

Monday, 20 May 2019

Rates: Cautiousness key as trade spat simmers

Global core bonds closed Friday's session nearly unchanged as headlines on international trade were mixed. Sentiment is mixed overnight as investors remain cautious, awaiting the next update in the US-Sino trade dispute. The eco calendar offers no guidance. We uphold our upward bias for core bonds today.

Currencies: Dollar retains the benefit of the doubt, at least for now.

At the end of last week, the dollar profited from a rise in interest rate support as US eco data printed solid. However, the dollar probably won't get additional interest rate support as uncertainty on the trade conflict persists. For now, the dollar enjoys some kind of by-default bit. The EUR/USD 1.1110 support is again coming within reach.

Calendar

Headlines

S&P	↗
Eurostoxx 50	↗
Nikkei	→
Oil	↗
CRB	↗
Gold	↘
2 yr US	→
10 yr US	→
2yr DE	→
10 yr DE	→
EUR/USD	→
USD/JPY	→
EUR/GBP	↗

- **US stock markets eventually failed to overturn opening losses (-0.5%)** despite a very strong May Univ. of Michigan consumer confidence. Asian bourses are mixed this morning with China underperforming as Huawei feels the trade heat.
- **Austrian President Kurz called snap elections in September** after the government collapsed over a fraud-related scandal about the country's far-right vice-chancellor Strache (head of coalition partner Freedom Party).
- **Australian PM Morrison's Liberal-National coalition government surprisingly secured a national election win** despite trailing opposition Labor for most of the past two years in the polls. AUD/USD rose back above 0.89.
- **Saudi Energy Minister al-Falih** sounded in favour of keeping production cuts in place. Global oil supplies are "plentiful" and inventories need to shrink. **Brent crude found its way back above \$73/barrel**, closing in on the cycle peak.
- The Japanese economy grew faster than expected in this year's 1st quarter (0.5% Q/Q vs -0.1%). However, **public spending, rising inventories and net exports (imports falling faster than exports) fuelled the rise.**
- **Exit polls indicated that Indian PM Modi's BJP-led National Democratic Alliance coalition will retain power**, securing 306 seats in India's 543-seat lower house. INR and Indian stock markets rally this morning.
- **Today's is very thin** with only Belgian consumer confidence. Fed Harker, ECB Praet and BoE Broadbent are scheduled to speak..

Rates

Cautiousness key as trade spat simmers

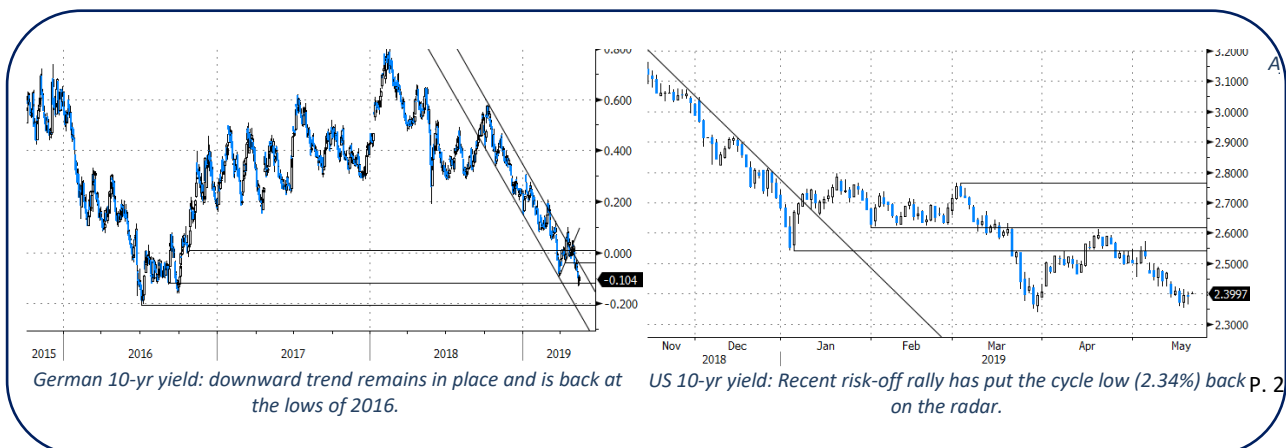
	US yield	-1d
2	2.20	0.01
5	2.19	0.00
10	2.39	0.00
30	2.83	-0.01

