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21st October 2019
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It looks to be an interesting week for the Krona as the much-awaited Riksbank decision emerges Thursday. Ingves and Ohlsson will give a speech after the decision, while data-wise, household lending, retail sales and PPI are all due Friday.

Mexico And Brazil a Drag on LatAm Growth, But Brazil a Brighter Prospect
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Since the end of July, Latin American currencies have underperformed their EM peers versus the USD, as reflected in the Bloomberg JPM Latin America Currency Index, which has slumped circa 8.50% since around mid-July, compared with a drop of 2.5% in the broader MSCI EM Currency Index.

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EU 2/10s Spread – 2½mth Base Completion Opens 47.6/53.5
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Buy on a clearance of 34.5 in anticipation of widening targeting 47.6/53.5. Stop and reverse on a break under 17.2.

EUR/NOK – Posting Record Highs
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Scope is seen for gains to 10.3073 next, and potentially, 10.5917 longer-term. Bears would need to trade back though 10.0969-9.9939 former highs to stall the advance.

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- by Ed Blake, p15
Buy near-term dips for a recovery extension to 270.65/280.30. Stop and reverse on a break under 251.50 in anticipation of a downtrend resumption opening 248.20/240.15.
The SEK Week - Bias is Bullish

By Rachel Bex, Senior FX Analyst

Date: 21 October 2019

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The SEK Week – cont’d

Expected EUR/SEK trading range: 10.71-10.83

It looks to be an interesting week for the Krona as the much-awaited Riksbank decision emerges Thursday.

Ingves and Ohlsson will give a speech after the decision, while data-wise, household lending, retail sales and PPI are all due Friday.

Speculation surrounding the Riksbank’s policy outlook, which currently points to a rate hike in either Dec or Feb, has been rife in recent weeks as bouts of soft Swedish data and worrying global developments saw specs start to price out the likelihood of any such tightening, with talk of rate cuts even creeping into play.

But persistently hawkish speak out of the CB and most importantly from the Governor himself have forced markets to rethink the data and indeed the policy outlook, and it seems likely that, given the Bank’s insistence that inflation expectations remain anchored, they will again guide markets to expect policy tightening at the turn of the year,

That said, much will certainly depend on Brexit developments, and if the EU reject an extension of the deal, then the Riksbank may be forced to rethink their hawkish outlook.

The main scenario, however, is that a no-deal outcome is avoided, which should in turn boost broader optimism and give Ingves an extra boost of confidence in his tightening plans.

Recall last week, players were seen fine-tuning their short Sek exposures after BoE’s Ramsden said that a smooth Brexit would put BoE rate hikes on the table, while weak Swedish jobs figures were shrugged aside after Statistics Sweden said it had discovered “quality flaws” in part of the data collection for the Labour Force Survey, not only for September, but for some time previously.

As a result, they warned that the unemployment figure was overestimated and employment slightly underestimated, which means the figures should be “interpreted with caution”. In turn, it looks as though the Riksbank will refrain from downwardly revising their employment forecasts for now.

Eur/Sek risks thus look skewed lower this week, with a loss of 10.75 to inspire fresh sales.
Mexico And Brazil a Drag on LatAm Growth, But Brazil a Brighter Prospect
By Christopher Shiells, Managing Analyst EM

Since the end of July. Latin American currencies have underperformed their EM peers versus the USD, as reflected in the Bloomberg JPM Latin America Currency Index, which has slumped circa 8.50% since around mid-July, compared with a drop of 2.5% in the broader MSCI EM Currency Index. This has been skewed by the capitulation in the Argentine Peso (-24.39%), but this makes up just 10% of the index weighting, which is dominated by the BRL (33%) and MXN (33%). Thus, the underperformance has been driven by the ca. 7.5% drop in value of the BRL vs. the USD (2nd worst performing EM currency since end of July after ARS) and the 1.5% drop in the MXN vs. the USD.

This is also reflected in the EPFR Fund Flows data, which shows investors largely showing little interest in the region this year, although flows have been less volatile than other EM regions, suggesting that players are waiting in the wings.

