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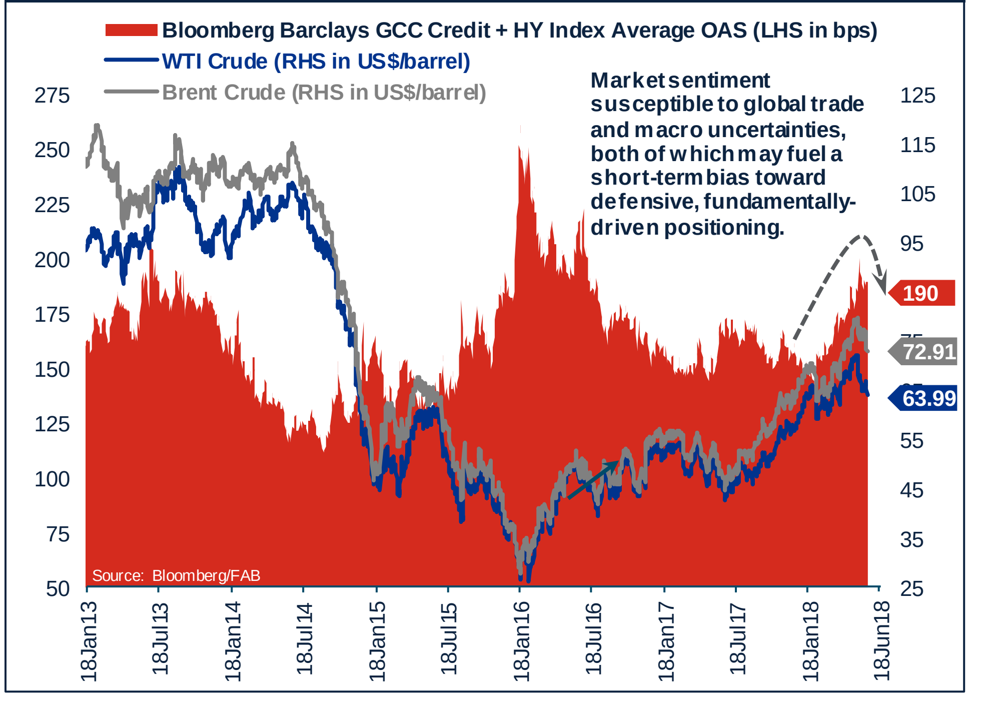
G10 Rates & FX, & Oil - The Traders' Views

Macro Strategy View: Positioning for a Confluence of Uncertainties

- We have long stated our belief that no one wins in a trade war, and as trade rhetoric heats up between the U.S. and China a softer bias is embracing financial markets this morning. This said, nothing seems to have really changed – or significantly deteriorated – on the global trade front in recent days, but as lower seasonal liquidity concerns perhaps begin to creep into investors' minds, so the market may prove to be more susceptible to headline risk over the coming weeks. As such, with China and Hong Kong markets closed today for the Dragon Boat Festival and Asian trading volume therefore sharply depleted, it is unsurprising that Japanese risk asset markets are leading the broader region lower, suggesting a fragile start to MENA markets at the return to work from the Eid al-Fitr extended weekend.
- The shift toward a more defensive market sentiment this morning has been a fillip for the yen, in turn is weighing on Japanese equities. Meanwhile, the specter of intensifying global trade tensions has also cast a fresh veil of uncertainty over oil prices. Both WTI and Brent crude are quoted lower this morning on Bloomberg, with the former currently shown at $63.84bbl, down from a recent high of $72.35bbl a month ago. The net negative effect of both of these moves seems set to dampen price action in MENA/GCC risk asset markets this morning, albeit that the sector should continue to benefit from its underlying fundamental strength and attractive yield levels.

Short-term caution?



- Looking ahead, we would suggest that markets could continue to see periods of heightened volatility over the summer months, fueled by the confluence of seasonality, global trade concerns and the broader implications of a still fragile outlook for global interest rates and central bank (Fed, ECB) monetary policy and balance sheet normalization. This said, we stick with our core view that investor capitulation is not a meaningful risk at this stage, albeit that against the backdrop of uncertainties we continue to advocate a bias toward fundamentally-driven, defensive positioning.

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

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

The hawkish rhetoric post the FOMC decision did little to help lift yields as markets focused more on the extremely dovish ECB meeting and the continued volatility across EM assets. CT10's finished the week lower at 2.92%, with CT5 and CT2 at 2.80% and 2.55% respectively. Currently the market is pricing an additional 35bp of tightening by the FOMC for the remainder of 2018.

