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Market Insights & Strategy
Global Markets

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EM Rates & FX, & Oil - The Traders' Weekly Views

Market Overview: Continued Confidence with Increasing Caution Overview

- Global markets are showing a renewed fragility as we head toward year end. Weak data from China late last week, following dovish comments from ECB president Draghi on Thursday, all coupled with the deepening Brexit chaos in the U.K. is feeding a degree of investor angst and offsetting the easing in global trade tensions felt earlier last week. Asian equities ended the week edging lower and the defensive investor bias is also evident in the widening seen in the Asia iTraxx credit indices, reflecting better buying cares of protection.
- In terms of the latest Chinese data, retail sales for November came in at a disappointing +8.1% YoY, not only down from +8.6% in the prior month but well shy of the expected pickup to +8.8%. Meanwhile November industrial production growth of 5.4% missed the forecast of +5.9%, the level seen in October. The Shanghai Shenzhen CSI 300 equity index ended the week 1.67% lower.
- In the emerging markets space we have seen a degree of relative stability compared to developed market counterparts, although the focus remains firmly on oil. There are concerns that the latest OPEC cuts may not prove supportive enough to provide continued support to oil market dynamics and that with the headwinds facing China, amongst others, demand is likely to be weaker into the new year. This pressure filtered through into the GCC FX curves towards the end of last week with international markets leading the way in the longer end of the curves (2y/3y). We anticipate this continuing into this week with the regional curves following suit.

Downbeat Draghi

- Meanwhile, the softer global macro picture was underscored by a relatively downbeat Draghi on Thursday as he admitted that recent Eurozone macro data had been weaker than expected. Draghi maintained his long-held line that risks are largely balanced, but did warn that he sees the balance ‘moving to the downside’. Draghi expressed his ‘continued confidence with increasing caution’.
- Consequently, the ECB has cut its growth forecasts for this year and next and has lowered the inflation outlook for 2019, while raising it slightly for this year. The euro traded lower on the back of the comments and we would expect the currency to remain under some pressure near-term as (initial) ECB rate hike expectations are now pushed further toward the end of 2019, if not into 2020.

