



Sunrise

Wednesday, 06 January 2016

Rates: Underperformance US Treasuries on the back of stronger data?

Today's eco calendar heats up in the US with ADP employment report, US non-manufacturing ISM and FOMC Minutes. We see risks for the eco data on the upside of expectations which is a negative for US Treasuries. Ahead of Friday's payrolls report, the reaction might remain subdued though. The FOMC Minutes might reveal more info on the timing of a 2nd hike.

Currencies: USD still paints diffuse picture

Yesterday, USD/JPY remained under pressure due to risk-off sentiment. At the same time, EUR/USD drifted below the 1.0780 support. Sentiment on risk remains fragile this morning. Will decent US eco data support the dollar further? EUR/GBP is correcting lower after Monday's rejected test of 0.7425.

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 ended** flat yesterday as Chinese tensions eased. The S&P rose 0.20%, but the Nasdaq ended slightly lower after a report that Apple is expected to cut production of its latest iPhone models. This morning, **most Asian shares trade lower**, while Chinese ones outperform.
- **Chinese stocks rebound today, supported by government buying and as the country is set to extend its ban on stock sales by large shareholders.** The yuan however sank to a five-year low after the central bank set its reference rate at an unexpectedly weak level.
- **North Korea said this morning it successfully tested its first hydrogen bomb.** Although specialists question whether it was a hydrogen device, the move reignites tensions with neighbours including China after months of calm.
- **Growth in China's services sector slowed sharply in December** to its second-slowest pace in more than a decade, the Caixin services PMI showed this morning, indicating that the slowdown in the Chinese economy spreads to the services sector. The official non-manufacturing PMI however rebounded at the end of last year.
- **Brent crude oil prices remain under pressure today (\$36.42/barrel)**, hovering close to 11-yr lows as rising stock levels and demand worries continue to weigh.
- Today, the **eco calendar is well-filled**, especially in the US with the **ADP employment report**, trade balance, factory orders and **non-manufacturing ISM**. Also in the euro zone (final) and UK, the **services PMI's** will be released. After the European close, the Fed publishes the minutes of its latest FOMC meeting.

Rates

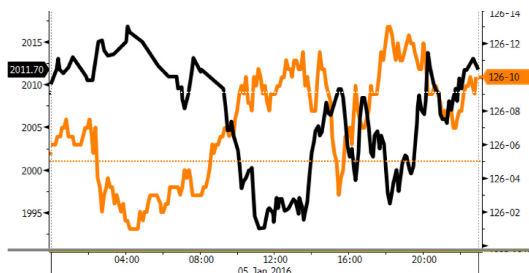
Bonds eke out modest gains in dull session

	US yield	-1d
2	1,0159	-0,0360
5	1,6974	-0,0460
10	2,2215	-0,0319
30	2,988	-0,0103

	DE yield	-1d
2	-0,3710	-0,0210
5	-0,1071	-0,0576
10	0,5468	-0,0432
30	1,4164	-0,0226

Global core bonds remained upwardly oriented in a dull trading session. In a daily perspective, the German yield curve shifted 1.1 bp (30-yr) to 4.2 bps (5-yr) lower. The German 2-yr yield reached the lowest level since the “disappointing” December ECB meeting (-0.37%) and the 5-yr yield (now -0.113% approaches the all-time lows (-0.20%). The 10-yr yield stands at 0.539%. Since early June, the 0.50%-mark has been a tough level to crack. Three attempts to break it failed and it could be an important technical level once again. **The move higher yesterday occurred in synch with the early down-leg in European equities.** Later on, equities recouped these losses, but Bunds kept their gains and evolved sideways. Eurozone inflation data disappointed, both headline and core, but couldn’t trigger an additional reaction. Changes on the US yield curve ranged between +0.8 bps (30-yr) and -2.2 bps (2-5-yr), steepening the curve, following Tuesday’s modest flattening. **US Treasuries reflected more than Bunds the intraday gyrations of equities.** On intra-EMU bond markets, risk off has no effect at all. 10-yr yield spread changes vs Germany were a tad lower with Ireland outperforming (-4 bps) on a favourable FT article and Greece underperforming (+36 bps) amid difficulties to agree on pension reforms.

