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Sunrise

Wednesday, 02 March 2016

Rates: US Treasuries crash as stronger eco data trigger equity rally

Dull session yesterday until the US eco data printed stronger and triggered a sell-off in US Treasuries. Technical pictures of US-T-Note future and US 5-yr yield deteriorated, while the technical picture of equities improved and oil tries to establish a double bottom. Will the ADP take yesterday's optimists awry or boost risk sentiment further?

Currencies: Dollar profits from risk-on and 'stronger' US eco data

Yesterday, the dollar gained further ground. EUR/USD declined in the 1.08 big figure as the US currency received additional interest rate support on better than expected US eco data. USD/JPY profited from global risk-on sentiment. This morning, sentiment remains constructive. USD traders keep an eye on the ADP labour market report.

Calendar

Headlines

- **US Equities rallied yesterday** as stronger than expected manufacturing ISM boosted sentiment. The S&P gained 2.4% and the Nasdaq rose almost 3%. This morning, **also Asian shares show strong gains**. Chinese stocks rise 4.5%, ignoring the rating outlook cut.
- Overnight, **Moody's downgraded the outlook on China's Aa3 rating** to negative from stable, citing uncertainty over the country's capacity to implement economic reforms, rising government debt and falling reserves. Moody's warned that without credible and efficient reforms growth would slow more markedly.
- In a letter to European lawmakers, ECB President **Draghi** said the **ECB will review its stimulus next week** against the background of heightened risks and weaker than expected inflation and added that **there are no limits to how far they will deploy their instruments.**
- **Donald Trump and Hillary Clinton won sweeping victories on Super Tuesday,** raising the odds that the property mogul and former secretary of state will face off in the November presidential elections. Both Trump and Clinton won in seven of the eleven states.
- **Australia's economy grew by a stronger than expected 0.6% Q/Q during the final three months of the year**, supported by strong consumer spending. Also the previous quarter's figure was revised higher from 0.9% Q/Q to 1.1% Q/Q. The Aussie dollar strengthened further today.
- **The Swiss economy grew by a stronger than expected 0.4% Q/Q during the final quarter of 2015.** Growth was however mainly based in inventories and government consumption and the Q3 outcome was revised slightly lower to -0.1% Q/Q. The Swiss franc strengthened only marginally.
- Today, **the eco calendar** contains the **US ADP employment report**. After the European close, the **Federal Reserve will publish its Beige Book**.

Rates

Global equity rally sharply hits US Treasuries

US yields sharply higher with technical consideration for several tenors

Triggered by better eco data

German bonds limit damage with bullish technical picture intact

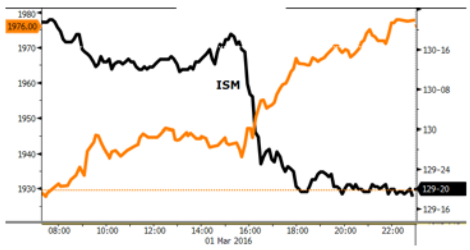
Yesterday, global core bonds corrected lower as a powerful equity rally developed after the release of a better-than-expected ISM and other data. These eased fears about the US economic outlook and by extension the global outlook. The short squeeze of equities lasted till the very end of the session and tilted the S&P 2.4% higher. Besides the better ISM (while is still below the 50 boom/bust at 49.5), there were strong car sales and constructive construction data. **The US Treasuries took the most outspoken brunt of the risk-on reaction with yields 6.5 (5-yr) to 10.4 (5-yr) bps higher, the belly underperforming the wings.** The curve movement shows that investors drew some conclusions for monetary policy. While probabilities for a March FF raise remain negligible, the probability for a December move jumped to 64% from 54% on Monday with about 20% expecting a 50 bps hike. **We think that the quite one-sided positioning in the core bonds and reversal of month end buying/selling may have exacerbated the moves. In commodity and dollar markets, the reaction was positive too, but less outspoken.**

The Bund opened weaker on the milder risk-on in the European equity markets, but stabilized before getting a hit on the US ISM release, but it rapidly went over to sideways trading. Contrary to the US bonds, the rise in German yields was much more modest and between 0.9 bps in the 2-yr to 6.6 bps at the 30-yr. On the intra-EMU bond market, peripheral spreads narrowed 8 to 9 bps for Italy, Spain and Greece with Portugal and Ireland lagging (-2 bps). It was a genuine risk-on move. Semi-core yield spreads were virtually unchanged.

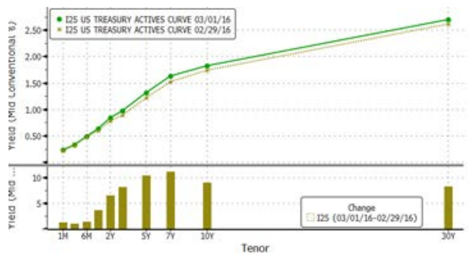
Focus on the US ADP employment report

ADP employment weaker than expected? Difficult to assess though

In January, the US ADP report and official payrolls showed a mixed picture. While ADP employment held up well, the increase in the official BLS reading halved at the start of the year. For February, the consensus is looking for an increase in **ADP employment** by 188 000, slightly down from 205 000 in January. Although jobless claims returned close to last year's lows, **we see risks are for a weaker outcome** following poor US eco data during the month. It is however difficult to make an accurate forecast for the ADP report due to the large dispersion between the ADP report and official BLS reading last month.



