Sunrise

Friday, 04 December 2015

Rates: Draghi disappoints, triggering a huge bond correction

Draghi fell short in delivering what he had suggested during the past month. It looks like he was called back by his council. This shook confidence in wrongly positioned markets and triggered a once-in-a-year huge sell-off. Today, the US payrolls take center stage. We side with consensus. It won't affect the Fed's lift-off decision, but surprises might still affect bonds.

Currencies: ECB disappointment sends euro sharply higher

EUR/USD set a new minor correction low in the run-up to the ECB-decision. However, the euro was captured by an impressive short squeeze as the ECB didn't deliver the expected aggressive easing. From now, the focus turns to the US payrolls and the Fed policy decision. Will a decent payrolls report cap the EUR/USD short-squeeze?

Calendar

Headlines

- Yesterday, **European equities** endured a real bloodbath as the ECB underperformed on expectations, losses mounted up to -3.7%. **US equities** also traded lower, with the S&P losing -1.5%. Overnight, **Asian equities** didn't remain uninfected by the global sell-off as losses mount up to -2.2%

- **Janet Yellen sounded hawkish in front of the Joint Economic Committee yesterday**, as she stressed the domestic strength and looks beyond the global drag. A rate increase late this month remains "a live option' she said.

- **The Japanese wages show modest growth in October** as they increased by 0.7% Y/Y, following a 0.4% Y/Y growth in September. This was better than the expected 0.5% Y/Y growth. J**apanese household confidence also improved to 42.**6, the highest level in over two years.

- The renewed oil contracts between Iran and China shows that **OPEC members are more competitors than partners**. **Saudi-Arabia will urge the OPEC members to cut production today**, but it is unlikely an agreement will be reached.

- **The Portuguese parliament approved the new socialist government's programme,** which will reverse a number of austerity measures, but promise to stick to European budget rules.

- **Commodities jumped on the weakening of the dollar**, especially soft commodities saw some big gains. **Brent Crude rose back to 43.80 $/barrel**.

- Today, the focus is on the US **monthly payrolls report**. Also interesting to watch are speeches of **Fed's Bullard and Kocherlakota.** The OPEC is holding a meeting in its Vienna HQ to discuss a cut in oil production.

Rates

Draghi's inability to deliver leads to a major sell-off

Major sell-off in German curve

US Treasuries lose too

Peripheral yield spread widening modest

Swaps outperform Bunds by 1 bp

	US yield	-1d
2	0,9548	0,0163
5	1,7203	0,0922
10	2,2888	0,1056
30	3,0343	0,1277

	DE yield	-1d
2	-0,2860	0,1590
5	-0,0020	0,2100
10	0,6970	0,2250
30	1,5040	0,1500

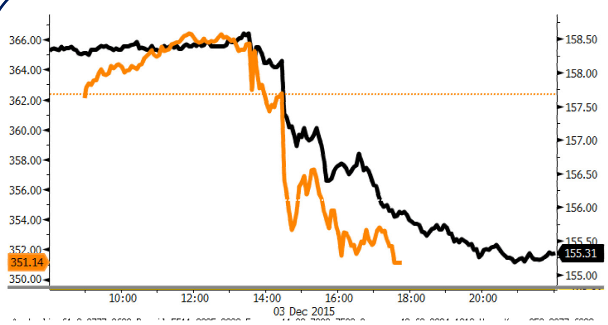
Yesterday, global core bonds fell prey to a violent correction as the ECB couldn't live up to the market's very dovish expectations. A six-month QE extension, 10 bps deposit rate cut and some other minor policy changes didn't do the trick. Markets felt betrayed by Draghi who massaged them towards expecting major policy action to rapidly lift inflation towards the target. Better economic data, stabilizing inflation rate expectations and no major downside inflation surprises left Draghi with few ammunition to convince his Council to follow him in a risky experiment. So the actual decisions fell short to market positions and triggered a huge re-positioning. The German curve shifted sharply higher with the 5-to-10-yr sector underperforming. German yields were up about 13/14 basis points at the wings and 17.8-to 19.6 in the 5-to-10-yr sector. US Treasuries weren't isolated from the carnage in the German bond market. The US curve steepened with yields up 1.6 bps at the 2-yr, 10 bps at the 5-yr, 13.4 and 14.6 bps at the 10- and 30-yr tenors. Of course, the sharp weakening of the dollar played a role. European, but also US, equities lost a lot of ground. In the intra-EMU bond market, peripheral 10 year yield spreads widened 3 to 6 bps. Spreads of semi core and non-German core bonds widened 1 bp. Swap spreads narrowed about 1 bp versus the Bunds.