16th December 2018

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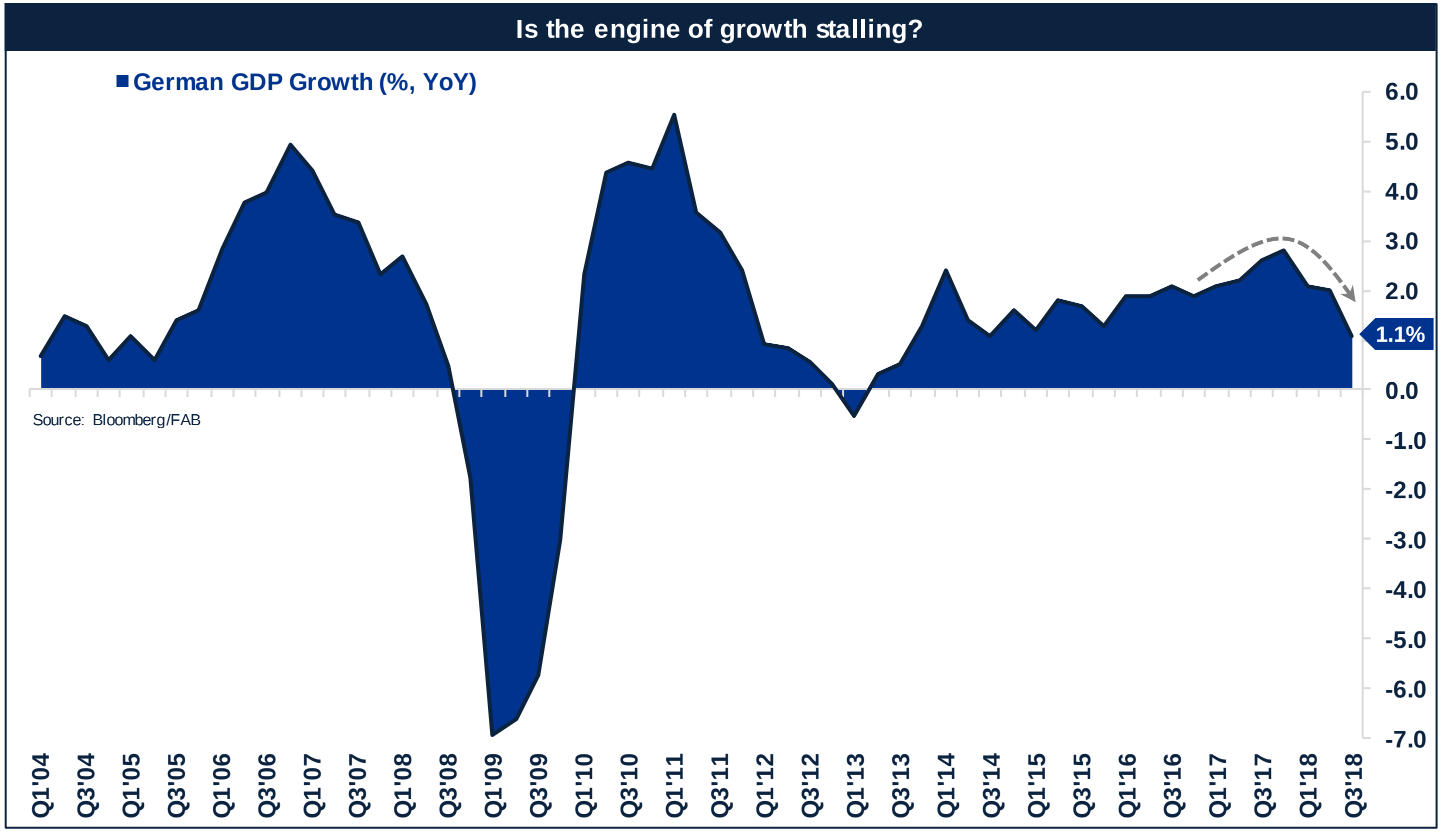
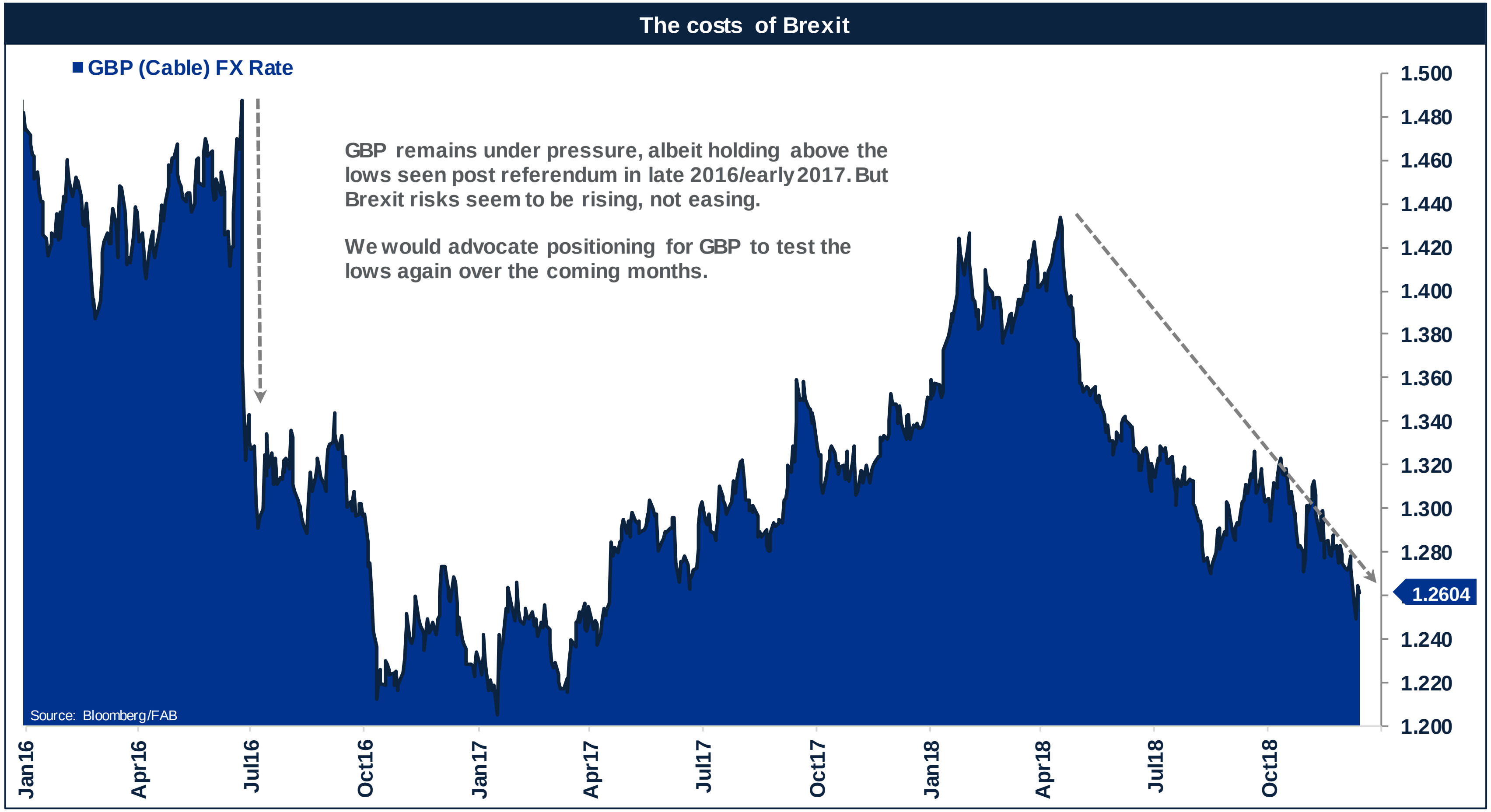