Today, the **eco calendar is well-filled with focus on US data, that disappointed recently.** The US labour market recovery is expected to have extended its recent trend in December. For the **ADP report**, the consensus is looking for an increase in private sector employment by 195 000, down from 217 000 in November. While the ADP report usually tends to underestimate actual payrolls growth, the opposite occurred in November with payrolls growth 20 000 below the ADP estimate, complicating our December forecast. Nevertheless, we believe that **the risks for the ADP report are for a slightly stronger outcome.** Despite a further slowdown in the manufacturing sector, a broadly stable **non-manufacturing ISM** is expected for December. After a sharp decline in November, the consensus is looking for a marginal pick-up from 55.9 to 56.0. We see risks for a **bigger rebound** as we don’t see any evidence of a significant slowdown in services sector activity. The **trade data** are forecast to show only limited movement in November and **US factory orders** are forecast to have dropped slightly in November due to a decline in non-durable orders. In the euro area, **the final reading of the services PMI** for December is expected to confirm the first estimate, which slowed a drop from 54.2 to 53.9. We see risks for a limited upward revision as was the case for the manufacturing ISM.



S&P future (orange) and T-Note future (black): US Treasuries quite sensitive to intraday gyrations equities (contrary to Bund)



German 10-yr yield: in sideways range but approaching bottom around 0.50%. In past tests failed. Is market afraid to test it again?

R2	160,66	-1d
R1	159,36	
BUND	159,09	0,4800
S1	156,4	
S2	154,54	

German Schatz auction: stronger demand than Q4 2015?

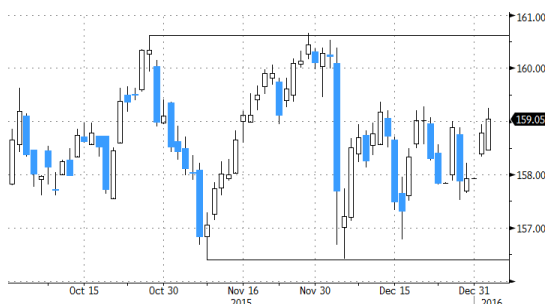
Today, the German Finanzagentur holds a 2-yr German Schatz auction (€5B 0% Dec2017). In Q4 2015, demand for German Schatz auctions were in line with Bobl and Bund auctions. Total bids averaged €5B at the past three auctions. Even though today's auction yield could be the lowest on record (currently - 0.38%), we still expect a pick-up in demand compared to Q4 2015. At the start of the year, sovereign debt auctions generally met with stronger demand. In the run-up to the auction, the bond traded stable in ASW-spread terms.

Today: Underperformance US Treasuries vs Bunds?

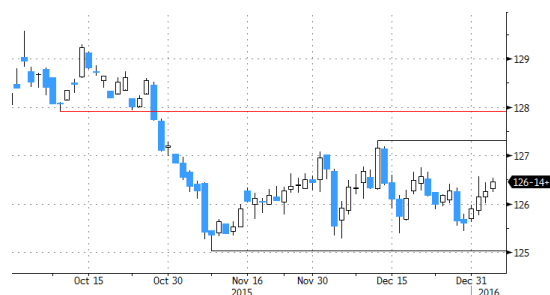
Overnight, main Asian equity indices trade up to 1% lower. Risk sentiment thus deteriorated following a positive close for the S&P 500 yesterday. North-Korea said that it tested an H-bomb which weighs on risk sentiment. The Chinese Caixin services PMI slid further with the composite back below the 50 boom/bust mark. The devaluation of the Chinese renminbi continues. Chinese stocks outperform (+1.5%) (more PBOC buying?).

