



Thursday, 04 July 2024

KBC Sunrise Market Commentary

Markets

- US Treasuries outperformed Bunds during a holiday-shortened session yesterday. Yields slid between 3.4 (2-yr) to -7.8 (30-yr) bps following a string of weaker-than-expected data (ADP job report, jobless claims & services ISM). The FOMC June meeting minutes, which were released after the early US market close, highlighted the need for additional evidence of inflation cooling before considering to cut rates. But there's **growing caution about the labor market** with "several" participants noting that a further weakening in demand may lead to actual higher unemployment rather than in fewer job openings. Since the policy meeting, we've seen a number of Fed officials including SF's Daly and governor Cook particularly focusing on the labour market so we're not surprised to see the topic gaining traction internally. German yields (ex. 2-yr, +1.2 bps) dropped in sympathy with the US with net daily losses of as much as 5.6 bps (30-yr). Narrowing yield differentials and the bullish equity sentiment (both S&P500 & Nasdaq finished at record highs) weighed on the dollar. EUR/USD swung from 1.0745 to an intraday high of 1.0817 before paring gains to 1.0786 in the close. DXY limited the fallout out from 105.67 to 105.40. USD/JPY eked out a gain nonetheless to 161.55, the highest close in 38 years.
- It's election day in the UK today.** Sterling shows little signs of nervousness though. The pound strengthened in recent days after EUR/GBP failed to take out 0.85 earlier this week. Anything but a (possibly record-breaking) **landslide Labour victory** would be a huge surprise. Keir Starmer's party has had a strong lead in the polls for more than two years now. Sterling's reaction to today's outcome should stay limited, eying Labour's policy plans and how they fund them instead. This will only get clearer as weeks pass by. We hold a negative EUR/GBP bias nonetheless mainly due to the euro-side of the equation ahead of the next round in the French parliamentary elections. Today's **French auction** is worth mentioning in this respect. In a sign of caution, treasury downsized the target size by €1.5bn to 10.5bn for a four-layered sale of bonds maturing between 2033 and 2066. Politics continue to take center stage in the US as well, even as **financial markets are closed for Independence Day. Calls internally grow louder for Biden to step down** after a disastrous showing during the debate with Trump. We expect an announcement in coming days. Trading in FX and FI core markets in absence of the US and economic data will be technically inspired.

News & Views

- The National Bank of Poland kept its policy rate unchanged at 5.75% yesterday.** New annual inflation projections put CPI at 3.7% this year (from 3.55%), 5.25% in 2025 (from 3.6%) and 2.7% in 2026 (from 2.9%). **The NBP expects inflation (2.6% Y/Y in June) to increase in the coming quarters and run above the NBP's inflation target mainly because of raised energy prices.** It's uncertain whether this will impact inflation expectations while elevated services price growth, future fiscal/regulatory policies, the pace of the economic recovery and labour market conditions (wage growth is still high) are other risks. Weakened Polish economic conditions (especially industry & construction) result in **downwardly revised growth forecast** for the 2024-2026 horizon: from 3.5%-4.25%-3.25% in March to 3%-3.8%-3.1% yesterday. NBP governor Glapinski will still give a press conference later today. He's unlikely to change previous guidance of unchanged policy rates for at least the remainder of the year. The Polish zloty holds near multiyear highs at 4.30.
- The Brazilian real finally found some relieve yesterday.** The currency lost more than 10% against the dollar since early May, propelling USD/BRL to 5.70 for the first time since early 2022. USD strength was this month accompanied by BRL weakness on the back of **multiple calls from Brazilian president Lula da Silva to defy spending cuts and wrestle the Brazilian central bank into larger policy rate cuts.** Yesterday, he more or less **changed course** by saying that his government sees fiscal responsibility as a commitment while Minister of Finance Haddad stressed that central bank directors have the autonomy to act. Simultaneously, Lula nevertheless unveiled a record breaking BRL 400bn of funding to support the Brazilian agricultural sector. USD/BRL fell back towards 5.55.