	DE yield	-1d
2	-0.65	0.00
5	-0.51	-0.01
10	-0.10	-0.01
30	0.54	0.00

Global core bonds closed Friday's session with gains with German Bunds outperforming US Treasuries. Risk-off prevailed on financial markets in early trading, as Chinese state-owned media signalled a lack of interest to continue trade talks with a "US tariff gun" pointed at their head. Global core bonds jumped higher on the news and continued an upward bias as the day went by. Ahead of the WS opening, comments by US president Trump turned the tide. He confirmed earlier rumours that the US will delay the decision to impose auto tariffs by 6 months, avoiding a trade dispute with important allies (the EU, Japan). Core bonds started to pair intraday gains with an unexpectedly strong University of Michigan sentiment adding to losses. The forward-looking component of the confidence gauge rose from 87.4 to 96.0 in May, a 15-year high. **The US yield curve flattened with changes in the range of -0.8 bps (30-yr) to +0.7 bps (2-yr). The German yield curve edged modestly lower with losses up to -0.9 bps (10-yr).** Peripheral spreads over the German 10-year yield cautiously tightened with Greece (-3 bps) outperforming.

Asian markets are trading mixed this morning as investors remain cautious as they await the next update in the US-Sino trade dispute. **Australian and Indian indices are outperforming following local elections.** Japan's economy unexpectedly grew in the first quarter, beating consensus. However, a look under the hood shows that the Japanese economy is less robust than the headline result would suggest. Core bonds edge cautiously lower this morning, but we remain careful and uphold our upward bias.

The trade story could temporarily shift to the background with the EU and Japan excluded from Trump's auto tariffs for at least 6 months. The US and China raised tariffs on each other's import, but didn't schedule a new date to continue negotiations. Today's eco calendar is close to empty and is thus not expected to offer investors much guidance. Catching our eye for the eco calendar for the rest of the week are the May Markit PMI's for the eurozone and the May German IFO expectations, both scheduled for Thursday. Moreover, the UK prints consumer inflation data (Wednesday) and investors will keep an eye on the meeting minutes of the Fed (Wednesday) and the ECB (Thursday) for more clues on future policy. **Long term view: markets concluded that the ECB missed out on this cycle.** They even start pondering the possibility of an additional deposit rate cut. The downtrend in the German 10-yr remains in place so far. **Regarding Fed policy, markets are now largely discounting a Fed rate cut by December.** The US 10-yr yield earlier this month temporarily returned above the lower bound of the previous 2.5%-2.79%. However, the cycle low (2.34% is again on the radar).



Currencies

R2	1.1815	-1d
R1	1.1621	
EUR/USD	1.1158	-0.0016
S1	1.1110	
S2	1.0864	

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8773	0.0041
S1	0.8500	
S2	0.8314	

USD maintains benefit of the doubt...

On Friday, global risk sentiment remained fragile as China showed reluctant to continue trade talks as the US put the country under pressure with multiple, punitive measures of late. EUR/USD, USD/JPY and EUR/JPY initially developed a mild downtrend. Later in US dealings, **the Michigan consumer confidence printed very strong, tilting the balance in favour of the dollar**. USD/JPY rebounded to close at 110.08. EUR/USD was pushed to new intraday lows and finished the day/week at 1.1158.

This morning, Asian markets are again trading mixed as investors await the next developments in the US-China trade war. Japan Q1 GDP printed at a stronger than expected (2.1% Q/Qa), but details (consumption and investments) were weak as expected. As usual, the impact on the yen was modest. **USD strength prevails this morning**. USD/JPY is trading in the 110.20 area. EUR/USD hovers just above the mid 1.11 area. The Aussie dollar jumped higher (AUD/USD 0.6920 area) after the victory of the Liberal-National coalition in the parliamentary election.

