Sunrise

Tuesday, 03 May 2016

Rates: Core bonds remain weakish, but losses stay limited

Initial core bond rally went awry as an air pocket was hit. Later on, strong equities kept bonds under pressure. Calendar is nearly empty today , while Asia took over the risk-on sentiment from Wall Street. Core bonds may still drop a bit lower, but we keep our view that the risk-on rally is nearly finished and so upgraded our core bond view to neutral from bearish.

Currencies: Dollar decline continues unabatedly

Yesterday, EUR/USD jumped above the 1.15 barrier as the headline US manufacturing ISM missed expectations. This morning, USD/JPY selling pressure persists and weighs on the dollar across the board. The EC's Spring forecast might be slight negative for the euro, but probably won't change the broader USD trend.

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 a slightly weaker manufacturing ISM, **US Equities showed a significant rebound yesterday**, posting its biggest daily advance in more than two weeks. This morning, **most Asian shares rebound too**, led by Chinese and Australian stocks. Japanese markets are closed.
- Bank of Japan Governor **Kuroda** said **the yen's biggest rally since Abenomics risks harming the economic recovery,** warning that they will closely monitor the impact of financial markets on the real economy and prices.
- The **Reserve Bank of Australia decided this morning to cut interest rates by 25 basis points to a record low of 1.75%** in an attempt to spur very low inflation rates. As markets were divided on the chances for a rate cut, the Aussie dollar dropped significantly lower.
- **China's Caixin manufacturing PMI slipped unexpectedly in April,** falling from 49.7 to 49.4, following a significant rebound in the month before, indicating that the pass through from monetary stimulus remains rather muted.
- **Growth in Asia-Pacific will slow only marginally this year, to 5.3%,** the **IMF** said yesterday, adding that consumption should be a key driver, while it also warned that high debt levels have become a significant risk, especially as debt levels have increased already markedly over the past decade.
- Today, **the eco calendar** contains the **UK manufacturing PMI** and US vehicle sales. The European Commission will release its **Spring Economic Forecasts** and Japanese markets are closed.

Rates

US Treasuries and Bunds cannot hold on to early gains. Losses still limited.

US curve bear steepens while German curve flattens

No big moves on intra-EMU bonds

	US yield	-1d
2	0,7935	0,0118
5	1,3215	0,0259
10	1,8723	0,0478
30	2,7245	0,0472

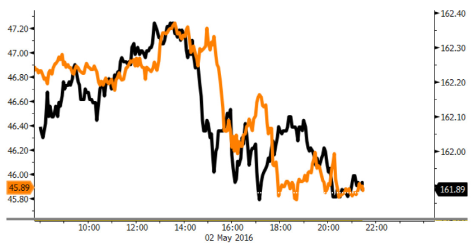
	DE yield	-1d
2	-0,4730	0,0030
5	-0,2860	0,0060
10	0,2730	0,0040
30	1,0004	-0,0186

Moderate core bond weakness as risk-on rally continues

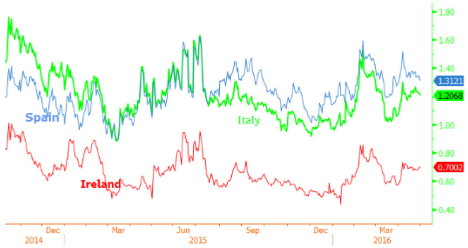
Yesterday, global core bonds started the week on a stronger footing and climbed robustly in the morning session, to hit an air-pocket in the afternoon, erasing all previous gains. The US manufacturing ISM fell more than expected with new orders and production indices falling. Both remained though at solid levels, suggesting that the details mitigated the weaker headline figure. The markets reacted accordingly and shrugged off the weaker headline reading, also as the ISM prices paid index jumped much stronger than forecast. The T-Note figure was almost immediately hit by an additional selling wave, while equities went up and the dollar remained under pressure though. Core bonds tried to fight back, but couldn't escape the laws of gravity when equities started another upleg and sank back to the intra-day bottom. **The sudden drop lower in the morning session and the dismal reaction on the weaker headline ISM (due to the higher prices?) despite weaker oil prices shows a similar fragility of core bonds as we saw last week. It suggests more weakness ahead or, our favourite scenario, base formation, in which case the Bund support at 160.81 and T-Note support at 128-01+ should hold. In a daily perspective**, the US yield curve bear steepened slightly with yields up 0.8 bp (2-yr) to 4.6 bps (30-yr). The German yield curve flattened with 2-yr yields up 0.7 bp and 30-yr yields down 3.1 bps. On intra-EMU bond markets, 10-yr yield spread changes versus Germany narrowed 1 to 2 bps.

