



AFS Insights

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Headline Sweep

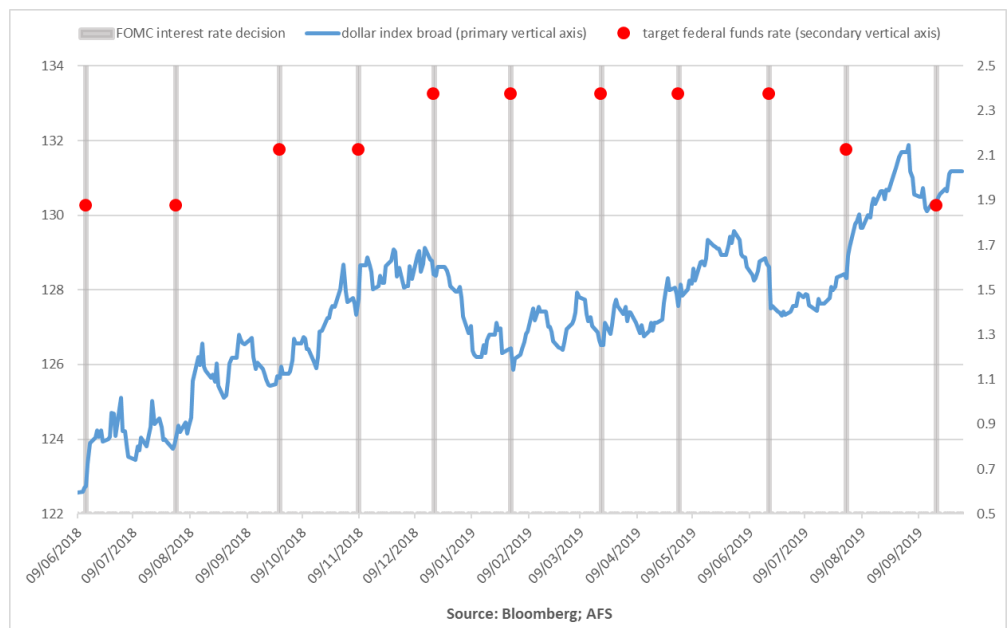
- IMF's Lipton Sees Sharper World Slowdown as Trade Tensions Flare
- ECB Begins Transition to New Benchmark Short-Term Interest Rate
- Bundesbank President Urges ECB Not to Question Bond-Buying Limits
- Johnson's Brexit Plan Sees 2 Borders for 4 Yrs: Telegraph
- Too big to lend? JPMorgan cash hit Fed limits, roiling U.S. repos
- Trump impeachment probe gains steam with briefing, depositions
- Fed's Bullard catches Trump's eye
- Hong Kong mops up after 180 arrested in violent National Day protests
- Swedish PMI Posts Biggest Decline Since Financial Crisis