Bund future (black) and S&P future (orange) (intraday): Stronger ISM triggers powerful risk-on rally equities and hits bonds



US yield curve (changes 1 day): substantial shift higher with belly rising the most

US-Ger

German Bobl auction: another failure?

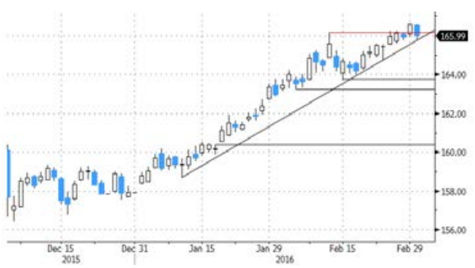
The German Finanzagentur launches a new on the run 5-yr Bobl (€4B 0% Apr2021). We believe that demand will remain mediocre at best given the record low absolute yield (-0.39%). Total bids averaged €3.97B at the previous 4 Bobl auctions, highlighting the risk that the auction won't be fully subscribed. Yesterday, **the Finnish treasury launched a new 10-yr benchmark (€4B 0.5% Apr2026) via syndication.** The bond was priced to yield MS + 2 bps.

Today: Technical break US Note future; more downside?

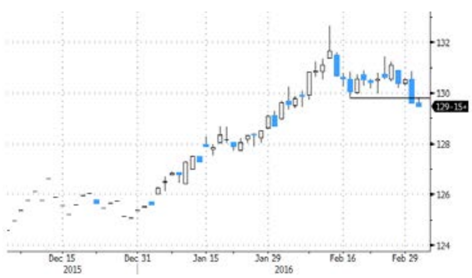
Overnight, Asian equity markets build on yesterday's European and US gains. China and Japan even outperform with main indices up to 4% higher. The US Note future remains under modest downward pressure, suggesting a lower opening for the Bund. Oil prices are stable with Brent just below $37.55/barrel resistance (neckline double bottom).

Today's eco calendar is thin with only ADP employment. Following yesterday's better-than-expected ISM and significant, technically relevant, market reaction, a strong reading won't go unnoticed. The market reaction could thus be asymmetric: more losses in case of a strong reading and limited gains in case of weakness. **So the market may be ripe for more profit taking.** Speeches by Fed Williams and ECB Coeure are wildcards.

Technically, the US Note future (June contract!) painted a double top on the chart. **The break below the 129-26 support level, suggests more downside.** The US 10-yr yield is ready for a test of 1.85% resistance. A break higher would confirm the break lower of the US Note future. **On equity markets, the break of the S&P 500 above 1950 is also technically relevant. This improvement in risks sentiment is additionally negative for US Treasuries.** The technical picture for the Bund is still better with the uptrendline intact, but Bunds will be vulnerable to some spill-over effects from weaker US Treasuries. Outperformance is nevertheless likely ahead of the ECB meeting.



German Bund: First test contract high failed, but still above trendline. Spill-over losses from weakness US Treasuries?



US Note future (June contract): break below double top suggests more downside

Currencies

Dollar extends rebound on 'better' US eco data

The dollar gained as US eco data were less poor than feared and as equities rebounded.

On Tuesday, EUR/USD traded in the upper half of the 1.08 big figure for most of the session. The final EMU manufacturing PMI was revised slightly higher from 51.0 to 51.2. However, after Monday's negative EMU CPI, the euro still suffered from market speculation on a substantial ECB easing next week. Later in the session, the dollar gained further momentum as US eco data (ISM manufacturing, construction output) were better/less weak than feared and as equities succeeded a nice rally. EUR/USD closed the session at 1.0868 (from 1.0873 on Monday). The gains of USD/JPY were more significant. The pair closed the session at 114.01 (from 112.69 on Monday evening). A further rise in the oil price was an additional supportive for risky assets.

Risk on trade continues in Asia

Aussie dollar profits from strong Q4 growth

This morning, the risk-on rally continues in Asia with Chinese and Japanese indices showing strong gains of 3%/4%. Markets apparently grow a bit more confident that growth in the US and China won't fall off a cliff. Even so, Moody's cut the outlook on China's credit rating from stable to negative. The rating agency mentioned uncertainty on the government capacity to implement reforms, rising government debt and declining reserves. However, the rating downgrade didn't hurt regional sentiment. The PBOC fixed the yuan weaker against the dollar (6.549). However, the decline of the CNY and the CNH is very modest. **Q4 growth in Australia was reported at a stronger than expected at 0.6% Q/Q and 3.0% Y/Y**. Household consumption and construction were strong. The report suggests that there is no needed for additional RBA stimulus. The Aussie dollar rebounded to the AUD/USD 0.7240 area. The risk-on rally is pushing USD/JPY to retest the 114 area. The gains of the dollar against the euro are very limited. EUR/USD trades currently in the 1.0860 area.