Empty eco calendar, but EC Spring forecast eye-catcher

The eco calendar is empty today, both in the US and euro zone, but interesting might be the **EC's Spring economic forecasts**. Both growth and inflation forecasts are still above the ECB's most recent projections and therefore also in the Commission's forecasts there is room for a downward adjustment. However, **more attention may go to the fiscal situation of the peripheral countries**. There seems to be substantial slippage in Spain and Portugal and maybe Italy. **This sets the stage for some country specific recommendations from the EC later on.** Portugal has a left government that is supported by an ultra-left party. Spain is still without government and is going again to the polls on June 26 without certainty that a workable government might come out of it. In Italy, PM Renzi has a hard time and pleads often for more fiscal leniency. So, Commission demands may clash with political interests. **We don't expect markets to be alarmed by the EC forecasts, but some unease may be visible in peripheral markets. ECB's Coeuré and Fed's Mester & Williams** are scheduled to speak. Coeuré spoke recently, but so did Fed Williams (centrist leaning recently somewhat to the hawkish side) (see below). Fed Mester's (moderate hawk) comments might be interesting, coming on the heels of last week's FOMC.



Bund future (black) & Brent future (orange) (intraday) Lower oil prices cannot prevent some losses for core bonds



10-yr yield spreads versus Germany: Some renewed narrowing recently, but will thev deterioration fiscal position stop this narrowing?

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Fed's Williams said that equilibrium rates (neutral rates) are much lower today than 20 years ago and sees significant downside risks to these rates. The new normal may be 3%, lower than the 3.25% from the dot plot. Nevertheless, he thinks it makes sense to raise rates. He said the Fed is right to take into account global growth and still sees insatiable demand for safe assets. Other assets are fairly priced versus US Treasuries, but he calls Treasuries priced extraordinarily high. **His comments are mixed for US Treasuries. On the one hand highly priced, but on the other hand lower neutral rate.**

Important test of core bonds' health continues

R2	163,16	-1d
R1	162,79	
BUND	**161,86**	-0,2100
S1	161,46	
S2	160,81	

Overnight, the Australian central bank cut its cash rate target by 25 bps (to 1.75%) The Caixin China manufacturing PMI disappointed as it slid to 49.4 in April from 49.7 in March (consensus 49.8), mirroring a tepid "official" PMI released over the weekend. The Chinese manufacturing sector is not falling off a cliff, but neither accelerating. Asian equities are doing well with Chinese and Australian bourses outperforming, also helped by good run on WS yesterday. Commodities are mixed. US Treasury futures jumped (modestly) higher on the Australian rate cut. The dollar weakens slightly more versus yen and stabilizes versus the euro.

Today's eco calendar is devoid of market moving issues. The EC Spring forecasts are interesting for the periphery, but probably not for core markets. So, the general sentiment on risk will be the driving force for markets. **In this context we prefer a neutral bias on today's trading.** A new quarter started yesterday and so we were looking out for new directions in markets, more in particular whether the risk-on has further to go. **Our basic view was "no", but it didn't turn out that way, even if nothing dramatically occurred in core bond markets.** Riskier assets are richly priced and oil/commodities should be toppish. Major central banks are side-lined and so are no support for riskier assets. Markets have priced in only one Fed rate hike for March 2017. Unless recession risks would rise, there is little scope for a still more gradual rate path. If it's because of higher recession risks, that shouldn't help the risk-on rally either. Of course, in recent weeks, especially the Bund traded weak, also in circumstances that would have justified a more bullish run (yesterday too). For the Bund, we think that 160.81 is a strong support (0.33% in 10-year German yield). **The downward correction of the Bund may have nearly run its course, unless these levels are broken (not our favourite scenario).** We changed our view on the core bonds from bearish to neutral.

