20 June 2017, 08:25 CET

MACRO MARKETS DAILY

Economic data today

- **Spain April Trade Balance** (last €-1.458bn). The strong activity data in the manufacturing sector and sound domestic demand point to a widening of the trade deficit in the coming months, mainly because of the increase in imports. The base effect of energy prices should help to moderate this negative impact of imports on the trade balance.
- **US 1Q17 Current Account Balance** (exp. US$-123.6bn, last US$ -112.4bn).
- **Central bank speakers:** The Fed's Fischer, Rosengren and Kaplan. The BoE's Governor Carney will deliver his postponed Mansion House speech this morning (09:30 CET).

Rates Strategy

- **EUR rates:** Yesterday's was a risk-on session in European markets due mainly to the outcome of the French parliamentary elections (Macron's *La République en Marche* party won an absolute parliamentary majority in Sunday's second round of votes), with no other relevant macroeconomic figures or events to discount. Core govies widened in most short-to-medium term tenors yesterday, with the 10y Bund yield edging back up to near the 0.3% level during the day (closing almost flat at around 0.28%) in a slight flattening move (2s30s -2bp). EUR swap rates followed suit, with yields rising up to the 10y part of the curve. Periphery paper outperformed core and semi-core bonds during the session, with Portugal performing particularly well as the 10y PGB succeeded in tightening in to below the 2.85% level (-5bp to 2.83%), while the Italian 10y yield dropped below the 1.95% mark (-4bp to 1.94%), with their spreads vs. Germany tightening by around 5bp to 255bp and 4bp to 166bp, respectively (10y SPGB -1bp to 1.43%).
- **Today**, with no significant macroeconomic figures to follow, markets will be focusing on central bank speakers, including the BoE's Carney and several Fed representatives, making their first appearance this week, after their key FOMC and BoE meetings last week.
- **ECB Buying:** Please see below for the latest details on the EAPP program.
- **Debt Supply:** Today, in the short-dated paper market, **Spain** will be selling 84d and 259d bills for up to €4bn, and the **ESM** is selling up to €1.5bn of 182d bills. Across the Atlantic, **the US Treasury** will test the short-dated market again, selling $35bn of 4-week bills and another $20bn of 52-week bills.
- **UK rates:** Yesterday's most notable market move was the strip's 3bp sell-off at the open, based on a Sunday Times report that the Term Funding Scheme (TFS) might be terminated early. We find this unlikely, and doubt that the MPC (let alone the FPC) will be inclined to pre-emptively decide the end date of the programme, which does not appear to be having any particularly ill effects. The article suggested that ending the programme is a necessary prerequisite to raising Bank Rate, which is clearly incorrect

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when three MPC members voted for a hike last week and saw no need to refer to the TFS. Carney's speech this morning is unlikely to touch on this rumour, but should provide some much-needed explanation after the shock of Thursday's 5-3 MPC vote. The press conference at the end of the first day of Brexit negotiations brought warm words but little news. There was no sign of indecision on leaving the single market and customs union on the part of the UK's Secretary of State for Brexit, David Davis.

- Further out, UK rates flattened and gilts outperformed swaps as investors appeared ready to start buying again after the recent news turmoil. 12y was the pivot point, with 10y yields up nearly 1.5bp but still outperforming USTs by 2bp. The 47s' ASW is now barely 2.5bp off its all-time widest, and some concession seems likely before Thursday's auction.
- **UK inflation:** Linkers followed the flattening profile of nominals, but outperformed ~2bp across the curve. Leading(and departing) MPC hawk Kristin Forbes was interviewed by Bloomberg, and repeated her view that the "increase in headline inflation isn't just a temporary effect of the exchange rate that's going to go away […] If you wait for wage growth to pick up, you've waited too long, given the other inflationary pressures in the economy". The widening of breakevens had already taken place, but her opinions may have helped reassure inflation buyers that there is some upside potential. Long linkers still look cheap on regressions vs. nominals, although we believe that the weakness of domestically-generated inflation may continue to weigh on sentiment around inflation beyond the currency-driven spike in the short run.
- **Gilt spreads in focus:** We published an article yesterday discussing the factors we see as potentially driving the gilt spread curve. We see the recent balance of these influences as likely to remain similar for now, continuing the recent trends for tighter front-end gilt spreads and stronger support further out. Reviewing recent performances across the gilt spread curve, we highlighted specific issues as attractive (23s, 30s, 32s, 52s) or rich (27s, 65s, 68s) vs. swaps.