EUR/USD negative structure remains in place, but important support area is coming within reach.

USD/JPY nearing ST range top

ADP report in focus for USD trading

Today, the ADP labour market report will be published. In January, the US ADP report and official payrolls showed a mixed picture. ADP employment held up well, but the increase in the official BLS reading halved. For February, the consensus is looking for an increase in **ADP employment** by 188 000, slightly down from 205 000. **We see risks for a weaker outcome**. Yesterday, markets reacted in a very constructive way to a slightly better than expected US ISM. Will the reaction of the dollar and of equities remain constructive in case of disappointing US labour data? **In case of a softer ADP report, we assume some consolidation on the recent USD rebound as investors will look for confirmation from the ISM non-manufacturing (tomorrow) and the payrolls (on Friday)**. Both EUR/USD and USD/JPY are nearing first important support (EUR/USD 1.0810)/resistance (USD/JPY 114.87). We assume that more positive US eco news is needed for a further widening of the US/German interest rate differential and for a sustained further USD rebound.

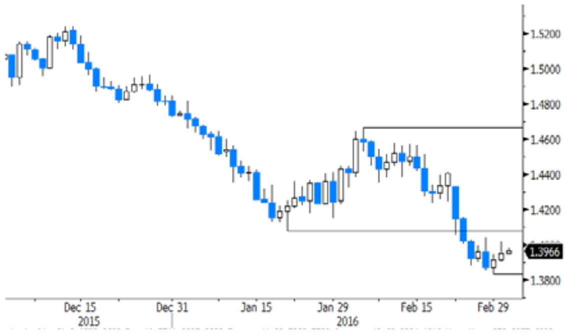
From a technical point of view, the correction high stands at 1.1376, next important resistance at 1.1495. Of late, the dollar gradually fought back from the 113.76 reaction top. The decline below 1.1060 was a ST negative for EUR/USD and finally opened the way to the 1.0810/1.0711 support area. A pause in the USD rally might be on the cards when EUR/USD nears this area. **USD/JPY dropped below the 115.98 pre-BOJ low.** Japanese officials warned on potential action, putting a short-term floor under the pair. Even so, it remains vulnerable. The USD/JPY rebound is nearing a first important resistance at **114.87. The 115.98 January low the next resistance.**

Sterling ignores poor UK data, at least for now

Sterling entered calmer waters earlier this week as the Brexit sell-off eased. Yesterday; **the UK manufacturing PMI declined more than expected from 52.9 to 50.8.** However, contrary to what was mostly the case of late, sterling this time more or less ignored the negative news. **The UK currency traded with a cautiously positive bias against the euro and the dollar early in Europe and that remained the case even after the publication of the PMI. During the US trading session sterling finally lost some ground against the euro and the dollar. EUR/GBP closed the session at 0.7789 (from 0.7813). Cable ended the session at 1.3952 (from 1.3917 on Monday).**

Today, the eco calendar only contains the **UK construction PMI**. A rebound from 55 to 55.5 is expected. We look out whether sterling will remain immune for negative news, if it were to occur. Later today, BoE's broadband and Cunliff will speak. Over the previous days, euro weakness prevailed as a driver for currency trading. **At the same time, the news on Brexit moved somewhat to the background as a ST driver for sterling trading.** Some consolidation or even a limited further rebound might be on the cards after the recent decline. However, for now, it is too early to call a sterling trend reversal. **The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top. The pair cleared the 0.7898 resistance last 0.8066 is the next important resistance.**

EUR/GBP: starting a topping out process?



GBP/USD: looking for a bottom?

Calendar

Wednesday, 2 March		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	-4.3%
14:15	**ADP Employment Change (Feb)**	**190k**	**205k**
15:45	ISM New York (Feb)	--	54.6
Japan			
00:50	Monetary Base YoY (Feb)	A 29.0%	28.9%
00:50	Loans & Discounts Corp YoY (Jan)	A 3.10%	2.57%
UK			
01:01	BRC Shop Price Index YoY (Feb)	A -2.0%	-1.8%
10:30	Markit/CIPS Construction PMI (Feb)	55.5	55.0
EMU			
11:00	PPI MoM / YoY (Jan)	-1.0%/-2.9%	-0.8%/-3.0%
Events			
09:30	ECB's Coeuré Speaks on The Future of the Finance Industry in Frankfurt		
11:00	BoE's Broatbent Speaks at London School of Economics		
15:00	BoE's Cunliffe Speaks on Housing at Lords Committee Hearing		
16:00	Fed's Williams Speaks in San Ramon, California		
18:00	ECB's Coeuré Speaks at EU Parliament on Budgetary Capacity for the Euro Area		
20:00	**U.S. Federal Reserve Releases Beige Book**		
Germany	**Bobl Auction (€4B 0% Apr2021) (11:30)**		
Norway	Bond Auction (NOK4B 1.50% Feb2026)		
Sweden	Bond Auction (SEK 2B 1.5% Nov2023, SEK2B 1% Nov2026)		

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