



## Sunrise

Tuesday, 03 November 2015

### Rates: Eyes on stock markets

Today's EU calendar only contains a speech by ECB president Draghi after European market closure. That means that sentiment on equity markets will set the tone for bond trading. Will the new VW accusations and S&P putting 8 large US banks on CreditWatch negatively spoil the very strong sentiment on equity markets of late?

### Dollar holding strong supported by risk-on sentiment

Yesterday, the dollar held tight ranges both against the euro and the yen. A strong bid in equities kept the downside of the dollar well protected. Today, equities and a speech of ECB's Draghi will set the tone for FX trading. The Aussie dollar rebounded to the AUD/USD 0.72 area as the RBA left its policy rate unchanged.

### 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** closed yesterday's trading session with nice gains after a somewhat weaker open. **US equities** continue to thrive, with the indices almost back at their highs. Overnight, **Asian equities** are trading in the green, ending a five day losing streak.
- **Rating agency S&P warned that the Federal Reserve's latest proposal on 'total loss absorbing capacity' may result in lower ratings** for eight top global US-based banks after putting them on negative watch.
- **The Reserve Bank of Australia has left interest rates unchanged at 2%**, but strongly hinted that further rate cuts are possible in the coming months given the inflation outlook. Expectations were divided 30% -Yes / 70% -No rate cut.
- **Hard commodities remain low**, with **Brent crude currently at \$48.68/barrel** after a drop yesterday afternoon; **gold is also at its 3-week-low**. Soft commodities are on the rise, with **sugar already +30% in over a month**.
- **On the corporate calendar today are the earnings releases from BMW and UBS (pre-market) and Tesla Motors (after-market).**
- The **eco-calendar** is rather thin today, with only **factory orders in the US** and **UK (Markit) construction PMI data**. Most interesting is ECB's President Mario Draghi's speech in Frankfurt today.

# Rates

## Post-FOMC downward correction resumes

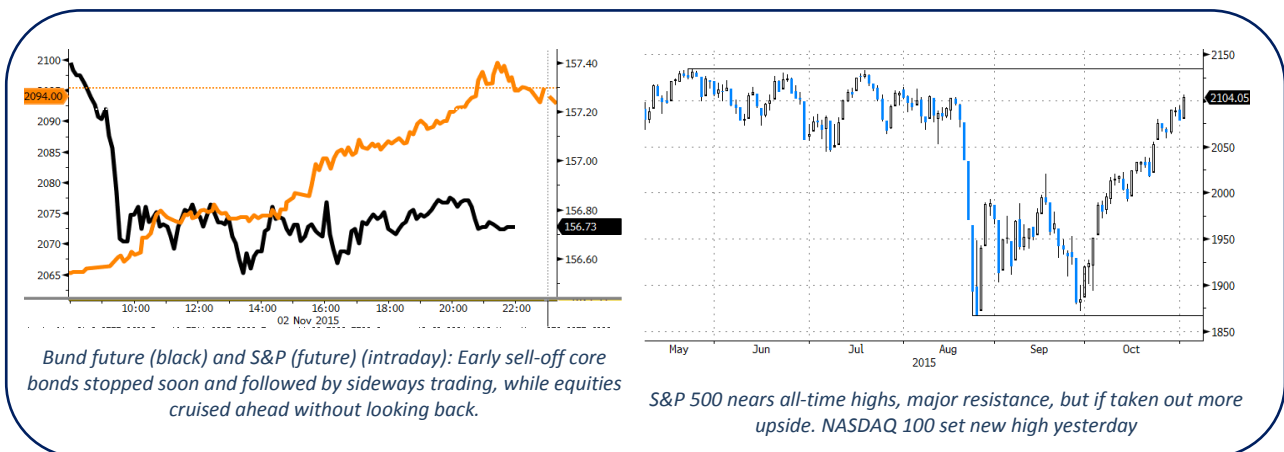
More losses for core bonds

Less soft Draghi and risk on major factors

German bonds underperform US ones at longer tenors

|    | US yield | -1d    |
|----|----------|--------|
| 2  | 0,7574   | 0,0252 |
| 5  | 1,5497   | 0,0378 |
| 10 | 2,1781   | 0,0449 |
| 30 | 2,9421   | 0,0302 |