Payrolls & OPEC meeting

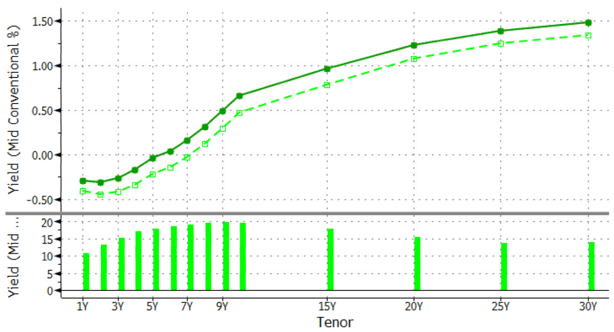
US payrolls expected strong enough to pave way lift-off

OPEC meeting likely to end without firm agreement

The change in nonfarm payrolls are expected to be 200k, coming from the exceptionally high 271k in the October report. Taking into account a good ADP report on Wednesday, we think a reading around 200k is a reasonable projection and therefore side with the market consensus. There are a number of pros and cons for a better or weaker payrolls report. The **US unemployment rate** is expected to stabilize at 5.0% and the **average hourly earnings** are expected to fall back a bit to 0.2%M/M and 2.5% Y/Y. We side with the market consensus regarding these expectations. Surprises in wage growth might affect markets. Such a plain vanilla report should pave the way for a December lift-off by the Fed. Also interesting to watch are speeches by Fed's Bullard and Kocherlakota. The latter, an ultra-dove, will resign by the end of the year and has no voting rights. Bullard is a moderate hawk, well on the side of a December lift-off. The weakening of the dollar makes the case of a lift off only easier.



Bund (black) & S&P future (orange): Huge sell-off bonds and equities as ECB moves more cautious than generally expected.



German yield curve (one-day change): Huge upward shift (up to 20 bps) as Draghi disappoints markets .

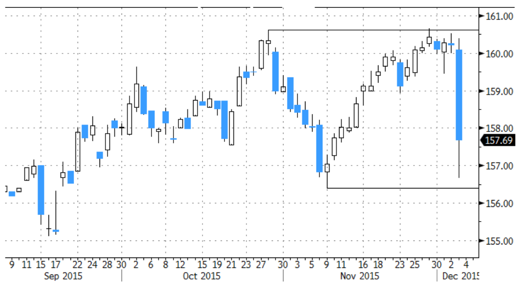
R2	161,71	-1d
R1	160,66	
BUND	**157,03**	
S1	156,4	
S2	154,54	

Today: Payrolls unlikely to influence Fed's judgment

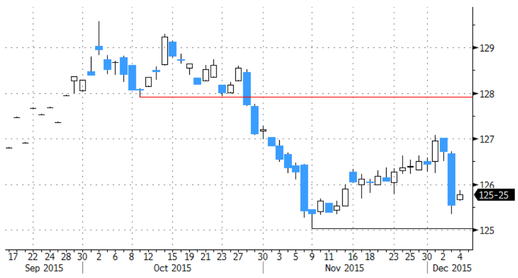
Overnight, most Asian stock markets lose 1% to2% on the back of European and US weakness yesterday. This morning, the US Note future is off yesterday's low heading into today's payrolls release.