Latin American Economic Outlook 2019 - latest from IMF/World Bank

Since the summer, when the US-China trade truce broke down and President Trump accused China of reneging on previously agreed terms, the EM asset class has been under pressure, with only the last few weeks providing any respite. The general view for Latin America is that persistent trade tensions and the slowdown in world growth will negatively impact economic activity more in this region than elsewhere, and whilst a new round of policy stimulus may create some room for manoeuvre in the region, this may not be enough.

Much of the regional weakness can be tied to Mexico and Brazil. GDP growth in Mexico has slumped since Q3 2018 (+2.49%) and actually contracted in Q2 this year by 0.82%. The slowdown in Brazil has not been as severe, but the growth rate has been lacklustre since the start of 2017, gradually slowing from just over 2% in Q4 2017 to near 0% in Q2 this year.

There have also been domestic factors that have slowed growth in Brazil and Mexico this year, namely uncertainty surrounding domestic economic policies in H1. This is supported by the World Bank, who earlier in October said that the economies in Latin America and the Caribbean are experiencing “lacklustre performance”, with the region expected to grow by just 0.8% this year (vs 1.7% previously) and this downturn was self-inflicted rather than imported. The IMF’s latest WEO is even more bleak, forecasting Latin American & Caribbean GDP growth this year of just 0.2% (down from 0.6% previously). The IMF forecasts meagre growth in Mexico of 0.4% this year (vs 0.9% previously), a slump after 2% growth in 2018, and predicts Brazilian GDP growth of 0.9%.

These low levels of growth are not likely to entice anyone to buy Mexican or Brazilian assets.

Weak Economic growth and sharp CPI slowdown in Mexico and Brazil creates policy room

Inflation in both countries is receding quickly. In September, Mexican CPI slid to the lowest level since 2016, while Brazilian inflation was the slowest since May last year and posted surprise deflation on a m/m basis. The deteriorating economic outlook mentioned above and the slowdown in CPI have fuelled bets that central banks in both countries will have to continue cutting rates. The BCB has led the way, cutting its benchmark Selic rate by 50bp at each of the last two meetings (July and September) and MIRP shows that investors are now betting on a further two 50bp cuts at the October and December meetings. Banxico has also cut its benchmark rate at the last two meetings (August & September), but in smaller 25bp steps and the market expects this pace to continue at the final two meetings of the year (November and December).

With CPI in Mexico expected to drop to 3.20% this year and remain benign next year, some are even suggesting that the Selic rate could go as low as 4.00% next year. However, whilst the market is fully behind a full throttle easing cycle by the BCB, caution remains over Banxico’s path, which was revealed in the September minutes to be concerned over high core-CPI, cooling expectations for a 50bp cut in November. The minutes suggested a policy rate in this cycle at slightly above neutral, at or above 5.75%-6%.

Brazil Upside, Mexican Downside

Brazilian money markets are more aggressive in their pricing of BCB rate cuts and this has been a factor in the BRL’s under performance over the last couple of months. However, the easing cycle is almost fully priced in and we see medium-term encouraging dynamics for BRL with approval of the oil auctions scheduled for 6 November and moderation of outflows related to re-payment of USD debt to be refinanced locally by companies.

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The oil auctions are seen as another big step in President Bolsonaro’s plan to reduce the influence of the state on the economy and shore up public finances. Valor reports that the total revenue from the sale of the fields could reach BRL628bn in 25-years based on tax collection estimates, with an immediate windfall of BRL106bn expected directly from the auctions.

The approval of the transfer of rights bill also paves the way for the pension reform bill to get its second vote in the Senate on 22 October and from there the government has an agenda of reforms it wants to advance, with some reforms to be voted on this year and some next. Senate government leader Bezerra told Bloomberg last week that the advancement of the government’s agenda could add 2-2.5% to GDP by the end of next year. It is this ‘moving forward’ on wider reforms that should encourage investors to increase bullish BRL bets, but this may be a gradual progress.

