

MACRO MARKETS DAILY

Economic data today

- **Spain June Registered Unemployment Change** (exp. -114.9k, last -111.9k). According to our estimates, the already released April and May figures on registered unemployment and Social Security affiliations point to very encouraging readings for the labour force (EPA) in 2Q17E. We forecast employment growing by 2.6% YoY (from 2.3% YoY in 1Q17) and unemployment decreasing by 12.9% YoY (from -11.2% YoY). This could result in the unemployment rate falling to 17.5% in 2Q17E, from 18.8% in 1Q17. All in all, we estimate that the economy is going to be able to maintain employment growth at slightly above 2.5% YoY in the next two years, clearly supporting households' gross disposable income and consumption, and we see the latter expanding by 2.5% in 2017E and 2.8% in 2018E.
- **Euro zone May PPI** (exp. -0.2% MoM and 3.5% YoY, last 0.0% MoM and 4.3% YoY). The energy component could be neutral for total prices sooner than expected, due to the fall in commodity prices in euros.
- **UK June Construction PMI** (fcst. 55.2, last 56.0). A slight climb-down from May's 17-month high is likely, but a pick-up in last week's EC confidence survey suggests a chance of further improvement. That would come as a relief after yesterday's weak UK Manufacturing PMI, but the focus will be on tomorrow's Services number, which recorded its lowest headline for four years in the EC equivalent.
- **BoE FPC meeting record:** Last week's Financial Stability Report contained no real surprises and was followed by (refreshingly) uninteresting comments from the BoE Governor, but it is possible that the Committee's discussions touched on more controversial subjects.
- **Central bank speakers:** The ECB's Praet and Nowotny.

Rates Strategy

- **EUR rates** put in a relatively mixed performance in a very quiet session yesterday (10y Bund +1bp to 0.474%), with 2y German yields heading towards the -0.60% mark (-1.2bp to -0.602%) as the market exercised some caution ahead of the publication of both the FOMC Minutes (on Wednesday) and the ECB accounts (on Thursday) from their last monetary policy meetings, and the very important June US labor figures at the end of this week. Periphery risk premia tightened in most tenors versus German bonds. In the 10y sector, Italy's and Spain's tightened by 3bp to 165bp and 2bp to 102bp, respectively, while Portugal outperformed its peers (in all tenors), tightening more than 5bp to 248bp (its lowest level since January 2016), all versus 10y Bunds at the close.
- **Today**, the US market will be closed for Independence Day, but, in Europe, the attention will be concentrated on ECB representatives Praet and Nowotny along with the ECB's QE purchasing data, which are being released a day later than usual. In **supply**, the Euro area bond-auction week begins today, with **Austria** reopening its 10- and 30-year RAGBs (0.5% Apr'27 and 1.5% Feb'47, respectively) for €1.3bn, while **Germany** will tap a 15y linker (0.5% Apr'30) for €0.5bn. In the short-dated Eurozone debt market, **Belgium** (up to €1.8bn of 98d and 161d bills) and **the ESM** (up to €1.5bn of 91d bills) will be selling bills.

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- **UK rates:** The UK was a notable outlier in yesterday's otherwise very strong round of manufacturing surveys, which helped GBP rates post a second day of (slight) cross-market outperformance. This was mostly in swaps rather than gilts, which still did well, ending the day barely changed versus a sell-off of up to 8bp in USTs after the blockbuster ISM release. This tightened gilt spreads across the curve, with a steepening flavour: short gilts rallied a touch on the weak UK PMI, whereas ultra-longs gave up 1bp as the linker syndication approaches (vs. just 0.3bp in the 30y). Conviction and volumes seemed low, which will likely be exacerbated by the US's Independence Day holiday today. The next serious move is likely to have to wait for the UK's Services PMI and IP data or, probably most importantly, US NFP.
- **UK inflation:** Breakevens continued to march higher, seemingly regardless of rate directionality, helped by the oil price's own daily recovery (Brent crude is fast closing back in on \$50/bbl). 10y was particularly strong, pushing our buy-UKTI 26s recommendation to its 300bp target, but we would hold out for a little more while oil keeps its momentum and the currency gives back some of its recent sharp gains. The ultras were little changed in real yield which represented a good day relative to (soft) nominals, and 30y was the softest spot on the BE curve. The syndication bond, IL56s, remains pretty much stuck at 2bp over the IL58s, but should give up some ground over the next week.

FX Strategy

- The US is on holiday today, which suggests that trading volumes will be lower and currencies may struggle to find new direction. Consequently, the Dollar may be able to hold on to much of yesterday's gains.
- That USD strength has pulled **EUR/USD** below 1.14, with a sparse European data calendar offering the EUR little obvious support today. For the Pound, If yesterday's much weaker-than-expected UK manufacturing PMI (54.3 versus 56.3 in May and the 56.3 expected) is repeated for the construction PMI, the Pound should slump further this morning.
- The UK's construction PMI is expected to dip to 55 in June, from 56 in May. If correct, the headline index would still be firm, but after yesterday's drop in manufacturing sentiment, any decline may weigh disproportionately on the Pound.
- **GBP/USD** may continue to hover around the 1.3000 level over the coming weeks, but yesterday's move lower –admittedly helped by a stronger USD rather than an underperforming Pound– indicates that the 18 May high at 1.3048 should offer very tough resistance.
- The firmer USD has taken some of the wind out of the CAD's sails. However, with the Bank of Canada turning more hawkish, admitting that the economic outlook has improved, the Canadian Manufacturing PMI could garner more attention than it usually does.
- The market is already pricing in over an 80% chance of a rate hike at the next BoC meeting on 12 July, and a strong PMI could cement that view and strengthen the Loonie. Either way, a rate hike by the end of the year appears likely.
- As we highlighted in "[CAD to gain as monetary policy convergence gains slow for EUR and GBP](#)", the combination of possible BoC rate hikes, the on-going reversal of CAD short positions and the forecast rise in the oil price by the end of the year imply ample scope for the currency to appreciate. Hence, we recommended selling **USD/CAD** at 1.2970, targeting a move to 1.2500 (our end-Q3-17 forecast), with a stop at 1.3200
- **AUD/USD** weakened after the RBA kept rates unchanged at 1.5%. However, despite weak growth in Q1-17, the RBA expects the economy to gradually recover. We believe that the Bank will maintain a neutral view throughout the summer. Hence, we reiterate our market recommendation from yesterday and continue to favour the downside in AUD/USD, selling at 0.766, with a target at 0.733 and stop loss at 0.783.
- Today's Central bank focus will be on the Riksbank meeting. We expect the Bank to keep rates on hold, at -0.5%. An improving domestic economy should be putting pressure on the Riksbank to tighten, or at least, to stop loosening monetary policy. However, Governor Ingves continues to highlight that the "repo rate cannot differ too much from rates abroad". While this may mean the Bank resists turning too bullish just yet, we expect a gradually more upbeat Riksbank in the coming quarters, which should support the SEK. Hence, we continue to foresee EUR/SEK falling to 9.5 by year-end.

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