Thursday, 08 June 2023

KBC Sunrise Market Commentary

Markets

- **The Bank of Canada yesterday joined the Reserve Bank of Australia in starting a second leg of the policy normalization cycle after a premature pause (see below).** Monetary policy **just wasn't sufficiently restrictive enough** to bring supply and demand back in balance and return inflation sustainably to the 2% target. The Fed gets a free analysis as it contemplates engineering its own pause at next week's meeting: US economic growth is slowing, although consumer spending remains surprisingly resilient and the labour market is still tight. On top **financial conditions have tightened back to those seen before the failures in the US and Switzerland.** Have it your way Powell and co, but don't mind the "told ya" afterwards. **US Treasuries sold off** after the BoC decision which was only 50% discounted in Canadian money markets. Interestingly, **the very long end of the curve underperformed.** At the front end, investors remain convinced (rightly so) that the Fed won't alter earlier guidance of pausing the rate hike cycle. At the long end, **US real rates** were responsible for the move rather than inflation expectations. This might imply **a repricing of how high the natural interest rate in the US will be in coming years, boosting the case for "higher for longer" instead of "a higher peak rate" for now.** US yields eventually added 7.7 bps (2-yr) to 13.6 bps (10-yr). German Bunds followed US Treasuries lower with German yields rising 8-9 bps for tenors up to 10-yr and by 5 bps at the very long end of the curve. US stock markets obviously didn't welcome the higher real rates, losing up to 1.3% for Nasdaq. The dollar failed to benefit with European rates trailing the move. EUR/USD again closed almost unaltered near 1.07. EUR/GBP was also nearly unchanged in the end at 0.86.

- Asian risk sentiment was mixed this morning and doesn't offer much guidance for the start today. **The May UK RICS housing price balance unexpectedly increased, extending a bottoming out process in place since the start of the year.** House price developments show a similar pattern in other countries/economies regions as well and might eventually weigh in central bank decision making processes. The eco calendar is razor thin further out with only US weekly jobless claims. **We are eager to find if core bonds remain in sell-off mode in the run-up to/putting pressure on Fed/ECB policy meetings next week.**

News & Views

- **The Bank of Canada yesterday resumed its hiking cycle by raising the policy rate by 25 bps to 4.75%,** the highest in 22 year. The BoC also continues its quantitative tightening. The Canadian central bank had paused its hiking cycle since January to assess the impact of previous tightening on prices and activity. However, **Q1 growth was stronger than expected (3.1% Q/Qa).** The BoC acknowledged that consumer spending was surprisingly strong and broad-based. Demand for services, but also for interest sensitive goods increased. Recently, **even housing activity had picked up again. The labour market remains strong.** Concluding: **excess demand is more persistent than expected.** Inflation in April ticked up to 4.4%. The BoC expects inflation to ease to around 3% in summer, but **with core inflation holding in the 3.5-4% range and excess demand to continue, concerns increased that CPI could get stuck above the 2% target,** justifying the case for additional tightening. The 2-yr Canadian government bond yield jumped almost 20 bps (4.58%). Markets expect an additional rate hike in July or at the latest in September. The loonie initially strengthened from near USD/CAD 1.34 to the 1.333 area, but currently again trades in the 1.3365 area.

- **The National Bank of Poland left its policy rate unchanged at 6.75% on Tuesday.** At the press conference yesterday, **governor Glapinski held a (modestly) dovish tone.** The NBP governor expects **inflation (also core) to continue to decline quickly in the coming months** and the decline in prices is spreading across categories beyond food and energy. Inflation is developing along that path the NBP expected and might slow to single digit levels in September. **If the central bank can be sure that inflation will continue to fall in the coming quarters, this opens the opportunity for rate cuts.** The NBP governor sees a good chance for the economy to make a soft landing, avoiding a recession. In this respect, he expects real wages to be positive from H2 2023. **Markets discount the start of rate cuts in autumn.** After testing the strongest levels against the euro since mid-2021, the zloty lost modest ground to EUR/PLN 4.49.

Graphs

GE 10y yield

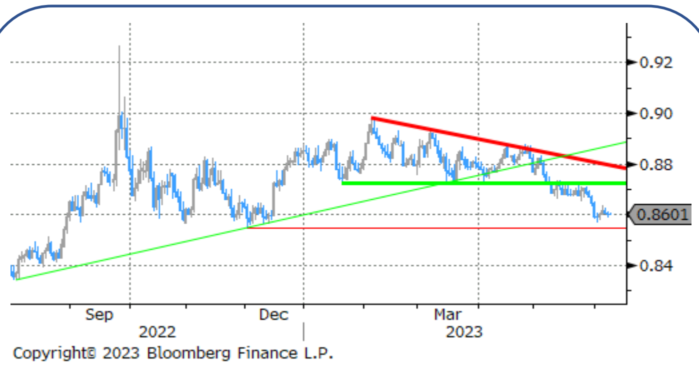
The ECB adopted a more gradual approach by slowing its tightening pace from 50 to 25 bps in May. It stated that in the base scenario rates will be brought to sufficiently restrictive levels (i.e. more hikes to follow) and will stay there for as long as necessary. **Combined with APP reinvestments fully 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

Thursday, 8 June		Consensus	Previous
US			
14:30	**Initial Jobless Claims**	**235k**	**232k**
14:30	Continuing Claims	1802k	1795k
16:00	Wholesale Trade Sales MoM (Apr)	0.90%	-2.10%
Japan			
01:50	BoP Current Account Adjusted (Apr)	¥1899.6bA	¥1009.0b
01:50	Bank Lending Ex-Trusts YoY (May)	3.80%A	3.50%
04:00	Tokyo Avg Office Vacancies (May)	6.16A	6.11
07:00	Eco Watchers Survey Outlook SA (May)	56.1	55.7
UK			
01:01	RICS House Price Balance (May)	-30%A	-39%
Hungary			
08:30	**CPI MoM/YoY (May)**	**0.50%/22.30%**	**0.70%/24.00%**

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	3.80	0.14		US	4.56	0.08	DOW	33665.02	91.74
DE	2.46	0.08		DE	2.94	0.08	NASDAQ	13104.89	-171.53
BE	3.14	0.10		BE	3.01	0.09	NIKKEI	31664.56	-249.18
UK	4.25	0.04		UK	4.57	0.09	DAX	15960.56	-31.88
JP	0.43	0.01		JP	-0.06	0.00	DJ euro-50	4291.91	-3.31

IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	3.40	4.35	5.00	Ester	3.1440	-0.0010			
5y	3.15	4.00	4.61	Euribor-1	3.2710	0.0170	Libor-1	5.2011	0.0000
10y	3.07	3.81	4.19	Euribor-3	3.4590	-0.0170	Libor-3	5.5133	0.0000
				Euribor-6	3.7330	0.0180	Libor-6	5.6446	0.0000

Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.0699	0.0006	EUR/JPY	149.92	0.60	CRB	261.43	0.76
USD/JPY	140.13	0.50	EUR/GBP	0.8602	-0.0005	Gold	1958.40	-23.10
GBP/USD	1.2438	0.0014	EUR/CHF	0.9738	0.0033	Brent	76.95	0.66
AUD/USD	0.6652	-0.0019	EUR/SEK	11.6546	-0.0182			
USD/CAD	1.337	-0.0033	EUR/NOK	11.8201	-0.0430			

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