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RBC European Rates & Economics Daily

- **Weekend news:** Nafta; Brexit; Italian warnings; Jackson Hole
- **Data and events:** Euro area money supply; ECB's Praet speaks
- **ECB Presidency:** Draghi succession needs to be seen in the context of a wider shake-up of top EU jobs

Weekend news: The US and Mexico have reached agreement on the renegotiation of Nafta trade terms. Amongst the main features of the deal is that 75% of the content of a product must be made in either country to be tax exempt, more than under the current deal. On cars it was agreed that 40-45% of a vehicle must be produced by workers earning at least \$16 an hour. Trump's economic adviser, Larry Kudlow, is quoted by Reuters as saying that the deal with Mexico should serve as a "reset" for talks with Canada. Canadian Foreign Minister Chrystia Freeland is expected to travel to Washington for talks today.

The new trade accord helped push Asian stocks higher for a second consecutive day, though Chinese equities dipped after Trump played down the significance of the Mexican deal for ending the current trade war with China. DXY is up 0.1% having gained on Friday in the wake of Powell's Jackson Hole appearance (see below). The Mexican peso fell 0.4% having gained 0.8% on Monday as markets absorbed the detail of the Nafta deal. Bloomberg Dollar Spot Index rose 0.1 percent. Ten-year Treasury yields are at 2.85%. Oil is at ~\$68.85 b/l (WTI crude).

In a speech in Paris, **President Macron** said that preserving EU unity was more important than forging a close relationship with post-Brexit Britain. He was also critical of the Italian government saying the migration situation there was due to a lack of solidarity between member states but that did not excuse "xenophobic rhetoric". **French Prime Minister Edouard Philippe** has asked his ministers to prepare contingency measures in case of a no-deal Brexit.

Italy Deputy PM and 5-Star leader, Di Maio said in an interview with La Stampa that he would start the process of opposing the EU's next budget framework over the migration issue. On a visit to China, **Finance Minister Tria** said that he wasn't looking for buyers of Italian bonds

In an interview on Sunday, **Irish Foreign Minister Simon Coveney** said it was "very, very unlikely" that the UK would crash out of the EU next year without an exit deal. In his weekly column for the Telegraph former UK foreign secretary **Boris Johnson** again criticized Prime Minister **Theresa May's** Chequers plan saying that under the plan the UK would become a "rules-taker from Brussels, with no say on those rules" and comparing the situation of the UK under Chequers to that of Greece. En route to a visit to Africa, May referred to recent comments from WTO chief Roberto Azevedo saying "He said about a no-deal situation that it would not be a walk in the park, but it wouldn't be the end of the world". Azevedo had told BBC radio last week that trade wasn't going to stop if Britain and the EU failed to strike a deal.

All values in GBP unless otherwise noted.

Priced as of prior trading day's market close (unless otherwise stated).

Market	Level	Chg**
Fixed Income		
TYU8	120.50	-0.09
RXU8	163.06	0.06
G U8	123.30	-0.02
2y UST	2.62%	0bp
5y UST	2.72%	0bp
10y UST	2.83%	0bp
30y UST	2.98%	0bp
2y Schatz*	-0.59%	-1bp
5y OBL*	-0.22%	1bp
10y B und*	0.35%	1bp
30y Bund*	1.0%	0bp
2y Gilt*	0.72%	0bp
5y Gilt*	1.0%	0bp
10y Gilt*	1.27%	0bp
30y Gilt*	1.75%	0bp
10y SP-GE*	102bp	-2bp
10y IT-GE*	274bp	2bp
10y FR-GE*	34bp	0bp
Money Markets		
EONIA	-0.363%	0bp
1y EONIA	-0.20%	0bp
ERU8	-0.3%	0bp
SONIA	0.70%	0bp
1y SONIA	0.97%	1bp
L U8	0.83%	0bp
Currencies		
EUR/USD	1.1572	0.003
GBP/USD	1.2827	0.002
GBP/EUR	1.1083	-0.002
Equities & commodities		
S&P 500	2,857	-5
Dow	25,657	-77
Euro Stoxx	3,419	-1
FTSE 100	7,563	-11
Nikkei	22,598	187
Oil (CO1)	\$75.16	0.43
Gold	\$1,188.52	2.96
VIX	12.41	0.16