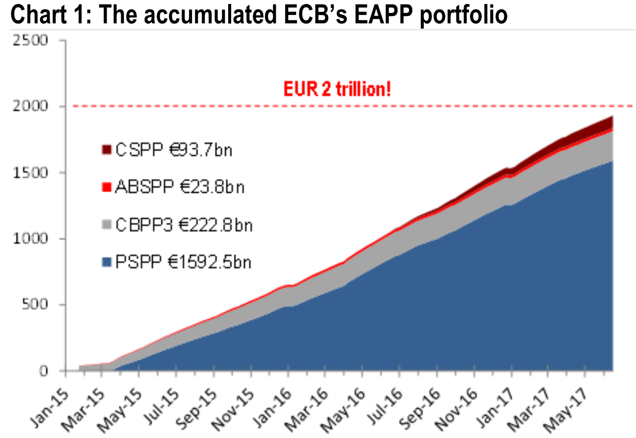
FX Strategy

- The USD has held on to most of Monday's gains, albeit with the **USD index** softening slightly in Asian trading. The USD had strengthened on hawkish comments from the Fed's Dudley, as he expressed confidence that the US recovery was set to continue.
- However, the currency slipped slightly with FOMC member Evans suggesting that the next rate hike could be delayed until December, although he was also upbeat about the US economic outlook and indicated that it supported gradual rate hikes.
- The combination of a firm USD and stronger Asian equities has pushed **USD/JPY** to test resistance at its 100-day moving average of 111.85, with support seen at 111.00.
- **GBP/USD** has held below 1.2750, but the pair continues to trade in the range established by its 50- and 100-day moving averages, at 1.2846 and 1.2631, respectively. The UK focus this morning will be on the delayed Mansion House speeches, with the market searching for any clues from policymakers as to both the outlook for interest rates and Brexit.
- The **EUR/USD** uptrend, which started in mid-April, appears to have petered out in June. The pair, helped by a 'dovish' ECB stance at its June meeting, had been unable to pull away from the 1.1200 level. Now, a stronger dollar implies 1.1200 is looking more like a resistance level, rather than a support. Further weakness, below the 15 June low of 1.1132 and then 30 May low of 1.1110 may encourage the market to unwind the recently added long EUR/USD positions.

Update on the ECB's EAPP

Yesterday, the ECB published an update of its Extended Asset Purchase Program holdings, which includes the purchases settled as at 16 June for all the ECB's purchase programmes (PSPP, CBPP3, ABSPP and CSPP). According to the overall figures, ECB asset purchases picked up pace compared to last week's report (€15.3bn vs. €14.6bn the previous week), with increases across all ECB programmes, and approaching the €2trn mark.

Chart 1: The accumulated ECB's EAPP portfolio



Source: ECB, Bloomberg, Santander

The **PSPP holdings** now stand at €1,593bn, an increase of €12.6bn on the previous week (last week's rise was €11.9bn). Looking at the five working-day average, the pace of daily purchases of sovereign bonds increased last week, to €2.51bn per day under the PSPP, which, while less than the accumulated daily average of €2.81bn since the programme got underway back in March 2015, exceeds the previous week's €2.39bn five-day average. The ECB's **CBPP3 holdings** now amount to €222.8bn, a €1.1bn increase, but short of the €1.2bn growth reported last week. The daily purchasing average under the CBPP3 fell to €219mn (from the €241mn reported last week). The **CSPP** shows holdings of €93.7bn, an increase of €1.6bn from the €1.4bn growth seen in last week's ECB report. The five working-day average shows that the ECB bought €318mn per day of corporate bonds (vs. the €284mn average posted last week). And the **ABSPP holdings** have reached €23.8bn, just €89mn higher (and slightly more than the €36mn increase reported last week). Here the daily average climbed to €18mn from €7mn last week.

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Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (decline in the yield rate), assuming a directional risk.	**Long / Receive fixed rate**	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
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Long a spread / Play steepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return of at least 5bp in 3 months (increase in the spread between both rates).
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