



Sunrise

Monday, 26 October 2015

Rates: Dovish central banks play first fiddle

We expect the Fed to keep policy unchanged on Wednesday, but the statement could provide us with more hints on the central bank's game plan. Is the December meeting still alive for a lift-off? The positive effect on core bonds from dovish central banks (ECB, Fed and BoJ???) is balanced by equity strength and higher inflation expectations.

Currencies: Euro hammered by ECB easing expectations

Last week, monetary developments conspired against the euro and supported the dollar. EUR/USD fell off a cliff and dropped below the 1.1087 support as the ECB prepared markets for further easing in December. Simultaneously, the dollar profited from risk-on sentiment in the wake of a PBOC rate cut. USD traders now look forward to the FOMC policy decision.

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	↘

- **European equities** soared on Friday after Mario Draghi inflated the markets with dovish talk on further easing monetary policy. **US equities** also thrived on Friday, driven by global easing expectations and good corporate earnings. Overnight, the **Asian equities** opened in the green, but the gains after Friday's PBOC rate cut are moderate.
- **The People's Bank of China unexpectedly cut its one-year interest rate by 0.25% to 4.35%**, making it the fifth time this year Chinese policymakers try to help turnaround the economic slowdown.
- **The US Treasury is postponing a Treasury bond auction due to the looming debt ceiling**, as congress fails to approve hiking the \$18tn debt limit.
- **The IMF is set to give green light for China's yuan to be included in the lender's benchmark currency basket**. China has implemented a list of reforms recently to liberalize its markets in order to help the yuan meet the SDR criterion.
- **Polish elections are won by the Eurosceptic Law and Justice party, with 37.7% of the votes, just enough to govern alone** and well ahead of the incumbent pro-EU Civic Platform party (23.6%).
- Today, **the new home sales in the US and the German IFO economic sentiment indicator are scheduled for release. ECB's Yves Mersch speaks in Brussels.**

Rates

Core bonds part ways: US underperforms Germany

German Bunds withstand equity strength

	US yield	-1d
2	0,6413	0,0285
5	1,4095	0,0460
10	2,0742	0,0390
30	2,8898	0,0243

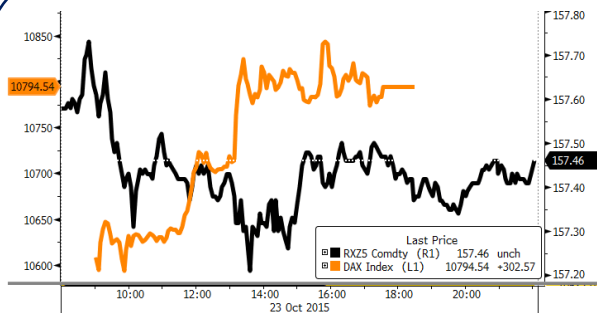
	DE yield	-1d
2	-0,3190	-0,0020
5	-0,0940	-0,0060
10	0,5080	0,0010
30	1,2770	0,0040

Eco data on the backburner, waiting for Fed meeting

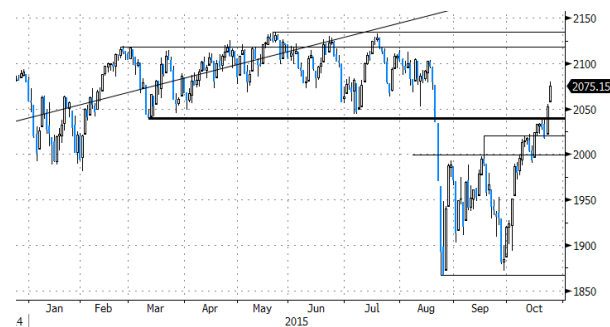
On Friday, German bonds eventually ended slightly lower. At the start of dealings, the Bund failed to take out the October 2 high following Thursday's surprisingly dovish ECB meeting. EMU PMI's beat expectations and improved in October. The ECB's promise of lower rates for longer prevented a downleg and the Bund soon slid into a tight sideways trading range. PBOC (China) easing and positive risk sentiment on equity markets didn't weigh on the Bund either. In a daily perspective, 2 and 5-yr yields were almost unchanged, while 10 and 30-year ones rose by 1.6 and 2.8 bps. Peripheral yield spreads modestly widened, reversing part of the post ECB narrowing. US Treasuries had more difficulties to hold up and gradually lost ground as US traders joined the fray. We suspect that equity strength played a bigger role here, but also upcoming supply and doubts on the increase of the debt ceiling. In a daily perspective, yields in the belly were up 6 bps, while yields at the wings were 4 bps higher.

