



Sunrise

KBC Market Research Desk – Havenlaan 2 , 1080 Brussels

Wednesday, 29 May 2019

Rates: US 10yr/3m spread at lowest level since global financial crisis

US yields fell hard yesterday, with the 10-yr yield falling below key support levels, paving the way for a return to the 62%-retracement level (2.06%). The US 10yr/3m falling to levels not seen since the global financial crisis further dims risk sentiment today, supporting core bonds. Today's eco calendar only offers secondary data.

Currencies: Dollar holding strong even as US yields nosedive

Trade tensions are reinforcing the global risk-off correction. The US expanded the list of countries it is monitoring on currency manipulation and US yields are declining. Even so, the dollar is holding strong. Today, eco data are second tier. How much more loss of interest rate support can the dollar sustain before it will weigh on its performance?

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	→

- Trade and growth uncertainty grabbed **US equities** by the throat yesterday. The Dow Jones underperformed (-0.93%). Most **Asian stocks** follow the US in lockstep, with Korea leading the losses.
- **Bond rates were also slapped** with the New Zealand 10y trading at a 1.70% record low. The German 10y (-0.16%) eyes the all-time low of -0.20%. The US 3M-10y yield curve inverted, hovering near mid 2007 levels.
- In the latest twist of the trade war, **China could restrict access of US companies to the country's rare-earth resources** used for making electronics and defense products.
- **The EU gathering to discuss the next leaders of the EU's institutions showed differences** between key players Merkel and Macron. Current EU Council president Tusk expects a decision to be made at the June 21 summit.
- **China is not a currency manipulator**, the US Treasury again concluded in its semi-annual report. However, conditions to be labelled as such have softened. Five nations, including Italy and Ireland, were added to the watch list as a result.
- **US home prices** decelerated for a 12th straight month in March, printing at 2.68% YoY (0.1% MoM). **Conference Board consumer confidence** (134.1) surprised on the upside and is just 3.8 points shy of its cycle high.
- **Today's economic calendar** is of second tier importance. The Bank of Canada convenes. German unemployment data, Swedish and (final) French GDP are due in Europe. The US and Germany tap the bond market.

Rates

US 10yr/3m at lowest level since global financial crisis

	US yield	-1d
2	2.12	-0.04
5	2.03	-0.05
10	2.27	-0.03
30	2.68	-0.05

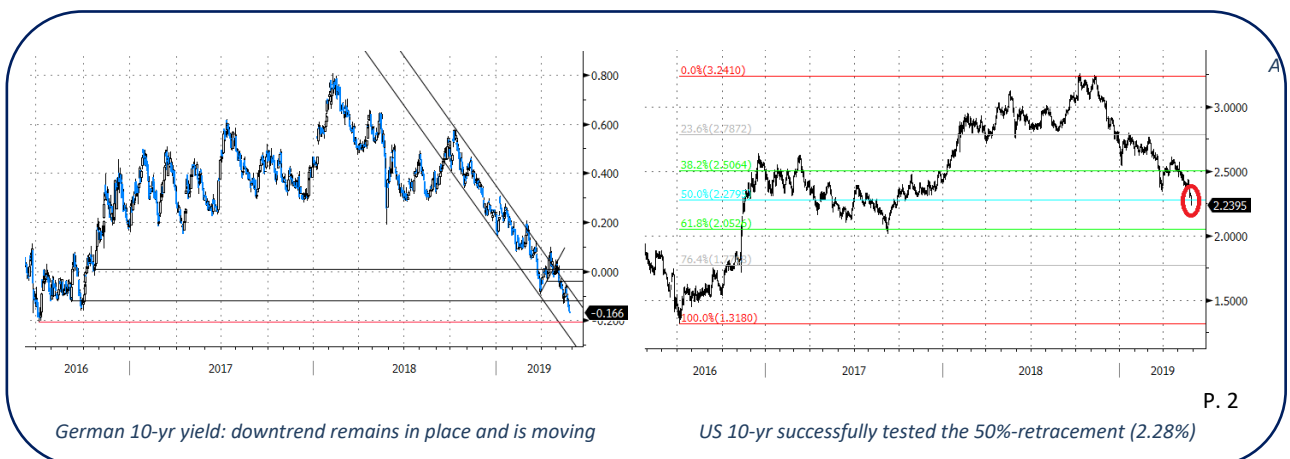
	DE yield	-1d
2	-0.64	0.01
5	-0.56	-0.01
10	-0.16	-0.01
30	0.48	-0.01

Global core bonds edged higher yesterday with US Treasuries outperforming German Bunds. Risk sentiment was fragile at the start of the day with EU investors still digesting EU election results and the renewed EU-Italy fiscal tensions. The ongoing trade spat between the US and China continues to weigh on sentiment as well, as hopes of an agreement fade by the day. Better-than-expected confidence indicators in both the EU and the US provided no solace. Investors continue to flee to safe havens, further supporting core bonds. **The German yield curve was mixed with yield changes varying between -1.7 bps (10-yr) to +0.5 bps (2-yr). The US yield curve edged lower with losses up to -5.4 bps (10-yr).** Peripheral spreads remained rather stable, with Greece (+5 bps) underperforming. **The ongoing rally in US Treasuries pushed the 10yr/3m spread to 10 bps, surpassing this year's low to levels not seen since the start of the financial crisis.** Historically, an inverted curve has been a signal of a looming recession.