Overnight Comment/The Day Ahead

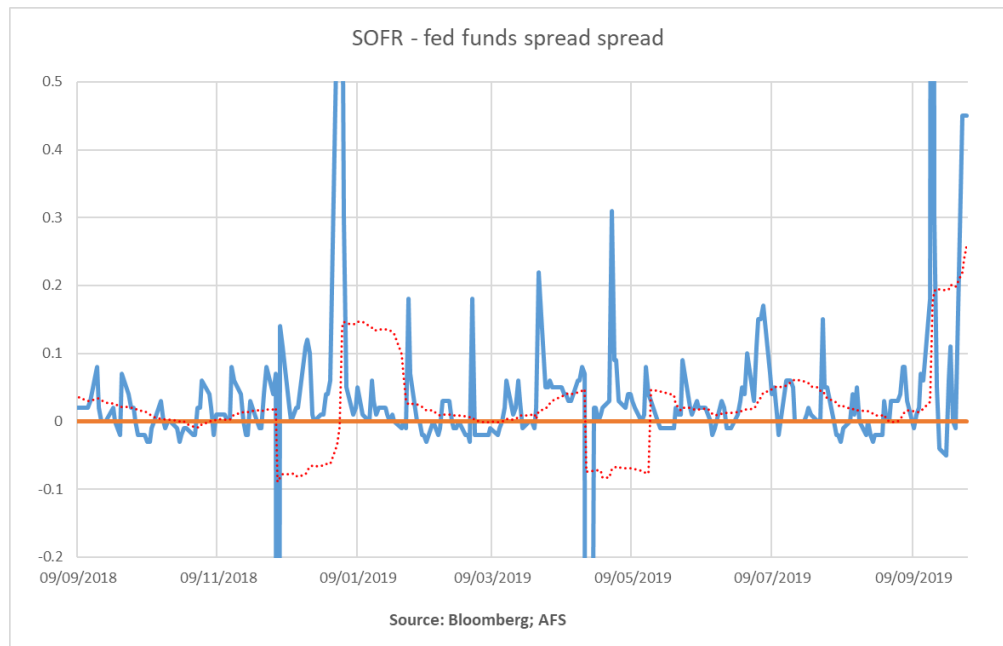
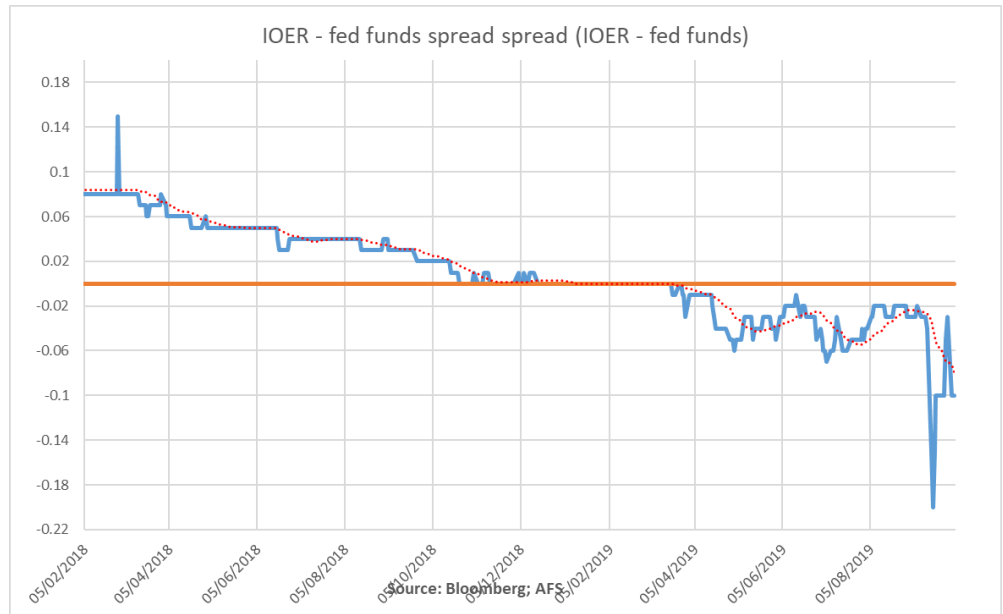
- **Not much of a rebound in US Treasury yields this morning following the epic plunge on Tuesday afternoon in the wake of the very disappointing US ISM Manufacturing PMI.** Just to refresh your memory, the PMI dropped to 47.8 from 49.1 on expectations of a reading just above the breakeven level of 50. Nearly every component of the survey was weak, hence yields edged lower and lower yesterday afternoon.
- **At pixel time the 10y Treasury yield traded at 1.66, up 4bps from yesterday's low but 10bps below yesterday's high.** The USD OIS 21m1m, the lowest point of the forward curve, was at 1.09 this morning after trading at 1.22 or so pre-ISM.
- **Equities in Asia took their cue from US markets last eve.** With the S&P 500 ending down 1.2% and at risk of dropping below its 50-dma around 2,950, we're seeing Asian markets down, with losses ranging from 0.5% for the Nikkei to 1.4% for the Aussie shares. Still, the Hang Seng is flat despite reports that Hong Kong suffered its worst violence on the PRC anniversary since the protests started earlier this year.
- **Turning to curvology, the Treasury yield curve did in fact *not* flatten/invert further on the ISM survey.** The 3m10y spread at minus 15bps remains moderately inverted, while the 2y10y spread actually steepened to nearly 10bps as punters see an increased likelihood of bad data invoking a response from the Fed by the way of easier policy. With the 2y10y spread not inverted, interpreting the curve remains as hard as it ever was. The 3m10y spread has closed below zero for 101 days this cycle, though the 2y10y spread refuses to invert sustainably. So, is the market pricing in an economy tethering on recession but still being saved by the Fed? Or a technical recession or something worse than that? In any case, as we

explained in yesterday’s Morning Comment, the US economy clearly is not out of the woods and there’s an elevated risk of a recession.

