Sunrise

Monday, 14 December 2015

Rates: Risk sentiment remains most important driver

Global core bonds remain strong on the back of crashing oil prices and deteriorating technical pictures on equity markets. Both the German Dax and US S&P 500 lost first important support. Today, risk sentiment will drive trading once more amid an empty calendar. Ahead of Wednesday's FOMC meeting, German Bunds could outperform US Treasuries.

Currencies: Risk off sentiment continues to haunt the dollar

The dollar is still weak as the risk off continued on Friday. Overnight, risk sentiment is more mixed with oil stabilizing, US Treasuries softer and Asian equities negative, but likely catching up with WS Friday. The PBoC took some decisions which aren't yet completely clear, but suggest they aim a further depreciation. S&P warns UK for the effect of Brexit on its rating.

Calendar

Headlines

S&P	↘
Eurostoxx50	↘
Nikkei	↘
Oil	→
CRB	→
Gold	↗
2 yr US	↘
10 yr US	↘
2 yr EMU	↘
10 yr EMU	↘
EUR/USD	→
USD/JPY	↘
EUR/GBP	↘

- On Friday, **European equities** continued their horrid losing stretch, with indices down up to -2.5%. **US equities** lost -1.94%. Overnight, **Asian equities** are negative too, but likely as a reaction on WS Friday, more than additional pain.
- **The PBoC has allowed the renminbi to weaken for the sixth consecutive time**, with a fix at USD/CNY 6.4495 this morning, the lowest mid-rate valuation since July 2011. On Saturday, **Chinese retail sales** came out strong at 11.2% Y/Y, so was the **Industrial production** for November at 6.2% Y/Y (vs 5.7% Y/Y expected).
- In the French regional elections, the **voters repelled the extreme right party "Front National" from taking control of any regional government.**
- The **S&P** said the prospect of **the UK leaving the EU is the biggest threat to the country's AAA credit rating**, as it kept the country's **outlook on negative**.
- **Japanese Tankan results came out stronger than expected**, with the Large manufacturing index remaining at 12 (vs 11 expected) and the Large non-manufacturing index at 25 (vs 23 expected), but the outlook worsened.
- **Oil prices continue to get big blows**, as the **Brent Crude** set a **new low** on Friday at **$37.36/barrel** and **WTI Crude** at **$35.16/barrel**. Overnight, some fragile stabilization.
- Today, the eco-calendar contains only the **October industrial production data for the Eurozone**. Potentially more important is the **speech of Draghi** at noon.
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Rates

US Treasuries profit from risk-off sentiment

Global core bonds end technically inspired session close to unchanged

Bunds outperform US Treasuries

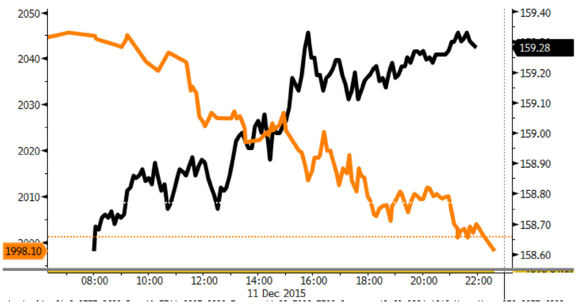
	US yield	-1d
2	0,9112	-0,0443
5	1,6052	-0,0642
10	2,1672	-0,0598
30	2,8941	-0,0694

	DE yield	-1d
2	-0,3500	-0,0210
5	-0,0967	-0,0189
10	0,5416	-0,0458
30	1,3371	-0,0760

