



Wednesday, 19 February 2025

KBC Sunrise Market Commentary

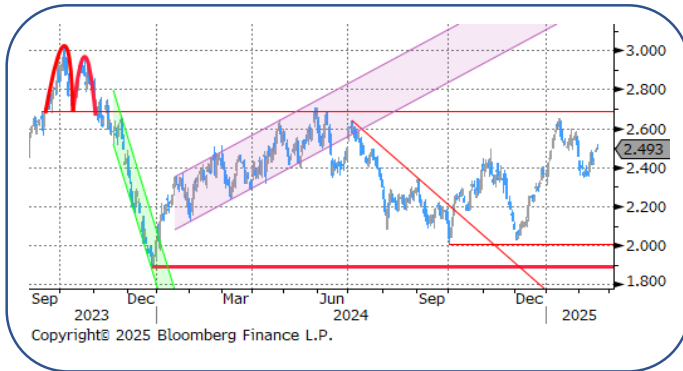
Market

- The first high-level in-person talks between the US and Russia since the 2022 invasion in Riyadh went well according to the parties involved but offered nothing concrete. **The talks were merely explanatory.** The fact they happened without Ukraine and the EU sparked outcry from both and prompted a handful of EU leaders into a crisis meeting on Monday to discuss upgrading the European defense capacity. Polish PM Tusk said that (funding) measures would be presented in time for an upcoming March 20-21 summit. We wouldn't be surprised if something came up sooner given the sense of urgency, provided German coalition building goes smoothly after this Sunday's elections. **French president Macron has called a second meeting for today**, involving several EU and non-EU states. Negotiations center around having a UN-mandated "peace-keeping operation" in Ukraine to uphold any future ceasefire/peace deal. The war theme stays at the center of attention but markets are wary to frontrun on any outcome for the time being. Monday's slide by European bonds in anticipation of significantly increased defense spending eased yesterday. German rates gapped higher at the open but pared gains afterwards to close virtually unchanged. UST's caught up during their first trading day of the week by adding between 4.7-7.5 bps across the curve yesterday. **The US dollar held the upper hand.** EUR/USD fell to 1.0446, DXY bounced back to 107. Sterling appreciated on an across-the-board beat by the labour market report. EUR/GBP lost 0.83 and withstood overall USD strength (GBP/USD 1.261). **Next up in the UK: CPI.** Headline inflation only dropped 0.1% m/m, pushing up the yearly figure to a quicker-than-expected 3%. Core CPI jumped to 3.7% from 3.2% and services inflation to 5% from 4.4%. Bank of England governor Bailey flagged the inflation spike in a speech yesterday and warned not to read too much into it. It explains this morning's muted GBP reaction. UK money market pricing barely changed and sticks to just two rate cuts for all of 2025.
- Aside from the running war theme, **Trump's tariff policy comes back to front as well.** The FX ex. USD market isn't impressed by a renewed (car, pharma & chip) import tariff threat by Trump late-yesterday though. The president said an announcement could come April 2, offering time to hammer out a deal. The greenback trades on the backfoot against all G10 peers. The eco calendar further contains the **January Fed meeting minutes.** The slew of policymakers since that gathering that came to cement the long pause suggests a broad consensus and means the minutes probably have little surprising or new to offer. We assume technically inspired FX and FI trading.

News & Views

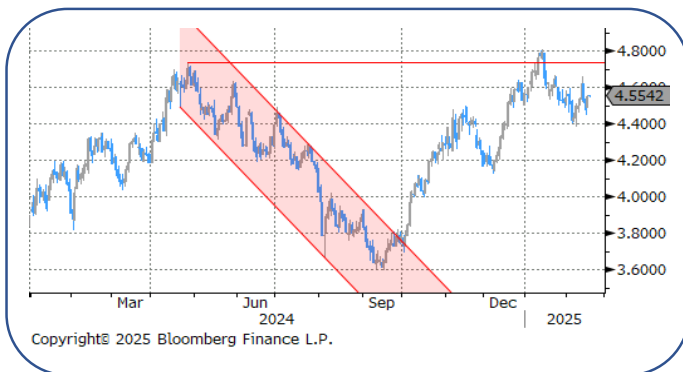
- The Reserve Bank of New Zealand today reduced the policy rate further by 50 bps to 3.75%.** The move was largely expected. **CPI inflation remains near the midpoint of its 1-3% target band** (0.5% Q/Q and 2.2% Y/Y in Q4). Firms' inflation expectations are at target and core inflation continues to fall towards the target midpoint. The economic outlook remains consistent with inflation remaining in the band over the medium term. **Economic activity remains subdued** and spare productive capacity and domestic inflation pressures continue to ease. Price and wage setting is adapting to a low-inflation environment. The RBNZ expects **economic activity and employment growth to recover this year**, but there is a high degree of uncertainty, amongst others due to trade. The RBNZ governor indicated that the **RBNZ might ease policy a bit faster than indicated earlier, with follow-up rate cuts (25 bps) in April and May.** The Monetary policy report sees the policy rate on average near 3.1% in Q4. The NZ 3-y bond yield initially dropped after the decision but current trades little changed near 3.85%. The kiwi dollar made a similar move, reversing an earlier decline after governor Orr's press conference, currently even trading slightly higher at NZD/USD 0.573.
- BoJ Board member Takata in a speech today advocated that **the bank should continue to consider gradual further rate hikes to contain upside inflation risks.** With long-term inflation expectations rising and companies more actively passing on costs, conditions for further policy normalization are falling into place. Maintaining expectations for interest rates to stay low for a prolonged period of time might overheat the economy and financial activity. He indicated that it is difficult to estimate a neutral policy rate and finds it **problematic for the Bank to announce a certain level of the neutral policy rate.** It could be seen as pre-committing and would reduce the bank's policy flexibility. At 1.435%, the 10-y Japanese government bond yield this morning touched the highest level since 2009.