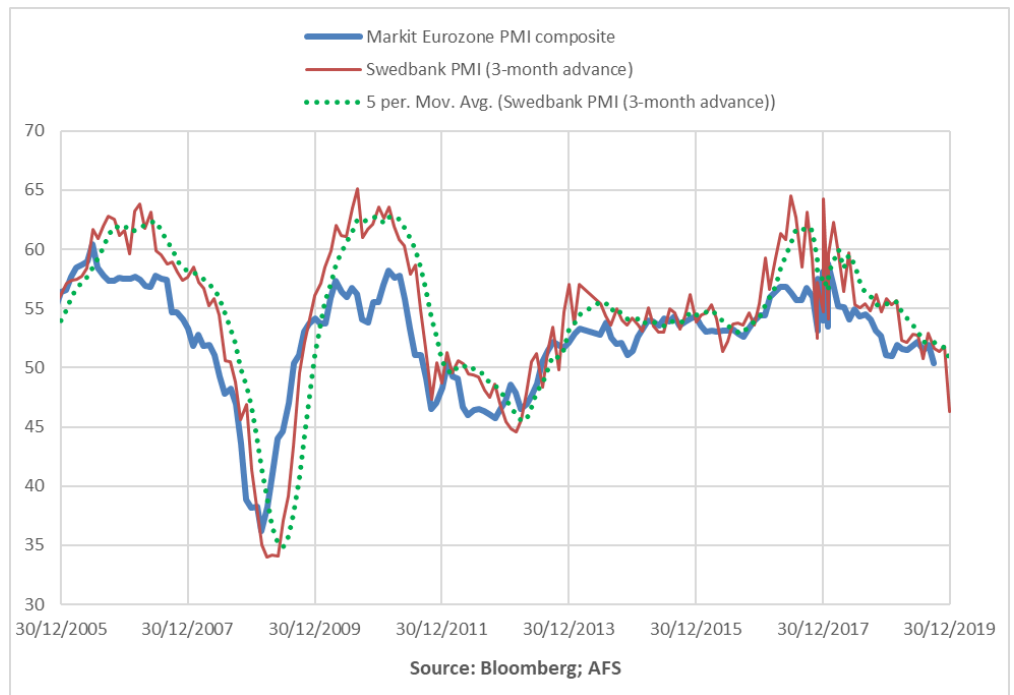
- **Elsewhere in markets Bunds were boosted by bad US data, with the 10y falling from minus 0.51 to minus 0.56 in the wake of the data.** Worth mentioning here is that over the past five days peripheral spreads were flattish, with Italy actually narrowing a bit. Fundamentally speaking, the move in BTPs is perplexing as the budget proposal for 2020 results in a further deterioration of the structural budget balance and probably also a worsening of the headline fiscal deficit because of an optimistic growth assumption of 0.6%. The new government targets a deficit of 2.2% of GDP next year, but the economic outlook suggests a wider deficit.
- **In FX the dollar has been gaining against most currencies except for CHF and JPY.** In fact, over the past five days the dollar index is up 1% while EM currencies are down 1% against the greenback. The overly strong dollar just screams policy mistake. As we have mentioned ad nauseum in these comments, the trade-weighted dollar is trading just below its all-time high. We think it’s a big mistake that the Fed does not take the exchange rate into account when setting monetary policy. It’s textbook economics that monetary conditions are measured by interest rates and the exchange rate. The Fed should take a cue from the ECB’s playbook and start considering the exchange rate when setting policy.



- **Elsewhere in FX in the South Korean won is talking the plunge on North Korea launching a missile just days after Pyonyang said it would resume nuclear talks with the US.**
- **US money markets are relatively quiet (for now at least) thanks to the Fed’s liquidity injections with daily repos.** However, repo rates remain elevated while fed funds and SOFR have clearly settled with too big a spread above the Fed’s IOER rate:



- **We want to share this important story from Reuters on causes of the runaway US onshore money market rates.** The [link](#) is here, and we will probably come back on this in the next few days.
- **Regarding US money markets, [the ECB published ESTR at 08:00 CET this morning](#), the first time the ECB published the EONIA replacement.** At -0.549 the settlement is in line with pre-ESTR, which also settled about 5bps below the deposit rate.
- **And speaking of the Eurozone, we have to mention Swedbank's Sweden PMI, which was published last morning.** The Sweden PMI, which was equally horrible as its US counterpart, tends to be overlooked by the market:



- **The Sweden PMI tends to lead the Eurozone PMI by three months.** Clearly, this is a very bad signal for growth in the remainder of the year. Underlying GDP growth in the Eurozone is just 0.1% to 0.2% quarter-on-quarter. It won't take much of a shock to see negative growth rates.
- **Looking ahead, it goes without saying that punters will be closely eyeing US data.** The 140k increase consensus expects for ADP payrolls are still consistent with GDP growth around potential. However, the risks for the data are clearly skewed to the downside, and that also applies to tomorrow's very important US ISM services PMI and Friday's official payrolls data.

Calendar

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:30	Switzerl.	CPI MoM	Sep	0.10%	0.00%
08:30	Switzerl.	CPI YoY	Sep	0.30%	0.30%
08:30	Switzerl.	CPI Core YoY	Sep	0.40%	0.40%
09:00	Spain	Unemployment Change	Sep	--	54.4k
10:30	UK	Markit/CIPS Construction PMI	Sep	--	45
11:30	Germany	Sells 3 Billion Euros of 0% 2024 Bonds			
14:00		Fed's Barkin Speaks at a Conference on the Rural Economy			
14:15	US	ADP Employment Change	Sep	140k	195k
15:00		Fed's Harker Speaks at Community Banking Conference			
16:50		New York Fed's Williams Speaks in San Diego			
		Poland Central Bank Interest Rate Decision			
		First Publication of ECB Euro short-term rate			

Consensus data: Bloomberg News; All Times Are in Central European Time

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