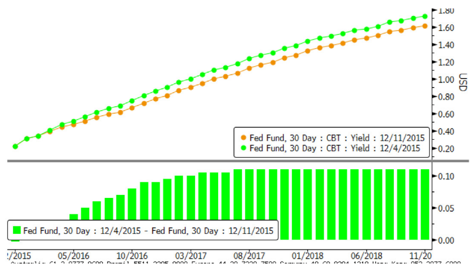
On Friday, global core bonds ended with moderate to strong gains on the back of a substantial further decline in oil prices and a sell-off in equities. It was a risk-off session from start to finish. US eco data were modestly bond negative. Retail sales were reasonably strong and producer prices well above expectations. However, a very shy test to push core bonds lower ran immediately into resistance. Bonds turned north again, continuing their rally and setting new intraday (or correction) highs. **US Treasuries sharply outperformed Bunds. The T-Note future (127-05) is again well above the pre-ECB sell-off level, while the Bund has still some work to do to erase those losses. In a daily perspective, the belly of the US curve outperformed with yields up to 12.5 bps (5-yr) lower. However also the 2-yr yield fell 6.8 bps.** Chances on the December lift-off are nevertheless little changed, but markets are re-pricing the Fed's rate path following the lift-off. The second rate hike, according to market expectations, is now more likely towards mid-2016. **In the German bond market, the curve bull flattened with yields between 1.8 and 5.6 bps lower. European and US equities are trading about 2% lower, with the Dax breaking through the key 10500 support level and the S&P breaking below the previous low (2020), painting a bearish double top on the charts.** On intra-EMU bond markets, relative calm reigned with 10-yr yield spread changes versus Germany ranging between +2 bps and +4 bps with Greece underperforming (+13 bps).

Draghi speaks again: Is he becoming nervous?

Today, the eco-calendar contains only the October industrial production data for the Eurozone. We see some upward risks, but they won't stir markets. Potentially more important is the **speech of Draghi** at noon (and ECB Costa in late afternoon). The market reacted sharply when Draghi/ECB didn't deliver the kind of substantial easing that had been expected. **The euro appreciated about 2% on a trade weighted basis since, which is substantial and bonds sold off before risk off allowed them to recoup part of the losses.** The stronger euro goes against the ECB policy to push inflation higher. The **weakening of the yuan** will be of concern too (see FX section). So, we will eagerly listen whether Draghi tries to weaken the euro and if he succeeds. His catch phrase that the ECB will do more if needed starts to sound hollow. Last week, Draghi's credibility took a hit, as the governing council drew a line in the sand regarding additional easing.



German Bund (black) and S&P future (orange): risk off session triggered by oil prices



US Fed funds curve: Since early December, Fed fund futures shifted lower, re-pricing Fed path by more than 10bps. Lift-off not put into question: reasons commodities & equities

R2	161,71	-1d
R1	160,66	
BUND	**159,18**	0,6500
S1	156,4	
S2	154,54	

Austria and Spain tap the market this week

This week's scheduled EMU bond supply comes from Austria and Spain. On Tuesday, the Austrian treasury sells the off the run 10-yr RAGB (3.4% Nov2022) and the on the run 10-yr RAGB (1.2% Oct2025) for a combined €1.1B. On Thursday, the Spanish debt agency auctions the on the run 5-yr Bono (1.15% Jul2020) and two off the run Obligacions (4.4% Oct2023 & 4.9% Jul2040). The auctions will be supported by a €15B Italian redemption.

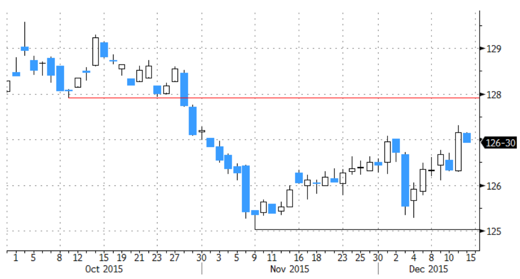
Today: Sentiment on equity/commodity markets key

Overnight, risk sentiment on Asian equity markets is negative though losses remain rather contained given the huge sell-off in Europe and the US on Friday. Chinese indices outperform on the back of further weakness in CNY (lowest level since 2011). Eco data (Japanese Tankan, Chinese retail sales & industrial production) were solid to mixed (Japanese ones)but ignored. The US Note future trades off Friday's high suggesting a slightly softer opening for the Bund as well.

