# Sunrise

**Thursday, 07 January 2016**

## Rates: Panic in (Chinese) equities and oil stimulates safe haven bond buying

More disarray in equity and commodity markets push global core bonds higher, while peripheral bonds remain largely shielded from the traditional risk sell-off. The FOMC Minutes didn't reveal much, but overnight Chinese equity trading halted as the 7% circuit breaker kicked in. Brent oil falls below $33/barrel. More good news for core bond trading today.

## Currencies: EUR/USD rebounds as China crisis intensifies

Yesterday, the moves in the major FX cross rates were moderate given the big swings in other markets. USD/JPY drifted further south. The EUR/USD decline finally halted. It looks as if the cross rate is ready for a normal risk-off/risk-on reaction function.

## 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 extended their downtrend yesterday** with the S&P falling below the 2 000 level to close at its lowest level in three months. Energy shares and materials were hit the hardest. This morning, **Asian shares show broad-based losses** due to renewed turmoil in China.
- **The People's Bank of China set the official midpoint rate on the yuan again 0.5% weaker than the day before**, accelerating the depreciation of the yuan. The move weighed further on equity market sentiment. Chinese shares plunged up to 8%, triggering a full-day trading suspension.
- In an attempt to ease panic among equity investors, **China's securities regulator renewed restrictions on the amount major corporate shareholders can sell.** The new regulation will start on January 9.
- Turmoil in China pushed the **Brent oil price 3%** lower this morning, below $33/barrel. **Gold continues to profit from safe haven flow,** trading currently around $1100/ounce, its highest level in two months.
- The **Minutes of the latest FOMC meeting** showed that **the decision to raise rates was unanimous, although for some members it was a close call**, with some officials expressing concern that inflation would linger below their target.
- **German factory orders rose for a second straight month** in November and at a much stronger pace than expected (1.5% M/M vs 0.1% M/M expected), boosted by both domestic and non-EMU orders. **Retail sales** picked up slightly in the same month, broadly in line with expectations.
- Today, the **eco calendar is well-filled** in the euro zone with the unemployment rate, retail sales and European Commission's confidence indicators. In the US, only the jobless claims will be released.

# Rates

## Risk aversion and oil weakness trump strong eco data

| | US yield | -1d |
|---|---|---|
| 2 | 0,968 | -0,0479 |
| 5 | 1,6188 | -0,0786 |
| 10 | 2,142 | -0,0795 |
| 30 | 2,9016 | -0,0864 |

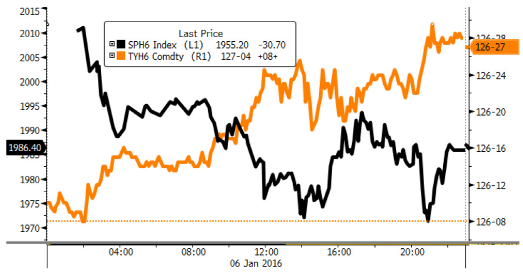
| | DE yield | -1d |
|---|---|---|
| 2 | -0,3790 | -0,0080 |
| 5 | -0,1373 | -0,0302 |
| 10 | 0,5007 | -0,0461 |
| 30 | 1,3769 | -0,0395 |

**More disarray in equity and commodity markets push global core bonds higher, while peripheral bonds remain largely shielded from the traditional risk sell-off. The ECB 's QE-programme and reasonable good eco data are still supportive. Strong US eco data (ADP report) temporarily capped gains. The FOMC Minutes didn't bring much new info regarding the policy path going further. In a daily perspective,** the US yield curve shifted lower with 5-to-10 yr outperforming (-7 bps). The 2-yr yield fell 3.8 bps and the 30-yr 5.5 bps. Changes on the German yield curve were smaller with yields up to 3.3 bps lower. On intra-EMU bond markets, 10-yr yield spreads versus Germany widened up to 4 bps (Portugal) with Greece underperforming (+9 bps).