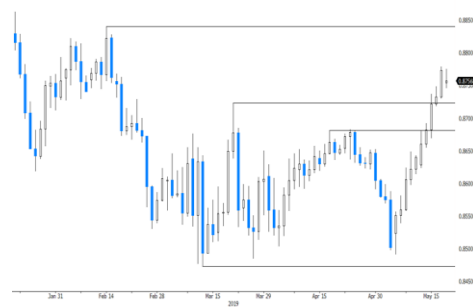
Later today, the eco calendar is very thin. The Chicago Fed activity index is no market mover. At the end of last week, the decline in US yields slowed/bottomed, at least for now. This process might continue today as US equity futures show a cautiously positive start for risky assets. However, trade tensions might return at any time and markets are still pondering the consequences of the recent escalation for the global/US economy and for Fed policy going forward.

At the end of last week, the dollar outperformed the yen and the euro. However, the risk context suggests that **further USD interest rate support won't be evident**. If so, it is in the first place a negative for USD/JPY. The picture for EUR/USD is more mixed. Selling pressure from EUR/JPY might make a EUR/USD rebound more difficult. Even so, we maintain the working hypothesis that the EUR/USD 1.1110 level won't be easy to break without real negative EMU news.

On Friday, sterling lost further ground as political **uncertainty in the UK mounted** after the Brexit talks between the government and the labour opposition collapsed. UK PM May said she will put a deal with an improved package of measures to Parliament, but it is unlikely it will be approved. **The focus now turns to the contest on the leadership for the conservative party**. The EU parliamentary election might show big support for hard-line Brexiters. We assume this context to remain negative for sterling, even as the currency takes a breather this morning. EUR/GBP 0.8840 is next resistance on the technical chart.



EUR/USD: dollar outperformance euro as decline in US yields halts, for now



EUR/GBP: sterling suffers from persistent political uncertainty

Calendar

Monday, 20 May		Consensus	Previous
Japan			
01:50	GDP SA QoQ (1Q P)	A: 0.5%	R: 0.4%
01:50	GDP Annualized SA QoQ (1Q P)	A: 2.1%	R: 1.6%
01:50	GDP Deflator YoY (1Q P)	A: 0.80%	R: 0.5%
01:50	GDP Private Consumption QoQ (1Q P)	A: -0.1%	R: 0.2%
01:50	GDP Business Spending QoQ (1Q P)	A: -0.3%	R: 2.5%
06:30	Industrial Production MoM / YoY (Mar F)	A: -0.6%/-4.3%	-0.90%/-4.6%
UK			
01:01	Rightmove House Prices MoM / YoY (May)	A: 0.9%/0.1%	1.10%/-0.1%
EMU			
10:00	ECB Current Account SA (Mar)	--	26.8b
Germany			
08:00	PPI MoM / YoY (Apr)	0.30%/2.40%	-0.10%/2.40%
Belgium			
15:00	Consumer Confidence Index (May)	--	-7
Events			
10:00	ECB Chief Economist Praet Speaks in London		
15:30	Fed's Harker Speaks About Management Science in Boston (non-voter)		
18:30	BOE's Ben Broadbent speaks in London		
19:00	Clarida, Williams Take Part in 'Fed Listens' Event in New York (voters)		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	2.39	0.00		US	2.20	0.01	DOW	25764	-98.68
DE	-0.10	-0.01		DE	-0.65	0.00	NASDAQ	7816.285	-81.76
BE	0.38	-0.02		BE	-0.53	-0.01	NIKKEI	21301.73	51.64
UK	1.03	-0.04		UK	0.70	-0.03	DAX	12238.94	-71.43
JP	-0.05	0.01		JP	-0.16	0.00	DJ euro-50	3425.64	-12.92
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0.19	2.19	0.99	Eonia	-0.3700	0.0010			
5y	-0.03	2.19	1.07	Euribor-1	-0.3680	-0.0020	Libor-1	2.4419	0.0012
10y	0.42	2.35	1.23	Euribor-3	-0.3130	-0.0010	Libor-3	2.5219	0.0022
				Euribor-6	-0.2400	-0.0030	Libor-6	2.5538	0.0023
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.1158	-0.0016		EUR/JPY	122.8	0.05	CRB	180.99	-1.34
USD/JPY	110.08	0.23		EUR/GBP	0.8773	0.0041	Gold	1275.70	-10.50
GBP/USD	1.2724	-0.0074		EUR/CHF	1.1280	-0.0005	Brent	72.21	-0.41
AUD/USD	0.6868	-0.0024		EUR/SEK	10.7582	-0.0122			
USD/CAD	1.3458	-0.0002		EUR/NOK	9.8146	0.0430			

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