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Market Insights & Strategy
Global Markets

G10 Rates & FX - The Traders' Weekly Views

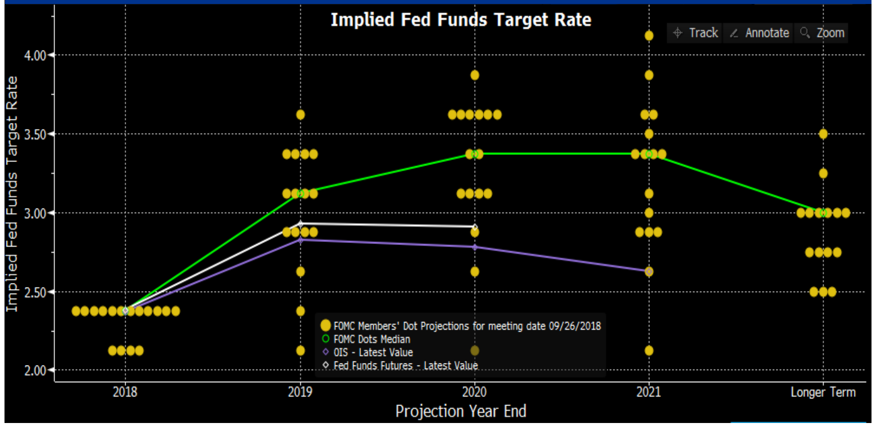
Market Outlook - FOMC

- We have continued to highlight the suppressive nature of g3 yields for the last couple of months. In our late September trader views, we expressed our disagreement with market pricing of 25bp of Fed tightening in 2019 and viewed the terminal rate of 2.80% as far too low, given the level of US economic output.
- In recent session the market has re-priced 2019 FOMC meeting dates and now implies a 50bp of tightening and moved the terminal rate higher close to 3%.
- 2018 has seen US Treasury and swap yields move 80bp (see fig 1) higher as revised expectations of the US terminal rate and normalisation of the FED balance sheet, pushed benchmark 10yr yields to 3.20%. However, with a heavy issuance calendar for the remainder of 2018, we ***continue*** to expect upward pressure on yields as market players and investors absorb supply.
- Fig 2 compares the medium FOMC dot plot projection with current market pricing, where medium dots are 3.125% (vs market implied OIS at 2.82%) in 2019 and 3.375% (vs market implied OIS at 2.80%) in 2020. We ***continue*** to view the market pricing of FOMC dates as suppressed.
- FAB believes yields should be higher due to;
  - Steepening of the money market curve as the FOMC continues to tighten policy in 2019 by more than current market pricing
  - The beta effect from rising yields in the UK and Eurozone
  - Continued normalization of the FOMC balance sheet and continued positive net supply of US treasuries putting upward pressure on yields.

Fig 1: 10Y Bonds

Source: Bloomberg/FAB

Fig 2: Market Pricing vs FOMC



Source: Bloomberg/FAB

7th October 2018

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Market Outlook – EUR & GBP

- 10y BTP/Bund spreads continue to be a key driver of G3 yields and curvature. Recent renewed pressure on the BTP's have pushed 10yr yields to a multiyear high of 3.45% and BTP/bund back towards 300bp (see fig 3).
- However, as we highlighted in our late September trader views, bund yields remain were too suppressed at .40% and the implied FTQ (Flight-to-quality) premium too high. Despite renewed tension on BTP's, bund yields have risen by 10bp to .55%, we continue to expect a move back toward 1% by q1 2019 as the ECB APP will stop its net monthly purchases of assets.
- 10y Gilt yields (see fig 4) have risen steadily through 2018 as the UK economy continues to improve and the BOE gradually reduces their amount of monetary accommodation. Current MPC pricing is 25bp of tightening of Bank Rate in 2019 and 2020.
- Key risks for the UK economy are uncertainties around the transition and exit from the European Union. However, recent positive rhetoric from both UK and Eurozone ministers has pushed the probability of a hard Brexit scenario to the tails of the distribution of outcome probabilities.
- FAB believes yields should be higher due to;
  - Suppressed terminal rate pricing in both the Eurozone and the UK.
  - Benign forward pricing of ECB and BOE meetings in 2019 and 2020.