Today, the eco calendar contains **the final figure for the EMU services PMI. Risks are for an upward revision, but we don't expect an impact on trading.** Overall, **risk sentiment on equity markets (bad following Asia?) and developments on commodity markets should be key for European trading.** That could modestly underpin core bonds via classic safe haven flows. The US eco calendar contain ADP employment report, non-manufacturing ISM and FOMC Minutes of the December (liftoff) meeting. We believe that the eco data might be stronger than expected, which is a negative for US Treasuries, but the sentiment on risk may eventually prime the eco data. The market reaction could remain numbed by Friday's payrolls report also. FOMC Minutes might give more hints on the Fed's intentions about the next rate hike.

Technically, both the Bund and the US Note future are in sideways trading ranges since November respectively between 156.40 & 160.66 and 125-01 & 127-10. We prefer a **sell-on-upticks approach with entry levels around those recent highs**, especially in the US. Longer term, we believe that December policy action by the ECB (failing to deliver on expected easing) and the Fed (start tightening cycle) puts a firm bottom below rate markets. In yield terms, we don't eye a return of the German 10-yr yield below 0.40% and of the US 10-yr yield below 2.1%.



German Bund: Sideways trading range



US Note future (March contract!!): Topside protected by start Fed tightening cycle. Sell-on-upticks near those highs (127-10)

Currencies

Dollar holding strong despite global risk-off trade

USD/JPY is the exception to the rule as yen remains the preferred safe haven

Euro underperforms

R2	1,106	-1d
R1	1,0946	
EUR/USD	1,0751	-0,0079
S1	1,065	
S2	1,0524	

Risk off sentiment in Asia as yuan sets multi-year low

There plenty of eco data in the US

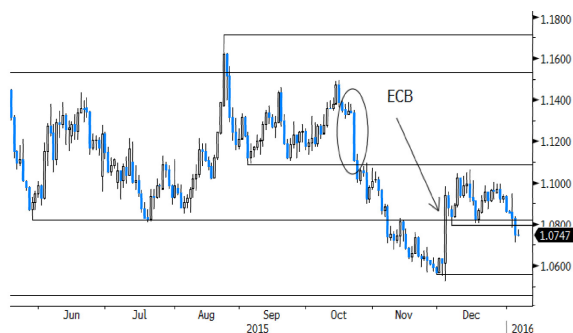
However, global factors will probably continue to dominate global currency trading

Dollar trading dominated by risk-off sentiment

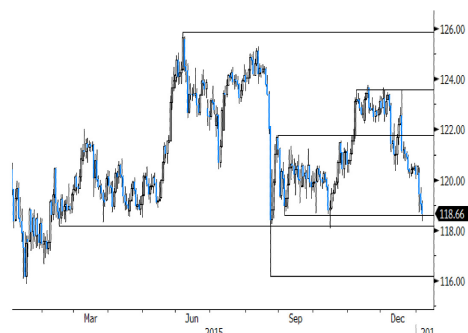
On Tuesday, the dollar painted again a mixed and diffuse picture. USD/JPY traded according to the usual risk-on/risk-off reaction function. A decline due to equity weakness in Asia and at the start of European trading slowed later on as US risk sentiment improved slightly. USD/JPY closed the session at 119.06 (from 119.40 on Monday). EUR/USD remained captured in a clear short-term downtrend. A soft EMU inflation reading reinforced the move, but the trend was already in place before the release. EUR/USD drifted further below the 1.0780 support area and closed the session at 1.0748 (from 1.0831).

Overnight, Asian markets stay in risk-off modus. The Caixin China services PMI dropped to 50.2 from 51.2 and the composite index fell below 50 (49.4), suggesting a further cooling of the Chinese economy. The PBOC lowered the fixing of the yuan to the lowest level since April 2011. USD/CNY trades currently in 6.5465 area. The spread between the on-shore and the off-shore yuan widened further this morning. China is devaluing its currency and putting pressure on other economies in the region, while it weighs on regional (equity) sentiment too. In addition, the region was confronted with another source of tension, North Korea conducted a nuclear test. Losses in Asian equity indices are modest and trading orderly. China outperforms on the weaker yuan, while Japan underperforms with USD/JPY extending its risk-off driven downtrend and trading in the 118.70 area. EUR/USD is little changed in the 1.0745/50 area.

