



Sunrise

Wednesday, 16 December 2015

Rates: End of an era

The Fed is expected to start its monetary tightening cycle with a 25 bps rate hike. That's discounted by markets. The 2016 forward guidance will be key for the market reaction. We expect the mean dots for 2016 & 2017 to be lowered by 25 bps. That could trigger a short term sell-the-rumour, buy-the-fact reaction (higher US Treasuries), but we prefer to sell any uptick.

Currencies: Will dollar profit from lift-off?

We foresee lower 2016 dots and a soft Yellen (gradual). Riskier assets should profit and in theory also the dollar, even if lower dots mean a less outspoken divergence of monetary policy stance with other central bankers.

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 | → |

- Yesterday, **European equities** had an impressive rally as main indices showed profits of up to 3.2%. **US equities** had their second straight winning session as the S&P closed 1.0% in the green. Overnight, **Asian equities** are also on the rally-cart with all indices trading positive.
- **The restrictions on US crude oil export that have been in place for 40 years, have been lifted** as part of a budget deal in Congress yesterday evening. Oil prices haven't reacted on the news.
- **The Greek parliament approved a bill containing reforms demanded by the country's lenders in exchange for €1bn of bailout funds.**
- The **European Union** is set to agree a **six-month extension of its economic sanctions on Russia** this Friday.
- **Commodities have remained stable overnight**, with Brent Crude trading at \$38.37/barrel. **Metal prices are trading slightly higher**, with Gold up 0.35%, Platinum up 0.7% and copper up 0.3%.
- Today the **eco-calendar** contains some key market moving releases. In the US there is the **highly anticipated FOMC rate decision** and the November housing data. In the eurozone, there are the Markit PMI's for December and the final reading of the CPI inflation data for November.

Rates

Double whammy for core bonds

Global core bonds were sold ahead of the FOMC meeting. The selling spree started at the onset of European trading and lasted until the US session really got going. Recovering oil and equity prices suffered the first blow to core bond markets. Higher than expected US inflation pulled the second trigger. That's because Fed chairwoman Yellen said that after the lift-off, the Fed wants to see actual signs of picking up inflation before continuing its monetary tightening cycle. After this double whammy, core bond markets stabilized as the countdown to the FOMC meeting kicked in. **At the end of the session**, changes on the German yield curve ranged between flat and +6.7 bps. The US yield curve shifted 2 bps (2-yr) to 4.4 bps (10-yr) higher. On intra-EMU bond markets, 10-yr yield spreads versus Germany narrowed up to 3 bps with Greece underperforming (+4 bps).

Rebound equities/oil and higher US CPI hit core bonds

| | US yield | -1d |
|----|----------|--------|
| 2 | 0,9721 | 0,0285 |
| 5 | 1,691 | 0,0529 |
| 10 | 2,264 | 0,0564 |
| 30 | 2,9856 | 0,0456 |

Fed lift-off, but lower dots, indicating an "easy" tightening cycle

| | DE yield | -1d |
|----|----------|--------|
| 2 | -0,3340 | 0,0040 |
| 5 | -0,0444 | 0,0479 |
| 10 | 0,6559 | 0,0698 |
| 30 | 1,4300 | 0,0426 |

Fed rate hike: an end of an era

Today the eco-calendar heats up with EMU PMI, final EMU CPI and US Housing data. However, only one thing matters: the FOMC rate decision. The **Fed** is expected to increase the upper bound of its policy rate from 0.25% to 0.50%. We expect the mean dots 25 bps lower in both 2016 (3 rate hikes instead of 4) and 2017 (4 rate hikes instead of 5). There's also a possibility, but still a big question mark, that the long run neutral Fed fund will be lowered to 3.25% (from 3.5%). Regarding the data, **US housing starts**, are expected to have increased by 6.6% M/M in November, following a decline of -11.0% M/M in October. **The amount of building permits** are expected to have declined by -1.0% M/M in November. For both figures we see some upside risks compared to the market expectations. **In the eurozone, the Markit manufacturing PMI** is expected to remain stable at 52.8, but **the Markit services PMI** is expected to decline marginally from 54.2 to 54.0. We see no specific risks to these readings and side with the consensus. Finally, the final reading of the **CPI inflation** for November in the eurozone is expected to stay at 0.1% Y/Y with a **core inflation** of 0.9% Y/Y. We side with the market consensus regarding the inflation expectations.



