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Global Markets

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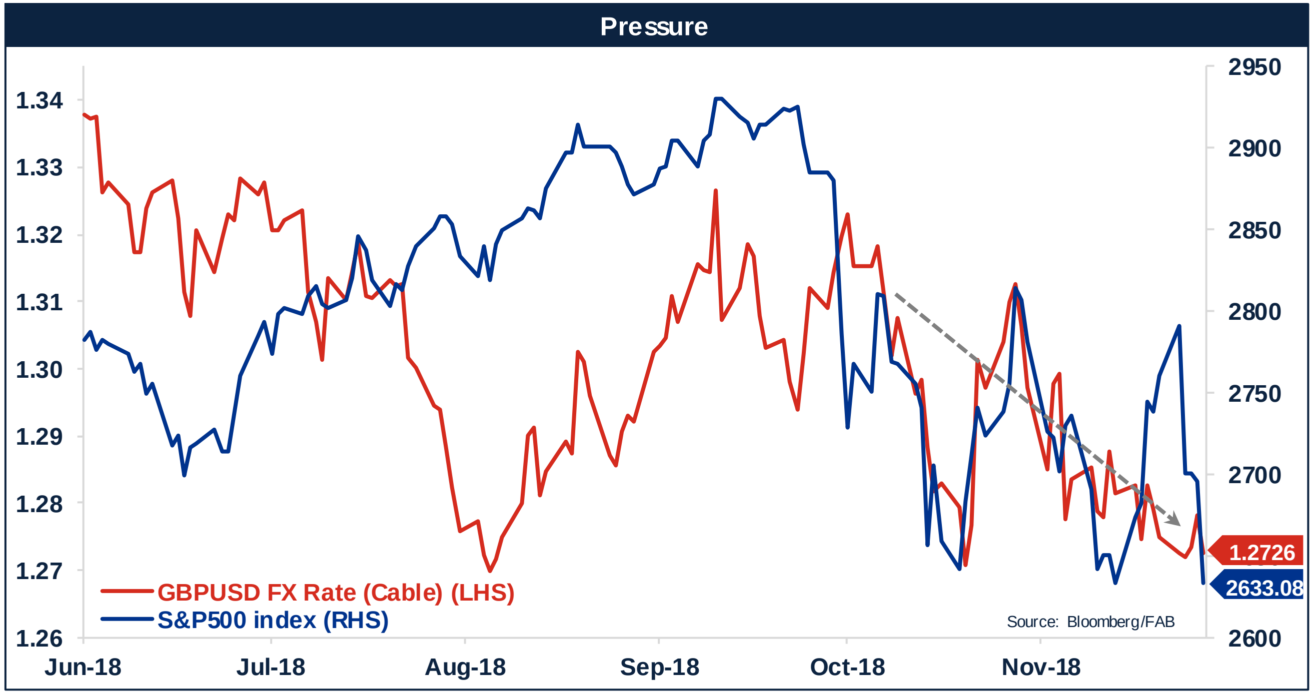
G10 Rates & FX, & Oil - The Traders' Weekly Views

Market Overview: Cocktail Hour.. Molotov Cocktail

- A confluence of macroeconomic and geopolitical strains led to a repricing in the rates market late last week and a subsequent rise in risk aversion. Trade tensions between the U.S. and China refuse to abate and are now beginning to weigh heavily on the global growth outlook. Meanwhile the European spotlight is honing in on Tuesday's Brexit vote by U.K. parliament.
- Renewed uncertainties on all fronts drove a sharp correction in risk asset pricing; the S&P 500 equity index ended the week down 4.6%, sterling resumed its downward path while the Bloomberg Barclays GCC credit index ended 9bps wider from the week's low.



- Across G3 markets we saw a huge move in rates last week as a result of the risk off move amid speculation that economic growth may have peaked. The lack of resolution to the Trump administration's belligerent approach to U.S./China trade coupled with stubbornly hawkish rhetoric from the FOMC is proving to be something of a Molotov cocktail for fixed income and equity markets alike, especially the more cyclical sectors that have performed strongly on prior robust growth assumptions.