Later today, the eco calendar is well-filled, especially in the US with the ADP employment report, trade balance, non-manufacturing ISM, factory orders and the Fed's FOMC minutes. In the euro zone, the final reading of the December services PMI will be released. We see slight upward risks versus the consensus for ADP job growth and for the Non-manufacturing ISM (see fixed income part of this report). The final EMU services PMI might be revised marginally higher. However, it is doubtful that such an outcome will change sentiment on markets. It looks that sentiment might stay risk off as markets focus economic uncertainty in China and its impact on the global economy. This context remains negative for USD/JPY. Decent US eco data might slow the decline but sentiment on risk should improve to put a floor under USD/JPY. It's too early to make this call now (US equity futures show losses of about 0.75%)



EUR/USD: extends break below 1.08 support area



USD/JPY still pressured by risk-off sentiment

Wednesday, 06 January 2016

We are still a bit puzzled on the reaction function of EUR/USD. For now, the risk-off sentiment didn't really narrow the US-German rate differentials. This is keeping the dollar well supported against the euro. However, this pattern might change if the risk sentiment remains really negative or even deteriorates further. In such a scenario, markets might scale back fed rate hike expectations. In this context we're not keen to jump on the recent EUR/USD decline even as the technical picture of EUR/USD turned negative after the break below 1.08 and as we are rather positive on the dollar longer term. However, the reason for the EUR/USD decline occurred for the 'wrong reason' (risk-off rather than decent US eco data). We still look for a rebound higher to sell EUR/USD (e.g. closer to the 1.10/1.11 area).

From a technical point of view, EUR/USD failed to regain important resistance (previous range bottom/break down at 1.1087 and the 62% retracement from the October high at 1.1124) after the December ECB policy meeting and it will be tough to break. Yesterday, EUR/USD dropped below 1.0796 (07 Dec low), which improves the ST technical picture for the dollar. Next support is at 1.0650 (76% retracement off 1.0524/1.1060) and at 1.0524. The technical picture/short term trend are quite obvious. However, we are reluctant to jump on this break as the fundamentals don't fit (cf. supra). The picture for USD/JPY (below 120). The 118.07 (15 Oct low) and 116.18 (August low) levels are next supports.

Cable extends downtrend. GBP/EUR rebounds

On Tuesday, sterling showed a similar diffuse picture as the US dollar. Sterling continued to fight an uphill battle against a (remarkably) strong dollar. Cable finally set a new short-term low (1.4648). At the same time, sterling regained ground against the euro as the correlation between EUR/USD and EUR/GBP came again in play. Monday's rejected test of the 0.74/0.7425 area triggered some scaling back of EUR/GBP longs. **The UK PMI of the construction sector rebounded more than expected from 55.3 to 57.8 but global factors/technical considerations prevailed.** Cable closed the session at 1.4676 (from 1.4716). This is in the first place due to dollar strength. EUR/GBP experienced a material setback but we consider this in the first place euro weakness. The pair closed the session at 0.7324 (from 0.7359)

R2	0,7493	-1d
R1	0,7424	
EUR/GBP	0,7331	-0,0023
S1	0,7305	
S2	0,7193	

This morning, BRC shop prices were reported at -2.0% Y/Y (from -2.1%). Both cable (1.4655 area) and EUR/GBP (0.7325 area) are trading near recent lows. **Today, the UK services PMI will be published.** A slight decline from 55.9 to 55.6 is expected. We don't have strong reasons to take different view from the consensus. Sterling (especially cable) might be slightly more sensitive to a negative surprise rather than to a positive one. **Global factors and the Brexit debate remain an important factor for sterling trading.** A sustained rebound of sterling will be difficult unless there are signs of progress in one of those two factors. That said, Monday's rejected test of the 0.74 area has apparently improved the short-term momentum for sterling against the euro. 0.7424 is a first short-term resistance. Next resistance is seen at 0.7493 (Oct top). The rebound of EUR/GBP was a bit exhausted. Some further correction might be on the cards. A drop below the 0.73 area would call off the ST uptrend. **The technical picture** of sterling against the dollar remains fragile. The key 1.4566 2015 low comes within reach.