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Fig 3: 10Y BTP/Bund

Source: Bloomberg/FAB

Fig 4: 10Y Gilt Yields

Source: Bloomberg/FAB

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

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
EUR	The single currency suffered significant losses over the last two weeks and was hostage to headline risk from Italy and/or Brexit related. Adding to the mix relentless dollar strength that translated into seven consecutive days' selloff and now the chances of a correction have elevated. The desk recommends buying EURAUD at 1.6200 with a SL around 1.6150 as a short term rebound play, especially now that Italy lowered its budget deficit target as a compromise and EU Brexit negotiators released on Friday that they believe the divorce with Britain is very close.	-	3m 1.1600 12m 1.1900
JPY	The deteriorating risk sentiment weighed on JPY last week and the 10Y JGB yield rose to 0.157%, levels not seen since 2016. Additional factors that aided the USD rally against JPY include unhedged Japanese foreign investment in treasuries globally, which is why USDJPY rallied to 114.55 with ease. That said, caution is advised against chasing USDJPY above 114.00, which is seen clearly as the pair could not hold on to the gains on Thursday. Going into this week, expect the risk off tone to dominate the market especially after US VP Pence's comments which reflects a possible escalation to the US/China trade war negotiations, especially as Trump announced that he's going to make China a top priority.	Neutral	3m 110.00 12m 108.00
CHF	Swiss franc safe haven status is starting to erode as investors reflect on EU-Swiss negotiations. Discussions on streamlining bilateral trading agreements have slowed down between the European Union and Switzerland and with Brexit negotiations reaching critical stages, appetite for Swiss franc has subsided. USD/CHF climbed 1.3%, opening on Monday at 0.9800 levels and reaching highs of 0.9940 on Friday.	Neutral	3m 0.9900 12m 0.9700
AUD	AUD has suffered its worst week as it fell to the lowest levels since February 2016. AUD/USD has extended its decline for its fourth day as it breaks 0.7060.market is bearish Aussie as support levels at 0.7000. AUD get crushed as dollar grows stronger with good data and their economic stability with hikes rates. On the other hand political issues grow bigger with china and Brexit that reflects negatively on Aussie. As option expiration's worth of A$446m happened on Friday at a cap spot of 0.71 we would see spot under selling pressure as investors will protect its position. Retail sales rose to 0.3% slightly better than expected 0.2%. Coming up next week data Westpac and home loans.	Bearish	3m 0.6900 12m 0.6500

G-10 FX	Macroeconomic/Fundamental Analysis	Views (Bearish/Bullish) 2-week Time Frame	Intermediate & Long-term Views (3mth & 12mth Time Frame)
NZD	New Zealand is being but in a critical position as it sank to the lows of 2016 and not that far away from 0.6130 which is the lows of 2015. NZDUSD stands at the lows of 0.6460 as the green storms higher in a continues range this week. US had strong data and with chair of Federal Reserve being hawkish, market gave more support to the dollar then it other currency peers. USD data coming out today would cause kiwi to dip to 63.50 if the numbers are stronger than expected; Trade Balance, Non-farm payrolls, and unemployment rate. Market is bearish NZD as support level at 0.6430.	Bearish	3m 0.6300 12m 0.6100
CAD	A new trade agreement was concluded after long drawn out negotiations and signals stability to the North American trading zone. Despite the modest tweaks between Nafta and the U.S. Mexico Canada Agreement (USMCA) a weight has been lifted from the Canadian and Mexican economies. Selloff in U.S. Treasuries spread into Canadian bonds with the 10 year yield jumping to the highest in more than four years. Canadian stocks also followed the U.S. equity slide with the TSX falling by 0.4%. The loonie also lost value, trading at 1.2940 against the greenback by the end of the week from lows of 1.2783 on Monday.	Bearish	3m 1.2500 12m 1.2200

GCC FX Commentary	
SAR	The SAR FX curve was steeper on the week with internationals buying the longer end of the curve. The 1Y FX swap is now trading at 25 points mid, 2 points higher on the week, reversing some of last week’s move lower. The 2Y FX swap was 20 points higher at 110, while the 3Y FX swap remained unchanged at 285 points mid. SAR FX spot is currently trading at 3.7507 mid, 6.5 pips higher on the week on the back of international banks buying USD following a $300m ATM 1Y SAR call option that crossed the market.
AED	The AED FX curve was unchanged on the week. The 1 year FX swap at 28 and 2y at 75 points mid. AED FX spot is currently trading at 3.6730 mid, unchanged on the week.

GCC FX Commentary	
KWD	The KWD FX curve moved higher in tenors up to 1Y, regaining some of the move lower last week. The 1Y FX swap is now at -230 mid, 20 points higher on the week, while shorter tenors (1 month - 6 months) moved 5 points higher as liquidity tightened further.1, 2 and 3 month FX swaps are trading at -24, -42 and -65 mid, respectively. KWD FX spot is currently trading at 0.30363 mid, 25 pips higher on the week following a 75 pip move higher the week before as the market digested the rate decision.
OMR	The Omani FX curve moved higher as some internationals showed interest to take the 1Y OMR FX swap following a sharp sell-off in the prior week. The curve moved marginally higher this week with the 1Y FX swap at 290 mid, 10 points higher. Liquidity has been relatively tight in the short dates, causing the shorter end of the curve to move to the right, with the 1,2 and 3-month FX swaps at 20, 40 and 55 mid, respectively. OMR FX spot is trading at 0.38500 mid, 1 pip higher on the week.
BHD	The Bahraini FX swaps curve remained offered following the official announcement of a $10bn 5-year aid package from UAE, Saudi Arabia and Kuwait to help finance a range of domestic reforms and cost-cutting measures that are aimed at balancing the Bahraini budget by 2022. The 1Y FX swap is now at 150 mid, unchanged on the week following a 40 point move lower in the prior week on speculation of an imminent deal. USD/BHD spot is trading at 0.37699 mid, 3 pips lower on the week. Liquidity returned this week following three T-bill issuances in the prior week which temporarily drained liquidity from the market. The most recent 3-month BHD T-bill issuance yielded investors 4.18%, up 1 basis point from the previous auction. The coverage was the highest it has been in 6 months at 130% vs. 110% in the prior week. The 6-month and 12-month issuances yielded 4.37% and 4.81%, respectively.

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