* Chg as of T-2 COB

** Chg as of T-1 COB

Levels as of Aug 24 07:05 GMT

Source: Bloomberg

Region	BST	Period	Data/Event	RBC	Consensus	Prior
France	07:45	Aug	INSEE consumer confidence index		97.0	97.0
Euro area	09:00	Jul	M3 money supply y/y (%)		4.4	4.4
Italy	09:00	Aug	ISTAT consumer, manufacturing confidence index		115.9, 106.8	116.3, 106.9
Euro area	12:00	...	ECB Chief-Economist Peter Praet speaks			
US	15:00	Aug	Conf. Board Consumer Confidence	127		127.4

Sources: Bloomberg, Reuters and RBC Capital Markets estimate

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Exhibit 1: Key EU events and posts coming up for renewal in 2019

Event	European Council	EU Parliament elections	ECB Chief Economist	European Council	ECB President	President of the European Council	President of the European Commission	European Council	ECB Board member
January									
February									
March	21-22 Mar								
April									
May		23-26 May	Peter Praet						
June				20-21 Jun					
July									
August									
September									
October					Mario Draghi	date tbc			
November						Donald Tusk	Jean -Claude Juncker		
December								date tbc	Benoit Coeuré

Sources: ECB, www.consilium.europa.eu, EU commission, RBC Capital Markets

The Fed’s **Jackson Hole Symposium** concluded on Sunday. Friday’s speech by **Fed Chair Powell**, delivered before the European close, was seen as fairly balanced, supporting the Fed’s policy of “gradually raising interest rates” while arguing that risks of overheating do “not seem to be elevated”. Other notable contributions came from **Bostic** (voter) and **Kaplan** (non-voter) who said that tariff costs may be passed through more easily in the current, tight operating environment.

The lone data release of note yesterday was the German IFO survey, which beat expectations with the business climate component rise more than 2 points to 103.8.

Data and events: The main euro area release scheduled for the day ahead is the **M3 money supply data** for July which will include data on the supply of loans to the euro area private sector.

From the **ECB**, **Chief Economist Peter Praet** participates in a conference on "Monetary and Macprudential Policy Interactions" which is being held in Cologne.

ECB Presidency: Over the last few days, the debate about whether or not Bundesbank president Jens Weidmann would succeed Mario Draghi as ECB president has gained traction again. The reason was an article in German business daily ‘Handelsblatt’ suggesting that Germany would rather pursue the EU Commission presidency than the ECB’s top job. [We have already, back in January, opined](#) that Weidmann’s chances of taking the top job at the ECB were far from a slam dunk.

Back then we argued that, upon closer inspection, Germany would unlikely push too hard for the ECB presidency. The task of policy normalization and the distinct possibility that over the next president’s term an economic downswing unfolds, makes the tenure of the next ECB president ‘something of a poisoned chalice’. This seems particularly true given that Germany is already widely blamed for post crisis ‘austerity policy’ and of being the mastermind of the bail-outs which remain highly unpopular across the euro area, particularly its Southern fringes. This could be supercharged by the current political climate (recall the comments by Italian politicians that the ECB ‘must’ further support the BTP market).

The latest developments, therefore, do not come as a surprise to us. In fact, pursuing the role of EU Commission president in a time when, most likely, the EU is bound to undergo fundamental transformations (think Brexit, migration policies, European Monetary Fund, enhanced military cooperation, etc.). Against this backdrop, holding the EU presidency offers a unique seat at the heart of these developments. Furthermore, over the last years the EU commission president has obtained quite a lot of international heft – as was exemplified, for instance, by Juncker’s visit to US president Trump.

That the nomination for these roles should not be seen in isolation becomes even clearer if we take a further step back. 2019, will be a year when a whole host of major EU major roles will be up for grabs. And, as is customary in Europe, the nationality of the successful candidate for one post has knock-on implications for the chances of candidates for other roles. Exhibit 1 illustrates the roles that we consider



are relevant to keep in mind, when thinking about these processes. Apart from the ECB President and the EU Commission President, currently the running for the chair of the ECB's Supervisory Board (incumbent France's Danielle Nouy) is already well underway.

Furthermore, we also highlighted the importance of the ECB chief economist in the January note. In fact, we argued that it will become quite apparent whether or not Weidmann has a fighting chance if and when this role will be filled. However, also important to note that; the post of President of the European Council (incumbent Poland's Donald Tusk) will also come up for renewal during 2019. Also quite plausible is that the head of the ESM (incumbent Germany's Klaus Regling whose term expires in 2022) could be due a reshuffle if it undergoes a substantial change in its remit to create a 'euro area IMF' as seems likely at some stage.

