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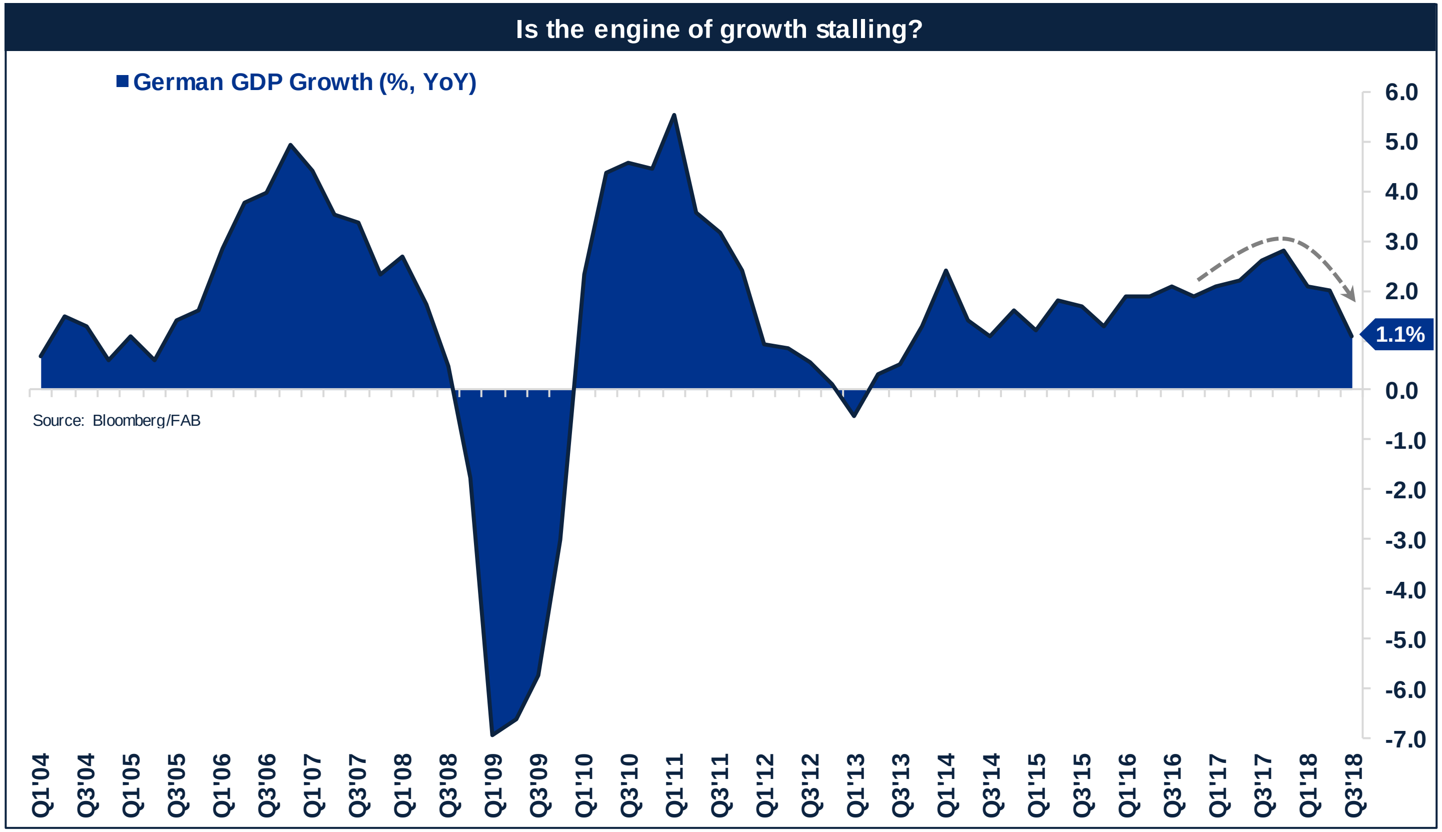
G10 Rates & FX, & Oil - The Traders' Weekly Views

