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G10 Rates & FX - The Traders' Views

The back up in rates seen since December remains of little concern to global credit markets, at least for now, but concerns are growing that a correction in risk pricing is on the way. Indeed, the correction could already be quietly underway in some assets, underscoring the need for investors to now pay increasing attention to fundamentals and idiosyncratic risk in investment strategies. In this environment we believe that selective MENA credit will look increasingly attractive to investors as a result of its incremental yield opportunities and, in many cases, robust and improving macroeconomic fundamentals.

Notwithstanding corporate bond spreads that are now quoted at multi-year lows - European and US investment grade spreads have been eroded back to levels last seen prior to the Global Financial Crisis - investors are still seemingly chasing yield. Issuers are able to shrink - if not erase - new issue pricing discounts as investor appetite results in many new issues still being well oversubscribed. This level of demand is helping to generate positive excess returns over weak government bonds, which in turn may be creating a virtuous circle.

According to the ICE BofAML indexes, European investment grade credit has yielded an excess return of +0.67% ytd over government bonds and Euro sub-investment grade paper has seen an excess return of +1.1% over government debt. Meanwhile the MENA Corporate Plus index has produced a total return of 0.258% ytd, equivalent to an excess return of +1.428% ytd over government benchmark paper.

The backup in government bond yields - the US 10Y to 2.84% currently up from around 2.35% in December - seems set to continue through 2018, a move that will have significant asset allocation implications. The latter has not yet transpired, but we believe that a break in the 10Y to a 3% handle, with the spectre of continued selloff toward 3.5% could trigger a sharp correction in risk appetite.

Over-inflated asset prices will deflate. In this respect we note the current correction in the cryptocurrency sector, from what were arguably irrationally exuberant levels late last year. Are investors beginning to focus more on relative value? If so, valuations across other risk asset areas could soon follow.

A more fundamentally-driven approach to risk over the coming quarters should favor MENA credit as an asset class. We would note the stable macro environment of the UAE that benefits from the recent uptick in the oil price and the solid, stable AA sovereign rating, based on a low debt/GDP ratio and improving fiscal deficit. The improving GDP outlook for Saudi Arabia (0.3% last year, 2.0% forecast this year and 2.10% in 2019) with a rebound also expected in Kuwait's growth profile should add to the appeal of the sector among investors. We would also offer a cautiously positive near to medium prognosis for Egypt, where we see attractive yield levels and a robust 4.40% GDP growth forecast this year.

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

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

Despite retracements in global equity markets, higher interest rates across global bond markets have again been a dominant theme this week, with the abrupt acceleration in yields catching many investors and forecasters off guard. CT10's moved 15bp higher (currently 2.78%) as large January month-end bond extensions failed to provide any support for treasuries. Bunds and Gilts have tracked the moved higher (to 0.73% and 1.53% respectively), as the market remains upbeat in its outlook for economic activity. Current market pricing implies 75bp of hikes from the FOMC in 2018, 15bp of rate hikes by Mar 2019 from the ECB and 35bp of hikes from the BOE by Dec 2018.

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
EUR	Despite weaker CPI prints across all German regions, Eurozone core CPI, reported last week, beat estimates at +1.3% YoY. Ongoing strength in the Eurozone economy and slightly hawkish rhetoric from ECB governing council members have continued to underpin demand for the EUR. We remain bullish on EURUSD and bearish on bunds, with end 2018 forecasts of 1.35 and 1% respectively.	Bullish	1.2500 3m; 1.3500 12m
GBP	Brexit uncertainty continues to cloud the market's judgement of UK economic performance and the future path of Bank Rate. The UK fiscal position continues to look poor, with the current account deficit running at -4.6% in Q3 2017, which makes GBP's recent performance even more impressive. Brexit uncertainty appears set to overshadow the currency near term, which will likely contain Cable (GBPUSD) appreciation below the 1.45 level. Long term our view is bullish on GBP and bearish on gilts.	Bullish	1.4500 3m; 1.5000 12m
JPY	USDJPY seems to be in a relatively tight range despite efforts from the BOJ in unexpectedly boosting its bond-buying program in the 3-5y segment. A very limited reaction in bond markets coupled with the downward momentum in DXY should limit the scope of any pull backs to 111.00 and thus supporting a stronger JPY vs USD over the course of this year. Point made when a softer than expected Tokyo CPI print could not manage to lift USDJPY and in the case of any increase in JPY safe haven flows could push USDJPY even lower.	Bearish USDJPY – with preference to sell the rallies above 110.00	107.00 3m; 108.00 12m
CHF	CHF outperformance continues with the Deutsche Bank CHF trade weighted spot index currently up at 139 (+2% YTD). By comparison, EURCHF has not managed to hold on to the gains made after the ECB meeting and continues to tread water around the 1.160 mark. With the next SNB monetary policy meeting not until March 15, there appears plenty of room for the usual SNB rhetoric regarding the currency being overvalued, although the market has become immune to such words, suggesting that CHF outperformance could be sustained for the time being.	Neutral Swiss although we are still alert to any escalation in global political tensions for safe haven flow	0.9300 3m; 0.9700 12m

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
AUD	Australian dollar appreciation vs the US dollar since the beginning of the year now puts the RBA in an uncomfortable position given the already challenging position of the Aussie economy with its weak employment picture. The currency touched a 3-year high of 0.8115 on Jan. 26, before fading back to 0.7931 by Friday's close. AUD started the past week at 0.806 and managed to fluctuate around that support level before attempting another leg higher. Resistance is seen at 0.804 and support at 0.7980, all in the context of USD strength on the back of some robust US macro data, including the non-farm payrolls data on Friday of +200,000 (ahead of the +180,000 consensus).	Bearish	0.7500 3m; 0.7500 12m
NZD	Similar to its antipodean neighbor, DB trade weighted NZD continued to climb higher to 92 this past week, a level not seen since 2014; NZDUSD broke 0.7400 and before quickly reversing back to 0.736. With the next RBNZ policy meeting on February 8th , the market is now wary of adding to long positions ahead of possible currency related rhetoric and the risk of a correction in the Kiwi back toward the 0.7100 level. To express our bearish stance, the desk recommends shorting NZDJPY between 80.80 and 81.50 targeting 79 as an initial target, followed by 77.50.	Bearish	0.6800 3m; 0.6300 12m
CAD	The continued upward trend in WTI is giving a boost to CAD; DB CAD trade weighted index has risen to 126.5 in turn pushing USDCAD to 1.23. There are plenty of reasons to support a stronger CAD, mainly higher oil coupled with strong Canadian data and more specifically inflation and higher wages which may support a more hawkish CAD rate outlook.	Neutral	1.2500 3m; 1.2200 12m

Contributors

FAB Global Markets FX & Rates

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Alison Higgins
Alison.Higgins@bankfab.com

Simon Turner
Simon.Turner@bankfab.com

Nourah Al Zahmi
Nourah.Alzahmi@bankfab.com

Meera Al Marar
Meera.AlMarar@bankfab.com

GCC & EM FX

Husain Askar
Husain.Askar@bankfab.com

Ahmed El Alami
Ahmed.ElAlami@bankfab.com

Pinrath Wongtrangan
Pinrath.Wongtrangan@bankfab.com

Danay Sarypbekov
Danay.Sarypbekov@bankfab.com

Rashid Rasul
Rashid.Rasul@bankfab.com

Tel: +971 2611 0111