Global core bonds started the trading week on a weaker footing, as risk-on sentiment returned in early European trading. Also rather dovish comments by Draghi, who slightly downplayed his very soft post-ECB meeting comments, played a negative role. German Bunds slightly underperformed US Treasuries, narrowing the yield differential at the longer end of the curve. In a daily perspective, the German curve bear steepened with yields 1 bp to 5.2 bps higher. US yields ended higher too with the belly underperforming. 5-to10-yr yields increased by 3.4 to 2.9 bps, while yields at the wings closed 2.9 bps (2-yr) to 2.2 (30-yr) higher. **So the post-FOMC correction is not over yet, even if losses were confined to a narrow time-frame between 8 and 9:40 pm CET. The eco data were ignored.** EMU manufacturing PMI's were revised upwards for October, the UK PMI was strong, while the US ISM remained weak at a nearly unchanged 50.1. On **intra-EMU bond markets**, 10-yr yield spreads versus Germany widened up to 4 bps with Greece underperforming (+13 bps).



## US eco data and speech Draghi only focus today

|    | DEyield | -1d    |
|----|---------|--------|
| 2  | -0,3020 | 0,0180 |
| 5  | -0,0470 | 0,0340 |
| 10 | 0,5660  | 0,0410 |
| 30 | 1,3130  | 0,0520 |

R yield

Will Draghi repeat his words during speech after market closure?

The US factory orders are expected to have decreased by -0.9% in September, following a -1.7% decline in August. The durable orders, which count for more than 50% of the factory orders, are already reported, and showed a disappointing 1.2% M/M decline in September. So, the factory orders should be negative too, but it is less of a market mover. The **NY Fed manufacturing index** is of less importance. The October car sales are a good gauge for consumer spending. They are at historical highs, making the expected decline no reason for concern. Also interesting today is ECB's President Mario Draghi's speech in Frankfurt. Over the weekend, **Mr. Draghi** repeated that the ECB will take the necessary actions if the inflation outlook is at risk and will see whether more stimuli are needed. He added though that it is **too early to judge whether it will be needed to lower the deposit rate (and what with the QE?)**. That suggests that the ECB may keep a deposit rate cut for in case the euro strengthens. The decline of the euro makes it less compelling and so do the reasonable good eco data. On inflation, the signs are more mixed. (higher core CPI, but flat headline; expectations of price declines in business surveys). We are curious whether Draghi will confirm this tempering of market expectations about ECB easing in December.

|             |               |                |
|-------------|---------------|----------------|
| R2          | 160,62        | -1d            |
| R1          | 158,6         |                |
| <b>BUND</b> | <b>156,68</b> | <b>-0,6400</b> |
| S1          | 155,87        |                |
| S2          | 155,41        |                |

### Austria set to complete 2015 funding need

Today, the **Austrian debt agency** taps the on the run 10-yr RAGB (1.2% Oct2025) and 20-yr RAGB (2.4% Mar2034) for a combined €1.32B. After this auction, the debt agency completed this year’s funding need with still one final auction data penned in (Dec 15). Both bonds cheapened slightly in ASW spread terms going in the auction. The 10-yr RAGB also trades rather cheap on the Austrian curve. Overall, we expect plain vanilla demand.

### Today: Equity markets expected to set the tone

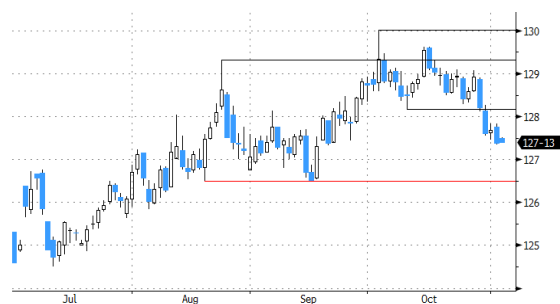
**Overnight**, most Asian stock markets trade positive in line with the strong WS session yesterday. Japanese markets are closed for Culture Day. The RBA kept its powder dry, but indicated that the outlook for inflation may afford scope for further easing. The US Note future trades marginally lower. **The new VW accusations and S&P putting 8 global systemically important banks on CreditWatch negative have no impact on trading at this stage with risk spoiling equity market sentiment.**