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

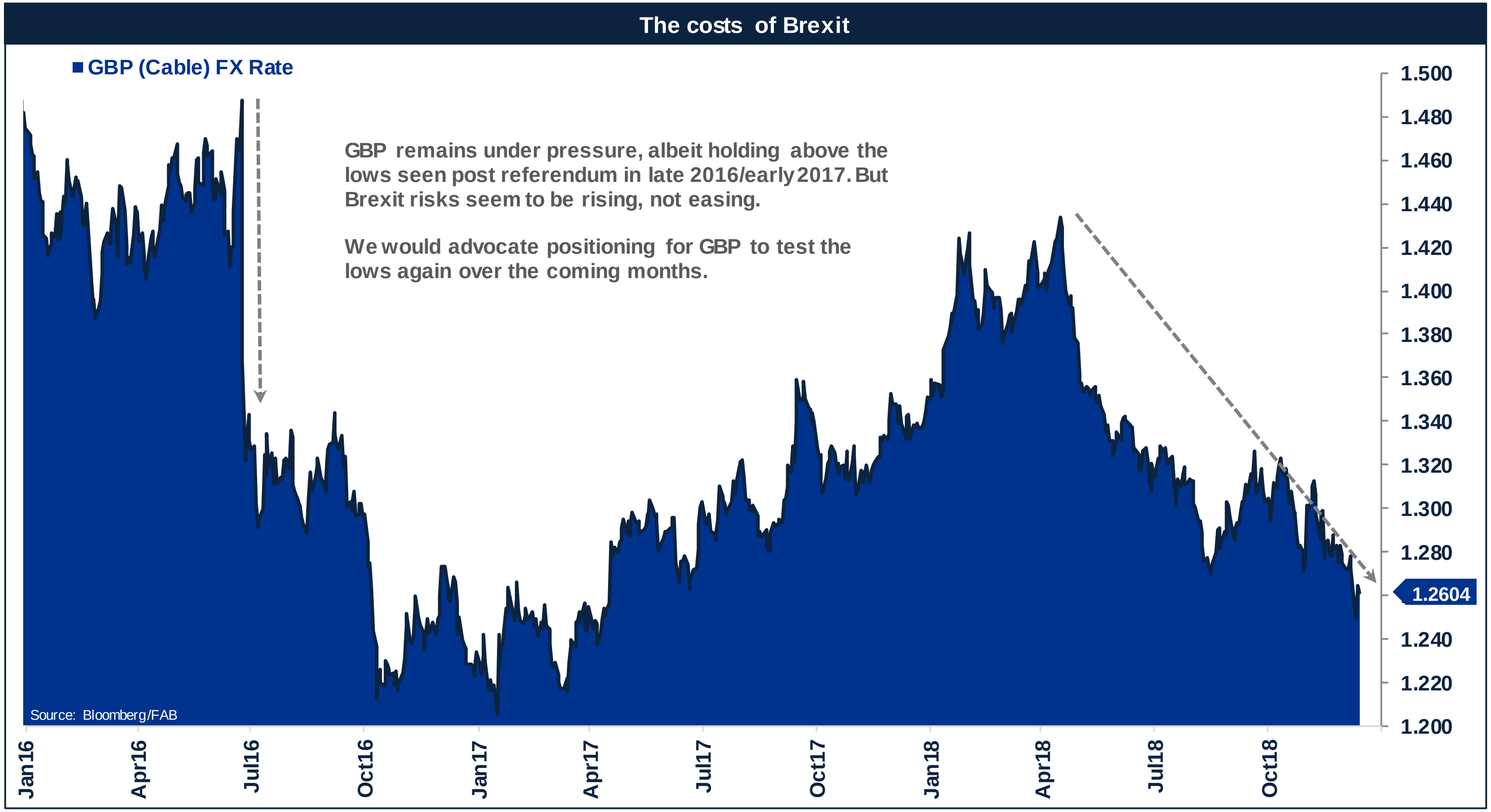
- Meanwhile, the softer global macro picture was underscored by a relatively downbeat Draghi on Thursday as he admitted that recent Eurozone macro data had been weaker than expected. Draghi maintained his long-held line that risks are largely balanced, but did warn that he sees the balance ‘moving to 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.