**The FOMC Minutes contained one sentence that caught the eye (dovish) *"Some members said their decision to raise the target range was a close call"*. Some governors spoke since the meeting and gave some hints about how they perceive the gradual pace. Fed vice-chair Fischer** said that he thinks the market's view of where rates will be is too low and that an estimate of 4 rate hikes this year is 'in the ballpark'. Once oil prices stabilize, he believes that the inflation trend will turn and that the Fed will reach its 2% inflation target. **Yellen** said every meeting is a live meeting and Williams said their shouldn't be a predictable path in the increases (his guess was 3 to 5 and called 4 hikes reasonable). He added that inflation will be key. If global growth slows and inflation falls while the dollar strengthens, it might take longer to reach the goal and have an impact on the pace of rate increases. Stock volatility won't alter course, but that probably won't hold in case of sharp falls. **Fed Mester** spoke about data-dependency. She said temporary fluctuations in activity are not important, but are used to evaluate the outlook and the risks on the outlook.

## Thin calendar, some Fed speakers

In EMU, the **EC confidence indicators** are forecast to show a broad stabilization for the second month running. We see however risks for a stronger outcome following a slight improvement in the PMI's and as also consumer confidence improved. The **unemployment rate** is forecast to have stabilized at 10.7, following a limited drop in October, with, possible surprises following strong Spanish and German labour data. Finally in the EMU**, the retail sales** are forecast to increase for the first time in four months, although only marginally. Another weaker outcome is not excluded following poor national data. Finally in the **US, initial jobless claims** are expected to reverse part of the previous week's uptick. Holiday-related swings may continue.




*S&P future (black) and T-Note future (orange): Full blown risk-off*


*Brent oil: illusive to call for a bottom*

| | | |
|---|---|---|
| R2 | 161,71 | -1d |
| R1 | 160,66 | |
| **BUND** | **159,67** | 0,5800 |
| S1 | 156,4 | |
| S2 | 154,54 | |

## France starts 2016 issuance

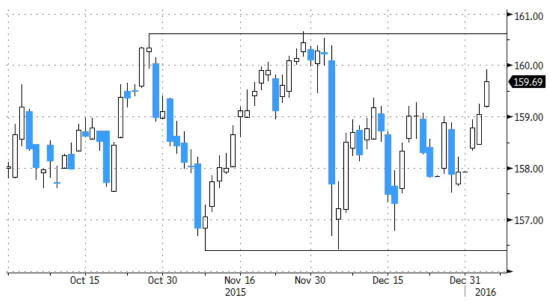
**Today, the French treasury sells the on-the-run 10-yr OAT (1% Nov2025), 15-yr OAT (1.5% May2031) and 30-yr OAT (3.25% May2045) for a combined €8-9B.** In the run-up to the auction, the bonds cheapened 2 to 5 bps in ASW spread terms. On the French curve, the 10- and 30-yr OAT's trade normal while the 15-yr OAT is rather rich. We nevertheless expect the auctions to go well. This year, the French Treasury aims to raise €187B net of buybacks via medium and long term debt: the same amount as last year (€220B gross issuance and €32B buybacks).

## Today: Risk aversion supports core bonds

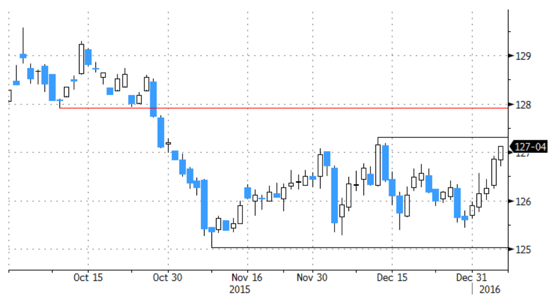
**Overnight,** risk aversion remains the name of the game. Chinese trading halted within the hour as indices reached their 7% circuit breakers. The Chinese renminbi was once again fixed significantly weaker. Other Asian equities join the sell-off and lose around 2%. On commodity markets, the slide in oil prices continues with Brent dropping to $33/barrel. The US Note future prolongs this week's rally suggesting a firm opening for the Bund.

**Today**, the eco calendar contains **EC confidence data and US weekly claims but we don't expect an impact on trading.** Overall, **risk sentiment on equity markets and developments on commodity markets should be key for European trading.** That could underpin core bonds further via classic safe haven flows. Tomorrow's payrolls report doesn't seem to be an issue at this stage.

