Tuesday, 06 June 2023

KBC Sunrise Market Commentary

Markets

- **A disappointing US non-manufacturing ISM was yesterday's defining moment for FI and FX trading.** Up until the release, the post-payrolls momentum still pushed US rates and the dollar gently higher. Afterwards, intraday fortunes changes, the first Pavlov reaction didn't really gain traction afterwards. Turning to the data first, the ISM fell from 51.9 to 50.3, holding just north of the 50 boom/bust market. With the exception of Dec2022, it was **the weakest reading since May 2020,** undershooting the consensus estimate (pick-up to 52.4) as well. **Deteriorating services sentiment is something to keep a close eye on as this sector kept global economies humming over the past months.** Details didn't offer much hope with inventory building (58.3 from 47.2) and inventory sentiment (61 from 48.9) being the sole factors preventing a drop in contraction territory. Overall business activity moderated from 52 to 51.5 with new orders down to 52.9 from 56.1. The order backlog is gone (40.9 from 49.7). Employment declined from 50.8 to 49.2. Prices paid extended their disinflationary trend (56.2 from 59.6). **The market reaction was orderly overall.** US yield lost 0.2 bps (30-yr) to 3.3 bps (2-yr) in the end, hiding an intraday decline in the high single digits. German Bunds underperformed significantly with yields adding 5.5 bps (30-yr) to 7.9 bps (2-yr). They had some catching up to do with the end of last week's WS session, gapped higher at the open on rising energy prices and barely felt the impact from the non-manufacturing ISM. The trade-weighted dollar closed at 104 from an open at 104.04 and an intraday peak at 104.40. EUR/USD followed a similar intraday pattern eventually ending barely unchanged at 1.0713 coming off an intraday bottom at 1.0675.

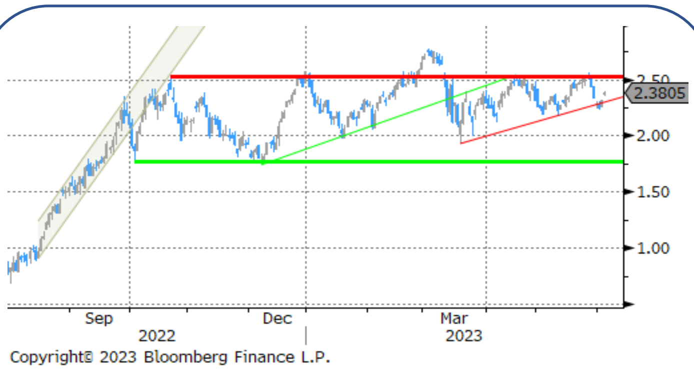
- **This morning's RBA decision (see below) was today's main dish and a reminder to central banks and markets globally that the inflation battle isn't easily won.** It sets the tone for the start of trading with core bonds again trading on the weaker side. Mixed Asian risk sentiment offers little guidance further out. The single currency gets some interest rate backing which it missed for most of the month May. EUR/USD changes hands at 1.0729 with the May low/1st support (1.0635) starting to look more solid. Today's eco calendar contains no events/data worth mentioning.

News & Views

- **The Reserve Bank of Australia raised its policy rate further by 25 bps to 4.1%.** A majority of analysts expected an unchanged decision after the RBA already restarted hiking rates last month. **The RBA assumes that inflation has passed its peak, but at 7% it is still much too high.** Recent data also indicated that **upside risks to the inflation outlook have increased.** Today's hike should provide greater confidence that inflation will return to the target within a reasonable time frame. Growth in Australia has slowed and conditions on labour market have eased but remain very tight. **Wage growth also has picked up in response to the tight labour market and high inflation.** In this respect the RBA Board remains alert to the risk that expectations of ongoing high inflation contributes to larger increases in both prices and wages, especially given the limited spare capacity in the economy and the still very low rate of unemployment. The board concludes that **some further tightening of monetary policy may be required.** The 2-y Australian government yield jumps 9 bps, setting a new cycle top near 3.85%. The Aussie dollar gains about 1 bp after the decision with AUD/USD changing hands near 0.6675.

