Sunrise

Wednesday, 27 January 2016

Rates: Will the FOMC be dovish enough to satisfy bond markets?

We (and the market) expect a dovish FOMC statement. The question is how dovish. Will they wipe the possibility of a March tightening off the table? Will they confess that their dots (rate) path for 2016 are out of sync with current developments? Given the dovish position, the hurdle for bonds to gain much more is quite high.

Currencies: Dollar in wait-and-see modus ahead of the FOMC decision

Yesterday, the dollar showed no clear direction even as equities and oil rebounded. Today, the focus will be on the Fed policy statement. Markets will look out whether the Fed gives any hints on a softening of its policy stance. If so, it might be slightly negative for the dollar but we don't expect a big change in the dollar's recent consolidation pattern.

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	↘

- **US Equities rebounded** yesterday as oil prices jumped higher again. The S&P gained 1.4% led by a pick-up in energy shares. This morning, **most Asian shares trade in positive territory**. Chinese equities underperform, trading slightly lower this morning.
- **The European Commission and Italy reached yesterday an agreement on a scheme to help Italian banks sell some of their €200 billion of bad loans**. The details are still being finalised.
- **China's central bank gave guidance to some Chinese banks in Hong Kong to suspend offshore yuan lending to curb short selling and tighten liquidity,** Bloomberg reports quoting sources with knowledge of the matter.
- **Apple announced yesterday its iPhone sales grew at the slowest pace since its introduction in 2**007 and forecast that revenue in the current quarter will decline for the first time in 13 years. Apple added that its results suffered from the strong dollar and slowing global growth.
- **Gold prices closed yesterday at its highest level in nearly three months ($1120/ounce)** as markets expect a soft message from the Fed today. The oil minister of Iraq said yesterday that **Saudi Arabia and Russia are showing signs of flexibility about agreeing to tackle the oil glut.** The Brent oil price picked up yesterday and hovers currently around $31.35/barrel.
- Today, **the focus will be on the FOMC meeting**. Ahead of the meeting, the US new home sales will be released and ECB's Lane, Lautenschlaeger, BoE's Bailey and Shafik are scheduled to speak.

Rates

Core bonds modestly lower in quiet session

New lows for German 2-5-yr yields and for Bund.

Slight gains for US Treasuries despite higher equities and oil

Peripheral spreads narrow, but Greek spread continues to widen

Global core bonds profited slightly from a weak equity opening, but as equities and oil turned around fast, bond gains became minimal. In a daily perspective , the German yield curve dropped between 0.9 and 3.8 bps, flattening the curve. German 2 and 5-yr yields are at record lows. The eonia curve discounts further depo rate cut(s) of slightly more than 20 bps. US yields were 1.7 to 0.7 bps lower with the 30-yr underperforming (yield flat) and marginally flattening the curve. Renewed calmness in markets allowed **peripheral bonds** to outperform the Bund with 10-yr yield spreads 3 to 4 bps lower. **Greece** continues to underperform with the 10-yr yield spread up 29 bps amid signals that the review will be postponed (initially expected in February) due to the inability of Greece to satisfy earlier made promises. Eco data had once more no lasting impact.

	US yield	-1d
2	0,8528	0,0127
5	1,4316	0,0161
10	1,9959	0,0139
30	2,7852	0,0158

The **focus will be on the FOMC meeting today**. ECB's Lane and Lautenschlaeger are scheduled to speak. In the US, **new home sales** are forecast to have increased for a third month in December to 500 000, a 2% M/M increase. Earlier released housing data showed a mixed picture. We see downside risks following two monthly increases as tight inventories still weigh on sales.

Fed to be dovish.