09th December 2018

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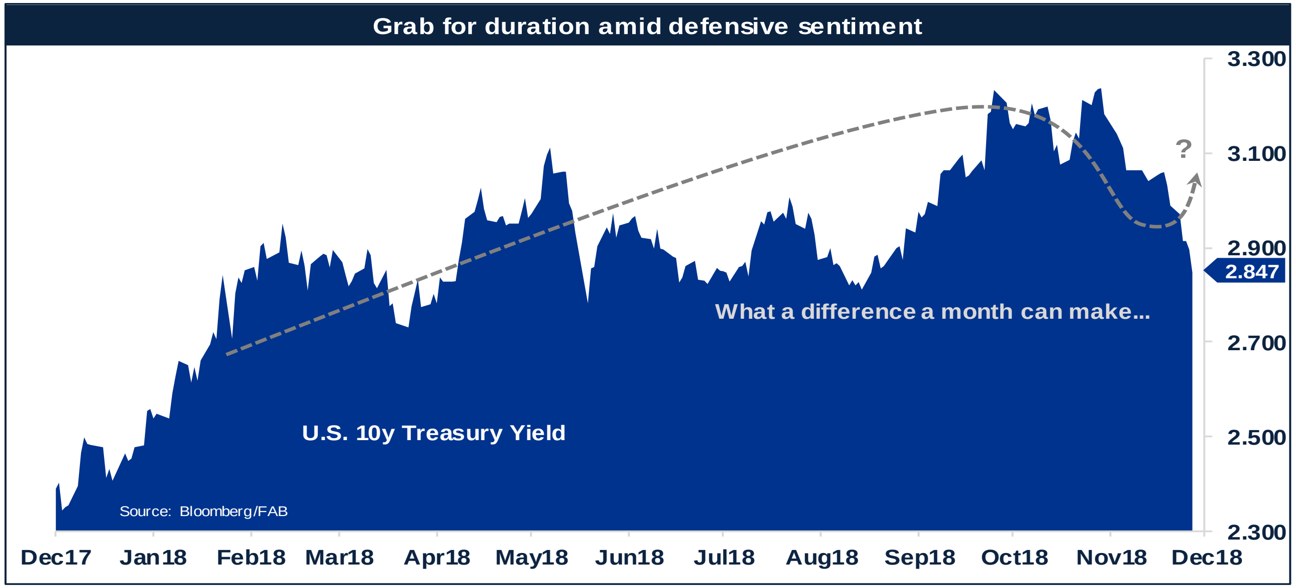
- The U.S. November non-farm payrolls report on Friday then added to the mixed messages. While the headline jobs number of +155,000 was shy of the expected +198,000 figure (and well down from October's revised +237k) and helped to underpin risk sentiment, resolutely firm wage growth data – average hourly earnings held at +3.1%, the strongest since April 2009 - helped to bolster short-term rate rise expectations.
- Nonetheless, the overall resultant sharp defensive bias and substantial duration grab over the week saw treasuries rally hard, with the yield on the 10y U.S. bond plunging 20bps from last Monday's high to end the week at 2.845%. Moreover, there has been a clear, dramatic reversal of sentiment across the fixed income space over the past month as growth assumptions get repriced, with the 10y treasury yield having now dropped around 40bps since early November.



- Looking beyond the near-term though, we continue to believe that the direction of travel for rates and yields should remain modestly higher during 2019. An easing of U.S./Sino trade tensions will be a key requisite in the first instance though for a resumption in the rates market sell off. For now the FOMC is largely seen raising the Fed funds rate by a further 25bps later this month (19th), but then the market has only 20bps of further Fed tightening priced in for 2019, with the terminal rate now seen at 2.65%.
- Meanwhile, GBP-denominated assets are looking friendless at the moment and the path least resistance for sterling still appears to be lower. The numbers are stacking up against prime minister May in terms of getting her withdrawal agreement passed in parliament on Tuesday (11th) and there have been some suggestions in the corridors of Westminster that May could call for the vote to be delayed while she seeks greater concessions from Brussels. That Brussels has made it clear though that there is no 'plan B' and that what they have offered is the best that the U.K. can expect, suggests that Mrs. May could be rapidly running out of options.
- Indeed, May's very survival in Downing Street could now be at risk. The specter of leadership instability or even of a general election that ushers in a Labour Party government under hard-left leader Corbyn, would only be expected to further emasculate investor sentiment toward GBP risk assets. We maintain our view that over the coming weeks the path of least resistance for cable is set to remain lower.

