

FINANCIAL MARKETS TODAY



European edition
Friday 5 January 2018

INSIDE TODAY'S EDITION:

- **NEWS & RUMOURS**

Australia recorded a trade deficit of -AUD628mln in November, worse than the market expectations of an AUD800mln surplus.

- **FOREX MARKET STRATEGY**

The USD turned lower again on Thursday, but the currency should benefit from a good US employment report on Friday. (Please see below for our updated FX strategy.)

- **BOND MARKET STRATEGY**

Treasuries found downward pressure across the curve on Thursday, pushing to session lows in the wake of stronger the expected ADP employment data for December.

- **UK: PMI, HOUSING DATA SUGGEST STEADY, MODERATE GROWTH**

The UK's latest data releases didn't provide much in the way of surprises but should alleviate concerns about a Brexit-induced weakening of the economy.

- **US PREVIEWS: EMPLOYMENT REPORT, TRADE BALANCE & MORE ON TAP**

The December Labor Department employment situation report will be released on Friday, 5 January at 08:30EST (13:30GMT). Overall, we expect non-farm payrolls will increase +180k in December.

- **FX TECH FOCUS: USD/JPY & USD/CAD**

-- USD/JPY: Price action holding in the upper half of the 108.00 and 114.35 range

-- USD/CAD: Sharp sell down through 1.2660/1.2600 towards key swing low at 1.2460

DAILY ECONOMIC DIARY

DD/MM	GMT	R*	CTRY	DATA RELEASE	FOR	ACTUAL	IDEA	MEDIAN	LAST
05/01	07:00	3	DE	RETAIL SLS M/M	NOV		1.2	1.0	-1.0%
05/01	07:00	3	DE	RETAIL SALES Y/Y	NOV		N/A	2.4	-1.4%
05/01	07:45	4	FR	CONS CONF	DEC		102	103	102
05/01	07:45	3	FR	HICP M/M P	DEC		0.2	0.4	0.1%
05/01	07:45	3	FR	HICP Y/Y P	DEC		1.1	1.3	1.2%
05/01	09:10		EU	RETAIL PMI	DEC		N.A	N.A	52.4
05/01	10:00	4	EU	CPI Y/Y (P)	DEC		1.4	1.4	1.5%
05/01	10:00	3	EU	CPI-CORE Y/Y (P)	DEC		1.1	1.0	1.1%
05/01	10:00	3	EU	PPI M/M	NOV		0.5	0.3	0.4%
05/01	10:00	2	EU	PPI Y/Y	NOV		2.8	2.5	2.5%
05/01	13:30	5	US	NONFARM PAYROLLS	DEC		180	190	228K
05/01	13:30	1	US	PRIVATE PAYROLLS	DEC		175	185	221K
05/01	13:30	3	US	MANUF. PAYROLLS	DEC		15	20	31K
05/01	13:30	5	US	UNEMPLOY RATE	DEC		4.1	4.1	4.1%
05/01	13:30	1	US	AVG HRLY EARNING	DEC		0.2	0.3	0.2%
05/01	13:30	1	US	AVG WEEKLY HOURS	DEC		34.5	34.5	34.5
05/01	13:30	4	US	TRADE BALANCE	NOV		-48.0	-48.1	-\$48.7B

05/01	13:30	2	CA	INT'L MERCH TRADE	NOV	-1.20	-1.25	-C\$1.47B
05/01	13:30	4	CA	NET EMPLOY	DEC	-5.0	-2.5	79.5K
05/01	13:30	4	CA	UNEMPLOY RATE	DEC	6.0	6.0	5.9%
05/01	15:00	3	US	ISM NON-MANF.	DEC	57.0	57.6	57.4
05/01	15:00	4	US	FACTORY ORDERS	NOV	1.0	1.4	-0.1%
05/01	15:00	1	CA	IVEY PMI	DEC	58.0	N/A	63.8
*R=Market Significance rating, on scale 0-5						Source: Reuters/Bloomberg		

DD/MM	GMT	CTRY	EVENT					

05/01		UK	BOE MPC'S HALDANE SPEAKS					
05/01	00:01	UK	BRC SHOP PRICE INDEX PUBLISHED, DEC					
05/01	09:30	UK	ONS PUBLISHES PRODUCTIVITY & UNIT LABOUR COSTS DATA, Q3					
05/01	15:15	US	PHILADELPHIA FED PRESIDENT HARKER SPEAKS					
05/01	17:30	US	CLEVELAND FED PRESIDENT MESTER SPEAKS					
06/01		UK	BOE MPC'S HALDANE SPEAKS					

NEWS & RUMOURS

China's central bank did not conduct open market operations for tenth day, saying that banking liquidity is at a relatively high level, offsetting the impact of required reserves payments.