Today, attention shifts to the US with November payrolls, the final big release ahead of the December Fed meeting. **Market expects 200k job growth and we side with consensus**. A >50k upside surprise should be needed to put the US Note future under more downward pressure following yesterday's beating. Even in case of weakness (>50k miss), we don't expect the payrolls to influence the Fed's judgment within a fortnight (25 bps rate hike). It could further stress the easy tightening cycle in 2016 though and slightly benefit the US Note future. **So all in all, we expect a straight forward market reaction on the US payrolls report.** If a weak headline figure is accompanied by **higher wage growth or a further drop in unemployment**, it could still weigh on US Treasuries though and vice versa. Yellen recently indicated that the Fed wants to see actual evidence of a pick-up in inflation before committing to more hikes in 2016. Overall, **we use our sell-on-upticks approach for return action to the 125-01 recent low in the US Note future (2.37% resistance in US 10-yr yield).**

Yesterday's 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 (ceiling for the Bund). After yesterday's Bund sell-off, we believe that in first instance a new equilibrium needs to be found around first support (March 2016 contract: 156.40; currently 156.84).



German Bund: Draghi fails to live up to market expectations. Heading to lower bound sideways range?



US Note future (March contract!!): heading to recent low going into the Dec 16 FOMC meeting?

Currencies

Draghi miss' propels euro sharply higher

The ECB fails to meet market expectations on further easing, triggered an impressive rebound of the euro

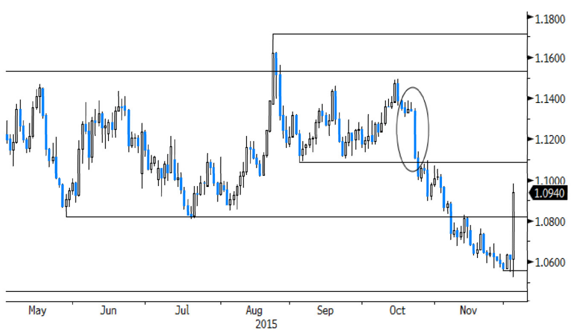
R2	1,11	-1d
R1	1,0981	
EUR/USD	**1,0918**	
S1	1,0521	
S2	1,0458	

On Thursday, the euro initially declined further as investors prepared for aggressive ECB easing. They didn't want to be euro long going this hyped ECB meeting. The euro spiked already higher just before the ECB announcement on rumours of an unchanged decision. These rumours proved wrong, but the ECB decision didn't stop the 'new' market dynamics anymore. The ECB 'under-delivered' as it 'only' cut the deposit rate to -0.3% and as it didn't expand the monthly asset purchases. This triggered a massive repositioning in bond markets and in the currency market. EUR/USD traded in the 1.0540 area just before the ECB announcement. In several waves it was squeezed higher to the 1.0980 area late in the US trading session. The pair closed the session at 1.0940 (1.0615 on Wednesday). The less-easy-than-expected ECB policy stance also hurt global equity markets. This weighed on USD/JPY. The pair closed the session at 122.61 (from 123.24). The comments of Yellen before the JEC were mostly in line with her assessment on Wednesday and had only a limited impact on currency trading. The ECB also caused a marked repositioning in the smaller currencies on the sidelines of the EMU. The likes of the Swedish lost quite some ground as the risk for a flood of euro liquidity to those currencies was less than feared.

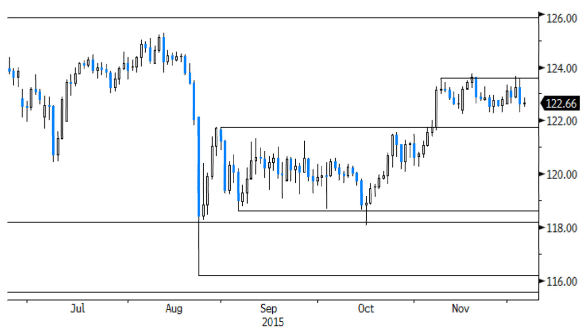
Asian markets join the post-Draghi correction this morning

The dollar holds near the recent lows against the euro and the yen.

