



AFS Insights

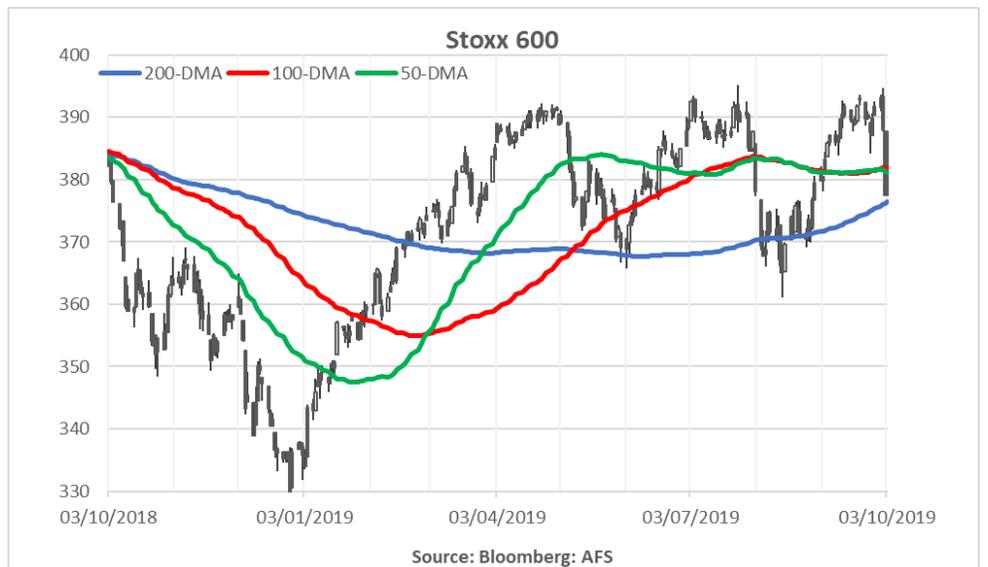
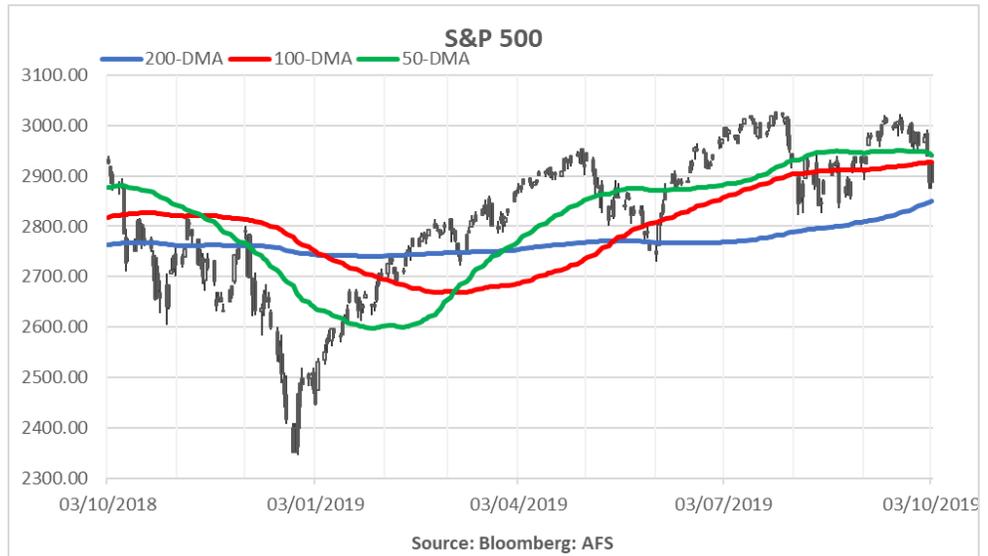
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Headline Sweep

- Trump lashes out at impeachment inquiry
- U.S. to Put Tariffs on Europe Planes, Whiskies After WTO Ruling
- BOJ's Funo Flags Overseas Risks Before 'Very Important' Meeting
- Boeing Urged FAA to Ease 737 Max Safety Standards: Seattle Times

