# Sunrise

**Wednesday, 16 March 2016**

## Rates: Hawkish Fed, negative for US Treasuries

US eco data will be noise ahead of the FOMC decisions, even in case of weaker outcomes. We expect the Fed to lower 2016 rate hike projections from 4 to 3 in the dot plot while reinserting the “balanced risks” phrase in the statement. That opens the way to a June rate hike, which is hawkish and negative for US Treasuries given the current market positioning.

## Currencies: Prospect of more Fed normalization supportive for dollar?

Today’s focus for USD trading is on the US data (CPI) and even more on the Fed policy decision. The Fed leaving the door open for more policy normalization further out this year should be a positive for the dollar. Sterling traders will keep an eye at the labour data and the UK budget proposal. Yesterday, Brexit fears returned as a factor for sterling trading.

## 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 | ↗ |

- Despite disappointing retail sales data and lower commodity prices, **US Equities ended mixed** yesterday. The S&P fell 0.18%, but the Dow ended marginally higher. **This morning, also Asian shares trade mixed.**
- **Donald Trump knocked Marco Rubio out of the Republican race** by winning primaries in Florida and three more states, but he lost to John Kasich in Ohio. **Democratic front-runner Hillary Clinton won in Ohio, Illinois, Florida and North Carolina,** widening her already significant lead.
- At the end of the annual meeting of parliament, **China’s Premier Li Keqiang vowed there would be no hard landing for his country** and said they will cut red tape for businesses, work to reduce corporate debt, improve financial regulation and ensure no mass layoffs we take place as they restructure heavy industries.
- Speaking before parliament, **BOJ governor Kuroda signalled there is in theory room to cut rates to -0.50%** but added that he cannot indicate which policy tools the BOJ would use in case it decided to expand stimulus again.
- **British Finance Minister Osborne will try to get his austerity drive back on track** as government plans to turn a budget deficit into a surplus by the end of the decade look off course. Osborne signalled already on Sunday he would need **to announce fresh spending cuts.**
- Today, **the focus will be on the FOMC meeting**. In the US, also the CPI inflation data, the housing starts and permits and industrial production data will be released. In the **UK, Chancellor of the Exchequer Osborne will make his budget speech to parliament** and the jobless data will be released.

# Rates

*More consolidation ahead of the Fed*

*Weak US retail sales unable to lift US Treasuries*

| | US yield | -1d |
|---|---|---|
| 2 | 0,9644 | 0,0125 |
| 5 | 1,4828 | 0,0134 |
| 10 | 1,954 | 0,0018 |
| 30 | 2,7121 | -0,0158 |

*Downside risks US CPI and US Industrial production*

*Upside risks housing starts and building permits*

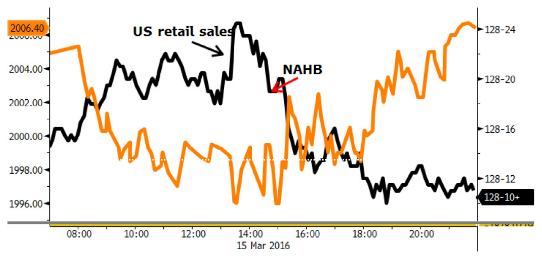
| | DE yield | -1d |
|---|---|---|
| 2 | -0,4470 | 0,0090 |
| 5 | -0,2410 | 0,0110 |
| 10 | 0,3180 | 0,0220 |
| 30 | 1,0752 | 0,0263 |

## More consolidation ahead of the Fed

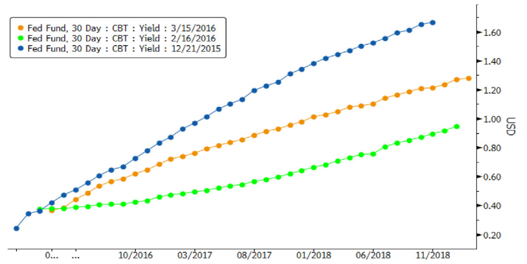
**Yesterday, global core bond markets consolidated further ahead of the Fed meeting, but German bonds underperformed US Treasuries.** Initially core bonds gained marginally on weaker oil and equity prices. US Treasuries briefly rallied on weak US retail sales (published simultaneously with a very strong NY Fed manufacturing survey). However, the bid dried up soon. US Treasuries and Bunds were sold afterwards amid a weak NAHB homebuilders' survey, but slightly rising oil and equity prices. US Treasuries erased all initial gains, while the Bund fell well below opening levels, approaching the recent lows. **In a daily perspective, US yield increased up to 1.3 bps (5-yr), with the 30-yr yield flat. The German curve bear steepened with yields up to 4.4 bps higher (30-yr).**

