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G10 Rates & FX - The Traders' Views

This coming week will all be about the power of 3… However, while we enter the 3rd month of the year, it is the specter of the US 10Y yield at some point reaching – and exceeding – the 3% level that may again be the main focus of investors. Remember that when the 10Y was trading close to 2% in September last year, 3% was the end-2018 target for the 10y for many investors; reaching that target this soon is unlikely to occur without creating some volatility. This said, the market has now digested the prospect of a 3% 10Y, beyond which it will be the perception of how high yields may rise, and over what timeframe, that will drive overall market reaction. We believe that a 3.5%+ target yield on the U.S. 10Y will begin to trigger more significant asset allocation considerations away from risk.

For now though, the selloff in the government bond market may have abated at the end of last week, with yields pulling back from their recent highs, but the path of least resistance for interest rates over the coming months likely remains higher. Central banks, led by the Fed, appear to be firmly committed to gradual policy normalization and balance sheet reduction. The only event that might knock them from this strategy would be a significant deterioration in the macroeconomic backdrop – something that is not our near-term base case scenario.

The velocity and extent of normalization – and how central banks communicate their intentions – will be key to the market reaction. Move steadily, allowing an improving growth dynamic to gain momentum and markets should react positively, albeit with asset allocation flows favoring fixed income product over higher risk equity and credit exposure as the yield structure rises. Hike rates too quickly though – conveying an overly hawkish outlook – and the macro environment will quickly begin to price in a slower growth, if not recessionary, outlook with consequent flight to safety trades reemerging.

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

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

Last week was characterized by gyrations across global bond and FX markets even as overall price movements remained muted. CT10, CT5 and CT2's currently sit at 2.90%, 2.65% and 2.24%, respectively. Across the pond both bund and gilt yields declined this week as the market tees up for the large negative supply coming into sight in March; 10Y bund yields currently sit at 0.68% with 10yr gilts at 1.52%. Attention has been focused on the widening of US FRA/OIS spreads and the subsequent possible ramifications and the spillover effects into other markets. The March-2018 basis is now over 40bps – the highest since 2016 when the US money market reforms we implemented. With the Federal Reserve continuing to reduce the size of its balance sheet and drain liquidity from the banking system, it's difficult to find strong catalysts for spread compression. Investors with floating rate LIBOR liabilities can hedge their exposures by buying Libor/OIS structures and thus mitigating any widening of the LIBOR basis.

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
EUR	Minutes of the January ECB meeting highlighted the governing council's continued positive assessment of the Eurozone economy and confidence that inflation will converge to target in the medium term. The market is expecting that April will be the most likely opportunity to outline changes to forward guidance with Asset purchases concluding in September. Market is pricing a 10bp hike in the deposit rate in early Q1 2019. EUR crosses remain supported, despite the recent move higher in DXY to 90 and risks around the Italian elections in early March.	Neutral	1.2500 3m; 1.3500 12m
GBP	The slow burning Brexit negotiations continue to play out with political movement somewhat limited from both sides. Market pricing is somewhat binary, with both interest rates and currency valuations largely dependent on the type of transition attained. MPC Sonia dates are pricing a 25bp hike from the BOE in August, which given the elevated level of both goods and wage inflation, seems fair value. We remain bullish on GBP and UK yields; we view the risks of an unfavorable Brexit transition as overstated.	Bullish	1.4500 3m; 1.5000 12m
JPY	Now that Kuroda's term has been renewed for the next 5 years, it has removed some uncertainty giving USDJPY some relief last week. The central bank of Japan is likely to maintain the same monetary policy, especially after the latest Japanese CPI nationwide release came in at 0.9% YoY; miles away from the central bank's 2% target. That said, caution is advised as the central bank has been slowly reducing its bond purchases in an effort to not shock the market. USDJPY managed to recover last week, buoyed by a slightly stronger dollar. However, in other JPY-crosses, JPY remains well supported despite the improved risk sentiment, which is a reflection of the heightened uncertainty.	Bearish USDJPY – with preference to sell the rallies above 108	107.00 3m; 108.00 12m

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
CHF	2018 has marked CHF as one of the top performing currencies buoyed by a sudden deteriorating risk sentiment on the back of the sharp drop in global equities. CHF safe haven flows remain at elevated levels, even after equities recovered. Therefore, EURCHF has been trading on the back foot with very shallow pullbacks; next level on the downside is 1.1400 where we would expect the SNB to be slightly more vocal about CHF appreciation.	Neutral Swiss although we are still alert to any escalation in global political tensions for safe haven flow	0.9300 3m; 0.9700 12m
AUD	Commodity linked currencies continued to suffer against a recovering dollar last week – even a better wage price index could not lift AUDUSD which dropped to 0.7800 mid-week. This week's commodity index data release will be closely watched for any temporarily relief to AUD back to above 0.7950 which will in turn provide decent opportunity to instigate short positions.	Bearish	0.7500 3m; 0.7500 12m
NZD	Last week saw mixed performance in the Kiwi, which was weaker against the dollar but slightly stronger against AUD and JPY. Furthermore, a small bump was seen mid last week as the market was caught short and New Zealand retail sales exceeded expectations at 1.7%. As soon as stops were cleared though, Kiwi resumed its downward trend. The desk has closed its short NZDJPY position in profit as Kiwi showed small signs of resilience despite the political backdrop. We remain on the sidelines at the minute looking for another opportunity to initiate another short NZD position.	Bearish	0.6800 3m; 0.6300 12m
CAD	Weaker than expected Canadian retail sales helped to push USDCAD as high as 1.2755 last Thursday. Note that CAD was the weakest performer last week across G10. The currency also showed heightened sensitivity to any weakness in Canadian data, which has been the case since the last BoC meeting. That said, expect the move to slightly run out of steam above 1.2850 and a slight pull back to materialize if commodities recover.	Neutral	1.2500 3m; 1.2200 12m

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