



Monday, 02 December 2019

Rates: SPD leadership contest adds probability of upped German fiscal spending

Leftist candidates won the SPD leadership ballot, significantly raising the probability of upped German fiscal spending and of an end to the “grand coalition”. Core bonds sell-off this morning in a reflationary trade. The US manufacturing ISM is forecast to rebound further in November, but remaining below the 50 boom-bust mark.

Currencies: EUR/USD looking for a bottom near 1.10

EUR/USD extensively tested the key support just below 1.10 last Friday, but no sustained break occurred. The debate on more fiscal spending in Germany in theory could be euro supportive, but it remains a long call. The manufacturing ISM is expected to come off recent lows, but it might not be strong enough to inspire further USD gains.

Calendar

Headlines



- **WS** dipped lower (up to -0.46%) over the weekend in a truncated US session. **Asian markets** are mostly ticking higher amid upbeat Chinese factory reports. Japan outperforms (+1%).
- **The Chinese Caixin manufacturing PMI surprised on the upside in November. The PMI rose from 51.7 to 51.8** on the back of stronger employment whereas key components such as new orders and business sentiment remain sluggish.
- **China is insisting the US to roll back tariffs as a top priority in any phase one trade deal**, China’s Global Times reported. According to the sources, Beijing not only wants the US to slash planned tariffs, but curtail existing ones too.
- **Iraq hinted OPEC and its allies are tossing around with the idea of deepening existing oils cuts by about 400K bpd.** Oil prices rebounded by as much as 1.9% after Friday’s plunge following Saudi production comments.
- **German chancellor Merkel’s government was thrown under the bus as SPD’s Norbert Walter-Borjans and Saskia Esken got elected on Saturday.** The leftists have voiced opposition to the alliance with Merkel and demand a policy shift.
- **Japanese firms raised capital spending by 7.1% (Y/Y) in Q3, widely beating the 5% forecast.** Solid business investments provide a bright spot for the Japanese economy amid cloudy sentiment and murky demand.
- In **today’s economic calendar** manufacturing PMI’s in the US (ISM), UK and EMU (both final). ECB’s Lagarde testifies at the European Parliament, where her strategic review of the ECB’s mission is likely to play a prominent role.

Rates

Increased probability of German fiscal spending

Core bonds ended (Black) Friday's trading session near opening levels despite some volatility towards the end of dealings. A drop in oil prices after Saudi Arabia indicated to be no longer willing to compensate for overproduction in other OPEC-countries, had no direct impact on trading. The US yield curve steepened with yield changes ranging between -1.3 bps (2-yr) and +1.6 bps (30-yr). Changes on the German yield curve varied between +0.3 bps (5-yr) and -0.5 bps (30-yr). 10-yr yield spread changes vs Germany were close to unchanged.

Asian stock markets trade in positive territory this morning with China somewhat lagging despite better than expected November (non-) manufacturing PMI's. A tweet by the Chinese tabloid "Global Times" suggesting that the Chinese government wants tariffs to be rolled back as part of the phase one trade deal with the US, adds pressure to negotiations. Scrapping the additional tariffs scheduled for December 15 isn't the same thing.

Core bonds sell-off this morning with Bunds underperforming US Treasuries following this weekend's **German SPD leadership ballot**. The party's leftwing contestants (Walter-Borjans & Esken) beat the centrist team of finance minister Scholz and Geywitz. **They campaigned on a platform of breaking with the CDU and trying to rebuild in opposition, a sharp rise in spending on infrastructure, tougher climate change laws and a big stimulus package to help the German economy through its current weak patch.** The SPD gathers this week in Berlin to contemplate whether or not to remain within the ruling coalition. **A decision to leave would most likely result in a temporary minority CDU/CSU government with main legislation passed through Parliament and fresh elections scheduled in 2021. Longer term, the SPD shift implies a higher likelihood of German fiscal spending, explaining this morning's reflationary reaction on bond markets.**

Today's eco calendar contains the **November US manufacturing ISM**. Consensus expects a second consecutive rebound, from 48.3 to 49.2. We side with these forecasts and think that risks, if any, are tilted to the upside. **Such outcome would weigh on core bonds**, though investors will probably be reluctant to already go "all-in" with ADP employment, non-manufacturing ISM and payrolls still coming later this week. Speeches by several ECB members and the NATO Summit are wildcards for trading.