This morning, the post-Draghi repositioning also leaves its traces on the Asian market. In line with the US, Asian equities trade with substantial losses of up to 2%. EUR/USD and USD/JPY maintain most of the post-Draghi repositioning, trading currently around 1.0925 and 122.60. respectively. The likes of the Aussie dollar traded very volatile in the wake of the ECB decision. The Aussie dollar closed yesterday's session higher on global dollar weakness (which was also a positive for most commodities). However part of these gains are reversed this morning as sentiment on risk remains negative.



EUR/USD: propelled sharply higher after' ECB disappointment'



USD/JPY losing slightly ground

Today, there are several second tier eco data on the agenda, but two themes will set the tone for global currency trading. **Firstly, all lot of investors will still have some repositioning to do in the wake of Yesterday's ECB decision**. The ECB-'under-delivering' market expectations is in theory a positive for the euro. However, we are not convinced that yesterday's forceful correction will have to

Tion

(Currency) markets will look for a new equilibrium after the Draghi repositioning

The focus turns from the ECB to the US payrolls/Fed.

go much further. Interest rate differentials at 2-year between Germany and the US have declined from the 140 area to 126 currently. This already quite a substantial adjustment. With the ECB deposit rate at -0.3%., the euro will continue to face an impressive interest disadvantage. The market focus will now gradually turn for the ECB to the US and the Fed. US payrolls growth is expected to decline from 271 000 to 200 000, which is still a lofty level. We see only slight downside risks. In such a scenario, a Fed interest rate hike won't be questioned anymore.

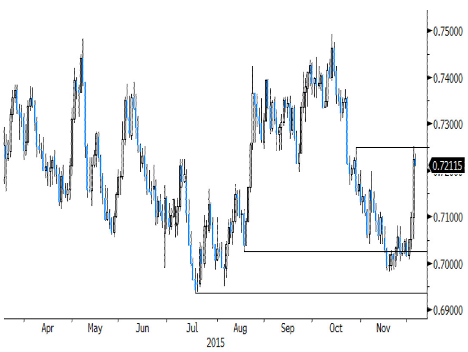
The debate will shift to the pace of further Fed tightening. In this respect, wage growth and the development of inflation will play a decisive role. With a Fed rate hike more or less cemented, the dollar will preserve a substantial interest rate support. Even after yesterday's ECB's failure to meet market expectations, policy divergence at some point might still have some role to play. Admittedly, from now it will have to come from USD strength, rather than from euro weakness. **We will recalibrate our strategy after the payrolls. Currently we look out where the current repositioning will stop. With short-term interest rate differentials still very much in favour of the dollarand with the Fed embarking for an albeit gradually hiking cycle, we are inclined to stay EUR/USD negative once this repositioning is over. The 38% retracement from 1.1714 to 1.0524 stands at 1.0979 and is currently under test. A previous range bottom/break down area comes in at 1.1087. In case of a decent payrolls report, this might become a first tough resistance going into the Fed policy decision. In case of a poor payrolls report, the correction has possibly some further to go.**

EUR/GBP and cable rebound on ECB decision.

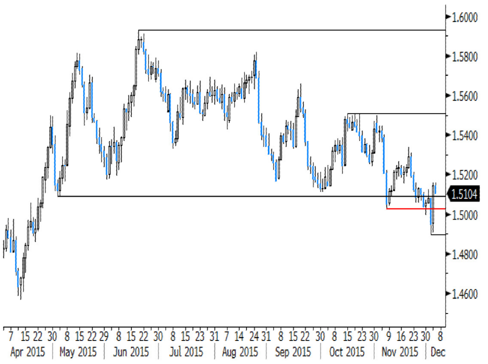
R2	0,7493	-1d
R1	0,7251	
EUR/GBP	**0,7223**	
S1	0,6983	
S2	0,6936	

On Thursday, the fall-out from the ECB decision drove sterling. Cable hovered in a tight range mostly slightly below 1.4950, but jumped higher on 'dollar weakness' after the ECB decision. The pair closed the session at 1.5144 from 1.4951. Evidently, cable underperformed EUR/USD in the post-ECB repositioning. EUR/GBP tested the 0.7250 area and closed the session at 0.7223 (from 0.7099).