Overnight Comment/The Day Ahead

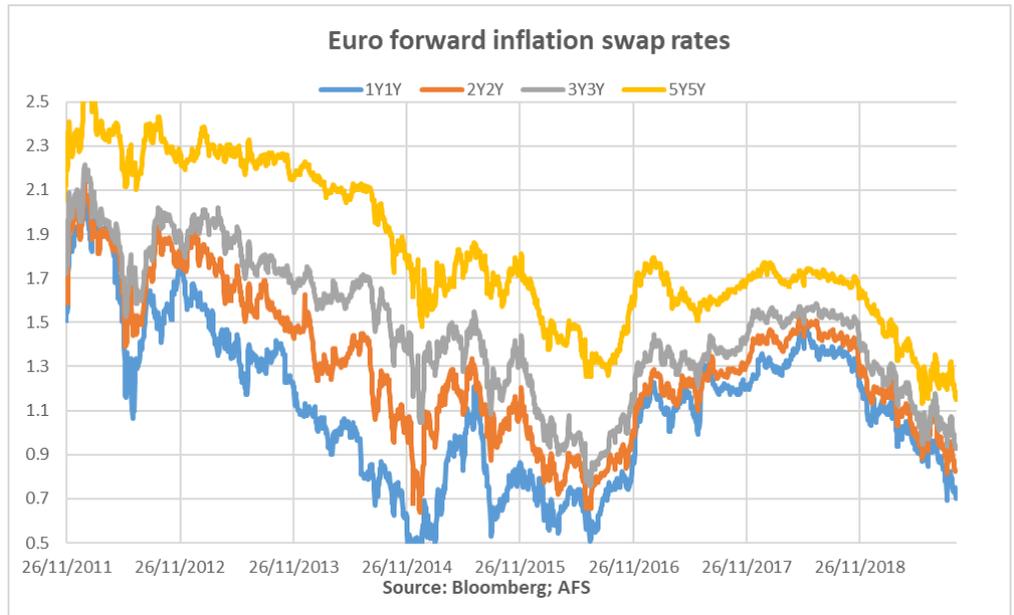
- **US Treasury yields have slid further overnight while equities losses are stacking up on – you guessed it – global growth fears.** That, and the Trump impeachment train is... well... moving forward.
- **With Treasury yields having failed to break out to the upside, the 10y at 1.58 could test the early September low of 1.43 if the US ISM services PMI and tomorrow's labor market report disappoint.** Still, the 2y10y yield spread is actually grinding wider as punters put increasing odds on further Fed rate cuts (3m10y spread closed below zero for the 101th day). Hence, forwards USD OIS rates have sagged. And, truth be told, the OIS market is a rollercoaster. That's not just because the volatility in the underlying, the federal funds rate, but also because markets need less than a week to price in or out a rate cut/hike. In any case, the 21m1m forward, the low point of the curve, was at 1.01 at pixel time. Early September we clocked a low at 0.75 and a high mid-September at 1.399.
- **In Asian equity markets this morning losses are ranging from 0.6% for the Hang Seng to 2.0% for Aussie and Japanese shares.** That follows a 1.8% loss for the S&P 500 yesterday and a stiff 2% to 3% plus losses for European markets, losses which were turbo-charged by the announcement that the US will impose tariffs on EU imports as a punishment for state-support for Airbus. On the charts things are starting to look interesting, with for example the Stoxx 600 and the S&P 500 about to test their 200-dmas:



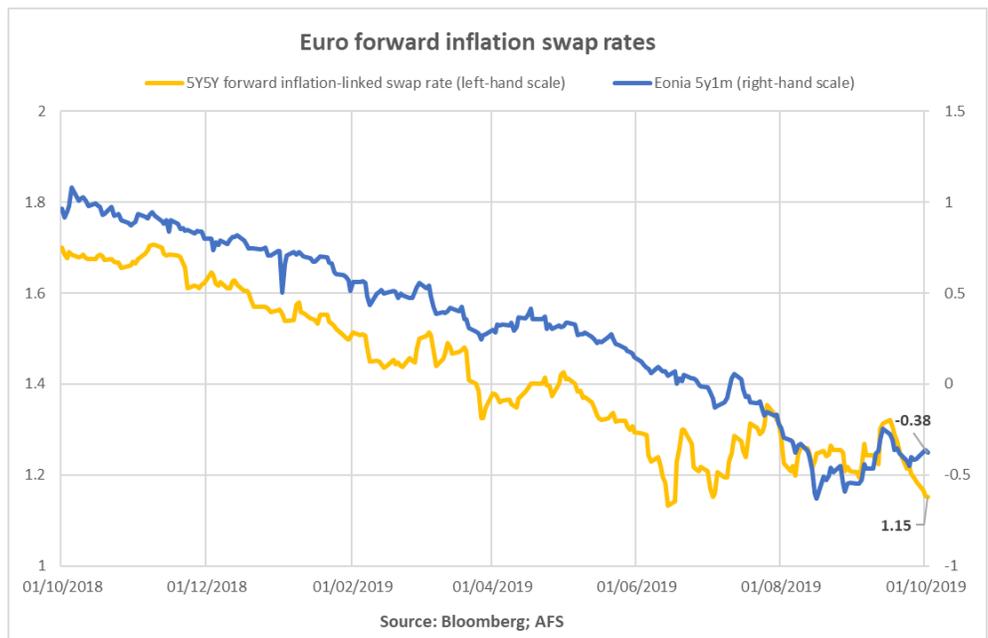
- **However, if growth fears are driving markets, Dr. Copper isn't getting the message.** Copper has been trading mostly sideways and it's actually flat for the week. And while it's easy to pick the rotten apples among the host of economic reports this week, the very important Markit Global Manufacturing PMI seems to be bottoming out at around the breakeven level of 50.
- **In FX the dollar has softened a bit since yesterday afternoon, but – and we can't repeat this enough – the greenback is still way too strong and way too overvalued.** In the risk-off environment JPY has been doing very well, rising further this morning against both EUR and USD. CHF is losing some of its luster though – maybe the SNB is intervening?
- **Credit markets in euro and USD remain orderly, so the risk-off sentiment has not sparked a rout or anything like that (yet).** And on a total return basis YTD most asset classes, ranging from EM FX and bonds to developed market credit, are showing healthy gains:

	YTD TOTAL RETURN	LOCAL CURRENCY
UBS UST 2Y TR	↔	2.65%
UBS US 10Y TR	↑	7.57%
UBS BUND 2Y TR	→	0.01%
UBS BUND 10Y TR	↑	8.05%
UBS ITALY 2Y TR	↔	3.43%
UBS ITALY 10Y TR	↑	18.37%
BLOOMBERG BARCLAYS EURO IG CORPORATE TR	↑	6.70%
BLOOMBERG BARCLAYS EURO HY CORPORATE TR	↑	9.42%
IBOXX EUR BBB CORPORATE TR	↑	7.94%
IBOXX EUR SENIOR FINANCIALS TR	↑	5.60%
IBOXX EUR SUBORDINATED FINANCIALS	↑	9.48%
BLOOMBERG BARCLAYS EUR GOVT LINKERS TR	↑	8.30%
BLOOMBERG BARCLAYS US LINKERS TR	↑	8.18%
BLOOMBERG BARCLAYS US CORPORATE IG TR	↑	15.78%
BLOOMBERG BARCLAYS US CORPORATE HY TR	↑	11.42%
BLOOMBERG BARCLAYS USD EM CORP BOND INDEX	↑	10.36%
BLOOMBERG BARCLAYS USD EM HY CORPORATE BOND INDEX	↑	7.49%
BLOOMBERG BARCLAYS USD EM SOVEREIGN BOND INDEX	↑	10.98%
S&P/LSTA Leveraged Loan Total Return Index	↑	6.78%
Stoxx 50	↑	17.00%
DAX	↑	12.94%
AEX	↑	18.15%
CAC	↑	18.14%
FTSE MIB	↑	19.82%
S&P 500	↑	16.95%
Nikkei	↑	10.94%
Hang Seng	↔	4.13%
MSCI EM	↑	6.27%