US Note future (black) and S&P future (orange): rebound equity markets weighs on core bonds



US 2-yr yield on the brink of breaking above the magical 1% border

| | | |
|-------------|---------------|----------------|
| R2 | 161,71 | -1d |
| R1 | 160,66 | |
| BUND | 157,69 | -0,9200 |
| S1 | 156,4 | |
| S2 | 154,54 | |

Today: forward guidance key for market reaction

Overnight, Asian stock markets build on positive momentum stemming from Europe and the US with Japanese indices eking out gains of up to 2.5%. The US Note future trades stable, suggesting a neutral opening for the Bund.

Today, trading will be sideways and rangebound going into the FOMC verdict despite the interesting EMU eco calendar. For the Fed, we've outlined our expectations above. For the market reaction, we exploit 4 scenario's:

Scenario 1 - No rate hike: Dovish repositioning; bull flattening US yield curve. Huge outperformance front end of yield curve.

Scenario 2 - Rate hike & Dovish liftoff (Fed significantly lowers dots, also neutral rate, and stresses risks stemming from EM, HY debt, low inflation,...): Front end US Yield curve stable and longer end outperforms; flattening yield curve.

Scenario 3 - Rate hike & Consensus liftoff (see above, 2016 & 2017 dots 25 bps lower): Scenario more or less discounted by markets. Sell-the-rumour, buy-the-fact? Could be used to sell-the-uptick in US Treasuries.

Scenario 4 - Rate hike & Hawkish liftoff (Fed sort of "flags" that the next rate hike will take place in sooner rather than later): bear flattening US yield curve. Sell-on-upticks US Treasuries.

In Europe, the December ECB meeting took the angle out of the threat that the ECB will ease policy forever. In retrospect, it might turn out to be the end of the global rat race to have the easiest monetary policy. That puts a huge bottom below European rate markets (German 10-yr yield 0.42%; ceiling for the Bund 160.66. Spill-over effects from the Fed's lift-off are expected to be limited



German Bund: Bounced off lower bound sideways range as oil price reaches new cycle low and risk sentiment on equity markets deteriorates.



US Note future (March contract!!): more neutral as commodities and equities suffer setback. Fed lift-off may still push contract to support

Currencies

Dollar fights back

Overnight, positive sentiment on risk,

| | | |
|----------------|---------------|----------------|
| R2 | 1,1124 | -1d |
| R1 | 1,1087 | |
| EUR/USD | 1,0946 | -0,0084 |
| S1 | 1,0524 | |
| S2 | 1,0458 | |

Lift-off, lower dots and soft Yellen outcome of this historical FOMC meeting?

First rate hike in about 10 years. How many current Fed governors have already raised rates?

Dollar fights back ahead of the FOMC decision

Yesterday, the dollar found its composure after a poor performance on Monday. A better global risk sentiment put a floor for the US currency going into the FOMC meeting. Slightly higher US inflation data gave the dollar additional interest rate support. EUR/USD closed the session at 1.0931 (from 1.0992). USD/JPY regained the 121-mark and closed the day 121.79 (from 121.03).

Overnight, Asian equities are trading with strong gains, following a decent session at Wall Street, Japan outperforming on the back of a weakening yen. The Nikkei manufacturing PMI for Japan stabilized at 52.5 in December. Commodities are going a bit higher, but not enough to call it a turnaround (except for oil that is slightly lower). US high yield bond troubles are shifting to the background following a rout in previous days. The trade weighted dollar is little changed as is EUR/USD (1.0940), while USD/JPY is modestly higher (121.90). US Congress apparently agreed a fiscal plan avoiding a potential government shutdown and lifted the restriction of a 40-year ban on oil exports. **So, the mood is positive going into the FOMC meeting.**

FOMC meeting: the long awaited lift-off. What's next?

Besides the FOMC, the European PMI's are interesting too. The **FOMC rate decision** for the Upper Bound is expected to increase from 0.25% to 0.50%. We expect the mean dots to be lowered by a one 25 bps rate hike in both 2016 (3 instead of 4) and 2017 (4 instead of 5), with a possibility, but big question mark, for a lowering of the long run neutral Fed fund to 3.25% (from 3.5%). This (especially if the long run neutral rate would be lowered) would support the gradual message that is expected from Yellen. (see below for dollar reaction). **In the eurozone, the December Markit manufacturing PMI** is expected to remain stable at 52.8, but **the Markit services PMI** is expected to decline marginally from 54.2 to 54.0. We see side with the consensus.