Brexit buffeting

- At the same time, broad market sentiment is also being undermined by the intensifying chaos surrounding the Brexit polemic. Sterling has tried to rally in the wake of Mrs. May winning (but nevertheless being left perhaps fatally wounded by) the confidence vote in her on Wednesday, but investors have been quick to fade the strength. If anything, the Brexit situation is now at even more of an impasse than it was before and we would expect to see renewed pressure buffeting cable and U.K. risk asset sentiment as we head into year-end.
- With 37% of her MPs having voted on Wednesday to eject her from Downing Street, Mrs. May now looks to be politically marooned. Moreover, that she only won the vote by promising Brexiteer backbenchers that she would not lead the Conservative party into the next general election (to be held by May 5 2022 at the latest, but possibly much sooner!) has seriously weakened her position. One might feel sorry for her; as a 'Remainer' in the 2016 referendum she hasn't asked for any of this.
- Nonetheless, the U.K. is now left with the incumbent prime minister, who in turn is left trying to muster support for – and to renegotiate terms on – her flawed Brexit withdrawal agreement, which itself lies at the heart of the current political malaise. But the EU elite have made it quite clear all along; there is no room whatsoever on their part for adjusting the terms of the agreement.

- The odds of a chaotic, no-deal Brexit divorce on March 29 next year are getting shorter by the day.



- The most controversial element of the agreement is the so-called Irish backstop. This concerns the plan for how to treat the Northern Ireland/Republic of Ireland border, which will be the only physical border between the U.K. and the EU post Brexit.

So what is the 'backstop' and why is it such a contentious issue?

- The backstop is intended to be a safety net, a way of avoiding a hard border to separate Northern Ireland from Eire, if appropriate customs arrangements can't be agreed between the EU and U.K. by the end of the transition period in December 2020. But for there to be a transition period of course there has to be a withdrawal agreement in the first place.

- Brexiteers argue that the backstop will keep the U.K. tied to EU rules indefinitely and curb its ability to strike trade deals with third countries. The EU believes the backstop should mean Northern Ireland staying in the single market and the customs union until the U.K. comes up with a permanent solution to the border issue. Theresa May wants a backstop that would see the whole of the U.K. staying in the customs union for a limited time after the transition period (so as to avoid any threat to the structure of the United Kingdom itself), but this is something the EU has said is unacceptable and has no room to move on.
- With the issue at apparent deadlock therefore, market uncertainty seems set remain elevated over the coming weeks. In turn, uncertainty breeds contempt and could see cable testing new lows as the chances of a no-deal Brexit rise.