## FOMC meeting key, but US eco data interesting too

After having picked up sharply in the previous few months, **US CPI inflation** is forecast to have dropped 0.2% M/M and slowed from 1.4% Y/Y to 0.9% Y/Y in February. Core inflation, which excludes volatile food & energy prices, is forecast to have stabilized at 2.2% Y/Y. Lower energy prices should be partly offset by moderate price increases elsewhere. After lower than expected PPI data yesterday, **we see risks for a downward surprise, both in the core and headline reading.** In February, **US industrial production** is expected to have dropped by 0.3% M/M following a sharp rebound in January. Manufacturing production, on the contrary, is forecast to extend its upward trend, rising by 0.1% M/M. Especially for the manufacturing sector, we **see downside risks** as hours worked in the sector dropped. Finally, **US housing starts and permits** are expected to show a mixed picture. **For both, we see upside risks supported by more favourable weather conditions.**




*T-Note future (black) & S&P future (oil) (intraday): T-Note cannot hold to initial gains even as retail sales and NAHB are weak. Afraid of hawkish FOMC today?*




*FF strip curve: after liftoff (blue), 1 month ago (green) and now (orange) Market raised again expectations following market turmoil at start of the year. Somewhat more after FOMC meeting?*

US-Ge

**No change in Fed policy is expected tonight. The Fed will wait for more activity and inflation data, confirming that the recovery is well established, while also looking for signs that market turmoil abated for longer.** The meeting is nevertheless interesting due to the publication of the Fed's new economic and rates projections and the press conference of chair Yellen. **We expect Yellen to keep the door open for a rate hike in Summer**, dependent on the incoming data. We expect the "balanced risks" quote to return into the statement to support the view that the rate cycle may soon be resumed. The "dot plot" will likely show 3 hikes for 2016 instead of 4 in December.

Two hikes would be a surprise and suggest a softer Fed. **Currently, the market attaches a 53.6% chance for a rate hike in June and the FF future fully discounts a first rate hike in October.** According to market pricing, the FF would be about 1% by end 2017 and 1.235% by end 2018. **As before, this is well below Fed's median dot rate projection**..

## German Bund auction

| | | |
|---|---|---|
| R2 | 164 | -1d |
| R1 | 163,4 | |
| **BUND** | **161,12** | -0,2000 |
| S1 | 160,81 | |
| S2 | 160,11 | |

**On Wednesday, the German Finanzagentur taps the on the run 10-yr Bund (€4B 0.5% Feb2026).** Total bids at the previous 4 Bund auctions averaged only €3.62B. Given that German yields remain near record lows, there's a good chance that today's auction is undersubscribed as well. In the run-up this tap, the bond cheapened marginally in ASW spread terms , while also trading rather cheap at the 10-yr part of the German curve.

## Hawkish Fed negative for US Treasuries?

**Overnight,** Asian stock markets trade mixed in a news-thin session. The oil priced is stable just north of $39/barrel while the US Note future has a small upward bias. Overall, we expect a neutral opening for the Bund.

**Today**'s eco calendar remains empty in the euro zone. In the US, CPI data, industrial production and housing starts & building permits will be released ahead of the FOMC meeting. **We see downside risks for the former two, but we fear that US Treasuries won't really profit ahead of the Fed (eg yesterday's retail sales). We expect the central bank to lower 2016 projected rate hikes in the "dot plot" from 4 to 3 while calling risks to outlook "balanced" from undefined. Such scenario paves the way for a June rate hike, which is more hawkish than current market pricing. Therefore we expect it to be negative for US Treasuries, forcing breaks higher in the 5-yr yield (1.5%), 10-yr yield (2%) and 30-yr yield (2.75%).**

Going forward, we think that there is a firm bottom below rate markets in yield terms. The ECB doesn't intend to lower rates further which gives the Fed more leeway to become more hawkish. **The German 10-yr yield tested 0.3% resistance (neckline double bottom). A break higher becomes very likely and would be a signal to sell the Bund.** Three other important markets already broke more or less similar key technical levels (Brent oil, S&P 500, US 10-yr yield). **This suggests that risk sentiment changed compared to the beginning of the year (more positive) and gives more downside for core bonds.**