Graphs



GE 10y yield

The ECB cut its key policy rates by 25 bps at the June policy meeting. A more bumpy inflation path in H2 2024, the EMU economy gradually regaining traction and the Fed's higher for longer US strategy make follow-up moves difficult. Markets are coming to terms with that. Meanwhile, much of the safe haven bids were reversed after the first round in the French elections. The 2.34%-2.4% support zone looks solid.



US 10y yield

The Fed needs more evidence than just one slower-than-expected (May) CPI is providing. **Upgraded inflation forecasts and a higher neutral rate** complicate the timing of a first cut further. June dots suggest one move in 2024 and four next year. The long end of the curve is supported by increased odds of a Trump presidency after the debate with Biden. The spectre of increased spending (risk premia) pulled the 10-yr away from the 4.2% support area.



EUR/USD

EUR/USD is stuck in the 1.06-1.09 range. The desynchronized rate cut cycle with the ECB exceptionally taking the lead, **strong US May payrolls and a swing to the right in European elections pulled the pair away from 1.09**. The Fed meeting balanced the weaker than expected US CPI outcome. The increased probability of a hung French parliament after the first round offered the euro some relief.



EUR/GBP

Debate at the BOE is **focused at the timing of rate cuts**. May headline inflation returned to 2%, **but core measures weren't in line with inflation sustainably returning to target** any time soon. **Still some BoE members at the June meeting appeared moving closer to a rate cut**. This might cap further sterling gains. **The euro's vulnerability to political event risk going into the French elections eased for now**. EUR/GBP 0.84 is becoming solid support.

Calendar & Table

Thursday, 4 July		Consensus	Previous
UK			
10:30	DMP 3M Output Price Expectations (Jun)	3.80%	3.90%
10:30	DMP 1 Year CPI Expectations (Jun)	2.80%	2.90%
Germany			
08:00	Factory Orders MoM/WDA YoY (May)	0.50%/-6.10%	-0.20%/-1.60%
Events			
04JULY	US financial markets closed for Independence Day		
04JULY	UK general elections		
10:30	Bank of England Bank Liabilities/Credit Conditions Surveys		
10:30	Spain to Sell Bonds		
10:50	France to Sell Bonds		
13:30	ECB Publishes Account of June Policy Meeting		
15:00	Polish Central Bank Governor Glapinski Holds News Conference		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	4.36	-0.07		US	4.71	-0.04	DOW	39308	-23.85
DE	2.59	-0.02		DE	2.92	0.01	NASDAQ	18188.3	159.54
BE	3.14	-0.05		BE	3.03	0.00	NIKKEI	40949.34	368.58
UK	4.17	-0.08		UK	4.17	-0.02	DAX	18374.53	210.47
JP	1.09	-0.01		JP	0.35	-0.01	DJ euro-50	4965.8	59.47
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	3.05	4.29	4.26	€STR	3.6630	0.0010			
5y	2.88	4.05	3.98	Euribor-1	3.6350	-0.0190	SOFR-1	5.3260	-0.0073
10y	2.83	3.94	3.87	Euribor-3	3.7050	-0.0090	SOFR-3	5.3075	-0.0088
				Euribor-6	3.6780	0.0020	SOFR-6	5.2238	-0.0186
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.0786	0.0041		EUR/JPY	174.42	0.94	CRB	294.02	1.67
USD/JPY	161.69	0.25		EUR/GBP	0.8466	-0.0004	Gold	2369.40	36.00
GBP/USD	1.2742	0.0057		EUR/CHF	0.9725	0.0012	Brent	87.34	1.10
AUD/USD	0.6705	0.0038		EUR/SEK	11.3213	-0.0468			
USD/CAD	1.3639	-0.0040		EUR/NOK	11.3857	-0.0798			

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