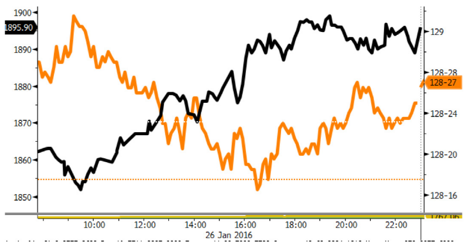
March move increasingly unlikely

Fed will try to calm markets

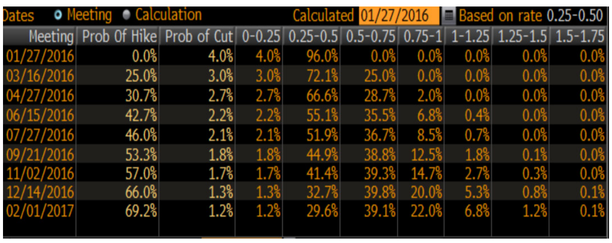
Various ways to express cautiousness

We expect the Fed to be dovish in their statement after the meeting. Since their rate hike in December, US equities have fallen almost 10% and oil was in free fall. Inflation was lower than expected in December and inflation expectations (5yr/5yr FRW) have fallen to the lowest levels ever. Activity data have been weaker like retail sales and production (business sentiment) leading to expectations for Q4 GDP of about 1% Q/Qa. On the contrary, employment grew strongly. Turmoil in global markets was severe and the ECB pre-announced a policy easing. **In this context, the four rate hikes embedded in the December dot plot look way out of reasonable expectations or at least the March meeting looks unlikely to bring another rate increase**. So, we expect the Fed to recognize the reality by changing the statement. It might do so in various ways. It may downgrade the assessment of the economy by saying the pace of activity has moderated, or specifically point to slowing consumption and investment growth. The Fed should also acknowledge one way or another the market behaviour and its possible negative impact on the economy. It may for instance change the balanced risks to the economy and inflation to nearly balanced. They may refer again to the recent negative global developments. While they should sound dovish, it is maybe too early for them to already exclude a March rate hike, which is, we think, highly unlikely. They may suggest though that more time is needed to assess the situation. Anyway, they are further away of the stronger actual inflation they want to see before acting again.

	DE yield	-1d
2	-0,4520	-0,0090
5	-0,2423	-0,0010
10	0,4440	-0,0240
30	1,1972	-0,0355



US Note future (black) and S&P future (orange): US Treasuries gain modesty ground as equities cannot hold on to early gain and hold on to these when US equities go higher



Dates Meeting Calculation Calculated 01/27/2016 Based on rate 0.25-0.50

Meeting	Prob Of Hike	Prob of Cut	0-0.25	0.25-0.5	0.5-0.75	0.75-1	1-1.25	1.25-1.5	1.5-1.75
01/27/2016	0.0%	4.0%	4.0%	96.0%	0.0%	0.0%	0.0%	0.0%	0.0%
03/16/2016	25.0%	3.0%	3.0%	72.1%	25.0%	0.0%	0.0%	0.0%	0.0%
04/27/2016	30.7%	2.7%	2.7%	66.6%	28.7%	2.0%	0.0%	0.0%	0.0%
06/15/2016	42.7%	2.2%	2.2%	55.1%	35.5%	6.8%	0.4%	0.0%	0.0%
07/27/2016	46.0%	2.1%	2.1%	51.9%	36.7%	8.5%	0.7%	0.0%	0.0%
09/21/2016	53.3%	1.8%	1.8%	44.9%	38.8%	12.5%	1.8%	0.1%	0.0%
11/02/2016	57.0%	1.7%	1.7%	41.4%	39.3%	14.7%	2.7%	0.3%	0.0%
12/14/2016	66.0%	1.3%	1.3%	32.7%	39.8%	20.0%	5.3%	0.8%	0.1%
02/01/2017	69.2%	1.2%	1.2%	29.6%	39.1%	22.0%	6.8%	1.2%	0.1%

FF implied probabilities matrix: No chances on rate hike today, 25% in March. First rate hike discounted in Summer