*German Bund (June contract): Bund sell-off despite additional ECB easing. Testing first support around 161.02 (38% retracement)/160.81 (neckline double top)*

*US Note future (June contract): break below double top suggests more downside, but consolidation ahead of the Fed*

# Currencies

## Fed to decide on next directional USD move

*Dollar mixed in technical trade ahead of the FOMC decision*

**Yesterday, the market shifted into a cautious risk off modus which was negative for USD/JPY. EUR/USD again didn't show a clear trend. Even poor US retails sales failed to give guidance. EUR/USD held close to the 1.11 handle and finished the session little changed at 1.1109. USD/JPY dropped intraday to the 112.65 area, but rebounded later to finish the day at 113.18 (from 113.82).**

*Asian equities show mixed picture*

*BOJ's Kuroda sees more room to cut rates*

*USD/JPY rebounds off recent lows.*

**This morning,** Asian equities trade mixed with Japan underperforming and China outperforming. Chinese Premier Li admits that the economy is facing headwinds but reiterated that the new growth targets are achievable and that China will avoid a hard landing. BOJ's Kuroda said the bank has several options to ease policy further, including interest rate cuts, an expansion of the monetary base and more buying riskier assets. He said that negative interest rates help to weaken the currency and could eventually go to -0.5%. It had only a limited trading impact, as markets are not convinced of further aggressive BOJ rate cuts. USD/JPY is trading marginally higher at 113.40. Oil is little changed. AUD/USD stabilizes in the mid 0.74 area. EUR/USD maintains a tight range in the 1.11 area.

| | | |
|---|---|---|
| R2 | 1,1376 | -1d |
| R1 | 1,1193 | |
| **EUR/USD** | **1,1089** | -0,0016 |
| S1 | 1,1068 | |
| S2 | 1,081 | |

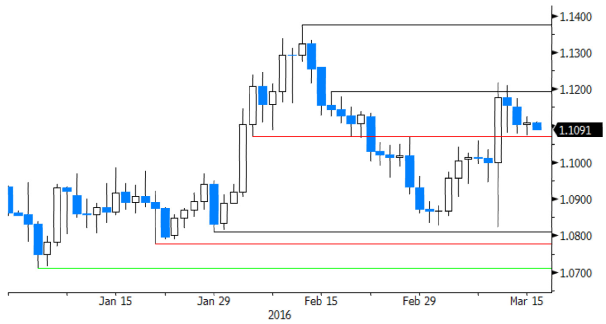
*The focus is on the Fed policy decision*

*Prospect for gradual Fed normalization might keep USD supported*

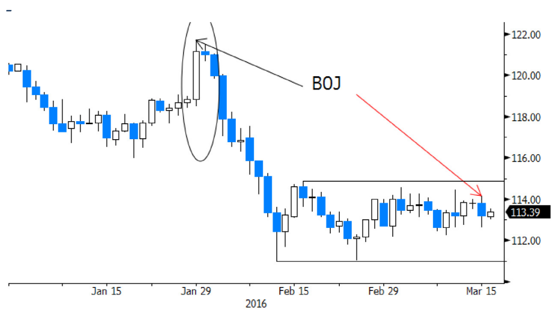
*Downside risks US CPI and manufacturing output, while upside risks for housing data*

**Today, the focus will be on the FOMC meeting**, but also the US data are interesting. **US CPI inflation** is forecast to have slowed to 0.9% Y/Y from 1.4% Y/Y. Core inflation is forecast stable at 2.2% Y/Y. **We see risks for a downward surprise, both in the core and headline reading.** In February, **US industrial production** is expected to have dropped by 0.3% M/M following a sharp rebound in January but manufacturing production, is forecast to extend its upward trend, rising by 0.1% M/M. Especially for the manufacturing sector we see downside risks. **We see upside risks for the US housing data, supported by more favourable weather conditions.** A the margin, the US data might be slightly negative for the dollar (due to lower inflation), but markets will stay wait-and-see modus going into the Fed policy decision.

For an in depth analysis of **the Fed-decision**, see the fixed income part of this report. The Fed dots will probably guide markets for three Fed rate hikes this year rather than four. However, this is still more than the market currently discounts. Market will still have doubts on such a scenario, but the Fed's determination to continue a gradual process of policy normalisation might keep the dollar well supported.