Attention turns to US eco data and the FOMC meeting

Today, the eco-calendar is thin with US new home sales and the German IFO indicator. The US new home sales are expected to have marginally increased to 550k in September, coming from 552k the previous month. We see downward risk to the (volatile) number. The German IFO indicator is expected to decrease to 107.8, coming from 108.5 previously. The expectations indicator is also expected to decline from 103.3 to 102.4. Risks, if any, are on the downside of expectations. ECB Mersch, a traditional hawk, speaks in Brussels. It will be interesting to see how ECB members position themselves towards the December policy decision. What kind of measures are "acceptable"?



Bund future (black) & Dax (orange) (intra-day): Bund keeps up well despite risk-on as ECB dovishness shelters German Bunds against headwinds



S&P surges through key resistances after Draghi suggested that more easing is coming, maybe triggering a global wave of policy easing. It surprises us that dollar strength isn't hampering equity gains.

FOMC to stand put, but will we get more clarity on their reaction function?

Regarding the FOMC meeting (Wednesday press release), the September Minutes and many Fed speeches strongly suggest that most governors want extra information before deciding in December whether or not the Fed can start its tightening cycle. They didn't see (in September) material changes in the economic outlook since the August meeting, but wanted nevertheless more clarity on the outlook. They didn't get that clarity since. Financial strains eased again (but maybe as a result of their inaction), while eco data deteriorated. Also the September payrolls, manufacturing ISM and retail sales disappointed.

So, we expect no policy changes at the October FOMC meeting. Since the September meeting, a number of governors, including two board governors, doubted that inflation wouldn't move to the target in the medium term. They questioned the relationship between full employment, higher wages and ultimately higher inflation (Phillips curve) and suggested that the lift-off might better be postponed until signs of wage inflation became visible. **This in fact questions the reaction function of the Fed, as perceived by the Fed chair and vice-chair.** So, markets are confused by the Fed's policy. We will closely look how the Fed perceives recent weak payrolls and whether they still are behind Yellen's reaction function, which implies that in case of stronger labour market conditions, one should not wait to see inflation actually going up before raising rates. Maybe we will have to wait for the Minutes (and speeches) before getting an answer to these questions.

R2	160,62	-1d
R1	157,79	
BUND	157,49	-0,0300
S1	155,71	
S2	155,41	

Today: Spotlight remains on central banks this week

Overnight, most Asian equity indices trade positive though gains are small given Friday's WS performance and taking into account the PBOC's rate cut. The US Note future trades stable.

Today's main trading theme is the German Ifo-indicator. Risks, if any, are on the downside of expectations. That could trigger a new test of the recent highs (157.67/79) in the Bund. The market reaction might be muted though as **spotlights remain on central banks.** The ECB's very dovish stance underpins EMU bond markets. Trading in the US will most likely be numbed by Wednesday's FOMC decision. We expect the Fed to keep policy unchanged while the statement might include more hints on the Fed's lift-off plans (December meeting still alive?). Friday's BoJ meeting will be closely monitored as well. Will governor Kuroda expand the QQE programme following pressures coming from the ECB? **Main equity indices remain a wildcard.** The ECB's very dovish message easily pushed EMU and US equities above important resistance levels, marking an end to the downward correction from a technical point of view. If risk sentiment further improves, that could hamper more gains for core bonds. **The pick-up in inflation expectations** following the ECB's announcement (Bund negative) also balances the prospect of more easing. **Therefore, we have a neutral view on core bond trading. A new test of the contract highs (especially Bund) is likely, but these resistance levels recently proved to be tough. On intra-EMU bond markets, the prospect of more political uncertainty is a short term negative for Portuguese OT's.**



German Bund: Dovish Draghi underpins Bund



US Note future: Numbed ahead of FOMC?

Currencies

ECB and PBOC fuel dollar rebound

Euro hammered, dollar jumping higher after ECB/PBOC action.

Asian equity markets show guarded reaction to the PBOC easing.

USD taking a breather this morning

R2	1,1302	-1d
R1	1,114	
EUR/USD	1,1042	-0,0067
S1	1,0984	
S2	1,0848	

IFO business climate and US new home sales scheduled for release today.