Asian equity markets are largely trading with losses overnight as the US-Sino trade tensions heat up again. Beijing yesterday announced it is gearing up to use its dominance of rare earths as a countermeasure in the trade spat with Washington, while **the US Treasury Department refrained from labelling China a currency manipulator** in its semi-annual foreign-exchange report. It did, however, change the criteria used to evaluate countries, thereby adding Ireland, Italy, Vietnam, Singapore and Malaysia to its watchlist. China, Japan, South Korea and Germany were already on that shortlist. The ongoing market uncertainties keep investors in full risk-off, further supporting core bonds at the start of the day.

Today's eco calendar only contains secondary data in both the US (Richmond Fed manufacturing index) and the EMU. Sweden publishes its first-quarter GDP result, while the Bank of Canada holds its May policy meeting. ECB governors Mersch and Rehn speak today. The international trade story continues to dominate financial markets, with investors eyeing key eco data next week.

Long term view: markets concluded that the ECB missed out on this cycle. They start pondering the possibility of an additional deposit rate cut. The downtrend in the German 10-yr remains in place so far and is moving towards the 2016 all-time low (-0.205%). **Regarding the Fed policy, markets are now largely discounting a Fed rate cut by December.** The US 10-yr yield fell below the cycle low (2.34%) and successfully tested the 50%-retracement (2.28%). A confirmed break would bring the 62%-retracement level (2.06%) on the radar.



Currencies

R2	1.1815	-1d
R1	1.1621	
EUR/USD	1.1160	-0.0034
S1	1.1110	
S2	1.0864	

The dollar faced conflicting signals, but retained the benefit of the doubt.

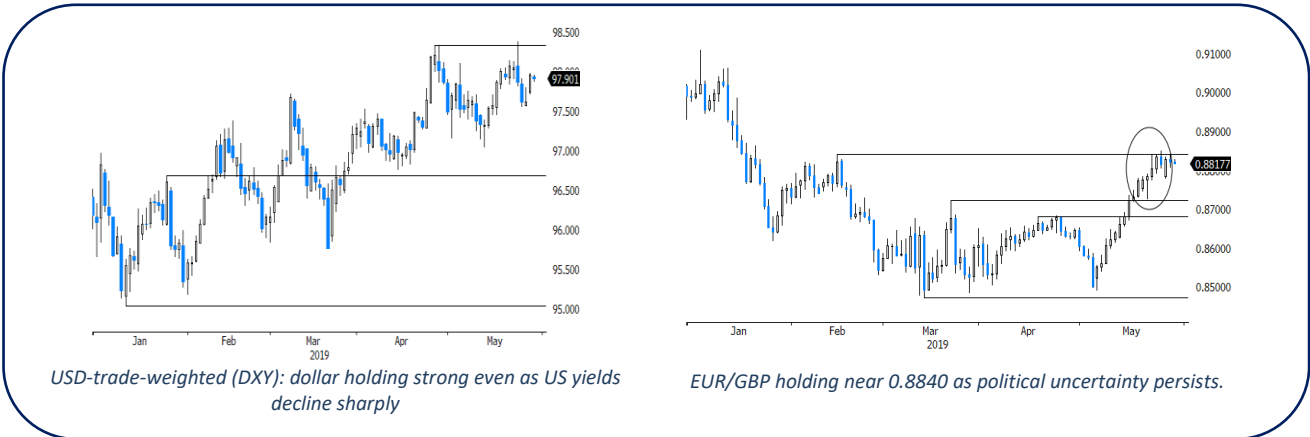
European equities failed to build on Asian gains. Even so, the euro received temporary support from decent EU confidence and money supply data, holding in the high 1.11 area. Later, US consumer confidence was strong but didn't help market sentiment. US Equities reversed earlier gains as trade tensions persisted. A classic risk-off move developed with core yields, USD/JPY, EUR/USD and EUR/JPY declining. A substantial narrowing in the US-German interest rate differential didn't help the euro. EUR/USD closed at 1.1160. USD/JPY finished at 109.38.

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8820	-0.0008
S1	0.8500	
S2	0.8314	

This morning, risk-off weighs on Asian equities, but losses remain orderly. Trade tensions are taking centre stage as the US published a list of countries it is monitoring on FX manipulation. China is stepping its rhetoric on the use of rare earths as a weapon in the trade war. The USD is holding strong, even as US yields are declining sharply. USD/CNY (6.9150 area) is testing recent top. EUR/USD is trading near 1.1165. USD/JPY hovers in the 109.25 area.

