SMBC Capital Markets, Inc.

U.S. Swaps and Currency Market Outlook for May 22, 2017

Interest Rate Market Focus

Investors' anxiety about the future of President Donald Trump's legislative agenda jarred financial markets on Wednesday, upending months of relative tranquility and steady gains. Following the series of damaging reports related to President Donald Trump in the aftermath of his decision to fire FBI Director James Comey, investors rushed into "safe haven" assets driving swap rates significantly lower. One fallout from this week's political turbulence was some wavering in investors' confidence that the Federal Reserve will raise interest rates next month. The Fed has sometimes been hesitant to raise interest rates during periods of volatility. Yet there were signs by Friday of calm returning to the markets, with swap rates increasing for the second consecutive session. For the week, swap rates decreased across the board by 2-9bps, closing at 1.52%, 1.86%, 2.18% and 2.44% on 2yr, 5yr, 10yr and 30yr rates respectively.

In economic data, housing is emerging as the economy's best surprise this year with today's housing market index, which tracks the nation's home builders, showing exceptional strength including strength in traffic where first-time buyers, until lately, had been scarce. Empire State data show a welcome slowing in the New York region's manufacturing sector after unsustainable strength in prior reports. The housing starts report is rather soft and includes downward revisions in what stands out as the single negative signal from an otherwise solid housing sector. The reverse is the case with industrial production where a surge in April manufacturing followed flat results in March. The labor market remains strong this month as jobless claims continue to track near record lows. And the factory sector may be accelerating even further based on another exceptionally strong Philly Fed report.

Treasury yields decreased across the board by 2-8bps, closing at 1.27%, 1.78%, 2.24% and 2.91% on 2yr, 5yr, 10yr and 30yr respectively. For the week, 2yr and 30yr swap spreads remained flat closing at 24bps and -46bps respectively. 5yr and 10yr swap spreads widened by 1bp closing at 7bps and -7bps respectively.

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FX Rate

The dollar started off the first half of last week looking slippery as the Deep State vs POTUS themed headlines (how'd you like a side of Trump "leaks" of intel to Russia with your Comey appetizer? Served fresh by WaPo) found a release valve in the USD. And even though Thurs offered a brief respite/uptick with Mueller's appointment to lead the Russia probe, Merkel just hammered the DXY lower with her own out-of-context remarks at 6am this morning: "The Euro is too weak, makes German products cheaper" screamed the headline…. EURUSD went screaming higher from close to the 1.1150 lows now up to 1.1250. Risk Reversals for the 1mth AND 3mth tenors now net favor calls, the latter in positive territory for the first time really since the GFC. And of course, spec positioning adds to the their long positioning in the cash market (only MXN more bloated than EUR).

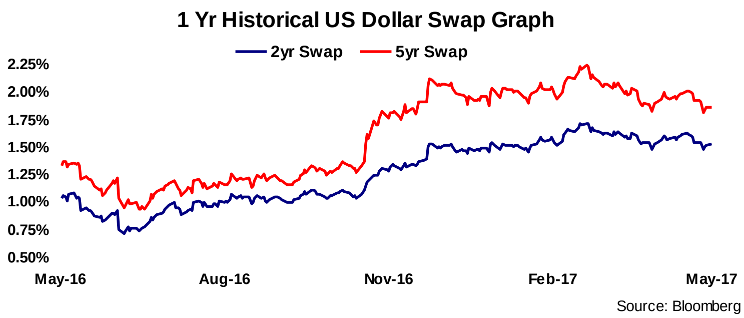
DXY is now below 97 from 99 a week ago – back to levels pre Trump election.

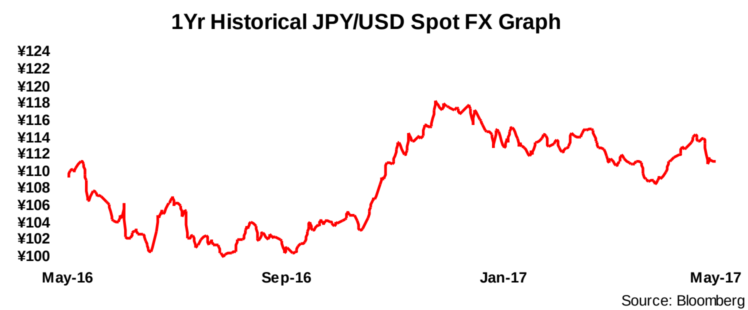
GBPUSD was a little shaky to start coming off the weekend with interview headlines from Brexit Secy David Davis suggesting the UK will quit talks if the EU insists on the €100bm bill – 1.2970 area lows now recovered though on the dollar softness and option expiries (1bn rolled down by the lows) clearing room for spot back to 1.3025 plus.

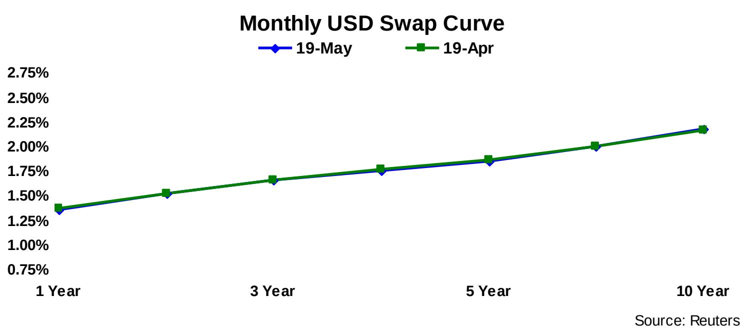
USDCAD is slipping below the 1.35 figure now on continued commod firmness – the Saudi Oil minister seems to think the rest of OPEC will agree to prod cut calendar extensions similar to the Russia agreement already well covered.

AUDUSD and NZDUSD are both firmer with the commodity sector firmness it seems, particularly the latter extending nearly to .70 perhaps on a ST push aboe .6950 resistance. Aussie is up .7460-.7490 on the day, but weekend news that the ratings agencies are now looking at local banks in Oz (the big 4 are safe for now) should have added some anxiety if anything, fresh off the back of the Canadian bank review.

China still looks supportive is the key, and EM in general (ex-Brazil perhaps as Temer tries to deny he drove through the car wash…) is vying for a chance to outperform recently, as long as the major geopolitical landmines can be side stepped and NKorea won't let the market sleep on that front (more missiles over the w/e) but for now it's not a nightmare.







Major Economic Releases

Date	Time	Event		Survey
5/23	10:00	New Home Sales	Apr	610k
5/24	10:00	Existing Home Sales	Apr	5.65m
5/24	14:00	FOMC Meeting Minutes	3-May	--
5/25	8:30	Initial Jobless Claims	20-May	238k
5/26	8:30	GDP Annualized QoQ	1Q S	0.90%
5/26	8:30	Personal Consumption	1Q S	0.40%
5/26	8:30	Durable Goods Orders	Apr P	-1.40%
5/26	10:00	U. of Mich. Sentiment	May F	97.5

Source: Bloomberg