*EUR/USD: holding near the 1.11 level going into the FOMC decision*




*USD/JPY: losing slightly ground post BOJ, but sill in sideways range*

**Of late, we advocated sideways EUR/USD trading within the 1.1200/1.0810 range. The top of this range was extensively tested after last week's ECB meeting but for now no-follow-through USD losses occurred. 1.1376 is the next important resistance that will hold, we assume, unless the US news flow turns really negative. We look for an EUR/USD topping out process. USD/JPY perfectly holds within the 110.99/114.87 sideways consolidation pattern. It looks like the downside is well protected. This is partially due to market fears for BOJ action in case of a sharp rise of the yen. At the same time, the dollar might profit from the prospect of Fed policy normalisation going forward.**

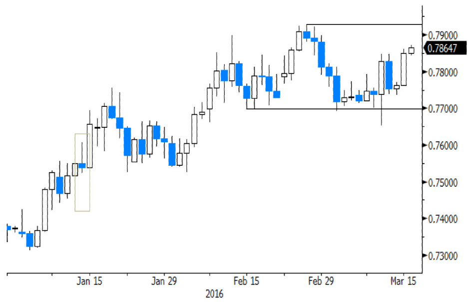
## Focus on UK labour data and budget statement

| | | |
|---|---|---|
| R2 | 0,8066 | -1d |
| R1 | 0,7929 | |
| **EUR/GBP** | **0,786** | 0,0078 |
| S1 | 0,7652 | |
| S2 | 0,7526 | |

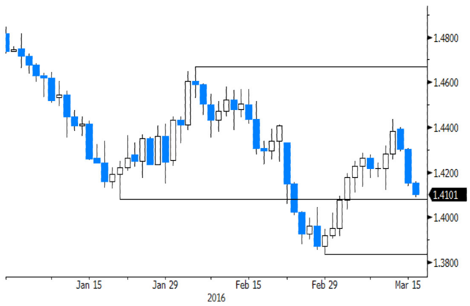
**On Tuesday, Brexit returned as a driver for sterling trading.** A poll indicated that Brexit supporters had a small lead over the 'remain camp'. The poll caused short-term investors to sell sterling after the recent rally. Cable dropped to the mid 1.41 area. EUR/GBP was also propelled higher even as EUR/USD traded with slight negative bias early in the session. **Uncertainty on** the UK budget proposal, the UK labour market data (today) and the BoE policy statement (Thursday) were additional factors to turn cautious on sterling. EUR/GBP tested the 0.7848 resistance and closed the session at 0.7850 (from 0.7763). Cable closed at 1.4151 (from 1.4302).

**Today**, the focus for sterling trading will be on the UK labour data and the budget statement. The UK labour market continued to perform well of late, despite signs of a slowdown in economic growth .Markets will keep close eye on wage growth. We expect a decent UK labour market report. In the budget statement, UK Fin Min Osborne will have to tighten spending, but the government will probably refrain from really tough measures ahead of the EU referendum. Even so, the headlines from the budget might be slightly negative for sterling. Last but not least, Brexit is back as a factor for sterling trading, even in the short-term. The day-to-day momentum of sterling turned again negative yesterday and this trend looks to continue this morning.

Of late, sterling bottomed out as Brexit-fears moved (temporary) to the background. For cable, the hypothesis of a bottoming out process remains in place. For EUR/GBP the picture was already damaged by Thursday's overall post-ECB euro rebound and the pair trades currently north of the 0.7850 resistance area. This move again deteriorates the short-term picture of sterling and brings the 0.7929 correction top again on the radar. **The medium-term picture of sterling against the euro remains negative as EUR/GBP holds above the 0.75 area. Short-term, EUR/GBP tested a first support at 0.7696 and temporary broke it last week. Finally, the test failed though. 0.7652 is the first important support level.**