Today, the eco calendar is empty apart from outdated EMU IP data which is no market mover. Speeches by ECB Draghi and Costa are wildcards (see above). That leaves sentiment on commodity and equity markets as main trading driver. **Both the German Dax and US S&P 500 fell below first important support levels. The deterioration of the technical picture in equity markets suggests more downside which is a positive for core bonds. German Bunds could outperform US Treasuries as US investors might be paralyzed ahead of the FOMC meeting.** More weakness in commodity prices is positive as well.

In Europe, the December ECB meeting took the angle out of the threat that the ECB will ease policy forever. In retrospect, it might turn out to be the end of the global rat race to have the easiest monetary policy. That puts a huge bottom below European rate markets (German 10-yr yield 0.42%; ceiling for the Bund 160.66. Weak commodity/equity prices currently underpin the Bund though. In the US, a 25 bps rate hike on Wednesday remains our base scenario, but the forward guidance for 2016 will be key for the US Treasury market. **Currently, risk off sentiment supports US Treasuries as well.**

German Bund: Bounced off lower bound sideways range as oil price faced another setback and risk sentiment on equity markets deteriorates.



US Note future (March contract!!): more neutral as commodities and equities suffer setback. Fed lift-off may still push contract to support

Currencies

Dollar under pressure against yen and to some extent against the euro and sterling

Commodity currencies lose ground versus US dollar

Chinese yuan depreciates with the "authorization" of Chinese policymakers in anticipation of US Fed lift-off?

R2	1,1124	-1d
R1	1,1087	
EUR/USD	**1,0962**	0,0017
S1	1,0524	
S2	1,0458	

Risk-off sentiment takes its toll on dollar

On Friday, equities and commodities (especially oil) stayed under sharp downward pressure. Brent oil lost again almost 2 dollar and closed at 37.93, a new cyclical low. US equities shed about 2% and the S&P fell below previous low, painting a ST bearish double top on the charts. **Initially, the impact on the dollar was mixed. USD/JPY suffered from the risk-off sentiment. At the same time the dollar performed reasonably well against the euro. The US data (retail sales and PPI) were OK, but had hardly any lasting impact on USD trading. Later in the session, risk-off sentiment intensified and became the dominant factor. US Treasuries sharply outperformed German Bunds and the 2-year (but at other maturities too) spread narrowed 5 bps.** EUR/USD tested the 1.10 barrier, setting an intra-day high at 1.1032 and approaching the correction high at 1.1043, but closed just below 1.10 at 1.0990 up from 1.0945 on Thursday eve. USD/JPY closed at 121.01 from 121.56 previously, setting a new correction low. **Understandingly, the commodity currencies Aussie, Kiwi, ZAR and CAD still underperformed the US dollar. Finally, the Chinese authorities continue to let their currency depreciate. USD/CNY trades now at 6.45, up for the sixth consecutive day, and the highest level since the August devaluation. The depreciation of the yuan needs to be followed closely, as it might intensify downward inflation pressure in the US and EMU, with potentially impact on monetary policy and thus on the currencies.** All in all, it was a bad day for the USD against euro and yen, but given the sharp risk-off and the narrowing of the yield differentials, it could have been worse.

Overnight, Chinese retail sales, industrial production and Fixed investment (Saturday) all pointed to a stabilization of economic conditions. The Japanese Tankan data were mixed: current headline indices were ok, but outlook was below expectations and lower than in September. The **PoBC said the yuan shouldn't be measured by its moves against the dollar alone** (see below for details). Chinese equities trade marginally positive, while most other Asian bourses are well in the red taking their clues from a nasty WS session on Friday. Commodities stabilize to be slightly higher, the trade-weighted dollar is marginally higher and the T-Note is lower. **So, weakness in Asian bourses isn't not enough to think it could only be a risk-off session today.**

EUR/USD: Consolidation in volatile trading condition

USD/JPY: Downside pressure persists.