UK BRC Shop Price Index for December declined -0.6% y/y, fall at fastest rate since March, down further from prior -0.1% seen in November. Meanwhile, the GBP/USD traded flat at 1.3556 by 02:00GMT.

Japan Finance Minister Aso said that the sales tax needs to be raised for fiscal consolidation. However, if the economy is not strong enough, the hike cannot proceed further.

Japan Nikkei December Services PMI fell to 51.1, down from 51.2 seen in November. On the other hand, composite PMI remained flat at 52.2 in December. Anything above 50-mark indicates growth. Meanwhile, the USD/JPY traded nearly flat at 112.81 by 02:30GMT.

Japan's December monetary base rose 11.2% y/y, down from prior 13.2% y/y.

Australia recorded a trade deficit of -AUD628mln in November, worse than the market expectations of an AUD800mln surplus, revised down from October's narrow AUD105mln surplus to AUD302mln deficit. Exports were largely unchanged on a seasonally adjusted basis, while imports rose 1%. Following this release, the AUD/USD fell 0.20% to 0.7849 by 02:20GMT.

-- Recap from yesterday's European session --

The ADP employment estimate came in at 250k for December, versus the revised 185k increase seen in November (prev. 190k), above market expectations for a +190k result. IDEA: despite the stronger result seen here, we anticipate a milder 180k increase in December non-farm payrolls on Friday, coupled with a 4.1% headline unemployment rate.

US Initial jobless claims for the week ending 30 December increased +3k to 250k, versus the revised 247k reading seen in the week prior (prev. 245k), above expectations for a 240k result. The 4-week average was reported at 241.8k, up from the revised 238.3k reading seen in the week prior (prev. 237.8k). Meanwhile, continuing claims for week ending 23 December decreased to 1.914mln, versus the 1.951mln reading seen prior.

The final Markit US Service PMI measure decreased to 53.7 for December (preliminary: 52.4), versus the 54.5 result seen for November. Meanwhile, the final Markit US Composite PMI measure decreased to 54.1 in December, versus the 54.5 reading seen for November.

According to Challenger, Gray & Christmas, planned US job cuts decreased -7.6% to 32,423 in December, versus November (down from 35,038). Compared to December 2016, the number of planned cuts decreased -3.6% (down from 33,627). IDEA: the Challenger survey represents planned intentions, which do not always materialize in actual cuts.

The Bloomberg US consumer comfort index decreased to 51.8 for the week ending 31 December, versus the 52.4 reading seen the week prior. IDEA: despite the weaker readings seen in recent weeks, the series continues to hold relatively steady compared to other sentiment measures.

The weekly EIA natural gas storage update revealed an overall decrease of -206bcf (to 3,126bcf) for the week ending 29 December, versus the -112bcf draw seen the week prior.

According to the US DOE, crude inventories decreased -7.4mln bbls (vs a draw of -4.6mln bbls seen prior) for the week ending 29 December. This came alongside an increase in gasoline inventories of +4.8mln bbls (vs a build of +0.6mln bbls seen prior) and an increase in distillate inventories of +8.9mln bbls (vs a build of +1.1mln bbls seen prior).

The Canada producer prices report revealed an overall increase in IPPI of +1.4% m/m for November, versus the revised +1.1% m/m increase seen in October (prev. +1.0% m/m. Meanwhile, the RMPI measure increased +5.5% m/m in November, versus the +3.8% m/m reading seen in October. According to the release, the RMPI measure increase was primarily due to higher prices for crude energy products.

JP Morgan's Global Composite PMI for Dec rose to 54.4 from an upwardly-revised 54.1. This is the highest since March 2015. IDEA: As such, it chimes with the synchronised upswing that currently characterises the global economy.

Following the FOMC minutes, **the probability of a March rate hike by the Fed rose to 67.5%**, up from 50% a week ago, according to Fed Funds futures as calculated by the CME. [IDEA: We expect hikes in March and June, with at least one coming in H2-18.] The 2yr T-note yield has also risen to a new 9-yr high of over 1.95%, though the 10yr is still below its December high of 2.50%. IDEA: We expect the latter level to be tested and broken soon, although Friday's US employment report will be important in this regard..

UK mortgage approvals for Nov rose to 65.1k from an upwardly revised 64.9k, vs expectations of a decline to 64.0k. [IDEA: While not a big change, this release - along with the Nationwide house price report earlier - will tend to alleviate pessimism about the country's property market - which is GBP+ve. Note that the improvement comes despite the BoE having raise rates in the same month.] Also released by the BoE, Net Consumer Credit remained steady vs a downwardly revised GBP1.4bn, vs expectations of 1.5bn.