R2	163	-1d
R1	162,03	
BUND	**161,83**	0,2800
S1	160,38	
S2	156,4	

Small German 30-yr Bund auction; US 5-yr Note

The German Finanzagentur taps the on the run 30-yr Bund (€1B 2.5% Aug2046). This year's "auction policy" has changed somewhat for 30-yr Bunds. The amount on offer dropped from €2B the past years to €1B because of the lower funding need. It also helps masking very weak primary market demand for long-dated German Bunds. Additionally, the German Finanzagentur also indicated that they would tap the off the run 30-yr Bund (2.5% Jul2044) three times this year. Traditionally, the Finanzagentur exclusively taps on the run bonds. On the secondary market, the Aug2046 Bund trades with a 5 bps premium in ASW spread terms over the rest of the very long end of the German yield curve. **The US Treasury started its end-of-month refinancing operation with a solid $26B 2-yr Note auction.** The auction stopped well below the 1:00 PM bid side, but the bid cover remained rather low (2.9 vs last year's average of 3.29). Bidding details showed a rebound in the indirect bid, but the dealer bid remained anemic. **Today, the Treasury holds a $35B 5-yr Note and a $15B 2-yr FRN auction.** Currently, the 5-yr WI trades around 1.435%.

Today: Dovish shift FOMC?

Overnight, Asian equity markets build on yesterday's positive risk sentiment in Europe and the US. Main indices trade with gains with Japan outperforming (+3%), but China underperforming (-3%). As we near the end of today's trading, Chinese bourses erase part of the intraday losses though. Oil prices are stable around $31.5/barrel and so is the US Note future around 128-25, suggesting a neutral opening for the Bund.

Today's trading will be sentiment-driven amid an empty calendar and ahead of the FOMC's verdict. No policy change is expected, but a downgrade of the statement (see higher) is likely. That would wipe a March rate hike and the Fed's dot plot (4 hikes in 2016) off the table. Given that markets are already very dovish positioned (25% chance of March hike; only 1 hike discounted in 2016), the upside of core bonds (bull steepening curve) could be limited. The market reaction (bear flattening) will be very larger in case the Fed surprises by holding a more neutral tone, keeping all option open. **We hold our view that there is little value in the Bund/US Note future when 10-yr yields drop respectively below 0.50% and 2%.** The front end of European yield curves is expected to remain near record low levels as we expect at least a 10 bps deposit rate cut at the March ECB meeting, while markets discounts already more than 20 bps rate cut.

German Bund: failed test of contract high

US Note future: Dovish positioned into FOMC meeting

Currencies

USD nowhere ahead of FOMC statement

Dollar basically going nowhere as oil and equities rebound

R2	1,106	-1d
R1	1,0985	
EUR/USD	**1,0862**	0,0003
S1	1,0711	
S2	1,0524	

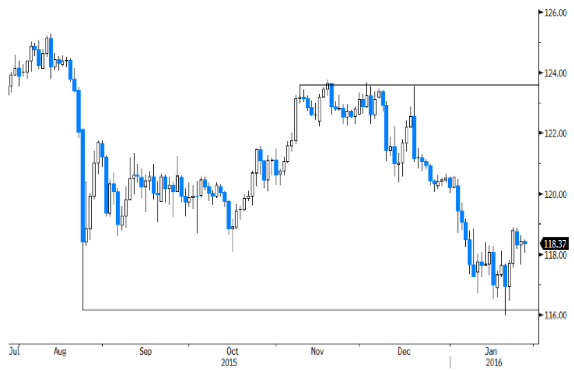
On Tuesday, the dollar held tight ranges against the euro and the yen. The US currency was under slight pressure early in the session as Chinese equities nosedived, but rebounded (temporarily) as European and US markets decoupled from China and as oil rebounded. In a broader perspective, the swings in USD/JPY and EUR/USD were again insignificant. The US eco data, consumer confidence and Richmond Fed manufacturing survey, were OK but largely ignored. EUR/USD closed the session at 1.0870 (from 1.0849 on Monday). USD/JPY closed at 118.42 (from 118.30).