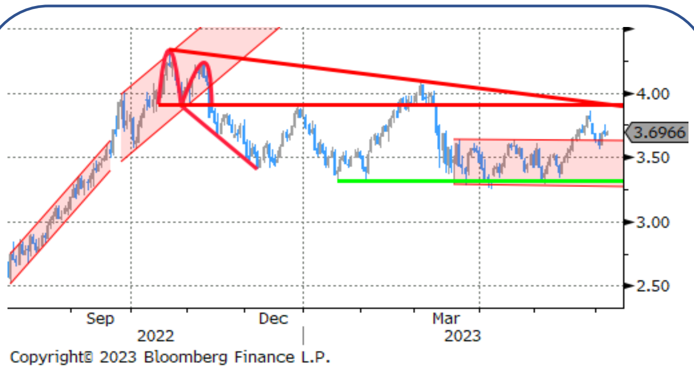
- **Japanese wages grew less than expected/hoped for in April.** Labour Cash earning rose 1% Y/Y down from 1.3% Y/Y in March. The April data are the **first wage data series after the labour spring negations (Shunto).** However it might **take some time to see the full impact** of the wage negotiations in the coming months. **Real cash earnings even were 3% lower compared to the same period last year.** Consumer spending data for April also disappointed printing 4.4% lower compared to the same month last year. Today's soft wage data probably won't inspire the BOJ to change its easy policy anytime soon. The 10-y Japanese government bond yield trades little changed near 0.43%. USD/JPY is losing a few ticks, but this probably mainly mirrors USD softness.

Graphs



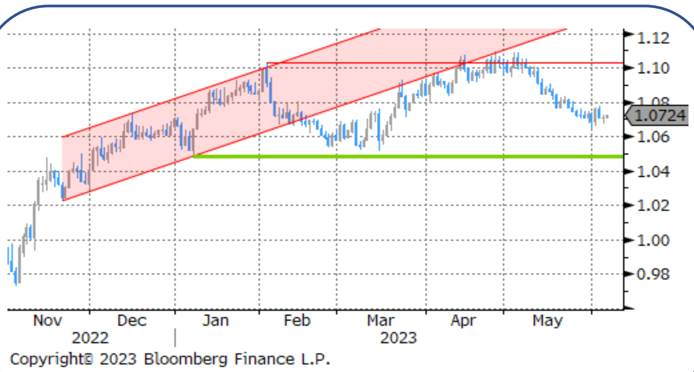
GE 10y yield

The ECB adopted a more gradual approach by slowing its tightening pace from 50 to 25 bps in May. It stated that in the base scenario rates will be brought to sufficiently restrictive levels (i.e. more hikes to follow) and will stay there for as long as necessary. **Combined with APP reinvestments fully stopping from 2023H2 on, we expect a solid bottom below European/German yields.**



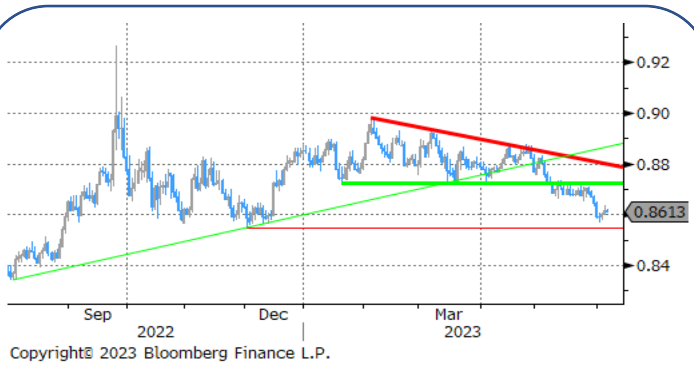
US 10y yield

The Fed hinted at a pause after delivering a 25 bps hike in May. They want more evidence on the pass-through of the previous 500 bps of tightening. **The regional bank implosion is expected to additionally weigh on activity going forward.** But elevated inflation and a strong labour market mean that the Fed will likely have to hike its policy rate again by July. It triggered underperformance of US Treasuries during the month of May.