EUR/USD: Will dollar get again positive momentum after FOMC?



USD/JPY: Will better equity sentiment after FOMC help dollar recapture 122.25 resistance? .

Of late, the US currency dropped below important support against the euro and the yen. At the end of last week and early this week, the dollar showed tentative signs of a bottoming out process, including the rebound yesterday. Today, the data (see above) won't trigger a directional USD move just hours before the key Fed-policy decision. The Fed is largely expected to raise the target range for its policy rate by 25 basis points. **This would be the de facto**

start of real policy divergence between the Fed and the ECB (and other central bankers). Of course, a lot of expected divergence is already discounted in interest rate differentials and in FX markets. At the same time, the Fed will reiterate that policy normalisation will be very gradual.

The Fed dots will be important for market expectations on the pace of further Fed tightening. If the dots indicate aggregate Fed expectations for **3 additional rate hikes in 2016, this might be neutral to slightly positive for the dollar,** especially in case of a constructive stock market reaction. Dots implying 4 expected rate hikes might further widen the interest rate differential between the dollar and the likes of the euro. In theory this would be a positive for the dollar too, but in that scenario the reaction on other markets (equities, oil..) might be less constructive. **So plenty of other scenarios are possible.** One should be really brave to front-run this FOMC decision. In a longer term perspective, we maintain the view that policy **divergence has probably still a role to play. Admittedly, this shouldn't affect the immediate reaction to the FOMC decision.**

From a technical point of view, EUR/USD cleared 1.0979 resistance, making the picture again neutral. A previous range bottom/break down area comes in at 1.1087 and finally the October high at 1.1124. **These are tough resistance levels. If broken it would make the picture dollar bearish.** This is not our preferred scenario, but the performance of the dollar was not really convincing of late. A sustained decline below 1.08 would improve the technical dollar picture. **USD/JPY dropped below a short-term range bottom in the 122.25 area, turning the short-term picture in this cross rate negative as well.** A sustained improvement in risk sentiment is needed to halt this decline

Dollar technicals deteriorated

| | | |
|----------------|---------------|--------|
| R2 | 0,7493 | -1d |
| R1 | 0,7302 | |
| EUR/GBP | 0,7273 | 0,0002 |
| S1 | 0,6983 | |
| S2 | 0,6936 | |

Sterling profits from better global sentiment

Today, the labour market data are for release. Recently, sentiment on sterling was rather negative. The labour market report is in this respect another hurdle. Especially the expected decline in wages, if confirmed, might weigh on sterling. Another item that is currently becoming into focus is the potential Brexit, with great concerns out of Germany and a poll that put chances on Brexit even.

So, for now we remain cautious on sterling and the test of the 0.73 may go on and in case of weaker labour data. For the FOMC meeting, we are neutral for EUR/GBP, but cable may be under pressure. We first want to see real sterling strength before becoming sterling positive again. **A sustained drop below 0.72 would be a positive. Technically longer term, the pair is still in a broad sideways range with boundaries between 0.6936 and 0.7483.**



EUR/GBP: Sustained trading below 0.72 would improve sterling picture, but pressure is on further weakening if labour data disappoint



Cable: Will UK labour data and FOMC decision push cable to the bottom of the range?