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 G10 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.

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
GBP	A pretty sensational series of events in UK politics as PM May faced a vote of non-confidence from her party, with Tory MP's rejecting the motion by 200 votes to 117. May now faces renewed hurdles over the NI backstop with several sources now calling for an extension to, or revoking of, article 50 deadline in March. Cable and short sterling reacted accordingly, as GBP initially fell 2% on the no-confidence motion before recovering 1.3% after the results were announced. There is 20bp of rate hikes priced in the Sonia MPC's for 2019, probably fair value at this stage.	Bullish	3m 1.300 12m 1.4500
EUR	The single currency attempted to break 1.1400 multiple times last week, but was faced with French protests, Brexit ultimatum where UK PM May was holding on by a thread, along with a weak set of flash PMIs not to mention the ECB which was the last straw that broke the camel's back. Notably, the ECB meeting was roughly as expected with small downgrades to growth and inflation forecasts, but during the press conference Draghi described the risks as balanced but moving to the downside, which was taken as dovish. Furthermore, ECB Vasiliauskas said on Friday that he sees risks tilted to the negative side and that they warrant monitoring; the comments were enough to send EURUSD 50 pips lower immediately and the move intensified as soon as the French PMIs released much weaker than expected, forcing EURUSD below 1.1270. The short-term outlook for EURUSD has certainly turned more and more bearish and the desk recommends selling the rallies with a stop above 1.1450.	Bearish	3m 1.1600 12m 1.1900

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
JPY	USDJPY has shown signs of life last week, albeit USD driven but a movement nonetheless. The pair managed to march towards 113.00 and even closed the week above 113.50; aided by easing trade tensions between the US and China. Looking at the price action and given the risk events that lie ahead, including the FED meeting, there is scope for more USDJPY gains, if the risk sentiment improves which in turn will see some JPY outflow, especially after the latest disappointing GDP figures out of japan.	Bullish	3m 110.00 12m 108.00
CHF	No surprises in Switzerland last week as most of the economic data released was in line with expectations. The unemployment rate of 2.5% was released on Monday and the Swiss National Bank keept the interest rate on sight deposits unchanged at -0.75%. The SNB reiterated that it thinks the economic situation remains fragile and that it forecasts lower inflation for 2019. USD/CHF was trading just below 0.9860 at the start of the week and quickly appreciated to highs above 0.9975 after speculation that the SNB would hike ahead of the ECB were squashed by a shrinking economy in the third quarter.	Neutral	3m 0.9900 12m 0.9700
CAD	More weak sentiment for the Canadian dollar as low oil prices persist due to global oversupply. Concerns that the Canadian economy will slip into a recession in 2019 were overshadowed by the arrest of Huawei's CFO and the subsequent arrest of a Canadian former diplomat. Trade tensions are still in focus as Canada and China attempt to navigate their relationship. Probabilities for a rate hike at the beginning of next year have fallen slightly as reflected by a flatter OIS curve. USD/CAD tested levels near its high of the year returning to 1.3400 levels at the beginning of the week from a low near 1.3300 on Monday. The move was largely reversed over the course of the rest of the week trading closer to 1.3380 on Friday.	Bullish	3m 1.2500 12m 1.2200
NZD	Kiwi finally managed to break 0.6800 firmly after multiple factors conspired and disturbed the currency's peace. The first culprit was none other than the RBNZ that decided to double the amount of capital the banks must hold. The second was worse than expected Chinese data that hit the commodity linked currencies and drove Kiwi to a low of 0.6780. The bearish signals are flashing and for now the top seems in place around 0.6970.	Bearish	3m 0.6500 12m 0.6300
AUD	The entire week of momentum was wiped out on Friday after weak Chinese economic data was released. China industrial production slowed to 5.4% in November, lower than estimated. Retail sales growth also slowed to 8.1%, much lower than the 8.8% the market was expecting. AUD/USD started the week near 0.7190 and trended higher gradually to reach a high of 0.7247 on Thursday before crashing lower on Friday to below 0.7160 with the release of the growth numbers.	Neutral	3m 0.7000 12m 0.7000

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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