencies | Close | -1d | | Currencies | Close | -1d | Commodities | Close | -1d |
| EUR/USD | 1.1174 | -0.0027 | | EUR/JPY | 122.75 | -0.01 | CRB | 182.32 | 1.67 |
| USD/JPY | 109.85 | 0.25 | | EUR/GBP | 0.8732 | 0.0011 | Gold | 1286.20 | -11.60 |
| GBP/USD | 1.2798 | -0.0047 | | EUR/CHF | 1.1286 | -0.0014 | Brent | 72.62 | 0.85 |
| AUD/USD | 0.6892 | -0.0036 | | EUR/SEK | 10.7704 | 0.0170 | | | |
| USD/CAD | 1.346 | 0.0022 | | EUR/NOK | 9.7716 | 0.0013 | | | |



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