**Today’s eco calendar is extremely thin. The most important item is the speech by ECB President Draghi after European closure (see above).** If Draghi further backtracks on his “promise” to ease in December, that reduces support for the Bund. Given the timing of his speech though, sentiment on equity markets will most likely set the tone for bond trading. **Moves might be limited though given this week’s back loaded eco calendar. Later this week, focus remains on US eco data (non-manufacturing ISM, ADP, payrolls) and Fed speakers (Dudley, Fischer,...).**

**The Fed bought an option for a December lift-off, though the central bank remains data-dependent.** In case of solid eco data, that’s a longer term negative for US Treasuries. Technically, the US Note future dropped below first support at 128-05+. **We believe that there is more downside with next support at 126-16.** The ECB on the other hand keeps a firm easing bias, which underpins EMU bond markets. Therefore, we expect only very limited spill over from higher US rates to Europe. US/German yield spreads should widen on this clear divide in monetary policy stance.



German Bund: off the highs following after Fed, but uptrend remains in place



US Note future: More downside after hawkish Fed

# Currencies

|         |         |         |
|---------|---------|---------|
| R2      | 1,114   | -1d     |
| R1      | 1,1096  |         |
| EUR/USD | 1,10255 | -0,0002 |
| S1      | 1,0848  |         |
| S2      | 1,0715  |         |

*USD holding strong*

*Asian equities join the risk-on rally*

*Dollar little changed this morning*

*Aussie dollar rebounds after unchanged RBA decision*

*Thin eco calendar today*

*Speech of Draghi is a wildcard.*

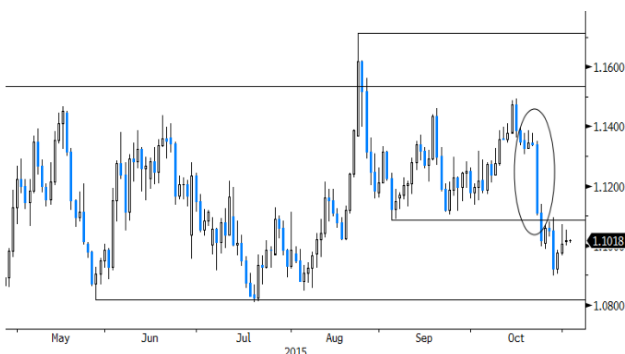
## Equities and the dollar are holding strong

On Monday, it looked that the dollar could fall prey to further profit taking as Asian markets started in risk-off modus. However, Europe didn't join this trend, which prevented further USD losses. The manufacturing ISM was close to expectations at 50.1. Not a great figure at all, but a crimp was avoided. This was enough to keep the risk-on rally alive and it shielded the downside in the dollar. EUR/USD closed the session at 1.1016, little changed from 1.1006 on Friday. USD/JPY ended the day at 120.76 from 120.62 on Friday eve.

Overnight, Asian markets join the risk-on rally. Japanese equity markets are closed. The dollar is holding near yesterday's closing levels against the euro and the yen. The Reserve Bank of Australia left its policy rate unchanged at 2%. The policy statement was hardly changed from the previous post meeting communiqué. Inflation is still expected to remain consistent with the target in the next one to two years. However, it is a little lower than earlier expected. The RBA considers leaving the policy rate unchanged at 2.0% as appropriate. However, it keeps the door open for further easing if needed. The Australian dollar is said to be adjusting to the significant declines in key commodities. The Aussie dollar was already in an intraday uptrend in the run-up to the policy announcement and jumped to the AUD/USD 0.72 area upon the publication of the report. The tone of the report was apparently more balanced./less soft than markets anticipated after the publication of soft Q3 CPI data.

Later today, the eco calendar is very thin. There are no important eco data in Europe. ECB president Draghi will give a speech after the close of the European markets. Will he keep the very dovish tone from the press conference or will he turn a bit more balanced? How much weight will he give to a potential further reduction of the deposit rate? If he downplays this option, it would be a temporary positive for the euro. In the US, the factory orders will be published. Bad news from the durable orders should already be incorporated. We don't expect a lasting impact on USD trading.

In a day-to day perspective, equities and the dollar hold remarkably strong. At some point a correction on the risk-on rally will occur and might trigger some moderate profit taking in the dollar, too. However, for now, there is no signal of such a change in sentiment yet. So, the working assumption is that the dollar can stay relatively strong going into the key US eco data later this week.