German Bund: move below 163.16 suggests return action to March low (160.81) is still possible. However, we don't expect a break and make our view neutral from bearish (160.81 to 164.60).

US Note future: Sideways trading likely in 131-21 to 128-01 range

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Currencies

R2	1,1712	-1d
R1	1,1561	
EUR/USD	**1,15345**	0,0069
S1	1,1398	
S2	1,1217	

Dollar weakens further

Dollar extends decline

EUR/USD rebounds north of 1.15

USD/JPY drops top 106 level

RBA cuts policy rate by 25 bp

Aussie dollar nosedives

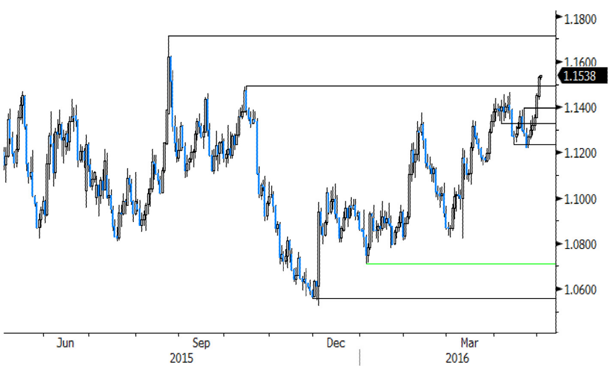
On Monday, USD weakness persisted from the European opening, even without hard news and ahead of the US manufacturing ISM. EUR/USD already tested the 1.1495/1.15 resistance intra-day and finally cleared the hurdle as the ISM printed weaker than expected. The break didn't spark aggressive follow-through USD losses though. EUR/USD closed the session at 1.1534 (from 1.1451 on Friday). USD/JPY finished the day little changed at 106.41.

Overnight, the China **Caixa manufacturing PMI** declined from 49.7 to 49.4, but no lasting reaction of Asian/even Chinese equities. Most Asian equities trade with modest gains. The **RBA cut its policy rate by 25 basis points** to 1.75%. The rate cut was executed as inflation remained lower than forecast and as the appreciation of the Aussie dollar was complicating the economic adjustment. AUD/USD dropped from the 0.7720 area and trades currently in the 0.7565 area. Japanese markets are closed, but It doesn't prevent further USD/JPY losses. The pair is testing the 106 big figure. Selling pressure from AUD/JPY after the RBA rate cut s filtering through in USD/JPY. EUR/USD is little changed from yesterday's close in the 1.1535 area.

EC spring forecast the only eco new to guide core markets trading today.

The eco calendar is empty today. However, the EC's Spring economic forecasts might be interesting. EC growth and inflation forecasts are still above the ECB's most recent projections. Therefore there is also room for a downward adjustment in the Commission's forecasts. Attention might also go to the fiscal situation of the peripheral countries as there might be a substantial slippage. In theory, lower growth and inflation forecasts and negative headlines on the periphery might be (slightly) negative for the euro; However, **it is unlikely that this well counterbalance that USD negative sentiment that currently reigns**.

In a daily perspective, there are no strong drivers for USD trading. **Some consolidation on the recent USD decline might be on the cards. However, there is no reason to row against the USD negative tide without** a clear trigger (better US data and/or less soft Fed comments), which won't be available today.



EUR/USD: breaking important 1.1465/95 resistance

USD/JPY: decline continues

Technically, EUR/USD finally broke above the 1.1495 MT range top yesterday, mirroring broad-based USD weakness. Yesterday's break above 1.15 is an important technical warning for further dollar losses and opens the way for a retest of the key 1.1712 2015 high. We maintain the view that the US economy is strong enough to allow the Fed to implement the two pre-announced rate hikes later this year. This is not discounted in the interest rate markets and the currency market. However, for now there is no trigger for the market to change his mind. **In this context, some further by default USD selling might be on the cards short-term**. The soft Fed approach, pockets of risk aversion and the Treasury report on currencies pushed USD/JPY to a new correction low at 106.14 on Friday and this level was again broken this morning. The inaction of the BOJ keeps the downside in USD/JPY fragile. **Verbal interventions from Japan to stop the rise of the yen are likely, but we doubt they will change the trend.** USD/JPY remains some kind of a falling knife.