Today, The UK calendar contains only the UK car registrations. So, sterling trading will remain at the mercy of global market developments. As is the case for EUR/USD, the jury is still out on how far the current repositioning will go. A less accommodative ECB over time might make it easier for the BoE to raise rates if data would allow them to do so. It is still early days, but in that scenario, one should expected a real long-term trend reversal in EUR/GBP. Of course, at this stage it is too early to bet on such a scenario. In a day-to-day perspective, we look out how the 0.7250 resistance area works out .



EUR/GBP: testing the 0.7250 resistance area



Cable: rebounds off the recent lows

Calendar

Friday, 4 December		Consensus	Previous
US			
14:30	**Change in Nonfarm Payrolls (Nov)**	**200k**	**271k**
14:30	Two-Month Payroll Net Revision (Nov)	--	12k
14:30	Change in Private Payrolls (Nov)	190k	268k
14:30	Change in Manufact. Payrolls (Nov)	0k	0k
14:30	**Unemployment Rate (Nov)**	**5.0%**	**5.0%**
14:30	**Average Hourly Earnings MoM/YoY (Nov)**	**0.2%/2.3%**	**0.4%/2.5%**
14:30	Average Weekly Hours All Employees (Nov)	34.5	34.5
14:30	Underemployment Rate (Nov)	--	9.8%
14:30	Change in Household Employment (Nov)	--	320.0
14:30	Labor Force Participation Rate (Nov)	--	62.4%
14:30	Trade Balance (Oct)	-$40.50b	-$40.81b
Canada			
14:30	Int'l Merchandise Trade (Oct)	-1.60b	-1.73b
14:30	Labor Productivity QoQ (3Q)	0.3%	-0.6%
14:30	Unemployment Rate (Nov)	7.0%	7.0%
14:30	Net Change in Employment (Nov)	-12.5k	44.4k
14:30	Participation Rate (Nov)	65.9	66.0
Japan			
06:00	Consumer Confidence Index (Nov)	A: 42.6	41.5
UK			
10:00	New Car Registrations YoY (Nov)	--	-1.1%
EMU			
10:10	**Markit Eurozone Retail PMI (Nov)**	**--**	**51.3**
Germany			
08:00	Factory Orders MoM/WDA YoY (Oct)	1.2%/-2.5%	-1.7%/-1.0%
09:30	Markit Germany Construction PMI (Nov)	--	51.8
10:10	Markit Germany Retail PMI (Nov)	--	52.4
France			
10:10	Markit France Retail PMI (Nov)	--	51.9
Italy			
10:10	Markit Italy Retail PMI (Nov)	--	48.8
Spain			
09:00	Industrial Output MoM/NSA YoY (Oct)	-0.6%/--	1.2%/4.0%
09:00	Industrial Output SA YoY (Oct)	4.1%	3.8%
Sweden			
09:30	Industrial Production MoM/NSA YoY (Oct)	-0.8%/4.0%	2.0%/6.3%
09:30	Industrial Orders MoM/NSA YoY (Oct)	--/--	22.3%/32.8%
09:30	Service Production MoM SA/ YoY WDA (Oct)	--/--	0.1%/1.4%
Events			
13:00	**EMU – ECB's Rimseviics holds press conference in Riga**		
16:45	US - Fed's Harker gives opening remarks at forum		
21:45	**US - Fed's Bullard Speaks on 'The New Normal' in Philadelphia**		
22:00	**US - Fed's Kocherlakota Speaks in Philadelphia on Renormalization**		

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