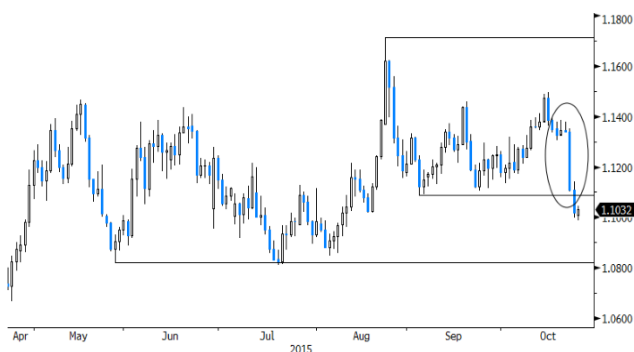
Soft ECB stance will cap the topside of the euro going into the FOMC meeting.

On Thursday and on Friday, the ECB and the PBOC were the trendsetters for trading. On Thursday, the ECB almost pre-announced a further easing in policy at the December meeting, pushing the euro off a cliff. On Friday, the PBOC also reduced its policy rate and the reserve requirement ratio for banks. This additional easing reinforced the risk-on sentiment and supported further USD gains. EUR/USD tested the 1.10 barrier and closed the week at 1.1018. USD/JPY ended the session at 121.47.

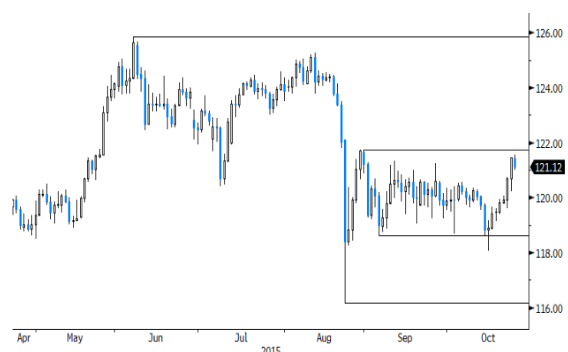
Overnight, Asian equities mostly show modest gains of less than 1%. So, the equity reaction to Friday's PBOC policy easing is positive, but not euphoric at all. During the weekend, there were comments from Chinese officials that China won't defend the 7% growth goal at any price. The comments did come in the run-up to a meeting later this week that will set the growth targets for the next five years. Markets probably see this as China preparing for a structural decline in trend growth. This slowed the post PBOC equity rebound. The CNY didn't really decline in the wake of the PBOC easing. USD/CNY is trading near the 6.35 level. USD/JPY is coming off the highs reached at the end of last week and early in Asia this morning. Limited equity gains probably slow the USD rebound. The dollar also regains slightly ground against EUR/USD, trading in the 1.1035 area.

Today, the calendar contains the German IFO business climate. Markets will look out whether there is any substantial impact from the Volkswagen. Friday's PMI's suggest that the damage might be limited, for now. A weaker than expected IFO might be a slightly negative for the euro. However, it won't change the global picture on the (im)balance between the Fed and the ECB. Neither will the US new homes sales.

In the wake of the ECB press conference, markets will now look forward to the Fed policy decision/statement on Wednesday. Markets focus will be whether the Fed changes its tone after the recent weaker US eco data and after the policy intentions/actions from the ECB and the PBOC. In a day-to-day perspective, the USD rally might slow as might be the case for equities. However, especially for EUR/USD there is no reason to row against the tide. We don't expect the Fed statement to be really different from the September one. If so, the debate on a Dec. Fed rate hike may continue. So, we expect the USD to remain rather well supported against the euro going into the FOMC decision.



EUR/USD declining below key 1.1087 support area



USD/JPY: testing top of the recent sideways range

In a longer term perspective, global markets recently struggled to assess the health of the global economy and its impact on monetary policy. Initially, (currency) markets focused on the impact of weaker US data on the Fed rate hike path. That made the dollar vulnerable. Last week, markets were positioned for soft ECB speak, but at the press conference, ECB's Draghi went much further towards additional easing than markets anticipated. The topside in EUR/USD (1.1460/95 resistance) was extensively tested, but the test was rejected, making the topside in EUR/USD better protected. The ECB preparing markets for a new round of monetary easing pushed EUR/USD beyond the key 1.1087/1.1105 support. If confirmed, this break paints a multiple top formation on the charts. The targets of this formation are in the low 1.07 area.