The UK services PMI reading for December came in higher at 54.2, vs an expected 53.8 seen in November. HIS Markit says the December PMI readings point to UK Q4 GDP growth of 0.4-0.5% q/q vs 0.4% in Q3. GBP was little changed following the release with cable around 1.3540 and EUR/GBP at 0.8885.

The UK Composite PMI for Dec of 54.9 is 0.1pt higher vs the downwardly-revised reading for the previous month, while matching the original release. IDEA: By remaining moderately in expansionary territory and within the middle of its tight 2017 range of 53.7-56.2 it suggests steady, reasonable growth ahead.

Eurozone final December services PMI came in higher at 56.6, vs an expected 56.5 and up from 56.2 in November. Meanwhile the composite PMI reading was also higher at 58.1, vs an expected 58.0 and up

from 57.5 in November. The service reading is the highest since April 2011 and the composite reading the highest since February 2011.

Italy's Services PMI for Dec unexpectedly improved to 55.4 from 54.7, taking the country's Composite index up half a point to 56.5, the highest since April.

In a **joint statement between German Chancellor Merkel's CDU/CSU and the Social Democratic Party** following a meeting on Weds, the two parties said they were optimistic about forming another coalition government.

Swedish services PMI came in at 64.6pts in December, up sharply from 61.9 in November. SEK is firmer overall with EUR/SEK down around 9.8125 from earlier levels near 9.8300.

According to the latest house price survey from the Nationwide Building Society, **UK house prices rose by 0.6% m/m**, 2.6% y/y in December, vs market expectations for 0.2% and 2.0% respectively.

FOREX MARKET STRATEGY

The USD turned lower again on Thursday, despite more unexpectedly-strong US data in the form of the ADP – which bodes well for Friday's NFP. This price action reflects overwhelmingly-bearish sentiment on the greenback, along with surging global risk appetite. We (in the minority) expect this to be overwhelmed by more aggressive-than-expected US interest rate increases this year. A strong employment report (with a particular eye on average earnings) should see the **DX** bounce back to this week's high of about 92.25, towards 92.50. Otherwise, the index would face its recent low of about 91.80, ahead of support at 91.50 and 91.00. In any case, post-payrolls direction will be informative.

EUR/USD should meanwhile trade between the 1.2000 mark that it has touched in recent days, and 1.2090, which it has also tested and approximately represents its 2017 high. On Friday, the preliminary Eurozone inflation rate for December is expected to have dipped to 1.4% y/y; but the significance is muted by the fact that the ECB's policy course is set for the first three-quarters of this year.

USD/JPY has diverged by climbing above 112.75 for the first time in one week as the pair was bolstered by dovish remarks from BoJ Gov Kuroda, along with higher US yields, particularly at the short end. This pair could go on up to 113.00, whereas otherwise 112.50 would provide support.

GBP/USD firmed into the middle of this week's range of roughly 1.3500-1.3600, modestly buoyed by slightly better-than-expected UK data on Thursday in the form of the services PMI, house prices and mortgage approvals.

Even as oil prices surged (taking WTI over \$62 for the first time since 2015) along with conflict in Iran, decreasing US inventories and heightened heating oil demand, **USD/CAD** has remained in this week's tight range of about 1.2500-1.2550, though with risks on the downside. Note that Canada releases its own employment report on Friday too. **AUD/USD**, though has been edging above its recent range of 0.7800-0.7850, next facing its October highs of nearly 0.7900.

BOND MARKET STRATEGY

US: Treasuries found downward pressure across the curve on Thursday, pushing to session lows in the wake of stronger the expected ADP employment data for December (increasing 250k in December, up from 190k in November). Despite the lackluster correlation between the ADP estimate and non-farm payrolls, further improvement on this front at least suggest further

improvement in employment conditions overall. All of this plays provides further support for additional policy tightening in the quarters ahead. As mentioned previously, continued support for higher rates clearly keeps the Treasuries on their collective heels, though there remain plenty of potential potholes with respect to data that could limit the Fed's desire to deliver another 75bps in 2018 (i.e.- further weakening in inflation). Markets now await a greater flow of data to finish off the week on Friday, highlighted by employment situation, trade balance, ISM non-manufacturing and factory orders releases.