Technically, the German 10-yr yield broke above -0.41% resistance as geopolitical uncertainty diminished, improving the technical picture. **Targets of this double bottom formation are -0.25% and -0.13%.** The 38% retracement level of the Oct-Aug decline stands at -0.24%. **The US 10-yr yield trades in the upper half of the 1.43%-1.94% sideways trading channel. First tests to take out 1.94% failed, causing temporary corrective return action lower.**





German 10-yr yield: fresh German fiscal stimulus bets to trigger new upleg?



US 10-yr yield: Can US eco data cause return to upper bound of sideways trading channel?

Currencies

EUR/USD still looking for a bottom near 1.10

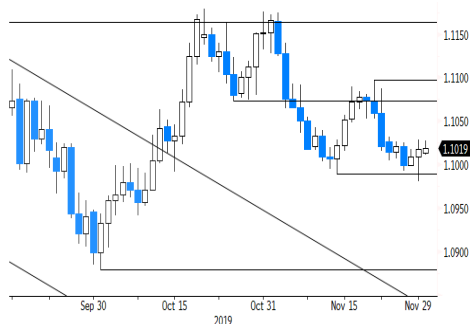


On Friday, trading in the major USD cross rates was mainly sentiment driven and technical in nature. There were no US data. EMU data (German labour data and EMU CPI) printed better than expected but had again hardly any impact on EUR/USD. The pair even extensively tested the 1.0989 support, but a sustained break didn't occur. Later, a risk-off (end of month?) profit-taking also hurt the dollar. EUR/USD returned north of 1.10 (close 1.1018). USD/JPY closed at 109.62. This morning, Asian equities are starting the month on a positive tone. The China Caixin manufacturing PMI (51.8) was better than expected, indicating a further bottoming might be developing. USD/JPY rallied after the release but struggles to maintain early gains. The yuan is little changed near USD/CNY 7.03. In Germany, Chancellor Merkel's coalition party, the SPD, voted for a left-wing leadership which might question the balanced budget approach. The bund future declines (higher yield) but for now with little impact on EUR/USD (1.1015 area).

Today, the calendar contains the final EMU November PMI's and the US manufacturing ISM. For the ISM, a rise from 48.3 to 49.5 is expected. Comparable measures in other major economies (EMU, China) recently showed tentative signs of bottoming. The ISM might join this move, we doubt to already see a big upward surprise. The SPD leadership change will have no immediate impact on German government spending. Even so, we look out for the reaction of German yields. Anticipation on a potential future fiscal loosening might raise yields and in theory could be euro supportive. Admittedly it remains a (very) long call.

Last week, the euro stayed in the defensive, even as EMU data weren't too bad. The 1.0989 support was extensively tested, but no sustained break occurred. Even so, the EUR/USD picture remains fragile. A drop below 1.0989/81 would bring the 1.0879 correction low in the radar. A return above 1.11 would call off the ST downward alert.

On Friday, EUR/GBP still held a tight sideways range in the lower half of the 0.85 big figure. The terrorist attack in London had little impact on trading. Some polls this weekend showed a slight decline in the lead of the conservative party. Sterling is losing a few ticks this morning. We expect sterling to stay strong as long as a Conservative majority remains to most likely scenario. Any comments from US president Trump (in London for the NATO summit) might cause some ST jitters.



EUR/USD holding near key support. Will debate on potential German fiscal stimulus support the single currency?



0.85/0.8472 solid support for EUR/GBP cross rate.