Sterling shows indecisive picture as rebound slows

R2	0,8117	-1d
R1	0,7993	
EUR/GBP	**0,7861**	0,0016
S1	0,7735	
S2	0,7652	

On Monday; in thin technical trade (UK markets were closed for the May Day holiday) sterling remained well bid. This was especially the case against a weak dollar. Cable initially even outperformed EUR/USD. The pair set new highs north of 1.4668 range top, reaching the highest level since Jan 05. The pair closed the session at 1.4673. EUR/GBP temporary fell to the 0.7820/25 area, but rebound as cable didn't follow the EUR/USD rebound after the US ISM release. EUR/GBP closed the session at 0.7861 (from 0.7836).

Today, UK April manufacturing PMI is expected to rebound marginally from 51.0 to 51.2. We see downside risks. Of late, UK eco data had no lasting impact on sterling trading. **A really poor figure might be a negative for sterling, especially against the euro.**

The technical picture of EUR/GBP improved as the pair broke above the mid 0.79 area. A counter move occurred over the previous two weeks and threatens to deteriorate the picture again. The drop below 0.7830 was s a first warning. A move below 0.7684 (38% retracement/previous lows) would make the technical picture again neutral. **Sterling had a nice rebound, but sterling sentiment will remain fragile as long as the referendum outcome isn't clear. More sterling gains might become difficult from current levels.**

EUR/GBP: sterling rebound halted

GBP/USD: breaking 1.4668 resistance on USD weakness

Calendar

Tuesday, 3 May		Consensus	Previous
US			
	Wards Domestic Vehicle Sales (Apr)	13.40m	12.97m
	Wards Total Vehicle Sales (Apr)	17.30m	16.46m
16:00	IBD/TIPP Economic Optimism (May)	46.5	46.3
China			
03:45	Caixin China PMI Mfg (Apr)	A 49.4	49.7
Australia			
06:30	**RBA Cash Rate Target**	**A 1.75%**	**2.00%**
UK			
10:30	**Markit UK PMI Manufacturing SA (Apr)**	**51.2**	**51.0**
EMU			
11:00	PPI MoM YoY (Mar)	0.0% / -4.3%	-0.7%/-4.2%
Sweden			
09:30	Industrial Production MoM YoY (Mar)	0.3%/3.4%	0.1% / 3.8%
09:30	Industrial Orders MoM YoY (Mar)	--	-3.1% / 2.0%
09:30	Service Production MoM YoY (Mar)	0.6%/--	-0.5%/ -0.2%
Events			
	Japanese Markets are Closed		
09:15	ECB's Coeuré Speaks In Paris		
11:00	**European Commission Releases Spring Economic Forecasts**		
16:30	Fed's Mester Moderates Panel on Financial Markets		
20:00	Fed's Williams Speaks with Bloomberg Radio		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	1,87	0,05	US	0,79	0,01	DOW	17891	17891,16
DE	0,27	0,00	DE	-0,47	0,01	NASDAQ	'or Exch - NQI	#VALUE!
BE	0,65	-0,04	BE	-0,43	-0,01	NIKKEI	16147	16147,38
UK	1,61	0,00	UK	0,50	0,00	DAX	10123,27	10123,27
JP	-0,11	-0,01	JP	-0,25	0,00	DJ euro-50	3033	3032,60

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,338	-0,005
3y	-0,090	1,036	0,957	Euribor-1	-0,34	0,00	Libor-1 USD	0,51	0,51
5y	0,075	1,278	1,128	Euribor-3	-0,25	0,00	Libor-3 USD	0,59	0,59
10y	0,660	1,730	1,544	Euribor-6	-0,14	0,00	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,1533	0,0066	EUR/JPY	122,16	0,01		184,6109	1289,66	46,19
USD/JPY	105,945	-0,58	EUR/GBP	0,7861	0,0014	-1d	0,00	-3,54	-0,67
GBP/USD	1,4668	0,0057	EUR/CHF	1,1007	0,0008				
AUD/USD	0,7566	-0,0041	EUR/SEK	9,1848	-0,01				
USD/CAD	1,2519	-0,0025	EUR/NOK	9,2488	0,03				

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