- **Looking ahead, all eyes will be on the US ISM survey out at 16:00 CET.** Besides that, there's a smattering of central bank speakers, second tier data and the usual bunch of Trump impeachment and Brexit headlines.
- **Following the release of the ISM Manufacturing shocker on Thursday, the risks are tilted towards a lower than expected reading.** Note that the Atlanta Fed's GDP nowcasts and the Markit Composite PMI survey have Q3 growth tracking at 1.5% to 2.0%, which is around the potential growth rate. With growth outside the US sagging to a much greater extent, the US remains the cleanest dirty shirt so to speak.
- **There are more than a few ECB-speakers scheduled to hit the mic throughout the day.** And that provides us with an opportunity to make sense of recent price action in the inflation swap market. Here are forward inflation-linked swap rates, which have really taken the plunge this year:



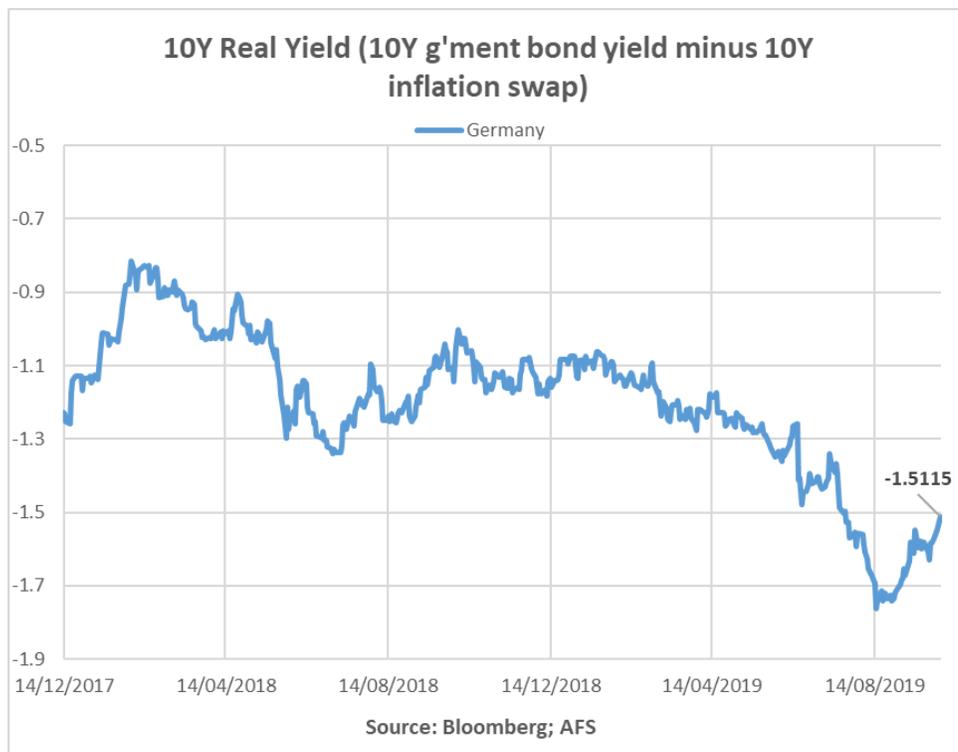
- **The ECB’s latest stimulus package hasn’t managed to turn the tide.** In fact, the 5y5y forward inflation-linked swap rate is flirting with its all-time low (note that we’ve included the 1-month EONIA 5 years forward as a proxy for the Eurozone neutral rate):



- **President Draghi, who will leave his post at the end of the month, and his former chief economist Peter Praet have mentioned the 5y5y swap as the bellwether for the market’s confidence in the 2% inflation target.** The reason we mention Draghi and Praet by name is that, as far as we can tell, no other Governing Council member has attached so much importance to this measure (or any market price for that matter). In fact, we cannot remember any other member mentioning the 5y5y in the past few years. In any case, if the market would have expected more aggressive easing of monetary policy under Lagarde, inflation swap rates wouldn’t be this depressed. Current pricing is a vote of no confidence in Lagarde’s inflation

credentials, and she faces an uphill battle if she wants to convince the market otherwise.