R2	0,7374	-1d
R1	0,723	
EUR/GBP	0,7208	-0,0009
S1	0,7168	
S2	0,7026	

EUR/GBP joins the global decline of the euro

At the end of last week trading in sterling was in the first place driven by global factors. On Thursday, strong UK retail sales temporarily supported the UK currency, both against the euro and the dollar. On Thursday, global euro weakness prevailed, pushing EUR/GBP around one big figure lower. On Friday, USD strength was the name of the game. This move at most impact on cable, but EUR/GBP stayed under pressure, too. EUR/GBP closed the week at 0.7194. Cable ended the week at 1.5314.

Dollar and euro moves determine price action in cable and EUR/GBP

During the weekend, BOE's Carney said that there is a prospect a possibility, but not a certainty of rate rise. Carney did speak in a conditional way and didn't openly chance its assessment on a BoE rate hike. Even so, markets might read the quotes as a softening in the BoE's stance.

Today, BBA loans for home purchases and the CBI trends orders and CBI optimism will be published. The BBA loans are expected to rise further. For the CBI data, a slight easing is expected. We expected the UK data to be only of intraday significance for sterling trading. Maybe there is a slight asymmetrical risk. Sterling might be slightly more vulnerable for bad news from the UK, rather than for good news. However, the global trading patterns in euro and the dollar will probably set the tone for trading in cable and in EUR/USD.

Looking at the broader picture, the downside in sterling against the euro (EUR/GBP 0.7483/0.75 strong resistance) looked already better protected last week. The soft tone at the ECB press conference pushed EUR/GBP back lower in the longstanding sideways range. The pair dropped temporarily below the 0.7196 support and the test of this level is ongoing. Euro weakness currently prevails, but EUR/GBP looks a bit oversold short-term. We look to sell EUR/GBP on upticks.



EUR/GBP testing the 0.7196



Cable fails to regain the 1.5508 recent top

Calendar

Monday, 26 October		Consensus	Previous
US			
15:00	New Home Sales (Sep)	550k	552k
15:00	New Home Sales MoM (Sep)	-0.4%	5.7%
15:30	Dallas Fed Manf. Activity (Oct)	-6.5	-9.5
UK			
12:00	CBI Trends Total Orders (Oct)	-9	-7
12:00	CBI Trends Selling Prices (Oct)	-7	-8
12:00	CBI Business Optimism (Oct)	2	8
Germany			
10:00	IFO Business Climate (Oct)	107.8	108.5
10:00	IFO Current Assessment (Oct)	113.5	114.0
10:00	IFO Expectations (Oct)	102.4	103.3
France			
18:00	Total Jobseekers (Sep)	3575.0k	3571.6k
18:00	Jobseekers Net Change (Sep)	3.2	20.0
Spain			
09:00	PPI MoM/YoY (Sep)	--/--	-1.7%/-2.2%
Switzerland			
09:00	Total Sight Deposits (Oct 23)	--	465.9b
09:00	Domestic Sight Deposits (Oct 23)	--	399.1b
Events			
11:45	EMU - ECB Executive Board Member Yves Mersch Speaks in Brussels		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	2,07	0,04	US	0,64	0,01	DOW	17647 17646,70
DE	0,51	-0,06	DE	-0,32	-0,06	NASDAQ	for Exch - NQI #VALUE!
BE	0,80	-0,08	BE	-0,27	-0,07	NIKKEI	18947 18947,12
UK	1,87	0,06	UK	0,54	0,04	DAX	10794,54 10794,54
JP	0,32	0,00	JP	0,01	-0,01	DJ euro-50	3426 3425,81

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,134 0,002
3y	0,049	0,999	1,117	Euribor-1	-0,12	0,00	Libor-1 USD	0,51 0,51
5y	0,270	1,402	1,438	Euribor-3	-0,05	0,00	Libor-3 USD	0,58 0,58
10y	0,902	2,004	1,890	Euribor-6	0,02	0,00	Libor-6 USD	0,74 0,74

Currencies			-1d	Currencies			-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,1042	-0,0286		EUR/JPY	133,54	-2,06			193,7146	1163,5	47,89
USD/JPY	120,96	1,24		EUR/GBP	0,7208	-0,0136		-1d	-3,71	-2,00	-0,23
GBP/USD	1,5316	-0,0105		EUR/CHF	1,078	-0,0090					
AUD/USD	0,7246	0,0052		EUR/SEK	9,3626	-0,07					
USD/CAD	1,3163	0,0038		EUR/NOK	9,2431	-0,03					

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