What does that mean for markets? We feel supported by our initial view that the odds of Weidmann to succeed ECB president Draghi are much slimmer than most market participants assume. We have already back in January suggested that particularly Ireland's Phillip Lane could be a good alternative candidate. His economic pedigree is strong and his reputation outstanding. Also working in his favour is that Ireland has never held an ECB board position before. Furthermore, we would consider it much easier to sell tighter monetary policy if it was delivered by a president from one of the peripheral countries rather than from a Northern European hawk.

We currently call for the first rate hike from the ECB for Q3 2019 and see no need to alter this call at present. However, we have argued that the series of hikes implied in the EONIA forward curve (essentially a very continuous hiking process following the start in 2019), particularly in the 2021/22 maturities, should be vulnerable to changes in sentiment. The potential withdrawal of one of the ECB members perceived to be very hawkish for the presidency, could foster a reduction of the medium term rate expectations indeed.

GBP and EUR Analytics*

Exhibit A: 3m Carry and Roll-down on the EUR swap curve

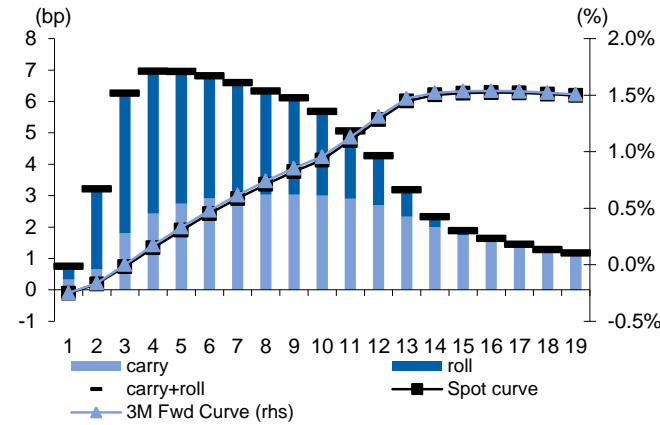


Exhibit B: 3m Carry and Roll-down on the GBP swap curve

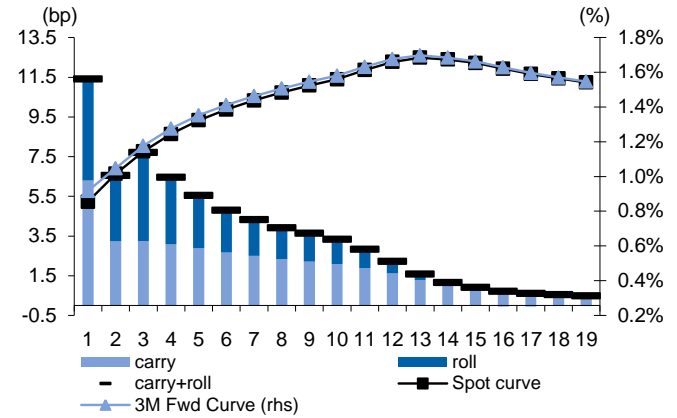


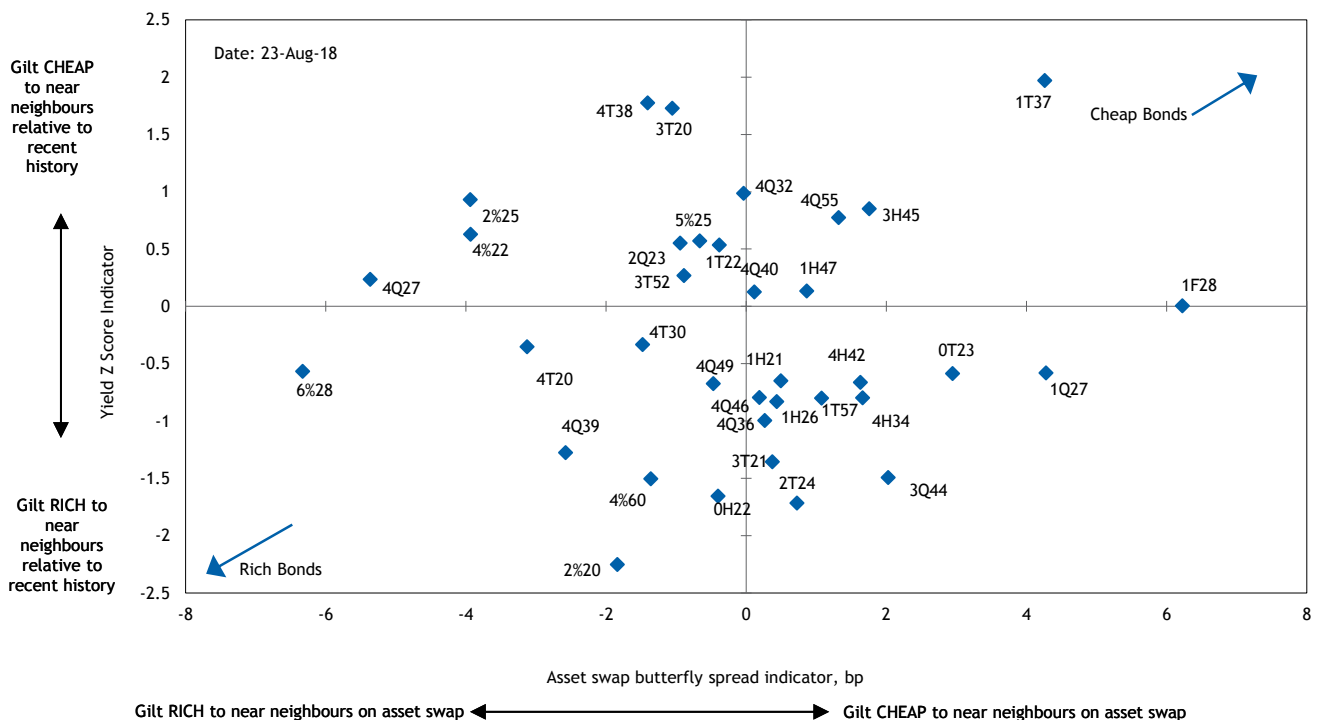
Exhibit C: Gilt micro butterflies (buy body v. sell wings), best trades per sector ranked by 30d z-score

	Butterfly (50/50)			Spread, bp	Z-score	
	Body	Short Wing	Long Wing		Z-score	Chg (7d)
1-7y	3T19	1T19	4T20	0.3	2.82	1.9 ▲
	3T20	2%20	1H21	-2.4	1.96	-1.4 ▼
	3T20	4T20	3T21	-2.6	1.49	-0.7 ▼
7-15y	2%25	2T24	1Q27	-6.8	1.19	-1.5 ▼
	4Q32	4T30	4H34	0.4	1.14	0.3 ▲
	2%25	5%25	1H26	-3.2	0.66	-0.7 ▼