**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 preferred a **sell-on-upticks approach with entry levels around those recent highs**, especially in the US, but as long as risk aversion rules trading, we'd be cautious and don't exclude a temporary break higher. 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 yields.




*German Bund: Sideways trading range. Risk aversion dominates trading*




*US Note future: Topside protected by start Fed tightening cycle. Sell-on-upticks, but be aware of temporary break higher in current climate*

# Currencies

## Will EUR/USD resume it's 'usual' risk-off pattern?

*Intensifying risk-off trade and soft FOMC minutes halt the decline of EUR/USD*

*Decent US eco data have no lasting impact on the dollar*

| | | |
|---|---|---|
| R2 | 1,106 | -1d |
| R1 | 1,0946 | |
| **EUR/USD** | **1,0818** | 0,0067 |
| S1 | 1,0711 | |
| S2 | 1,0524 | |

**On Wednesday, risk sentiment stayed outright risk-off**, **but the impact on the major currency cross rates was less pronounced than earlier this week**. USD/JPY touched an intraday low in the 118.25 area, but stabilized later in the session even as US equities were hit by a new late session downleg. The pair closed the day at 118.47 (from 119.06 on Tuesday). **EUR/USD showed tentative signs of a bottoming out process as the global risk-off trade continued.** The European (services PMI) and US (ADP report and trade balance, non-manufacturing ISM) eco data were mostly constructive but without impact on FX trading. The Minutes of the December FOMC meeting were rather soft. Almost all members agreed that the conditions for the lift-off were met. However some members saw considerable risks to inflation, with the dollar being one of them. **The dollar lost further ground against the euro after the publication of the minutes.** EUR/USD closed the session at 1.0781 (from 1.0741). So it looks that the 'risk-off rally' of the dollar against the euro has run its course.

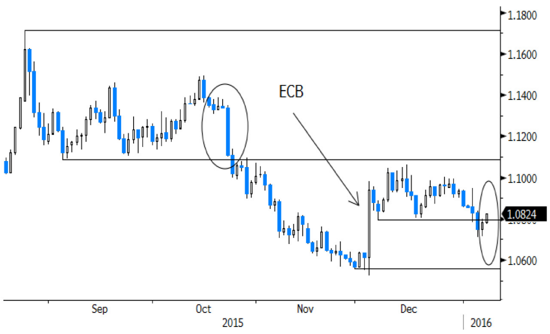
*Risk off sentiment in Asia intensifies as PBOC guides yuan lower again*

**This morning** ,the scenario on Asian markets is little different from earlier this week. The sell-off of Chinese equities even intensified as the PBOC set the fixing of the yuan 0.51% lower. USD/CNY trades currently in the 6.5930 area. The off-shore yuan initially reached its lowest level since September 2010, but rebounded later on suspected PBOC intervention. Mainland China equity indices reached the 7% limit, triggering a trading halt. The losses elsewhere in Asia are less pronounced but still substantial around 1% to 2%+. Oil is again hit hard and commodity currencies are under pressure, too. USD/CAD reached a multi-year top north of 1.41. AUD/USD dropped to the 0.7050 area. **Contrary to what was the case of late, the risk-off trade sends USD lower both against the yen and the euro.** USD/JPY extends its decline. The pair dropped temporary below 118. EUR/USD trades in the 1.0820 area.

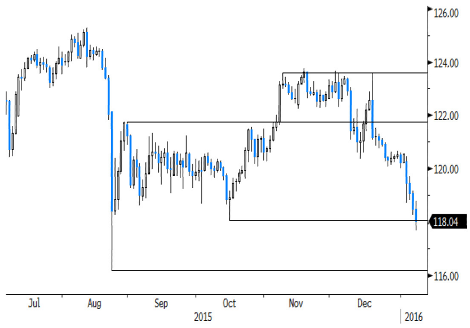
*Eco data will probably be only of second tier importance for currency trading.*

*Global factors will continue to dominate FX trading*

**Today,** there are several European eco data (EC confidence indicators, EMU retail sales and unemployment, retail PMI's). However, these data have usually only a limited impact on currency trading. In the US the **challenger lay-offs and the jobless claims** will be published. The data are interesting, but we doubt they will have a lasting impact on the USD just one day before the publication of the payrolls and with the market focus on global tensions.