EUR/USD: consolidation after the post-FOMC USD rally



USD/JPY: holding well north of the 120 big figure

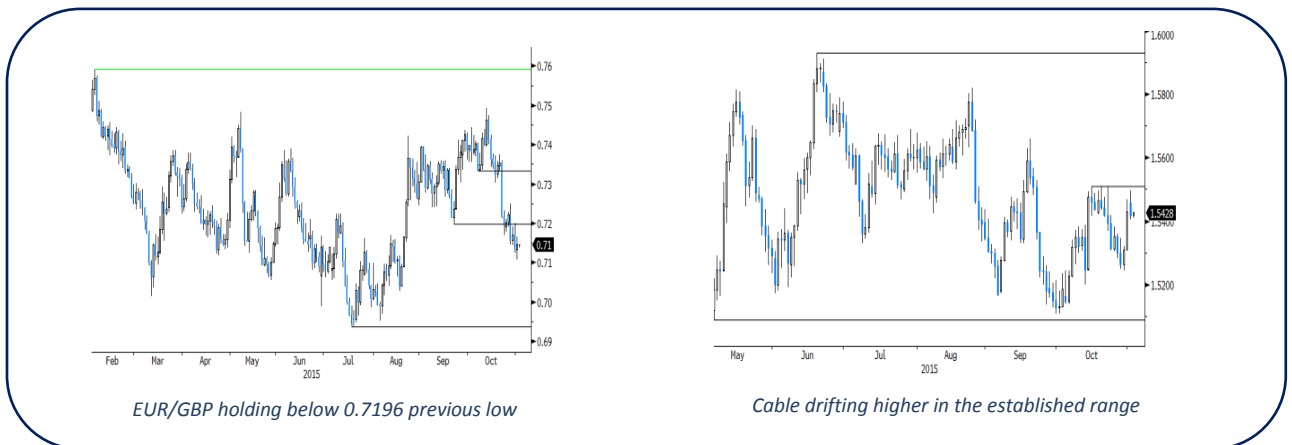
Over the previous two weeks; the market focus changed in favour of the dollar. At the ECB press conference, ECB Draghi surprised markets by suggesting that additional easing was forthcoming. This pushed EUR/USD below the key 1.1087/1.1105 support. Last week's Fed policy statement 'confirmed' a policy divergence between the Fed and ECB, pushing EUR/USD further south in the LT consolidation pattern. 1.0819 is a first important support area. The targets of the multiple top with neckline in the 1.1087/1.1105 area in the low 1.07 area. Some short-term consolidation on the recent USD rally is possible, but there is no reason to fight the euro negative/USD positive tide.

|                |               |         |
|----------------|---------------|---------|
| R2             | 0,7374        | -1d     |
| R1             | 0,725         |         |
| <b>EUR/GBP</b> | <b>0,7144</b> | -0,0001 |
| S1             | 0,7107        |         |
| S2             | 0,7036        |         |

### Sterling hardly profits from strong manufacturing PMI

Yesterday, the UK manufacturing PMI unexpectedly jumped from an upwardly revised 51.8 to 55.5. The figure came on the back of a series of disappointing data from the UK manufacturing/production sector. The initial reaction of sterling was understandably quite forceful. Cable jumped from the 1.5430 area to fill offers just below 1.55. EUR/GBP trended higher in early European dealings, but dropped to the 0.7110 area after the publication of the report. However, growth in the UK is in the first place driven by services. This might be one of the reasons why sterling returned a big part of the initial gains. The text of a speech from UK Fin Min Osborn asking for legal safeguards from non-EMU members might have also been a negative for sterling. Cable closed the session at 1.5417 (from 1.5428 on Friday). EUR/GBP ended the day at 0.7145 (from 0.7133). So in the end, sterling didn't profit from the strong PMI.

Today, the UK construction PMI will be published. A slight correction from a very high level (decline from 59.9 to 58.8) is expected. The report is usually only of second tier importance for sterling trading, expected in case of a really big surprise. That said, it is a bit disappointing that sterling didn't maintain any gains from yesterday's strong manufacturing PMI. Looking at the broader picture, the soft tone at the ECB press conference pushed EUR/GBP back lower in the longstanding sideways range. The pair tested the 0.7196 support, but the level was 'really' broken after the FOMC announcement. We maintain a sell-on-upticks approach for EUR/GBP. The BoE inflation report on Thursday is the next key reference from sterling trading.