Asian equities show a mixed picture with China underperforming

Moves in the major currency cross rates are limited

This morning, Asian equities show a mixed picture. Non-Chinese indices mostly show decent gains, but China struggles to join the rebound from Europe and the US yesterday. Chinese industrial profits declined a bigger than expected -4.7% Y/Y in December. Regarding the yuan, the PBOC maintains its recent tactics. It fixed the yuan slightly stronger against the dollar. Despite the disappointing equity performance, the off shore yuan and the Hong Kong dollar are again regaining limited further ground. The PBOC is said to have asked some banks to suspend offshore yuan lending in order to limited short-selling of the currency. The rebound of oil stalled late yesterday, but oil still preserves most of yesterday's intraday gain. EUR/USD (1.0860) and USD/JPY (118.30) are still holding tight ranges ahead of the FOMC decision.

EUR/USD locked within sideways range



USD/JPY: rebound slows even as equities rebound

Tion*There are few eco data with market moving potential today*

The focus will be on the Fed policy statement

Today, there are few eco data in Europe. In the US, the mortgage applications and the new home sales will be published. However, just hours before the release of the FOMC policy statement, the impact of the data on (currency) trading will probably be limited. **We expect the Fed to acknowledge to potential impact of the recent rise in market volatility. If the communiqué also refers to a further decline in inflation expectations, markets will see it as a sign of the Fed easing its policy stance and reducing the chances of next rate hike in the near future**. For an in depth analysis see the fixed income part of this report. An open reference to a decline in inflation expectations might also be a short-term negative for the dollar. We don't expect the Fed to openly amend its policy stance only one month after starting policy normalisation. If so, the damage for the dollar should be limited.

That said, in a day-to-day perspective we see risks of the dollar ceding some ground with the established ranges ahead and even after the Fed policy announcement. Equities and oil still can play a role, but we expect also wait-and-see behaviour in these markets ahead of the FOMC statement.

From a technical point of view, EUR/USD failed to regain important resistances at 1.1087 (breakdown) and 1.1124 (62% retracement from the October high). Earlier this month, EUR/USD failed also to sustain below 1.0796 support (07 Dec low). This area was again tested at the end of last week and early this week, but a break didn't occur. Next support is at 1.0711/1.0650 (correction low: 76% retracement off 1.0524/1.1060) and at 1.0524. On the topside, 1.0985/1.1004 (reaction top) is a first reference. This level was left intact even as sentiment was outright risk-off before the ECB meeting. Next resistance comes in at 1.1060/1.1124 (15 Dec top: 62% retracement). We expect this resistance to be strong and difficult to break. After the ECB announcement, we look to sell EUR/USD on upticks for return action lower in the range. **The picture for USD/JPY remains negative below 120, but the pair tries to build a bottom.** Still, we think that a sustained return above 120 will be difficult.

Sterling turns back south

R2	0,7755	-1d
R1	0,7715	
EUR/GBP	**0,7571**	-0,0073
S1	0,7525	
S2	0,7313	

There were no data in the UK yesterday. Sterling was under pressure early in the session as (Chinese) equities and oil declined. **However, European markets gradually disconnected from Asia. EUR/GBP touched an intraday top in the 0.7660/65 area early in Europe but soon started a gradual intraday downtrend.** Markets kept an eye on the hearing before the Treasury committee on the BoE financial stability report. Monetary policy was not the main topic but BoE's Carney repeated that conditions were not yet in place for a rate hike. He also elaborated on the risk of financing the UK current account deficit due to the uncertainty on the Brexit vote. The quotes had no big impact on sterling; The UK currency was still in the first place driven by the rebound in oil and equities. EUR/GBP closed the session at 0.7575 (from 0.7614). Cable rebounded to close at 1.4350 (from 1.4249).

Today, the nationwide house prices and the BBA loans for house purchases are on the agenda. We expect these data to be only of intraday significance for sterling trading. BoE's Bailey and Shafik will speak. We doubt they will address monetary policy issues. So, we expect technical trading in the major sterling cross rates ahead of the FOMC decision. A soft market reaction to the FOMC decision might also be a slightly negative for sterling against the euro.

