



Tuesday, 18 February 2025

## KBC Sunrise Market Commentary

### Market

- Spotlights were on Europe yesterday. US financial markets were closed for President's Day while French president Macron summoned a handful of European leaders as well as EC president von der Leyen and Nato chief Rutte. **The goal was not so much to announce big defense initiatives** – Europe's buy-in at the negotiation table with Russia – **as it was to show the EU's decisiveness and speediness when it is once again cornered.** Actual decisions, however, require all 27 member states to be part of the discussions. Funding as always will be one of the key topics. Options include an escape clause that keeps defense spending out of the fiscal equation so that countries can still abide by the 3% deficit rule or re-purposing existing funds (e.g. unused resources of the pandemic recovery fund). Eventually, though, **we think we will end up in a Next Generation EU-style joint borrowing on the European level.** Resistance from some of the staunchest opposition indeed appears to be easing. Either way, setting up a European defense architecture is going to **require massive investments with a significant part of that being recurring.** German bunds underperformed vs swap with yields rising between 2.7 and 7 bps in a bear steepening move. French OATs declined as well, pushing up rates 1.7-5.2 bps. UK gilts outperformed (+0.4-3.2 bps). The country is already spending 2%+ on defense, making the additional effort relatively smaller compared to European peers. The euro closed lower, against the dollar (EUR/USD <1.05) but more so against sterling. EUR/GBP turned to the 0.83 big figure ahead of some economic data scheduled for release starting today. **The labour market report was strong on all accounts** – 6% wage growth, a lower-than-expected unemployment rate and consensus-topping employment gains. EUR/GBP 0.83 is cracking. The US Treasury market reopened in Asia by adding several basis points across the curve. Fed governor Waller said inflation didn't show any real progress in recent months. A similar pattern emerged in 2024 which was then followed by easing price pressures after all that paved the way for the first rate cuts later in the year. Waller said this may be the case again in 2025 but until that's clear, he favours to keep rates steady. Today's eco calendar has not that much to offer but the geopolitical one does. US secretary of state Rubio, national security adviser Waltz, and Witkoff, Trump's special envoy to the Middle East, will be meeting Russia's foreign policy advisor Ushakov and foreign minister Lavrov in Riyadh. **It's the high-level first in-person meeting since the invasion in 2022.** We keep a slight bearish bias on core bonds and are neutral on EUR/USD. While the prospect of a ceasefire and eventual end to the war is positive for the euro, there are too many uncertainties as well as other topics including tariffs that are holding the common currency back.

### News & Views

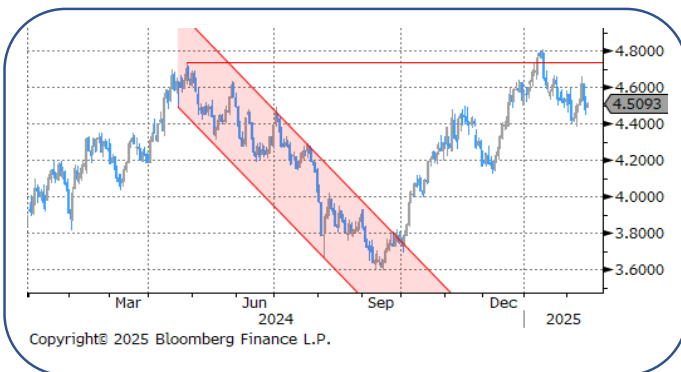
- After holding its policy rate at 4.35% since November 2023, **the Reserve bank of Australia (RBA) today made a first step in easing policy restriction as it cut the policy rate by 25 bps to 4.10%.** The RBA assesses that inflation has fallen substantially as higher interest rates have been working to bring aggregate demand and supply closer in balance. Underlying inflation reached 3.2% in the December quarter, a little faster than expected. Demand growth has been subdued and wage pressures have eased, giving the Board **more confidence that inflation is moving sustainably to the 2-3% RBA target.** However, the RBA still holds a **cautions stance on further easing** as risks to inflation are seen to the upside. In this respect, RBA refers to unexpectedly strong labour data of late. The RBA also slightly upwardly revised to path for underlying inflation over 2026 (2.7% EoY from 2.5%) and warns on a high degree of uncertainty both on growth and inflation. Policy will remain restrictive after today's decision. At the press conference, governor Bullock explicitly said that the RBA can't declare victory on inflation yet and that **today's decision doesn't imply that further cuts are coming.** For that more evidence on inflation is needed. The 3-y government bond yield rises about 6 bps (3.93%). AUD/USD trades unchanged at 0.636 despite overall USD strength.
- According to (outgoing) member of the Hungarian central bank (MNB) Gyula Pleschinger, **the MNB has no room to cut its policy rate this year.** At the same time he also sees it unthinkable for the MNB to hike rates. Pleschinger indicated that the new MNB leadership under the former Finance Minister Mihaly Varga **will remain focused on the bank's price stability mandate.** Pleschinger expects inflation to restart declining in February after the surprise uptick (1.5% M/M and 5.5% Y/Y) in January to return to 4.0% by the end of the year.