  (Simon Ballard, Macro Strategist, Market Insights & Strategy)
  (Alison Higgins, FX & Rates)

Please find below views on EM Rates & FX, & Oil directly from our traders.

Another volatile week across the board as the grab for duration continues. For the time being 2.85% is offering resistance in Ct10's, with the IRS curve still inverted in the front end (1y1y/2y1y now at -12bp) and 2/5

At -5bp. Dec FOMC remains 90% price of a 20bp rate increase, with a now just 20bp being priced into 2019. DXY has remained in a tight range but struggles to materially break below 96.50. Liquidity conditions are extremely thin going into year end with high gap risk across asset classes.

EM FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
SGD	USDSGD traded in a narrow 50 pips range in absence of major market moving catalysts this past week. Local retail sales data missed market consensus, but it had little impact on USDSGD. The local currency is still tracking broad USD movement as we head into the last FOMC meeting in 2018; at which the market anticipates a 20 bps hike. Nonetheless, global equities sentiment will also lead with a focus on US-China trade negotiations.	Neutral 1.3800	Bearish 1.3700
INR	Last week's resignation of the RBI governor and state elections were the main drivers for the INR. These events have pushed the local currency's performance to becoming the worst in Asia losing 1.30%. The resignation also raised concerns over the central bank's independence. From here, the INR will likely trade lower as the newly appointed governor is believed to be more dovish. Nonetheless, INR will also track the movement of crude oil prices a commodity that has seemingly found some support at the US$60 level for Brent after OPEC's surprise agreement to reduce supply last week.	Bullish 72.00	Bullish 74.00
CNH	USDCNH traded within a range between 6.86 and 6.92 during the past week eyeing the US/China trade talks. However, weaker than expected retail sales and industrial production data helped erased some gains as it showed some ongoing weakness in the domestic economy. We remain neutral on CNH into year end with a slight bullish bias on easing trade war concern. .	Neutral 6.9000	Bullish 6.9500

EM FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
KRW	USDKRW ran into good resistance at 1130 level as US-China trade negotiations appear to be making some progress despite the arrest of Huawei's CFO. Heading into year end, global risk sentiment and trade talks will continue to be main catalysts for KRW. As liquidity decreases therefore, we are neutral with slight bullish bias in KRW.	Neutral 1120	Bullish 1130
EGP	Spot USD/EGP continued to trade within a 17.86-17.96 range this past week. Consumer prices dropped in November to 15.7% YoY from 17.7% and is now back within the Central bank's range of 13 percent, +/- 3 percent. Core inflation – which strips out volatile items – also slowed to 7.94% from 8.86% and this may encourage the CB to keep interest rates on hold when they meet at the end of this month. In the NDF Market, we saw some demand across the 3m and 6m tenors, whilst the 1m-3m tenors bucket was relatively stable. EGP spot rate has traded within a narrow range for most of the second half of this year and we do not expect any change going into year end. We continue to like steepening trades of being short USD in 1-3 months and long in 9-12 months because we think that in the months to come USD/EGP spot could begin to move higher but the exact pace and timing of the move remains unclear.	Neutral to bullish USDEGP 17.85-18.00	Neutral to bullish 17.50-18.50
NGN	The NAFEX fixing was printing at levels around 365 this past week. There is still some demand for dollars but with the fix stable and continued supply of hard currency from the central bank it should not lead to a major change in the recent spot levels. 3rd Quarter GDP showed the economy grew by 1.8%, following a 1.5% rise in second quarter. The Central Bank continues to mop-up liquidity through OMOs. They sold approximately$60m worth of a 267-day paper at a yield of 16.80% whilst the 1-year paper is currently offered at 17.10% in the secondary market. Note that the implied yield of the 1 year NDF is 13.00%. Leaving you with a hedged return of about Libor + 4.10%. We remain positive on Nigeria and have been buying 3m-6m T-bills especially as spot has been relatively stable, and the Central Bank continues to build its foreign-exchange reserves. The last reading was $42.75bn, about 12-months' worth of import cover.	Neutral NAFEX USDNGN 362-365	Neutral to bullish 362-368
ZAR	A rather dull past week for the Rand. Initially losing ground along with other EM currencies on headlines around the Sino-American trade war but gained after CPI for November rose to 5.2% y/y from a year earlier. Retail Sales data meanwhile was strong, rising to 2.2% in October from 0.7%, which came in ahead of expectations. With inflation climbing to an 18-month high in November, the 25bps interest rate this month seems to have been justified as a surge in transport cost pushed consumer prices higher. Our outlook remains unchanged and for a weaker Rand as there is still a lot of uncertainty on the horizon including trade wars, an impending local election and weaker economic data out of China.	Neutral USDZAR 13.90-14.80	Bullish 14.75-15.50