In a longer term perspective, uncertainty on Brexit and global negative risk sentiment are important drivers for sterling weakness. As long as these issues aren't solved, a sustained sterling rebound is unlikely. **The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top**. **Next resistance stands at 0.7875.** A return below 0.74 would be a first indication that sterling enters calmer waters.

Calendar

Wednesday, 27 January		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	9.0%
16:00	**New Home Sales (Dec)**	**2.0% / 500k**	**4.3% / 490k**
20:00	**FOMC Rate Decision (Lower Bound)**	**0.25%**	**0.25%**
20:00	**FOMC Rate Decision (Upper Bound)**	**0.50%**	**0.50%**
Japan			
06:00	Small Business Confidence (Jan)	A 47.2	48.3
China			
02:30	Industrial Profits YoY (Dec)	A -4.7%	-1.4%
02:45	Westpac-MNI Consumer Sentiment (Jan)	A 114.9	113.7
UK			
08:00	Nationwide House Px MoM YoY (Jan)	0.6% / 4.7%	0.8% / 4.5%
10:30	BBA Loans for House Purchase (Dec)	45550	44960
Germany			
08:00	**GfK Consumer Confidence (Feb)**	**9.3**	**9.4**
France			
08:45	Consumer Confidence (Jan)	96	96
18:00	Total Jobseekers (Dec)	3576.9k	3574.8k
18:00	Jobseekers Net Change (Dec)	0.0	-15.0
Italy			
10:00	Consumer Confidence Index (Jan)	117.0	117.6
10:00	Business Confidence (Jan)	103.8	104.1
10:00	Economic Sentiment (Jan)	--	105.8
Spain			
09:00	Total Mortgage Lending YoY (Nov)	--	12.5%
09:00	House Mortgage Approvals YoY (Nov)	--	7.1%
Sweden			
09:00	Manufacturing Confidence s.a. (Jan)	110.1	114.3
09:00	Consumer Confidence (Jan)	97.5	98.7
09:00	Economic Tendency Survey (Jan)	108.0	110.1
Events			
	Nordea (07:00), Banco Santander (bef mkt), Fiat-Chrysler, Boeing (bef mkt), eBay (aft mkt), Facebook (aft mkt) Announce Q4 Earnings		
10:15	ECB's Lane Speaks at Conference in Dublin		
10:25	BoE's Bailey Speaks in Dublin		
14:00	ECB's Lautenschlaeger Speaks in Frankfurt		
17:30	BoE's Shafik Speaks in London		
Norway	**Holds Bond Auction (NOK3B 4.5% May2019)**		
Germany	**Bund Auction (€1bn 2.5% Aug 2046)**		
US	**2Yr FRN Auction ($15B) & 5Yr Notes Auction ($35B)**		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	2,00	0,01	US	0,85	0,01	DOW	16167	16167,23
DE	0,44	-0,02	DE	-0,45	-0,01	NASDAQ	'or Exch - NQI	#VALUE!
BE	0,72	-0,03	BE	-0,38	0,00	NIKKEI	17164	17163,92
UK	1,69	0,00	UK	0,40	-0,01	DAX	9822,75	9822,75
JP	0,22	0,00	JP	-0,01	0,00	DJ euro-50	3033	3032,84

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,236	0,002
3y	-0,090	1,070	1,012	Euribor-1	-0,23	0,00	Libor-1 USD	0,51	0,51
5y	0,131	1,360	1,274	Euribor-3	-0,16	0,00	Libor-3 USD	0,59	0,59
10y	0,759	1,842	1,702	Euribor-6	-0,08	0,00	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0862	0,0004	EUR/JPY	128,52	0,60		160,4594	1119,6	31,45
USD/JPY	118,355	0,55	EUR/GBP	0,7571	-0,0072	-1d	-3,34	5,34	1,93
GBP/USD	1,4337	0,0138	EUR/CHF	1,1046	0,0047				
AUD/USD	0,7035	0,0107	EUR/SEK	9,2909	-0,01				
USD/CAD	1,4106	-0,0200	EUR/NOK	9,4438	-0,08				

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