## Graphs



### GE 10y yield

The ECB is nearing a fine-tuning phase where back-to-back reductions are over. A rate cut in March (to 2.5%) may be complemented by removing the label “restrictive” on its policy stance as the debate on the neutral interest rate kicks off. For the long end of the curve, the escalating US trade war through risk aversion/growth worries conflict with upward yield pressures stemming from a massive defense investment wave that’s on the way.



### US 10y yield

After three consecutive cuts, the Fed installed a pause in January which we expect to last through June. The Fed wants to see “serial readings” suggesting inflation is progressing towards target. A pause simultaneously offers time to a clearer view on president Trump’s policies. The prolonged Fed rates status quo provides a solid bottom beneath front-end US yields. The long end is more vulnerable on how the explosive policy mix could backfire to the US economy as well.



### EUR/USD

Solid US data, reduced Fed rate cut bets and Trump’s election victory introduced and sustained USD strength during Q4 2024. The dollar dominated but tests of the key support at 1.0201 (62% retracement on 2022/2023 comeback) failed so far. It is still too soon for the euro to take over given the wide range of uncertainty elements. Positive headlines on the war in Ukraine might start providing some support.



### EUR/GBP

Long end Gilt underperformance due to fiscal risks weighed on the UK currency at the start of the year. EUR/GBP tested first resistance near 0.845. Return action occurred after US president seemed to be more forgiving towards the UK than the EU when it comes to tariffs. The Bank of England cut its policy rate from 4.75% to 4.50% at its February meeting with accompanying stagflationary message not boding well for the UK currency.

## Calendar & Table

Tuesday, 18 February		Consensus	Previous
<b>US</b>			
14:30	Empire Manufacturing (Feb)	-2.0	-12.6
16:00	NAHB Housing Market Index (Feb)	46	47
<b>Canada</b>			
14:30	CPI NSA MoM / YoY (Jan)	0.10%/1.90%	-0.40%/1.80%
14:30	CPI Core- Median YoY% (Jan)	2.50%	2.40%
14:30	CPI Core- Trim YoY% (Jan)	2.60%	2.50%
<b>UK</b>			
08:00	Average Weekly Earnings 3M/YoY (Dec)	5.90%	5.60%
08:00	Weekly Earnings ex Bonus 3M/YoY (Dec)	5.90%	5.60%
08:00	ILO Unemployment Rate 3Mths (Dec)	4.50%	4.40%
08:00	Employment Change 3M/3M (Dec)	48k	36k
08:00	Payrolled Employees Monthly Change (Jan)	-30k	-47k
08:00	Claimant Count Rate (Jan)	--	4.6%
08:00	Jobless Claims Change (Jan)	--	0.7k
<b>Germany</b>			
11:00	ZEW Survey Expectations (Feb)	20	10.3
11:00	ZEW Survey Current Situation (Feb)	-89.4	-90.4
<b>Australia</b>			
04:30	RBA Cash Rate Target	4.10%A	4.35%
<b>Events</b>			
00:00	Fed's Waller Gives Speech on Economic Outlook		
10:00	ECB's Holzmann Speaks in Vienna		
10:30	BOE's Bailey Speaks		
11:30	Germany to sell €4.5bn of 2.2% 2027 bonds		
12:00	Finland to sell 2.5% 2030 & 3% 2034 bonds		
15:00	ECB'S Cipollone Speaks in MNI Livestreamed Event		
16:20	Fed's Daly Speaks to American Bankers Association		
19:00	Fed's Barr Discusses AI, Financial Stability		

10-year	<u>Close</u>	<u>-1d</u>		2-year	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	4.48	0.00		US	4.26	0.00	DOW	44546.08	0.00
DE	2.49	0.06		DE	2.14	0.03	NASDAQ	20026.77	0.00
BE	3.04	0.05		BE	2.28	0.03	NIKKEI	39270.4	96.15
UK	4.53	0.03		UK	4.20	0.00	DAX	22798.09	284.67
JP	1.43	0.04		JP	0.83	0.01	DJ euro-50	5519.83	26.43
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>-1d</u>	<u>-2d</u>
3y	2.28	4.07	4.00	€STR	2.6650	-0.0010			
5y	2.33	4.04	3.96	Euribor-1	2.6160	0.0120	SOFR-1	4.3158	0.0008
10y	2.43	4.08	4.05	Euribor-3	2.5100	-0.0120	SOFR-3	4.3260	-0.0001
				Euribor-6	2.4890	-0.0250	SOFR-6	4.2949	-0.0028
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>	Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1.0484	-0.0008		EUR/JPY	158.85	-0.98	CRB	312.08	0.00
USD/JPY	151.51	-0.80		EUR/GBP	0.8304	-0.0032	Gold	2900.70	0.00
GBP/USD	1.2625	0.0039		EUR/CHF	0.9443	0.0005	Brent	75.22	0.48
AUD/USD	0.6356	0.0004		EUR/SEK	11.2104	-0.0099			
USD/CAD	1.4184	0.0002		EUR/NOK	11.6404	-0.0296			

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