In Mexico, economic growth has slowed sharply and the medium-term outlook, in our opinion, has less upside than in Brazil. President AMLO is pursuing a policy of extreme austerity, with the 2020 budget plan targeting a surplus of 0.7%, but based on unrealistic growth of 1.5-2.5% in 2020 and a record surge in oil production (+18% from 2019). At the same time productivity-enhancing reforms have largely stalled, whilst concerns over AMLO’s policy direction and the burden of PEMEX on the government’s finances (MXN86bn of funding via tax breaks and other measures) has slowed private investment.

**Brl/Mxn - a rebound to 4.8330 and beyond possible in the medium-term**

Both Brazil and Mexico have relatively bleak near-term economic outlooks and both central banks look set to deepen their easing cycles over the coming months. We would argue that there is greater upside potential in Brazilian GDP growth and greater downside risk in the Mexican outlook, but as highlighted by the CTCF data, investors are not positioned for BRL outperformance. BRL net positioning has been growing increasingly short since the end of July, but investors have been building up net longs in the Mxn.

Given the MXN’s small 1.5% decline vs the USD, vs the BRL’s 7.5% slump since the end of July, as highlighted at the beginning of this viewpoint, we believe the BRL offers some longer-term value at current levels.
Thus we recommend a LONG BRL/MXN position, on any dips towards 4.5000, targeting a return to 4.8330 and then possibly 4.90-5.00.

- BRL/MXN breached strong support between 4.636/4.646 (20 May and 23/24 September lows) to set new 12-1/2mth lows just under 4.604 (.618x 5.482/4.636 fall from 5.127)

- Bearish multi-timeframe studies suggest near-term downside risk to the 4.556-4.575 zone (.382x 6.886/4.462 fall from 5.482, 1 October 2018 low and a 16-3/4yr rising trendline), perhaps 4.462/4.481 (2018 low - 14 September and .764x 5.482/4.636 fall from 5.127), before we see a rebound

- A clearance of the 50DMA at 4.788 and then the 4.833 (3 October) lower high is required to confirm basing and allow a recovery extension to 4.938/5.019 (19/12 August minor lower highs)
Covered Snapshot: Weekly Wrap, Charts & Stats

By Eva Bobb-Compton

• There was an uptick in last week’s Euro-denominated Covered supply to EUR2.05bn (w/e 18 October) from EUR2bn the prior week. Year-to-date issuance now stands at EUR124.4bn versus EUR125.775bn sold during the same period in 2018.

• Issuers chose to tap into the seven and ten-year sweet spots; combined, the two maturity brackets make up close to half of all year-to-date euro covered volumes. See volume by maturity graphics below for further details.

• Sparebanken Sør Boligkreditt successfully placed a ‘Green’ covered deal during Thursday’s session and this may spur further issuance in the ESG/covered arena with two more borrowers set to present newly-established Green Bond Frameworks ahead of respective deals (see note on pipeline below). According to IGM data, just over EUR72.5bn worth of euro-denominated ESG bonds have been issued year-to-date (versus EUR60.1bn launched across the whole of 2018), with covered bonds accounting for EUR3bn of this year’s figure. The graph below shows the growth of euro ESG covered bonds since the first sustainable Mortgage Pfandbrief was launched in 2014 by Muenchner Hypothekenbank eG.

• The week’s deals fared better than the prior week in terms of investor reception, with all lines oversubscribed and Volksbank’s inaugural OBG achieving the highest over-subscription rate. Although the premium that it offered is vague, at reoffer the Volksbank seven-year did provide a pick-up of around +10bp versus BPER Banca’s EUR600m Apr-2026s and a chunkier +24bp over Banco di Desio’s EUR500m Jul-2026s, both issued this year.

• All of the week’s deals are trading inside reoffer (versus mid-levels) on Friday morning with both Volksbank and Sparebanken Sør Boligkreditt tightening by 2bp overnight.