Eco calendar unattractive, but ECB Draghi key event today

Commodities and equities wildcard

Today, the US eco-calendar empty and the EMU industrial production figures for October won't affect trading for long, also because they are outdated. Potentially more important is the **speech of Draghi** at noon (and ECB Costa in late afternoon). The market reacted sharply when Draghi/ECB didn't deliver, early December, the kind of substantial easing that had been expected. **The euro appreciated about 2% on a trade weighted basis since, which is substantial.** It goes against the ECB policy to push inflation higher. The **weakening of the yuan** will be of concern too (see higher). So, we will eagerly listen whether Draghi tries to weaken the euro and whether it succeeds. **Equities and commodities remain the wildcard.**

We think that dollar cautiousness is appropriate until the clouds disappear

Last week, the reaction function of the dollar was not consistent at all. Initially, downside pressure on oil and subsequent nervousness on global equities, weighed on the dollar. **The US currency dropped below important support against the euro and the yen. The global picture for the dollar became even more diffuse toward the end of the week.** USD/JPY remained under downward pressure as did oil and global equities. At the same time, EUR/USD stabilized in the 1.09/low 1.10 area, admittedly often in in very volatile trading. Sentiment on risk is mixed this morning and the dollar damage limited. This suggests that that the downside of the dollar is well protected going into the FOMC decision. Still, we stay cautious to buy the dollar as long as risk sentiment remains fragile.
In a longer term perspective, **the debate has shifted to the pace of further Fed tightening after this week's Fed meeting as the ECB is done for now.** It might still take some time (and some good US eco data) for the dollar to regain further ground. However, **even the 'ECB failure' to meet market expectations, policy divergence has probably still a role to play further down the road.**

Dollar technicals deteriorated

From a technical point of view, EUR/USD cleared the 38% retracement from 1.1714 to 1.0524 standing at 1.0979, making the picture again neutral . A previous range bottom/break down area comes in at 1.1087 and finally the 62% retracement from the October high at 1.1124. **This might be the first two tough resistance levels going into the Fed policy decision and if broken would make the picture dollar bearish**. A sustained decline below 1.08 would improve the technical picture for the dollar again. The USD consolidation at the end of last week eased the ST pressure, but more confirmation/signs of stabilisation are needed before reselling EUR/USD. **USD/JPY dropped below a short-term range bottom in the 122.25 area, turning the short-term picture in this cross rate negative.** An lasting improvement in risk sentiment is needed to halt this decline

Sterling captured in technical trading.

R2	0,7493	-1d
R1	0,7298	
EUR/GBP	**0,7213**	-0,0013
S1	0,6983	
S2	0,6936	

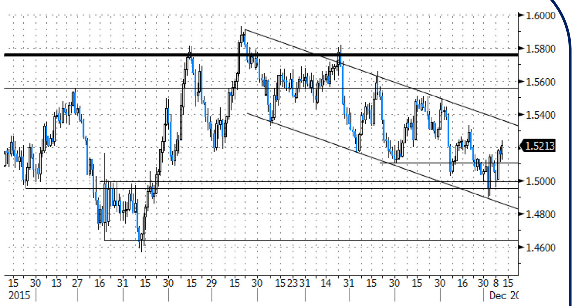
On Friday, there were **only second tier UK eco data**. **Trading in cable and EUR/GBP was driven by technical considerations. Cable profited from USD weakness** and regained the 1.52 level, with a 1.5225 close, up from 1.5160 previously. EUR/GBP tried initially to go higher, but finally backed off and closed nearly unchanged at 0.7224.

S&P confirmed the UK AAA rating and its negative outlook. The latter is due to uncertainties about the EU referendum which represents a risk for the financial sector, exports and the wider economy. The "remain" vote is still the more likely outcome. Should sterling's role as reserve currency diminish, the rating could be lowered. **This is a slight sterling negative, even as the decision doesn't contain much new info. However together with news HSBC is considering to move its HQ to Toronto, it might still be a negative.**

Overnight, The Rightmove house prices for December accelerated to 7.4% from6.2% I November but had no market impact. EUR/GBP is still trading close to 0.7220.Around noon, **BoE deputy governor Minouche speaks**, but after the recently released Minutes (and meeting), we don't think he will break new ground. This means sterling will take its clues once again from developments in the main crosses and the technicals.