Today, the eco calendar only contains second tier EMU and US data. The sharp decline in US yields and the flattening yield curve suggests markets are expecting difficult times ahead with multiple Fed rate cuts. For now, US-German spread narrowing didn't support EUR/USD much, as the situation in EMU remains fragile, too. Still, we are cautious on sustained USD gains, especially as there are ever more signs that the US wants a weaker dollar. **Last week**, EUR/USD tested the 1.1110 support, but no sustained break occurred. A broader USD up-move was capped as investors anticipate more Fed rate cuts as trade tensions might hurt US growth, too. Next week's key US data will bring an update in this debate. In the meantime, the EUR/USD **downside looks again better protected. Some modest/limited gains in the 1.1110/1.1324 range are possible with intermate resistance at 1.1265.**

Sterling still hovered near recent lows against the euro and the dollar as uncertainty on Brexit and on the succession of PM May persisted. However, there was again little high profile news on the issue. EUR/GBP hovered in the 0.8800/0.8840 area. **Today, more technical trading could be on the cards for sterling.** A further deterioration of global sentiment is probably no help for sterling. Will EUR/GBP finally break the 0.8840 resistance area.



Calendar

Wednesday, 29 May		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	2.40%
16:00	Richmond Fed Manufact. Index (May)	7	3
Canada			
16:00	Bank of Canada Rate Decision	1.75%	1.75%
UK			
01:01	BRC Shop Price Index YoY (May)	0.80%	0.40%
Germany			
09:55	Unemployment Change (000's) (May)	-8k	-12k
09:55	Unemployment Claims Rate SA (May)	4.90%	4.90%
France			
08:45	PPI MoM/YoY (Apr)	--/--	0.00%/1.90%
08:45	Consumer Spending MoM/YoY (Apr)	0.40%/0.60%	-0.10%/-1.90%
08:45	CPI EU Harmonized MoM/YoY (May P)	0.30%/1.20%	0.40%/1.50%
08:45	GDP QoQ/YoY (1Q F)	0.30%/1.10%	0.30%/1.10%
Italy			
10:00	Consumer Confidence Index (May)	110.0	110.5
10:00	Manufacturing Confidence (May)	100.4	100.6
10:00	Economic Sentiment (May)	--	98.7
Belgium			
15:00	GDP SA QoQ/YoY (1Q F)	--/--	0.20%/1.10%
Sweden			
09:30	GDP QoQ/WDA YoY (1Q)	0.20%/1.70%	1.20%/2.40%
Events			
09:30	ECB's Mersch Speaks in Frankfurt		
10:00	ECB's Rehn Speaks in London		
11:30	Germany to Sell 3 Billion Euros of 0% 2024 Bonds		
19:00	US to Sell USD32 Bln 7-Year Notes		

	<u>Close</u>	<u>-1d</u>		<u>2-year</u>	<u>Close</u>	<u>-1d</u>	<u>Stocks</u>	<u>Close</u>	<u>-1d</u>
US	2.27	-0.03		US	2.12	-0.04	DOW	25347.77	-237.92
DE	-0.16	-0.01		DE	-0.64	0.01	NASDAQ	7607.351	-29.66
BE	0.34	-0.01		BE	-0.55	0.00	NIKKEI	21003.37	-256.77
UK	0.92	0.00		UK	0.60	-0.04	DAX	12027.05	-44.13
JP	-0.10	-0.02		JP	-0.18	-0.02	DJ euro-50	3348.86	-15.18
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	<u>EUR</u>	<u>-1d</u>	<u>-2d</u>	<u>USD</u>	<u>-1d</u>	<u>-2d</u>
3y	-0.21	2.08	0.92	Eonia	-0.3700	-0.0010			
5y	-0.07	2.06	0.98	Euribor-1	-0.3740	-0.0020	Libor-1	2.4281	0.0000
10y	0.37	2.22	1.15	Euribor-3	-0.3150	-0.0040	Libor-3	2.5249	0.0000
				Euribor-6	-0.2420	-0.0020	Libor-6	2.5486	0.0000
Currencies	<u>Close</u>	<u>-1d</u>		<u>Currencies</u>	<u>Close</u>	<u>-1d</u>	<u>Commodities</u>	<u>Close</u>	<u>-1d</u>
EUR/USD	1.1160	-0.0034		EUR/JPY	122.06	-0.50	CRB	180.26	1.63
USD/JPY	109.38	-0.13		EUR/GBP	0.8820	-0.0008	Gold	1282.50	-6.70
GBP/USD	1.2653	-0.0026		EUR/CHF	1.1247	0.0011	Brent	70.11	0.00
AUD/USD	0.6924	0.0006		EUR/SEK	10.7139	-0.0109			
USD/CAD	1.3494	0.0050		EUR/NOK	9.7369	-0.0082			

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