• More ‘Green’ covered issuance is on the horizon with France’s CAFFIL scheduling meetings from 22 October to present its newly-established Green Bond Framework and an inaugural euro-denominated intermediate- to long-dated Green Obligation Fonciere (click here for roadshow details). Similarly, NORD/LB Luxembourg S.A. Covered Bond Bank will also present a newly-established Green Bond Framework to investors from 23 October with a view to issuing EUR300m (no grow) short- to medium-term Renewable energy Lettres de Gage (details are here).

• Away from the single-currency, DBS Bank issued a AUD750m Oct-2022 covered bond, backed by Singaporean Residential Mortgages.

Execution highlights

The first of the week’s activity was provided courtesy of La Banque Postale Home Loan SFH’s EUR1bn Oct-2029 OFH (AAA by S&P) on Monday. The deal almost exactly mirrored that of AXA Home Loan SFH from the previous week, but better-known LBP SFH’s came out on top where demand was concerned and managed to price 1bp inside AXA’s reoffer. Click here for relative value analysis and here for distribution stats on the LBP SFH deal.

EUR1.05bn was up for grabs on Thursday from three offerings after the sector drew blanks the two preceding days. First, Sparebanken Sør Boligkreditt AS followed hot on the heels of compatriot SR-Boligkreditt’s launch the prior week to sell its own EUR500m Oct-2026 Green covered bond (click here for stats). Thursday also saw two sub-benchmark trades from Sparkasse Hannover which extended its curve with a ten-year HP (stats are here) and from an inaugural EUR300m Oct-2026 OBG issue from Volksbank - Banca Popolare dell’Alto Adige S.p.A.. More background a relative value analysis on all three deals can be found here, continued page 9.
Covered Snapshot – cont’d

2019 EUR Covered Volume by Maturity (EUR bn)

YTD EUR Covered Average NIC & Average Cover Ratio

ESG* Euro Covered Bonds (EUR bn)

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Donald Trump, after the 13th round of US-China trade talks was wrapped up, on 11 Oct agreed to suspend the tariff increase which was supposed to come into effect on 15 October. In return, Donald Trump obtained China’s promise to buy more US agricultural products. Trump labeled the whole agreement as the phase 1 trade deal, which will be followed by phase 2 and even phase 3 if necessary. Though the phase 1 agreement, as per Donald Trump, will also cover currency, intellectual property protection and opening up of China’s financial services sector, no details have been disclosed yet. It appears to us that the phase 1 deal is largely about agriculture products purchase in exchange for suspension of October tariff increase, and that anything else will be more symbolic. For example, anything in the IP protection area, in our view, will be about copyrights and trademarks rather than data flows. In regard to opening up of the financial services industry, a bit more participation of the US firms may be allowed, but we doubt Beijing will let them be the majority shareholders or sole owners of operators there. As far as the currency is concerned, we don’t think Beijing will promise to avoid RMB depreciation or keep RMB FX in a pre-determined range on top of increasing the transparency of PBOC FX intervention. As far as an enforcement mechanism is concerned, nothing about it was mentioned in Trump’s announcement. In our view, this is the issue which Beijing resists the most. Thus, we doubt it will be resolved in the end.

Just a few days after Donald Trump announced the phase 1 trade deal, it was rumoured that Beijing may send a delegation led by Vice Premier Liu He to Washington for further discussion on the Phase 1 trade deal. As per the rumours, Liu He in the discussion will request the Trump administration shelves the planned tariffs scheduled for December. We won’t be surprised if more back-and-forth bargaining will happen before Trump and Xi sign the written agreement.

In the FX market, USD/CNH did reach as low as 7.05 after Donald Trump announced the Phase One trade deal. A lower low (probably in the area of 7.00-7.03) will likely emerge early next month unless we see some signs suggesting the US and China fail to conclude the deal. Before that, the market will price out some of the optimism with a rebound to 7.10-7.12 area (chart 1).