Calendar

Wednesday, 6 January		Consensus	Previous
US			
14:15	ADP Employment Change (Dec)	195k	217k
14:30	Trade Balance (Nov)	-\$44.00b	-\$43.89b
15:45	Markit Services PMI (Dec F)	54.0	53.7
16:00	ISM Non-Manufacturing (Dec)	56.0	55.9
16:00	Factory Orders (Nov)	-0.2%	1.5%
16:00	Factory Orders Ex Trans (Nov)	--	0.2%
Japan			
02:35	Nikkei PMI Services (Dec)	A 51.5	51.6
China			
02:45	Westpac-MNI Consumer Sentiment (Dec)	A 113.7	113.1
02:45	Caixin PMI Services (Dec)	A 50.2	51.2
02:45	Caixin PMI Composite (Dec)	A 49.4	50.5
UK			
01:01	BRC Shop Price Index YoY (Dec)	A -2.0%	-2.1%
10:30	Official Reserves Changes (Dec)	--	-\$1394m
10:30	Markit/CIPS Services PMI (Dec)	55.6	55.9
EMU			
10:00	Markit Services PMI (Dec F)	53.9	53.9
10:00	Markit Composite PMI (Dec F)	54.0	54.0
11:00	PPI MoM/YoY (Nov)	-0.2%/-3.2%	-0.3%/-3.1%
Germany			
09:55	Markit Services PMI (Dec F)	55.4	55.4
France			
08:45	Consumer Confidence (Dec)	95	96
09:50	Markit Services PMI (Dec F)	50.0	50.0
Italy			
09:45	Markit/ADACI Services PMI (Dec)	53.6	53.4
Spain			
09:15	Markit Services PMI (Dec)	56.6	56.7
Events			
Italy, Spain, Greece, Austria, Poland are closed in observance of Epiphany Day			
11:30	Germany – Schatz Auction (€5B 0% Dec 2017)		
14:30	Fed's Fischer to be Interviewed on CNBC		
20:00	Fed Releases Minutes from Dec. 15-16 FOMC Meeting		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	2,22	-0,03	US	1,02	-0,04	DOW	17159 17158,66
DE	0,55	-0,04	DE	-0,37	-0,02	NASDAQ	for Exch - NQI #VALUE!
BE	0,89	-0,06	BE	-0,34	-0,02	NIKKEI	18191 18191,32
UK	1,88	-0,01	UK	0,56	-0,03	DAX	10310,1 10310,10
JP	0,26	-0,01	JP	-0,01	0,00	DJ euro-50	3178 3178,01

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,251 -0,01
3y	0,003	1,340	1,208	Euribor-1	-0,21	-0,01	Libor-1 USD	0,51 0,51
5y	0,259	1,642	1,492	Euribor-3	-0,13	0,00	Libor-3 USD	0,59 0,59
10y	0,907	2,109	1,906	Euribor-6	-0,04	0,00	Libor-6 USD	0,75 0,75

Currencies	-1d	Currencies	-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,07505 -0,0079	EUR/JPY	127,46 -1,91		174,4858	1080,75	36,5
USD/JPY	118,58 -0,87	EUR/GBP	0,7333 -0,0021	-1d	-1,66	2,95	-0,80
GBP/USD	1,4658 -0,0063	EUR/CHF	1,0849 0,0000				
AUD/USD	0,7103 -0,0099	EUR/SEK	9,2376 0,03				
USD/CAD	1,4039 0,0123	EUR/NOK	9,5811 -0,03				

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