- **The decline in inflation expectations also helps explain why Eurozone bond yields have rebounded from their early September lows.** With inflation swap rates flat to lower, real yields have increased:



- **We put it that the market is pricing in a lowering of the ECB's inflation target when the upcoming monetary policy review is concluded somewhere early in Lagarde's term.** OK, it doesn't take a genius to make such a call. A quick glance at the inflation market tells you enough. Add to that the personnel changes, increasingly vocal hawks who have managed to sway key centrists, and voila.
- **So far, only the new hawkish Austrian central bank chief Robert Holzmann has suggested cutting the inflation target.** But we reckon he can count on the support of the leading hawks on the Council, the Dutchman Klaas Knot and the German Jens Weidmann. In fact, in his written criticism of the latest easing package Knot came close to all but abandoning the target, stating that the 2% aim "is not completely out of reach."
- **Furthermore, among the centrist we also note a distinct lack of willpower to ease policy.** The Finnish central bank governor Olli Rehn, which we rate highly as a bellwether for the Council, seems to have accepted the notion that monetary policy is played out. After the September meeting he only repeated Draghi's call for easier fiscal policy in the northern states. But before the meeting he had boldly called for the ECB to exceed market expectations, while the opposite happened.
- **The French central bank head Villeroy de Galhau is also in the 'let-fiscal-policy-take-over' camp.** Among the influential member states that leaves only the Spanish and Italian central bank heads to make the case for further ECB easing.
- **So, with persistent 1.0% core inflation readings since 2015; ECB staff forecasting inflation to fall short in the next two years, the path of the least resistance is either to continue the charade of having a target for reference purposes only, or**

to cut the target. The easiest way for the ECB to weasel out of the 2% target without completely abandoning it, is to introduce 1 percentage point band around the target. That would allow the ECB to call it a day and keep its dreams of 'normalizing' policy one day alive.

Calendar

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:45		Fed's Evans Speaks at Central Banking Conference in Madrid			
09:15	Spain	Markit Services PMI	Sep	53.9	54.3
09:45	Italy	Markit Services PMI	Sep	50.5	50.6
09:45		ECB's Guindos Speaks in Madrid			
09:50	France	Markit Services PMI	Sep F	51.6	51.6
09:55	Germany	Markit Services PMI	Sep F	52.5	52.5
10:00	Eurozone	Markit Services PMI	Sep F	52.0	52
10:00	Eurozone	Markit Composite PMI	Sep F	--	50.4
10:00		ECB's Rehn Press Briefing on Economy, Monetary Policy			
10:00		ECB's Hernandez de Cos Speaks			
10:10		Riksbank's Ohlsson Gives Speech			
10:30	UK	Markit/CIPS Services PMI	Sep	50.3	50.6
10:30	UK	Markit/CIPS Composite PMI	Sep	50.0	50.2
11:00	Eurozone	PPI MoM	Aug	-0.3%	0.20%
11:00	Eurozone	PPI YoY	Aug	-0.4%	0.20%
11:00	Eurozone	Retail Sales MoM	Aug	0.30%	-0.60%
11:00	Eurozone	Retail Sales YoY	Aug	2.0%	2.20%
11:00	Sweden	Sweden Sells I/L Bonds			
12:00	Czech Rep.	Sells 5 Billion Koruna of 28-day Bills			
13:05		Riksbank's Skingsley Gives Speech			
14:30	US	Initial Jobless Claims	Sep-28	215k	213k
14:30	US	Continuing Claims	Sep-21	1654k	1650l
15:45	US	Markit Services PMI	Sep F	50.9	50.9
15:45	US	Markit Composite PMI	Sep F	--	51
16:00		BOE's Tenreyro Speaks on Panel in Washington			
16:00	US	Factory Orders	Aug	-0.20%	1.40%
16:00	US	Factory Orders Ex Trans	Aug	--	0.30%
16:00	US	Durable Goods Orders	Aug F	--	--
16:00	US	Durables Ex Transportation	Aug F	--	--
16:00	US	Cap Goods Orders Nondef Ex Air	Aug F	--	--
16:00	US	Cap Goods Ship Nondef Ex Air	Aug F	--	--
16:00	US	ISM Non-Manufacturing Index	Sep	55.2	56.4
17:30	US	Sells 4-Week; 8-Week Bills			
18:10		Fed's Mester takes Part in a Panel Discussion on Inflation			
19:00		Fed's Kaplan Speaks			
19:00		Riksbank's Ingves Gives Speech			

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

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