GCC FX Commentary	
SAR	The short dated USD/SAR FX Swaps tightened up significantly this week, with day to day trading as high as +0.35 pips a day. The majority of the market was seen very short SAR funding, and sold USD/SAR Spot to generate SAR. Spot USD/SAR started the week at 3.7517/19 and closed the week at 3.7510/12, with a traded low of 3.7510. (7Pips lower on the week) The International market took the rest of the curve aggressively too, with 1Y trading a high of 75, 2Y 325 and 3Y at 600. The Local/Regional market reaction this week along the curve was a tad less lively, with the market closing 1Y 65/75, 2Y 295/325 and 3Y 550/625.
AED	The AED curve was given this week as the short dates were very liquid. The week closed in the Regional/Local market as follows. 3M 2.5/4.5, 6M 7/11, 12M 20/28, 2Y 60/80. AED FX spot is currently trading at 3.6730 mid, unchanged on the week.
KWD	KWD FX swaps continue to be well-offered by local banks in the shorter end of the curve out to 6 months. The remainder of the curve saw very little change with 1Y and 2Y FX swaps closing at 140/110 and 175/115, respectively. KWD FX spot is currently trading at 0.30430/40, around 35-40 pips over the CBK offer side, as demand for USD continued to be strong.
OMR	The Omani FX curve was unchanged on the week, although there has been some paying interest in the longer end of the curve. Short dates continue to be very liquid day-to-day and there are still good offers in the regional/local market creating a ceiling for the 1Y and 2Y FX swaps. The curve closed with the 1Y at 270/310 and 2Y at 600/700. OMR FX spot is trading 0.38500/03, unchanged on the week.
BHD	Bahraini FX swaps in the short dates were a tad liquid this week, as we saw a few Local names B/S USD/BHD aggressively. The 1-3 Months buckets on the FX Swap curve ended the week lower, but 6M and beyond saw no action, ending the week relatively unchanged as follows. 1Y 240/290, 2Y 500/600. USD/BHD spot is trading at 0.37700/03 unchanged from last week. The most recent 3-month BHD T-bill issuance yielded investors 4.27%. The 6-month and 12-month issuance yields are 4.45% and 4.93% respectively.

FX Options Commentary

- Volatility in the FX space remains elevated as the market continues to react to political headlines mostly from the US, UK and India. GBP was particularly whippy as the Brexit debate continues to heat up and uncertainty around the outcome heightens. GBPUSD hit a multi month low of 1.2480 but rebounded shortly after; GBP volatility was bid but softened later in the week as market makers took profit on long vol positions.
- USDINR volatility returned after the RBI governor resigned. The announcement hit the wires shortly after the onshore market closed and the NDF forward points rallied pushing implied spot up around 2% higher. In G4 we have noticed a slight dislocation between JPY and the US equity markets where USDJPY remains firmly bid while equities sell-off suggesting a slight breakdown in correlation.
- We still feel yield enhancement strategies like DCD's and TARF's offer good value but caution against the use of leverage and recommend barriers to protect clients against adverse spot movements as it appears markets will remain volatile going into year end.

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