(Simon Ballard, Macro Strategist, Market Insights & Strategy)

Please find below views on G10 Rates & FX, & Oil directly from our traders.

A huge move in g3 rates this week as a substantial duration grab and LDI demand pushed yields lower and dramatically inverted curvature. There is now just 20bp priced for the FOMC in 2019 and terminal rate now stands at 2.65%.

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
GBP	All eyes will be on next week's key parliamentary Brexit vote on Tuesday. GBP markets have remained relatively calm with gilt yields at 1.27% and GBP at 1.278	Bullish	3m 1.300 12m 1.4500
EUR	The single currency continued to trade heavily last week as indicators point that the markets positioning is short. Even when the greenback was trading on the back foot, EURUSD failed to sustain the rallies above 1.1400. This week, focus will shift towards the ECB, where the central bank is expected to end QE and downgrade its forecasts considering the latest weakness in data as well as the overall surrounding political uncertainties. The desk remains neutral at these levels and will reassess on a firm break of either the top or the bottom of the range (1.1150 – 1.1450)	Neutral	3m 1.1600 12m 1.1900
JPY	Recession worries manifested in the market and a wide spread panic on the back of the equity free-fall and Oil selloff led to a flight to safety move. As such JPY remained bid last week through the US-China headlines that made it very difficult to see the light at the end of the tunnel. Additional factors included the Wall Street Journal article that signaled that the Fed might adopt a wait-and-see approach after the hike in Dec. The desk believes that the JPY is likely to remain supported by the safe haven flows at least for the time being, keeping a lid on any rally around 115.00.	Neutral	3m 110.00 12m 108.00
CHF	Swiss franc as a safe haven is back in favour after a massive global equity selloff. Fundamentally one of the drivers of the risk-off sentiment involves the U.S. hence CHF has returned to the spotlight as a classic shelter for investors. USD/CHF started the week at around 0.9980 and hit lows of 0.9895 on Thursday, a drop of nearly 0.85%.	Neutral	3m 0.9900 12m 0.9700
CAD	The Bank of Canada announced it is keeping its target interest rate at 1.75% on Wednesday. Poor performance in the oil sector, weakness in third quarter business investment, a historical revision of GDP and continued risk to global economic growth all contributed to a doveish tone at Wednesday's announcement and was further explained at a speech on Thursday. USD/CAD hits high for the year of 1.3400 on Wednesday immediately after the BOC rate decision.	Bullish	3m 1.2500 12m 1.2200

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
NZD	The New Zealand dollar was devoid of economic data this week and so moved on headline news of "trade war truce". The kiwi initially gained to a four-month high at 0.6970 but subsequently gave back gains as markets second-guessed if a truce was really reached. We expect the currency to be driven by headline news with support around 0.6850 and a break below will target the 0.6800 level.	Bullish	3m 0.6500 12m 0.6300
AUD	The Australian dollar sold off as a string of bad economic data spurred traders to cut their bullish bets on the currency. The 3Q GDP came in at 2.8% YoY against market expectations of 3.3%. The Central Bank also left its target interest rate unchanged at 1.5% as expected. We expect pressure of the currency to continue as markets continues to make sense of the implications of the Sino-American trade truce which was reached at the G10 meeting last week. The short term support is at 0.7200 while resistance is 0.7250.	Neutral	3m 0.7000 12m 0.7000

FX Options Commentary

- Intraday volatility in FX is elevated as markets continue to be choppy leading into year end. There is no clear trend in FX and large USD rallies tend to be faded and reverse. Market makers tend to sell volatility over the festive season but with so much material news out driving the market we are seeing participants buy options to hedge and hence push up implied volatility levels to multi week highs.

- We feel markets will continue to be volatile over the next few months and recommend yield enhancement structures with shorter tenors and limited leverage to protect clients from exceptionally large deviations in FX spot.

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