EUROPE: Bunds, like Treasuries, appear to be on course for higher yields, with the US 10yr heading towards 2.50% while its German counterpart faces 0.50% (its approximate highs for September-October, having come within 3bps of that level so far this week). These levels could be tested on Friday assuming a strong US employment report. In any case, progressive interest rate hikes from the Fed (next in March), along with higher US inflation prospects, will continue to put upward pressure on short-end Treasuries (with the 2yr heading towards 2%), with inevitable spill-over to the longer end and global bond markets. Coming out earlier on Friday will be the preliminary Eurozone inflation rate for December, which is expected to have dipped to 1.4% y/y. In any case, monetary policy implications are minimal at this stage, with the ECB not set to make its next decision (on QE) until mid-year.

UK: PMI, HOUSING DATA SUGGEST STEADY, MODERATE GROWTH

The UK's latest data releases didn't provide much in the way of surprises but should alleviate concerns about a Brexit-induced weakening of the economy.

The UK Services PMI reading for December came in slightly above expectations at 54.2, up from 53.8 in the previous month. **The UK Composite PMI** (accounting for the drop in the reading for the smaller manufacturing sector to 56.3 reported on Tuesday) **of 54.9 is 0.1pt higher** vs the downwardly-revised reading for the previous month, while matching the original release. By remaining moderately in expansionary (i.e. 50+) territory and within the middle of its tight 2017 range of 53.7-56.2, it suggests steady, reasonable growth ahead. The survey provider, IHS Markit, said the readings in fact point to Q4 GDP growth of 0.4-0.5% q/q vs 0.4% in Q3.

Also published on Thursday, **the December UK house price survey from the Nationwide Building Society showed a rise of 0.6% m/m, 2.6% y/y.** This was well above expectations and up from 0.1% m/m, 2.5% for November. The annual rise was still the weakest since 2012 and in London prices fell by 0.5% for the first time in a full year since 2009. For what it's worth, the Nationwide expects house price growth in 2018 to slow further to just 1%. That isn't unreasonable as the effect of tax disincentives to buy-to-let investors, slightly higher mortgage rates (following the BoE's first rate hike in November), greater supply, and (last but definitely not least) Brexit worries take their toll.

Also, the BoE reported that **mortgage approvals for November rose slightly to 65.1k** from an upwardly-revised 64.9k the previous month, vs expectations of a decline to 64.0k. This happens to be close to its 5-year average pace. These more forward-looking data will also help alleviate pessimism about the country's property market.

So while Brexit uncertainty – as well as the likelihood of the UK leaving the single European market sometime in the future – will weigh on the economy to some extent, the negative effect should be mitigated by improving global activity as well as the still-relatively weak GBP. Most important, negotiations with Brussels on the UK's departure from the EU are progressing and will deliver a 'stand-still' transition agreement in the coming months, we expect.

That should bolster confidence – and allow the BoE to resume raising rates. We in fact predict two more such moves this year, the next coming as soon as May. **This will in turn prompt**

further **GBP outperformance and see Gilts underperform**. We see Cable rising to at least 1.40 this year while (assuming a declining EUR/USD) EUR/GBP drops towards 0.82.

US PREVIEWS: EMPLOYMENT REPORT, TRADE BALANCE & MORE ON TAP

Employment Situation: The December Labor Department employment situation report will be released on Friday, 5 January at 08:30EST (13:30GMT). Overall, we expect non-farm payrolls will increase +180k in December (market expectations are for a +189k increase), versus the +228k reading seen in November. This should come alongside no change in the unemployment rate of 4.1% (market expectations are for a 4.1% result). Greater focus will likely be paid to gains in total private employment which we expect will increase around +175k. Beyond the headline, we expect average hourly earnings will increase +0.2% m/m, alongside no change in weekly hours of 34.5. On balance, despite the volatility seen in recent months, we anticipate continued improvement taking hold in the coming months as conditions gradually improve. Given the greater focus on what the Fed is likely to do next, we anticipate the December employment report will be sufficiently strong enough to justify additional moves higher (reaffirming long-established market expectations).

December non-farm payrolls look to continue along an expansionary course, something that could be improved by revisions to the November estimate (possibly also for October), further undoing some of the weakness related to hurricane activity in recent months. On balance, we expect solid improvement in services to accommodate further gains. With respect to the headline, we anticipate net gains in payrolls of 180k in December, following the +228k result seen in November, alongside no change in the headline unemployment measure of 4.1%. As conditions improve, we expect to see some further downward pressure in the unemployment rate, possibly offset by people re-entering the workforce (making it more sticky), though we anticipate broader improvement in the quarters ahead.