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
EUR	The market was expecting the ECB to provide further details on the tapering of the APP, which it duly delivered. "Purchasing will continue at EUR30bn until September, after which (subject to incoming data), purchasing will reduce to EUR15bn until December 2018. Moreover, reinvestment of redemptions and coupons will continue as long as the key ECB (are) left unchanged". Growth was revised down growth to 2.1% (previously 2.4%) for 2018, inflation in both 2018 and 2019 was revised higher to 1.7%. In a unexpectedly dovish assessment Mr Draghi announced "the key ECB interest rates to remain at their present levels at least until the summer of 2019", both bond and Euribor futures reacted accordingly with red contracts (1y1y) rallying 15bp and EGB yields falling across the board.	Neutral	3m 1.2000; 12m 1.3500
GBP	Once again sterling markets have looked for inspiration from neighbors; as the BOE attention remains focused on key Brexit milestones and any sign of domestic price pressure. Wage inflation came in line at 2.5%, not strong enough to change the probability of an August hike (still at 50%). This week's MPC meeting is unlikely to provide any new color on the future path of interest rates, with no change expected on Wednesday; the market will focus on forthcoming data in its assessment of the status of the UK economy.	Bullish	3m 1.4000; 12m 1.5000
JPY	Although policy was announced as unchanged at the BOJ, they downgraded their medium term outlook for inflation. USDJPY remains very range bound and the slightly more dovish rhetoric has kept the cross above the key 110 level.	Bearish	3m 110.00; 12m 108.00

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
CHF	The SNB is still playing defense against a strong Swiss franc as the ECB both announces the end of QE and emphasizes no change in rates until middle of 2019. We are eagerly waiting to see if the SNB can exert some independence by hiking ahead of the ECB, however, for the time being they appear to be in no rush to change their current policy. USD/CHF continues to be driven largely by USD strength and by European credit. We saw USD/CHF trading below 0.9880 for most of last week with a sudden spike above 0.9960 on Thursday.	Bearish USDCHF	3m 0.9300; 12m 0.9700
AUD	AUD/USD has been falling softly for the past week; the big hit was on Thursday as the ECB sounded dovish after leaving rates unchanged at the latest Council meeting. Meanwhile, there has been little to excite the Aussie market amid a stable macro backdrop with soft job growth, albeit with the unemployment rate dipping to 5.4% in May, from 5.6% the prior month and better than expectations of a more modest dip to 5.5%. Market rate expectations do not see a hike by the RBA until early 2019, albeit that the release of the RBA June meeting minutes tomorrow (June 19) will be closely analyzed, alongside Q1 house price data. Other key data this week will include the Westpac Leading Index, due Wednesday (20th).	Bearish	3m 0.7500; 12m 0.7500
CAD	Pressure on the Canadian dollar continues as the US confronts issues about trade tariffs and President Trump criticizes its Prime Minister Trudeau. Going forward we will be closely watching for (strong) retail sales and CPI data due at the end of the week as an indication that the BOC will maintain its rate tightening bias over the remainder of the year. USD/CAD jumped above 1.3100 on the news from the G7 after trading range-bound all week around the 1.3000 mark.	Neutral	3m 1.2500; 12m 1.2200

Continued…

Interest Rate and FX Options Commentary

- Currency markets were fairly calm throughout last week as the Trump / Kim summit went smoothly but volatility returned yet again in the latter part of the week in the wake of a Dovish ECB and the Fed rate hike. This combination boosted the USD across all pairs and sent FX volatility firmly bid. The market is now watching key levels in G10 FX, but with US equities still trading close to historic highs and the USD losing momentum, we think volatility may ease in the coming days; the major political events and economic releases are also behind us for now.

- Meanwhile, we saw some buyers of interest rate volatility early last week ahead of the Trump/Kim summit in Singapore. It seems US rates volatility buyers gave up after the success of the U.S. and North Korea leaders' meeting. Market participants gave top priority to this event and then moved on; US rate vols went offered with the market rallying back. Looking ahead, we expect USD interest rate volatility to keep trading cheap; FED was on the hawkish side but the overall reaction in rates was tepid and vols got sold. In the GCC markets, liquidity in AED and SAR rates volatility is quite scarce – AED and SAR rates vols are stable/soft side.

Oil Commentary

- Last week was another interesting week, as oil kept being impacted by both bullish and bearish news, thus trading within a range. Bearish API numbers (API reported post-settlement a 0.8 mln bbls build in US crude inventories last week, with gasoline and distillate also witnessing a build), combined with the headlines about Russia willingness to return back to Oct16 production levels are pressuring the oil price. Venezuela and Iran production uncertainties/issues is still supporting the oil price.

- Inventory EIA Report: Crude Oil fell 4.14 MLN BARRELS, exceeding market expectation of -1.1 mmbbl draw. Gasoline & distillate inventories as well fell significantly making the report bullish.

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G10

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