*EUR/GBP: propelled higher on Brexit fears*




*GBP/USD: cable drifting lower in the range*

# Calendar

| Wednesday, 16 March | | Consensus | Previous |
|---|---|---|---|
| **US** | | | |
| 12:00 | MBA Mortgage Applications (Mar 11) | -- | 0.2% |
| **13:30** | **Housing Starts total/MoM(Feb)** | **1150k /4.6%** | **1099k/-3.8%** |
| **13:30** | **Building Permits total/MoM (Feb)** | **1200k/-0.2%** | **1202k/-0.2%** |
| **13:30** | **CPI MoM YoY (Feb)** | **-0.2% / 0.9%** | **0.0% / 1.4%** |
| **13:30** | **CPI Ex Food and Energy MoM YoY (Feb)** | **0.2% / 2.2%** | **0.3% / 2.2%** |
| 13:30 | Real Avg Weekly Earnings YoY (Feb) | -- | 1.2% |
| **14:15** | **Industrial Production MoM (Feb)** | **-0.3%** | **0.9%** |
| 14:15 | Capacity Utilization (Feb) | 76.9% | 77.1% |
| **19:00** | **FOMC Rate Decision (Lower Bound)** | **0.25%-0.50%** | **0.25%-0.50%** |
| **Japan** | | | |
| 03:00 | Tokyo Condominium Sales YoY (Feb) | A -13.9% | -11.0% |
| 07:00 | Machine Tool Orders YoY (Feb F) | A -22.5% | -22.6% |
| **UK** | | | |
| 10:30 | Claimant Count Rate (Feb) | 2.2% | 2.2% |
| **10:30** | **Jobless Claims Change (Feb)** | **-9.1k** | **-14.8k** |
| **10:30** | **Average Weekly Earnings 3M/YoY (Jan)** | **2.0%** | **1.9%** |
| 10:30 | Weekly Earnings ex-Bonus 3M/YoY (Jan) | 2.1% | 2.0% |
| 10:30 | ILO Unemployment Rate 3Mths (Jan) | 5.1% | 5.1% |
| **EMU** | | | |
| 08:00 | EU27 New Car Registrations (Feb) | A 14.3% | 6.2% |
| **Norway** | | | |
| 10:00 | Trade Balance NOK (Feb) | -- | 16.9b |
| **Events** | | | |
| **13:30** | **UK's Osborne Makes Budget Speech to Parliament** | | |
| **19:30** | **Fed Chairwoman Yellen Speaks after Interest Rate Decision** | | |
| **Germany** | **Bund Auction (€4.0B 0.5% Feb2026)-** | | |
| Sweden | Bond Auction (SEK3.5B 5% Dec2020, SEK0.5B 2.25% Jun2032) | | |

| 10-year | td | -1d | 2 -year | td | -1d | STOCKS | | -1d |
|---|---|---|---|---|---|---|---|---|
| US | 1,95 | 0,00 | US | 0,96 | 0,01 | DOW | 17252 | 17251,53 |
| DE | 0,32 | 0,02 | DE | -0,45 | 0,01 | NASDAQ | 'or Exch - NQI | #VALUE! |
| BE | 0,56 | 0,02 | BE | -0,39 | -0,01 | NIKKEI | 16974 | 16974,45 |
| UK | 1,55 | -0,02 | UK | 0,50 | -0,04 | DAX | 9933,85 | 9933,85 |
| JP | -0,05 | -0,03 | JP | -0,18 | -0,02 | DJ euro-50 | 3067 | 3067,21 |

| | | | | | | | USD | td | -1d |
|---|---|---|---|---|---|---|---|---|---|
| IRS | EUR | USD (3M) | GBP | EUR | -1d | -2d | Eonia EUR | -0,248 | -0,005 |
| 3y | -0,085 | 1,161 | 0,918 | Euribor-1 | -0,31 | -0,01 | Libor-1 USD | 0,51 | 0,51 |
| 5y | 0,095 | 1,393 | 1,091 | Euribor-3 | -0,23 | 0,00 | Libor-3 USD | 0,59 | 0,59 |
| 10y | 0,670 | 1,786 | 1,509 | Euribor-6 | -0,13 | 0,00 | Libor-6 USD | 0,75 | 0,75 |

| Currencies | | -1d | Currencies | | -1d | Commoditie | CRB | GOLD | BRENT |
|---|---|---|---|---|---|---|---|---|---|
| EUR/USD | 1,1089 | -0,0016 | EUR/JPY | 125,73 | -0,10 | | 171,0724 | 1234,1 | 39,09 |
| USD/JPY | 113,395 | 0,12 | EUR/GBP | 0,786 | 0,0078 | -1d | -1,31 | 4,10 | 0,01 |
| GBP/USD | 1,4103 | -0,0165 | EUR/CHF | 1,0957 | -0,0006 | | | | |
| AUD/USD | 0,7454 | -0,0042 | EUR/SEK | 9,2484 | -0,02 | | | | |
| USD/CAD | 1,3358 | 0,0063 | EUR/NOK | 9,4885 | 0,07 | | | | |

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