Trade Balance: The November Commerce Department trade balance report will be released Friday, 5 January at 08:30EST (13:30GMT). We anticipate the trade deficit will show overall widening to around -\$48.0bln in November versus -\$48.7bln reading seen in October. Weaker global demand (dampening exports) will likely be outpaced weaker performance from imports in November, leading to an overall decrease in the US trade deficit. Moving forward, fear of potential weakness in growth for key trading partners should weigh on foreign demand. Meanwhile, improved demand out of the US will likely continue to bolster imports measures. Anticipating this will be partly on hold in the November reading, we expect an overall trade deficit narrowing to around -\$48.0bln.

The export component of the November ISM manufacturing survey decreased to 56.0 (from 56.5). Meanwhile, the imports measure increased to 54.5 (from 54.0). Overall, the mixed support in the readings seen in manufacturing exports reported by the ISM in recent months is congruent with performance seen elsewhere. Looking at the ISM non-manufacturing release, the export component decreased to 57.0 in November (from 60.0). Meanwhile, imports increased at 52.5 in November (from 52.0). On balance, we put greater emphasis on the manufacturing survey as the exchange of goods represents about 77 percent of US trade activity, versus 33 percent represented as trade in services, placing forecast risks to the downside. All things considered we anticipate some downward in the US trade deficit, leading to a shortfall of around -\$48.0bln.

ISM Non-Manufacturing: The December Institute for Supply Management non-manufacturing report will be released on Friday, 5 January at 10:00EST (15:00GMT). We expect the headline

measure will show modest downward pressure in December to around 57.0, versus the 57.4 reading that occurred in November. As seen previously, weak inflation adjusted consumption levels decreased the real purchasing power of individuals to the extent that markets observed clear signs of slowing in relatively stable areas of the economy, particularly the service sector. Anticipating some pullback from the mixed reading seen in recent months, we expect a modest decrease will be on display in the December release, yielding a 57.0 result.

Looking back at the November release, business activity decreased in November to 61.4 (from 62.2). Meanwhile, prices paid decreased to 60.7 in November, from 62.7 in October. Overall, downward pressure was seen from new orders (58.7, from 62.8), employment (55.3, from 57.5), inventory sentiment to 56.0 (from 61.0) and exports to 57.0 (from 60.0) and supplier deliveries to 54.0 (from 58.0), partially offset by an increase seen in imports to 52.5 (from 52.0). Alongside the weaker headline result, most underlying components show dampened support for gains moving forward, though remaining broadly supportive of our view of gradually improved growth in the quarters ahead.

Factory Orders: The November Commerce Department factory orders report will be released on Friday, 5 January at 10:00EST (15:00GMT). We expect an overall increase in factory orders of +1.0% m/m in November. Mirroring the results seen in durable goods orders data, factory orders should reflect near-term improvement for the industrial sector, supporting our call for a +1.0% m/m increase for November, with some risks to the upside.

Looking back at the October numbers, alongside the weaker headline reading, mixed pressure has been seen across a number of series thus far in 4Q17, something we expect will gradually improve in the months to come. Despite the overall decrease seen in orders, shipments increased +0.6% m/m in October, versus the +1.1% m/m reading seen in September. Meanwhile, inventories increased +0.2% m/m, following the +0.6% m/m reading seen in September, leading to no change in the inventory/shipments ratio of 1.37 months.

The -4.2% m/m reading seen in transportation equipment orders provided some downward momentum for the overall measure, alongside mixed readings seen elsewhere. Moving forward, the ongoing concern remains the status of inventory levels amid improvement in consumer demand. However, we do not expect to see any consistent improvement in manufacturing until the auto sector completely rights the ship and the inventory correction spurs activity, something that appears to be increasingly underway.

FX TECH FOCUS: USD/JPY & USD/CAD

USD/JPY [Bullish congestion +20%] Price action is holding in the upper half of the well established sideways range between 108.00 and 114.35. This has been in place for most of last year and showing no signs yet of breaking out. The weak attempt to trade back to the 114.35 high into the end of last year was quickly neutralized and seeing the start of the year with the price action showing little activity in either direction. Watch pivotal support at 111.00 on further draw down, below which would see a drift back towards the 110.00 and 108.00 area. Really need to see a break out from the range for a more sustained to develop.



USD/CAD [Bearish turn -30%] The failure to clear the 1.2915 resist top in Dec has led to a sharp sell down through initial supports at 1.2660/1.2600 and focus now on a test of key swing low at 1.2460. Any break clear below this area, including the brief low of 1.2410 in Jul, will turn the bias towards a renewed bearish push towards the major swing low in Oct at 1.2060. Intermediate support at 1.2200. Pivotal resist now at 1.2660 and above would limit the bearish appetite with further levels then at 1.2760 through to the now major topside level at 1.2915.



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