Calendar

| Wednesday, 16 December | | Consensus | Previous |
|------------------------|---|------------|----------|
| US | | | |
| 13:00 | MBA Mortgage Applications | -- | 1.2% |
| 14:30 | Housing Starts (Nov) | 1130k | 1060k |
| 14:30 | Housing Starts MoM (Nov) | 6.6% | -11.0% |
| 14:30 | Building Permits (Nov) | 1150k | 1150k |
| 14:30 | Building Permits MoM (Nov) | -1.0% | 4.1% |
| 15:15 | Industrial Production MoM (Nov) | -0.2% | -0.2% |
| 15:15 | Capacity Utilization (Nov) | 77.4% | 77.5% |
| 15:15 | Manufacturing (SIC) Production (Nov) | 0.0% | 0.4% |
| 15:45 | Markit US Manufacturing PMI (Dec P) | 52.6 | 52.8 |
| 20:00 | FOMC Rate Decision (Upper Bound) | 0.50% | 0.25% |
| 20:00 | FOMC Rate Decision (Lower Bound) | 0.25% | 0.00% |
| Japan | | | |
| 07:00 | Machine Tool Orders YoY (Nov F) | -- | -17.9% |
| UK | | | |
| 10:30 | Claimant Count Rate (Nov) | 2.3% | 2.3% |
| 10:30 | Jobless Claims Change (Nov) | 0.8k | 3.3k |
| 10:30 | Average Weekly Earnings 3M/YoY (Oct) | 2.5% | 3.0% |
| 10:30 | Weekly Earnings ex-Bonus 3M/YoY (Oct) | 2.3% | 2.5% |
| 10:30 | ILO Unemployment Rate 3Mths (Oct) | 5.3% | 5.3% |
| 10:30 | Employment Change 3M/3M (Oct) | 150k | 177k |
| EMU | | | |
| 10:00 | Markit Eurozone Manufacturing PMI (Dec P) | 52.8 | 52.8 |
| 10:00 | Markit Eurozone Services PMI (Dec P) | 54.0 | 54.2 |
| 10:00 | Markit Eurozone Composite PMI (Dec P) | 54.2 | 54.2 |
| 11:00 | Trade Balance SA (Oct) | 20.6b | 20.1b |
| 11:00 | Trade Balance NSA (Oct) | -- | 20.5b |
| 11:00 | CPI MoM/YoY (Nov) | -0.2%/0.1% | 0.1%/-- |
| 11:00 | CPI Core YoY (Nov F) | 0.9% | 0.9% |
| Germany | | | |
| 09:30 | Markit/BME Germany Manufacturing PMI (Dec P) | 52.8 | 52.9 |
| 09:30 | Markit Germany Services PMI (Dec P) | 55.5 | 55.6 |
| 09:30 | Markit/BME Germany Composite PMI (Dec P) | 55.0 | 55.2 |
| France | | | |
| 09:00 | Markit France Manufacturing PMI (Dec P) | 50.6 | 50.6 |
| 09:00 | Markit France Services PMI (Dec P) | 50.8 | 51.0 |
| 09:00 | Markit France Composite PMI (Dec P) | 51.0 | 51.0 |
| Events | | | |
| 20:30 | US - Fed president Yellen speaks after fed meets to decide interest rate policy | | |

| 10-year | td | -1d | 2-year | td | -1d | STOCKS | -1d |
|---------|------|------|--------|-------|------|------------|------------------------|
| US | 2,26 | 0,06 | US | 0,97 | 0,03 | DOW | 17525 17524,91 |
| DE | 0,66 | 0,07 | DE | -0,33 | 0,00 | NASDAQ | for Exch - NQI #VALUE! |
| BE | 0,97 | 0,06 | BE | -0,29 | 0,00 | NIKKEI | 19050 19049,91 |
| UK | 1,95 | 0,08 | UK | 0,63 | 0,02 | DAX | 10450,38 10450,38 |
| JP | 0,30 | 0,00 | JP | -0,01 | 0,00 | DJ euro-50 | 3242 3241,51 |

| | | | | | | USD | td | -1d |
|-----|-------|----------|-------|-----------|-------|------|-------------|---------------|
| IRS | EUR | USD (3M) | GBP | EUR | -1d | -2d | Eonia EUR | -0,239 -0,009 |
| 3y | 0,026 | 1,266 | 1,208 | Euribor-1 | -0,19 | 0,00 | Libor-1 USD | 0,50 0,50 |
| 5y | 0,294 | 1,624 | 1,508 | Euribor-3 | -0,13 | 0,00 | Libor-3 USD | 0,58 0,58 |
| 10y | 0,975 | 2,146 | 1,970 | Euribor-6 | -0,04 | 0,00 | Libor-6 USD | 0,74 0,74 |

| Currencies | | -1d | Currencies | | -1d | Commodity | CRB | GOLD | BRENT |
|------------|---------|---------|------------|--------|--------|-----------|----------|--------|-------|
| EUR/USD | 1,0946 | -0,0084 | EUR/JPY | 133,37 | 0,14 | | 174,2633 | 1064,2 | 38,17 |
| USD/JPY | 121,875 | 1,08 | EUR/GBP | 0,7273 | 0,0002 | -1d | -0,59 | 0,00 | 0,44 |
| GBP/USD | 1,5046 | -0,0115 | EUR/CHF | 1,0832 | 0,0004 | | | | |
| AUD/USD | 0,7200 | -0,0047 | EUR/SEK | 9,2921 | -0,03 | | | | |
| USD/CAD | 1,3736 | 0,0029 | EUR/NOK | 9,4974 | -0,04 | | | | |

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