EUR/USD

The US dollar struck back in May. Local financial stability concerns moved to the background and market focus returned to monetary policy. Rebounding US yields caused EUR/USD to fall below the 1.0727/1.0735 support zone, paving the way towards 1.06 in first instance. 1.0484/1.0516 is the hard lower bound as the ECB still retains a hawkish upper hand vs. the Fed.



EUR/GBP

The BoE's conditional rate hike approach comes back to haunt them after **May CPI delivered a nasty surprise.** UK money markets expect several more rate hikes this year, pushing sterling to a now YtD high below EUR/GBP 0.865. The short-term momentum in sterling improved, but we stay cautious MLT. Divergency within the BoE about the way forward still might change sentiment on sterling further down the road.

Calendar & Table

Wednesday, 17 May		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	6.30%
14:30	Housing Starts Total/MoM (Apr)	1400k/-1.40%	1420k/-0.80%
14:30	Building Permits Total/MoM (Apr)	1430k/0.00%	1430kR/-7.70%R
Japan			
01:50	GDP SA QoQ/QoQ Annualized (1Q P)	0.40%A/1.60%A	0.00%/-0.10%R
01:50	GDP Deflator YoY (1Q P)	2.00%A	1.20%
01:50	GDP Private Consumption QoQ (1Q P)	0.60%A	0.20%R
01:50	GDP Business Spending QoQ (1Q P)	0.90%A	-0.70%R
01:50	Inventory Contribution % GDP (1Q P)	0.10%A	-0.50%
01:50	Net Exports Contribution % GDP (1Q P)	-0.30%A	0.40%
EMU			
08:00	EU27 New Car Registrations (Apr)	--	28.80%
11:00	CPI MoM/YoY (Apr F)	0.70%/7.00%	0.70%/6.90%
11:00	CPI Core YoY (Apr F)	5.60%	5.60%
Events			
01:00	Fed's Bostic and Goolsbee Discuss the Economic Outlook		
09:15	ECB's De Cos Speaks		
11:00	ECB's Elderson Speaks		
12:00	ECB's Centeno Speaks at Bank of Portugal Press Conference		
17:15	ECB's Guindos Speaks		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	3.68	-0.01		US	4.47	-0.03	DOW	33562.86	-199.90
DE	2.38	0.07		DE	2.89	0.09	NASDAQ	13229.43	-11.34
BE	3.06	0.06		BE	2.96	0.09	NIKKEI	32472.79	255.36
UK	4.21	0.05		UK	4.45	0.08	DAX	15963.89	-87.34
JP	0.43	0.00		JP	-0.06	0.00	DJ euro-50	4293.24	-30.28
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	3.36	4.23	4.93	Ester	3.1480	0.0000			
5y	3.10	3.88	4.56	Euribor-1	3.2220	0.0040	Libor-1	5.1886	0.0000
10y	3.01	3.72	4.15	Euribor-3	3.4930	0.0030	Libor-3	5.4963	0.0000
				Euribor-6	3.7390	0.0110	Libor-6	5.6234	0.0000
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.0713	0.0005		EUR/JPY	149.56	-0.20	CRB	260.44	0.76
USD/JPY	139.58	-0.34		EUR/GBP	0.8614	0.0014	Gold	1974.30	4.70
GBP/USD	1.2438	-0.0015		EUR/CHF	0.9709	-0.0023	Brent	76.71	0.58
AUD/USD	0.6617	0.0007		EUR/SEK	11.6263	0.0616			
USD/CAD	1.3445	0.0020		EUR/NOK	11.8202	0.0206			

Contacts

KBC Economics – Markets Brussels		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
		France	+32 2 417 32 65
		London	+44 207 256 4848
		Singapore	+65 533 34 10
CSOB Economics – Markets Prague		**Prague**	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
CSOB Economics – Markets Bratislava		**Bratislava**	+421 2 5966 8820
Marek Gabris	+421 2 5966 8809		
K&H Economics – Markets Budapest		**Budapest**	+36 1 328 99 85
David Nemeth	+36 1 328 9989		

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