Graphs



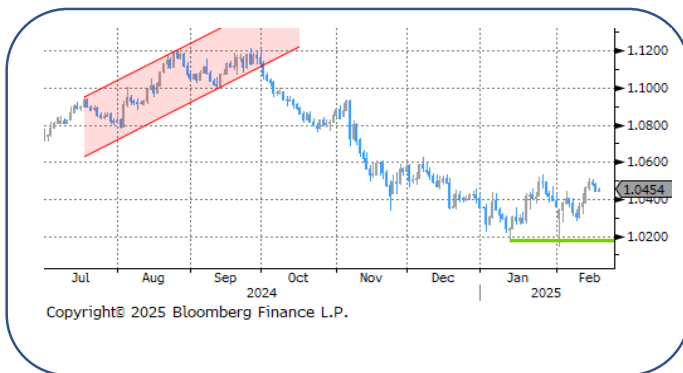
GE 10y yield

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

Wed, 19 February		Consensus	Previous
US			
14:30	Housing Starts (Jan)	1390k	1499k
14:30	Housing Starts MoM (Jan)	-7.30%	15.80%
14:30	Building Permits (Jan P)	1460k	1482k
14:30	Building Permits MoM (Jan P)	1.5%	-0.7%
20:00	FOMC Meeting Minutes	--	--
Japan			
00:50	Trade Balance Adjusted (Jan)	-¥856.6bA	-¥221.0bR
00:50	Exports YoY (Jan)	7.20%A	2.80%
00:50	Imports YoY (Jan)	16.70%A	1.70%R
UK			
08:00	CPI MoM / YoY (Jan)	-0.3%/2.8%	0.3%/2.5%
08:00	CPI Core YoY (Jan)	3.70%	3.20%
08:00	CPI Services YoY (Jan)	5.10%	4.40%
08:00	PPI Output NSA MoM / YoY (Jan)	0.20%/0.10%	0.2%/0.1%
08:00	PPI Input NSA MoM / YoY (Jan)	0.70%/-0.60%	0.1%/-1.5%
EMU			
10:00	ECB Current Account SA (Dec)	--	27.0b
New Zealand			
02:00	RBNZ Official Cash Rate	3.75%A	4.25%
Events			
11:30	Germany to sell €4.5bn of 2.5% 2035 Bonds		
23:00	Fed's Jefferson Speaks on Household Balance Sheet		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	4.55	0.07		US	4.31	0.05	DOW	44556.34	10.26
DE	2.49	0.00		DE	2.13	-0.01	NASDAQ	20041.26	14.49
BE	3.05	0.00		BE	2.27	-0.01	NIKKEI	39164.61	-105.79
UK	4.56	0.03		UK	4.24	0.04	DAX	22844.5	46.41
JP	1.44	0.01		JP	0.83	0.00	DJ euro-50	5533.84	14.01
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	2.28	4.12	4.03	€STR	2.6660	0.0010			
5y	2.33	4.11	3.99	Euribor-1	2.6240	0.0080	SOFR-1	4.3202	0.0045
10y	2.44	4.15	4.07	Euribor-3	2.5160	0.0060	SOFR-3	4.3310	0.0050
				Euribor-6	2.4840	-0.0050	SOFR-6	4.3108	0.0159
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.0446	-0.0038		EUR/JPY	158.84	-0.01	CRB	315.53	3.45
USD/JPY	152.06	0.55		EUR/GBP	0.8283	-0.0021	Gold	2949.00	48.30
GBP/USD	1.2613	-0.0012		EUR/CHF	0.9436	-0.0007	Brent	75.84	0.62
AUD/USD	0.6353	-0.0003		EUR/SEK	11.2001	-0.0103			
USD/CAD	1.4196	0.0012		EUR/NOK	11.6534	0.0130			

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