*EUR/USD: break below 1.08 support area rejected?*




*USD/JPY still pressured by risk-off sentiment, testing the 118.07 support*

**It looks that sentiment will remain riskoff today as uncertainty on China continues to spook global markets**. This context is negative for USD/JPY. The losses of USD/JPY this morning are substantial but could have been even bigger given the intense Chinese sell-off. Still, there is no reason to row against the tide unless risk sentiment improves. **Over the previous days we were puzzled on the decline of EUR/USD** even as sentiment was risk-off. Recently, the risk-off sentiment didn't really narrow the US-German rate differentials, which was maybe part of the explanation for the USD resilience against the euro. However, **spreads might narrow and interest rate support for the dollar decline if the risk-off trade persists.** Markets might scale back Fed rate hike expectations. The US 2-yr yield already dropped back below the 1.0% mark. **Earlier this week, we advocated not to jump on the EUR/USD decline even as the technical picture turned negative after the break below 1.08. We hold on to that view as we see rising chances for a EUR/USD rebound if the risk-off context persists**. As we keep a moderately positive USD bias longer term, we will reconsider to sell EUR/USD higher in the recent trading range (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. Earlier this week, EUR/USD dropped below 1.0796 (07 Dec low), which deteriorated the short-term picture in this cross rate. However, it looks that this attempt might be rejected. Next support is at 1.0650 (76% retracement off 1.0524/1.1060) and at 1.0524. On the topside, 1.1004 (reaction top) is a first important reference. The picture for USD/JPY remains negative below 120. The 118.07 level (15 Oct low) is currently under test. Next support comes in at 116.18 (August low).

## Cable extends downtrend. GBP/EUR rebounds

| | | |
|---|---|---|
| R2 | 0,7493 | -1d |
| R1 | 0,7424 | |
| **EUR/GBP** | **0,7395** | 0,0064 |
| S1 | 0,7305 | |
| S2 | 0,7193 | |

**On Wednesday,** sterling trading was again primarily driven by global factors. **The UK services PMI declined from 55.9 to 55.5; close to expectations (55.6).** There was no lasting impact on sterling trading. Early in the session EUR/USD and cable moved largely in lockstep. EUR/GBP initially held a sideways range in the 0.7320/30 area, but rebounded later in the session as the euro performed better across the board. EUR/GBP closed the session at 0.7368 (from 0.7324). Cable set a new correction low in the 1.4610 area, but didn't succeed a late session rebound like EUR/USD. The pair closed the session at 1.4630 (from 1.4675).

**Today, the Halifax house prices and the UK car registrations will be published. We expect these data to have no lasting impact on sterling trading.** Global factors continue to set the tone for sterling trading. Over de previous days, EUR/GBP temporary joined the EUR/USD decline. However, it now looks that the EUR/USD guidance will point north rather than south. A sustained rebound of sterling will be difficult unless there are signs of progress in the Brexit debate or unless risk sentiment improves. EUR/GBP 0.7424 is a first short-term resistance. Next resistance is stands at 0.7493 (Oct top). A drop below the 0.73 area would call off the ST uptrend, but this looks unlikely short-term after yesterday's reversal. **The technical picture** of sterling against the dollar remains fragile. The key GBP/USD 1.4566 2015 low comes within reach.