# Calendar

| Tuesday, 3 November |  | Consensus | Pre |
|---------------------|--|-----------|-----|
| <b>US</b>           |  |           |     |
|                     | Wards Domestic Vehicle Sales (Oct)                       | 14.10m    | 14  |
|                     | Wards Total Vehicle Sales (Oct)                          | 17.70m    | 18  |
| 15:45               | ISM New York (Oct)                                       | 46.0      | 4   |
| 16:00               | Factory Orders (Sep)                                     | -0.9%     | -1  |
| 16:00               | IBD/TIPP Economic Optimism (Nov)                         | 47.4      | 4   |
| <b>Australia</b>    |  |           |     |
| 04:30               | RBA Cash Rate Target                                     | A: 2.0%   | 2   |
| <b>UK</b>           |  |           |     |
| 10:30               | Markit/CIPS UK Construction PMI (Oct)                    | 58.8      | 5   |
| <b>Spain</b>        |  |           |     |
| 09:00               | Unemployment MoM Net ('000s) (Oct)                       | 71.0      | 2   |
| <b>Events</b>       |  |           |     |
| 09:15               | Sweden - Swedish Riksbank's Floden Gives Speech          |           |     |
| 11:15               | Austria - Eur 1.32bn; 1.2% Oct 2025, 2.4% May 2034 RAGBs |           |     |
| 20:00               | EMU - ECB's Draghi Speaks in Frankfurt                   |           |     |
| Before market open  | Earnings releases from BMW, UBS,                         |           |     |
| After market open   | Earnings releases from Herbalife, Tesla Motors,          |           |     |

| 10-year | td   | -1d   | 2-year | td    | -1d  | STOCKS     | -1d                    |
|---------|------|-------|--------|-------|------|------------|------------------------|
| US      | 2,18 | 0,04  | US     | 0,76  | 0,03 | DOW        | 17829 17828,76         |
| DE      | 0,57 | 0,04  | DE     | -0,30 | 0,02 | NASDAQ     | for Exch - NQI #VALUE! |
| BE      | 0,87 | 0,05  | BE     | -0,27 | 0,01 | NIKKEI     | 18683 18683,24         |
| UK      | 1,95 | 0,02  | UK     | 0,63  | 0,02 | DAX        | 10950,67 10950,67      |
| JP      | 0,31 | -0,01 | JP     | 0,01  | 0,00 | DJ euro-50 | 3435 3434,50           |

|     |       |          |       |           |       | USD  |             |      |      |
|-----|-------|----------|-------|-----------|-------|------|-------------|------|------|
| IRS | EUR   | USD (3M) | GBP   | EUR       | -1d   | -2d  | Eonia EUR   | td   | -1d  |
| 3y  | 0,056 | 1,119    | 1,190 | Euribor-1 | -0,12 | 0,00 | Libor-1 USD | 0,51 | 0,51 |
| 5y  | 0,300 | 1,505    | 1,516 | Euribor-3 | -0,07 | 0,00 | Libor-3 USD | 0,58 | 0,58 |
| 10y | 0,944 | 2,075    | 1,949 | Euribor-6 | 0,01  | 0,00 | Libor-6 USD | 0,74 | 0,74 |

| Currencies |         |         | -1d | Currencies |        |         | -1d | Commoditie | CRB     | GOLD  | BRENT |
|------------|---------|---------|-----|------------|--------|---------|-----|------------|---------|-------|-------|
| EUR/USD    | 1,10255 | -0,0002 |     | EUR/JPY    | 132,98 | 0,18    |     | 194,9138   | 1136,55 | 48,69 |       |
| USD/JPY    | 120,62  | 0,20    |     | EUR/GBP    | 0,7144 | 0,0001  | -1d | 0,76       | -4,60   | -0,88 |       |
| GBP/USD    | 1,543   | -0,0003 |     | EUR/CHF    | 1,0869 | -0,0008 |     |            |         |       |       |
| AUD/USD    | 0,7209  | 0,0066  |     | EUR/SEK    | 9,3937 | -0,01   |     |            |         |       |       |
| USD/CAD    | 1,3083  | 0,0010  |     | EUR/NOK    | 9,3453 | -0,01   |     |            |         |       |       |

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