In the medium term, RMB depreciation will resume and reach our target 7.20 against USD even if the Phase One trade deal gets officially signed. As a matter of fact, flexibility in the exchange rate is needed to ensure monetary policy independence and a weaker RMB FX over the medium term may still be needed to ensure China’s transition to a lower economic growth rate is a sustainable one.
Know The Flows: Flickers of Hope For Trade And Brexit Deals Boost Risk Appetite

By Cameron Brandt, Director, Research

The second week of October saw flows to EPFR-tracked High Yield and Emerging Markets Bond rebound, US and UK Equity Funds snap three-week outflow streaks and UK Bond Funds post their biggest inflow since June as Sino-US trade and UK-EU exit deal talks took turns for the better. Investors are also pricing in another rate cut from the US Federal reserve when it meets on the final days of the month.

This cautious optimism was not enough to banish concerns about the outlook for Emerging Asian exporters and the political risks facing continental Europe. Asia ex-Japan Equity Funds recorded their 13th outflow in the past 15 weeks and Europe Equity Funds their 38th in the past 40 weeks. Europe Money Market Funds, meanwhile, chalked up their biggest outflow since late 2Q16.

Overall, EPFR-tracked Equity Funds recorded collective net outflows of $271 million for the week ending October 16, with $800 million flowing out of Balanced Funds and $26 billion from Money Market Funds. Investors steered $584 million into Alternative Funds and $10.4 billion into Bond Funds. Flows into Dividend Equity Funds were positive for the fifth week in a row, extending their longest inflow streak since 3Q17.

At the asset class and single country fund level, France, Spain and Germany Equity Funds recorded their sixth, 12th and 26th consecutive outflow respectively while Italy Bond Funds added to their longest run of inflows since EPFR started tracking them. Municipal Bond Funds posted their 41st straight inflow, Mortgaged Backed Bond Funds their 40th in the past 41 weeks and Inflation Protected Bond Funds their third in the past four weeks.

With the bar set low for the third quarter corporate earnings season and some better than expected results already trickling in, investors opted to increase their sector positions during the week ending October 16 before the 3Q19 reports really start rolling in. Of the 11 major Sector Fund groups tracked by EPFR, 10 of them recorded inflows that ranged from $92 million for Telecoms Sector Funds to $558 million for Technology Sector Funds.

For further information on EPFR, please click HERE
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EU 2/10s Spread – 2½mth Base Completion Opens 47.6/53.5

Technical Analysis by Ed Blake

- Extended the 20-month narrowing trend to 11.4 (25 September, 11-year low), before bouncing to form a 2½ month base
- Firming daily studies suggest a sustained break of 29.5/33.4 (base trigger/12-month falling trendline) to confirm widening
- The initial target is 47.6 (base objective), beyond which opens 53.5/58.4 (July lower high/Fibonacci retracement)
- Dips should hold the 17.2/22.2 support zone (October lower highs) and only below negates basing and re-opens 11.4

STRATEGY SUMMARY

Buy on a clearance of 34.5 in anticipation of widening targeting 47.6/53.5. Stop and reverse on a break under 17.2

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EUR/NOK – Posting Record Highs

Technical Analysis by Andrew Dowdell

- Breaking higher from a multi-year ascending triangle pattern
- Weekly MACD is starting to trend higher after repeatedly finding support near its 0 line in 2018/19

STRATEGY SUMMARY

Scope is seen for gains to 10.3073 next, and potentially, 10.5917 longer-term. Bears would need to trade back though 10.0969-9.9939 former highs to stall the advance
Technical Analysis by Ed Blake

- Consolidates the 300.10/248.20 fall in a narrowing band bound by support at 251.50 (1 October low) and resistance at 263.85 (six-month falling trendline)
- Studies are building, however, above 264.15/270.65 (lower highs) is needed to confirm broader basing and re-open 280.30 (lower high)
- While 270.65 caps, bears will try resuming the wider downtrend for 248.20/247.25 then 240.15 (equality target)

**STRATEGY SUMMARY**

Buy near-term dips for a recovery extension to 270.65/280.30. Stop and reverse on a break under 251.50 in anticipation of a downtrend resumption opening 248.20/240.15
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