# Calendar

| Thursday, 7 January | | Consensus | Previous |
|---|---|---|---|
| **US** | | | |
| 13:30 | Challenger Job Cuts YoY (Dec) | -- | -13.9% |
| **14:30** | **Initial Jobless Claims** | **275K** | **287k** |
| **14:30** | **Continuing Claims** | **2200K** | **2198k** |
| **UK** | | | |
| 10:00 | New Car Registrations YoY (Dec) | -- | 3.8% |
| **EMU** | | | |
| 10:10 | Markit Eurozone Retail PMI (Dec) | -- | 48.5 |
| **11:00** | **Economic Confidence (Dec)** | **106.0** | **106.1** |
| 11:00 | Business Climate Indicator (Dec) | 0.39 | 0.36 |
| 11:00 | Industrial Confidence (Dec) | -2.9 | -3.2 |
| 11:00 | Services Confidence (Dec) | 12.6 | 12.8 |
| 11:00 | Consumer Confidence (Dec F) | -5.7 | -5.7 |
| **11:00** | **Unemployment Rate (Nov)** | **10.7%** | **10.7%** |
| **11:00** | **Retail Sales MoM/YoY (Nov)** | **0.2%/2.0%** | **-0.1%/2.5%** |
| **Germany** | | | |
| **08:00** | **Factory Orders MoM YoY (Nov)** | **A 1.5%/2.1%** | **1.8% / -1.4%** |
| **08:00** | **Retail Sales MoM YoY (Nov)** | **A 0.2%/2.3%** | **-0.1% / 2.1%** |
| **Italy** | | | |
| 10:00 | Unemployment Rate (Nov P) | 11.5% | 11.5% |
| **Belgium** | | | |
| 11:00 | Unemployment Rate (Nov) | -- | 8.7% |
| **China** | | | |
| | Foreign Reserves (Dec) | $3450.0b | $3438.3b |
| **Sweden** | | | |
| 08:30 | Swedbank/Silf PMI Services (Dec) | -- | 56.3 |
| **Events** | | | |
| 14:45 | Fed's Lacker Delivers Economic Outlook in Raleigh, N.C. | | |
| 20:15 | Fed's Evans Speaks on Economy and Monetary Policy in Madison | | |
| UK | Gilt Auction (£1.5B 4% Jan 2060) | | |
| **France** | **OAT Auction (€8-9B 1% Nov2025, 1.5% May2031, 3.25% May2045)** | | |
| US | Announces Details of 3Yr, 10Yr Note & 30Yr Bonds Auction | | |

| 10-year | td | -1d | 2 -year | td | -1d | STOCKS | | -1d |
|---|---|---|---|---|---|---|---|---|
| US | 2,14 | -0,08 | US | 0,97 | -0,05 | DOW | 16907 | 16906,51 |
| DE | 0,50 | -0,05 | DE | -0,38 | -0,01 | NASDAQ | for Exch - NQI | #VALUE! |
| BE | 0,85 | -0,04 | BE | -0,34 | 0,00 | NIKKEI | 17767 | 17767,34 |
| UK | 1,80 | -0,07 | UK | 0,51 | -0,04 | DAX | 10214,02 | 10214,02 |
| JP | 0,25 | -0,01 | JP | -0,01 | 0,00 | DJ euro-50 | 3139 | 3139,32 |

| | | | | | | | USD | td | -1d |
|---|---|---|---|---|---|---|---|---|---|
| IRS | EUR | USD (3M) | GBP | EUR | -1d | -2d | Eonia EUR | -0,253 | -0,002 |
| 3y | -0,013 | 1,261 | 1,161 | Euribor-1 | -0,21 | 0,00 | Libor-1 USD | 0,51 | 0,51 |
| 5y | 0,233 | 1,562 | 1,434 | Euribor-3 | -0,13 | 0,00 | Libor-3 USD | 0,59 | 0,59 |
| 10y | 0,872 | 2,029 | 1,840 | Euribor-6 | -0,04 | 0,00 | Libor-6 USD | 0,75 | 0,75 |

| Currencies | | -1d | Currencies | | -1d | Commoditie | CRB | GOLD | BRENT |
|---|---|---|---|---|---|---|---|---|---|
| EUR/USD | 1,0818 | 0,0068 | EUR/JPY | 127,52 | 0,06 | | 173,0666 | 1099,8 | 32,79 |
| USD/JPY | 117,89 | -0,69 | EUR/GBP | 0,7395 | 0,0062 | -1d | -1,42 | 19,05 | -3,71 |
| GBP/USD | 1,4627 | -0,0031 | EUR/CHF | 1,0845 | -0,0004 | | | | |
| AUD/USD | 0,7028 | -0,0075 | EUR/SEK | 9,2665 | 0,03 | | | | |
| USD/CAD | 1,4129 | 0,0090 | EUR/NOK | 9,6892 | 0,11 | | | | |

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