Euro weakness helped sterling becoming stronger last Thursday, but after the steep losses of previous sessions, that's not enough to become sterling positive. We first want to see real sterling strength, it's unlikely that we'll get it today**. A sustained drop below 0.72 would be a positive,** but we would remain cautious ahead of the FOMC meeting and probably also afterwards as trading will rapidly thin going towards year-end**. Technically longer term, the pair is still in a broad sideways range with boundaries between 0.6938 and 0.7483.**

EUR/GBP (1-yr): Sustained trading below 0.72 would improve sterling picture



Cable (1-yr): dollar weakness pushes cable higher, but still in range

Tion

Calendar

Monday, 14 December		Consensus	Previous
Japan			
00:50	**Tankan Large Mfg Index (4Q)**	**A: 12**	**12**
00:50	Tankan Large Mfg Outlook (4Q)	A: 7	10
00:50	**Tankan Large Non-Mfg Index (4Q)**	**A: 25**	**25**
00:50	Tankan Large Non-Mfg Outlook (4Q)	A: 18	19
00:50	**Tankan Large All Industry Capex (4Q)**	**A: 10.8%**	**10.9%**
05:30	Industrial Production MoM/YoY (Oct F)	A: 1.4%/-1.4%	1.4%/-1.4%
05:30	Capacity Utilization MoM (Oct)	A: 1.3%	1.5%
05:30	Tertiary Industry Index MoM (Oct)	A: 0.9%	-0.4%
UK			
01:01	Rightmove House Prices MoM/YoY (Dec)	A: -1.1%/7.4%	-1.3%/6.2%
EMU			
11:00	**Industrial Production SA MoM/WDA YoY (Oct)**	**0.3%**	**-0.3%**
Italy			
10:00	CPI EU Harmonized YoY (Nov F)	--	0.1%
Sweden			
08:00	PES Unemployment Rate (Nov)	--	4.1%
Events			
11:00	**EMU - ECB's Nowotny Briefs with IMF on Article 4 Mission**		
12:00	**EMU - ECB President Draghi speaks at conference in Bologna, Italy**		
16:00	**EMU - ECB's Costa, Krugman Speak at Conference in Lisbon**		
13:00	**UK - BOE Deputy Governor Minouche Shafik Speaks in London**		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	2,17	-0,06	US	0,91	-0,04	DOW	17265	17265,21
DE	0,54	-0,05	DE	-0,35	-0,02	NASDAQ	for Exch - NQI	#VALUE!
BE	0,85	-0,03	BE	-0,30	-0,02	NIKKEI	18883	18883,42
UK	1,81	-0,07	UK	0,56	-0,04	DAX	10340,06	10340,06
JP	0,30	-0,01	JP	-0,01	0,01	DJ euro-50	3203	3203,21

IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	USD	td	-1d
							Eonia EUR	-0,231	0,001
3y	-0,010	1,240	1,151	Euribor-1	-0,19	-0,01	Libor-1 USD	0,51	0,51
5y	0,228	1,581	1,422	Euribor-3	-0,13	-0,01	Libor-3 USD	0,59	0,59
10y	0,875	2,095	1,858	Euribor-6	-0,04	0,00	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0962	0,0017	EUR/JPY	132,82	-0,72		177,0283	1073,4	37,75
USD/JPY	121,235	-0,80	EUR/GBP	0,7213	-0,0013	-1d	-0,53	3,65	-1,77
GBP/USD	1,5187	0,0049	EUR/CHF	1,0798	-0,0008				
AUD/USD	0,7195	-0,0059	EUR/SEK	9,3409	0,03				
USD/CAD	1,3721	0,0084	EUR/NOK	9,5226	0,05				

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