>15y	1T37	4H34	4Q39	5.1	2.55	1.6 ▲
	4T38	4Q36	4Q40	0.1	2.14	2.9 ▲
	4T38	1T37	4Q39	-2.5	1.41	2.3 ▲

Exhibit D: Gilt micro barbells (sell body v. buy wings), best trades per sector ranked by 30d z-score

	Barbell (50/50)			Spread, bp	Z-score	
	Body	Short Wing	Long Wing		Z-score	Chg (7d)
1-7y	1H21	3T20	3T21	-0.5	1.61	0.3 ▲
	2T24	2Q23	5%25	-2.4	1.37	-0.3 ▼
	2T24	0T23	2%25	-0.6	1.35	-0.8 ▼
7-15y	6%28	4Q27	4Q32	6.7	0.77	0.6 ▲
	1H26	5%25	4Q27	-3.0	0.67	-0.1 ▼
	4T30	1F28	4H34	4.4	0.42	1.4 ▲
>15y	4Q36	4H34	1T37	1.3	1.16	-1.6 ▼
	1H47	3H45	3T52	-1.5	1.05	-0.1 ▼
	4H34	4T30	1T37	-2.2	0.93	-1.7 ▼

Exhibit E: Gilt RV quadrant chart, 30d yield butterfly z-score, with asset swap butterfly indicator, bp ***



Source: RBC Capital Markets

* The above charts and tables draw on numerical analysis and do not necessarily represent our views and convictions ** Butterflies with the highest z-scores indicate the most attractive short-term switch opportunities out of the wings into the belly. The most negative z-scores indicate the best short-term opportunities to sell the belly into the wings *** The quadrant diagram combines two measures of relative value. On the horizontal axis a swap spread butterfly indicator is used and on the vertical axis the butterfly yield spread trading range z-score indicator is presented. The quadrant diagram has been designed to facilitate easy identification of rich and cheap bonds. The closer a bond is to the north-east vertex, the better value it represents versus its near neighbours. The closer a bond to the south west vertex, the worse value it represents versus its near neighbours. The most attractive switches should be those that involve selling a bond in the south west quadrant into a bond in the north east quadrant.
 August 28, 2018



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