Calendar

Monday, 2 December		Consensus	Previous
US			
16:00	ISM Manufacturing (Nov)	49.2	48.3
16:00	ISM Employment (Nov)	48.3	47.7
16:00	ISM Prices Paid (Nov)	47.0	45.5
16:00	ISM New Orders (Nov)	--	49.1
16:00	Construction Spending MoM (Oct)	0.30%	0.50%
Canada			
15:30	Markit Canada Manufacturing PMI (Nov)	--	51.2
Japan			
00:50	Capital Spending YoY (3Q)	7.10%A	1.90%
00:50	Capital Spending Ex Software YoY (3Q)	7.70%A	-1.70%
00:50	Company Profits YoY (3Q)	-5.30%A	-12.00%
00:50	Company Sales YoY (3Q)	-2.60%A	0.40%
00:50	Loans & Discounts Corp YoY (Oct)	2.24%A	1.90%
06:00	Vehicle Sales YoY (Nov)	-14.60%A	-26.40%
EMU			
10:00	Markit Eurozone Manufacturing PMI (Nov F)	46.6	46.6
Italy			
09:45	Markit Italy Manufacturing PMI (Nov)	47.5	47.7
China			
02:45	Caixin China PMI Mfg (Nov)	51.8A	51.7
Norway			
09:00	DNB/NIMA PMI Manufacturing (Nov)	--	54.9
Spain			
09:15	Markit Spain Manufacturing PMI (Nov)	46.5	46.8
Sweden			
08:30	Swedbank/Silf PMI Manufacturing (Nov)	46.9	46
Events			
02DEC	NATO leaders meeting		
08:00	ECB's Rehn Opens Conference on Financial Stability and Data		
11:00	ECB's Holzmann Speaks on Austrian Financial Stability		
15:00	ECB President Lagarde Testifies at European Parliament		

10-year	Close	-1d		2-year	Close	-1d		Stocks	Close	-1d
US	1.78	0.01		US	1.61	-0.01		DOW	28051.41	-112.59
DE	-0.36	0.00		DE	-0.63	0.01		NASDAQ	8665.471	-39.70
BE	-0.06	0.00		BE	-0.62	0.01		NIKKEI	23529.5	235.59
UK	0.70	0.02		UK	0.54	0.03		DAX	13236.38	-9.20
JP	-0.05	0.03		JP	-0.16	0.01		DJ euro-50	3703.58	-0.90
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	-1d	-2d
3y	-0.31	1.58	0.80	Eonia	-0.4460	0.0000		Libor-1	1.6971	-0.0114
5y	-0.23	1.59	0.83	Euribor-1	-0.4370	0.0020		Libor-3	1.9055	-0.0014
10y	0.05	1.70	0.91	Euribor-3	-0.4010	-0.0040		Libor-6	1.8969	0.0017
				Euribor-6	-0.3430	0.0040				
Currencies	Close	-1d		Currencies	Close	-1d		Commodities	Close	-1d
EUR/USD	1.1018	0.0009		EUR/JPY	120.61	0.06		CRB	176.66	-3.69
USD/JPY	109.49	-0.02		EUR/GBP	0.8519	-0.0009		Gold	1472.70	11.90
GBP/USD	1.2925	0.0013		EUR/CHF	1.1019	0.0023		Brent	60.49	-2.78
AUD/USD	0.6763	-0.0007		EUR/SEK	10.5554	0.0329				
USD/CAD	1.3282	0.0000		EUR/NOK	10.1622	0.0679				

If you no longer wish to receive this mail, please contact us: "kbcmarketresearch@kbc.be ' to unsubscribe

Contacts

Brussels Research (KBC)		Global Sales Force	
Mathias Van der Jeugt	+32 2 417 51 94	Corporate Desk(Brussels)	+32 2 417 45 82
Peter Wuyts	+32 2 417 32 35	Institutional Desk(Brussels)	+32 2 417 46 25
Mathias Janssens	+32 2 417 51 95	CBC Desk (Brussels)	+32 2 547 19 19
Dieter Lapeire	+32 2 417 25 47	France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Singapore	+65 533 34 10
Shawn Britton	+353 1 664 6892		
Prague Research (CSOB)		Prague	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
Bratislava Research (CSOB)		Bratislava	+421 2 5966 8820
Marek Gabris	+421 2 5966 8809		
Budapest Research		Budapest	+36 1 328 99 85
David Nemeth	+36 1 328 9989		

ALL OUR REPORTS ARE AVAILABLE VIA OUR KBC RESEARCH APP (iPhone, iPad, Android)

This non-exhaustive information is based on short-term forecasts for expected developments on the financial markets. KBC Bank cannot guarantee that these forecasts will materialize and cannot be held liable in any way for direct or consequential loss arising from any use of this document or its content. The document is not intended as personalized investment advice and does not constitute a recommendation to buy, sell or hold investments described herein. Although information has been obtained from and is based upon sources KBC believes to be reliable, KBC does not guarantee the accuracy of this information, which may be incomplete or condensed. All opinions and estimates constitute a KBC judgment as of the date of the report and are subject to change without notice.

