KBC Market Research Desk - Havenlaan 12, 1080 Brussel

# Sunset

Wednesday, 23 November 2016

# Headlines

- **European equities** corrected up to 1% lower today despite decent EMU PMI data. **US stock markets** also correct around 0.5% in a rising interest rate environment.
- Euro zone business activity expanded the most in nearly a year in November on **strong manufacturing and buoyant services growth in Germany,** stirring some optimism that economic momentum is picking up again. The November composite manufacturing PMI increased from 53.3 to 54.1 whereas a stabilization was expected.
- The ECB is looking for ways to lend out more of its huge pile of government debt to **avert a freeze in the €5.5 trillion short-term funding market** that underpins the financial system, central bank sources told Reuters.
- Brussels is proposing **an array of changes to the EU's banking rules** in a bid to end the era of taxpayer bailouts while also sweeping away red tape that officials fear could be holding back lending. The package of measures stretches from adjustments to banker bonus rules to plans for forcing US and other non-EU banks to set up holding companies within Europe.
- Chancellor of the Exchequer Hammond said the U.K. economy will grow more slowly (1.4%) than previously forecast (2.2%) in 2017 and **the government will need to borrow more over the next five years,** as he laid out the framework for a post-Brexit Britain.
- Orders for U.S. business equipment climbed in October for the fourth month in the last five and sales also advanced, indicating corporate investment may be starting to thaw. Headline durable goods orders rose 4.8% M/M (1.7% M/M) expected. **Shipments of non-defence capital goods excluding aircraft, used in calculating GDP, rose 0.2% M/M.**

# Rates


*German Bund (intraday, this week): new selling wave ends upward correction*

## New sell-off wave hits core bond markets

**A triple whammy hit core bonds today.** Traded volumes were high, despite tonight's early US close and tomorrow's US holiday (Thanksgiving). **Stronger eco data, rumours about ECB action to unfreeze the repo-market and UK Chancellor Hammond's Autumn Statement triggered a new sell-off. At the time of writing,** the German yield curve bear steepens with yields 5.2 bps (2-yr) to 9 bps (30-yr) higher. The UK yield curve shifts in similar fashion with the 30-yr yield up to 11 bps higher. Changes on the US yield curve range between +4.2 bps (2-yr) and +7.4 bps (10-yr). On intra-EMU bond markets, 10-yr yield spread changes versus Germany are nearly unchanged with Italy (+5 bps) and France (+3 bps) underperforming.

Intraday, the Bund started with an upward bias, extending yesterday's short covering move. Strong November EMU PMI data didn't harm sentiment, but a Reuters article did. **Sources indicate that the ECB plans to take action to tackle**

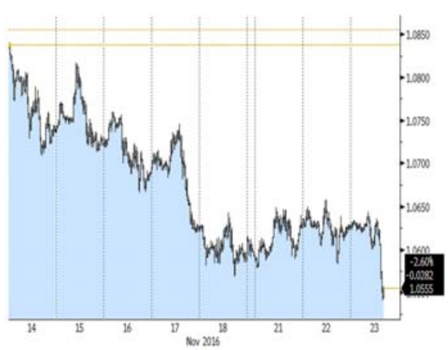
**the treat of a malfunctioning repo market.** The ECB's QE-programme caused shortage of HQ collateral, often used for repo transactions between financial institutions and to balance outstanding derivatives at clearing houses. By easing conditions for lending securities held under the QE-programme, the ECB hopes to buttress the repo market. This reduces the "scarcity" of eg German bonds and takes away some upward price pressure, causing a drop in Bunds. Around European noon, **UK Chancellor Hammond delivered his Autumn Statement, highlighting a higher short term borrowing need and debt levels.** UK Gilts crashed and pulled Bunds and Treasuries (initially unmoved on ECB rumours) lower. Shortly after Hammond's message, US durable goods orders surprised on the upside of expectations, while claims rebounded in line with expectations, remaining near historically low levels. Stronger US eco data weighted further on core bond sentiment.

# Currencies

## Dollar rally reaccelerates

**Today, the EUR/USD initially failed to profit from a strong EMU PMI and from rising European yields on headlines that the ECB might take action to address collateral shortage. This inaction suggested ongoing underlying USD strength. The dollar rally resumed going into the US session and accelerated after decent US early morning data. USD/JPY jumped above the 111.50/80 resistance and trades currently at 112.25. EUR/USD set new Post-Trump lows, changing hands in the 1.0550 area.**

**Overnight,** Asian equities continued their recent uptrend. Australian equities outperformed as most commodities remain well bid. AUD/USD rebounded to the mid 0.7435 area, but ceded some ground later in the European session. Oil stabilized as OPEC looked for a solution on Iran/Iraq's efforts in the production cut deal. In thin trading, USD/JPY changed hands near 111. The dollar traded marginally softer against the euro, with EUR/USD hovering around 1.0635.



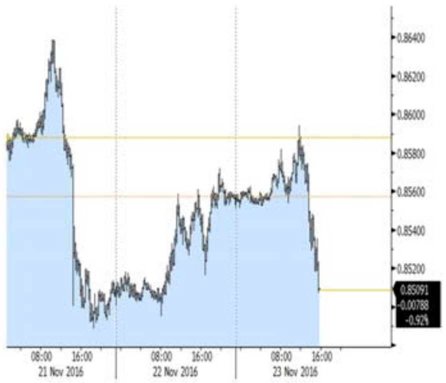

*EUR/USD: dollar rally resumes*

In the European session, there was interesting eco news with the EMU PMI's. There were also relatively sharps swings in the European bond market and to a lesser extent in equities. **The EMU November composite PMI rose unexpectedly to 54.1 from 53.3,** a significant outperformance versus consensus, but the move left hardly any traces on the European bond markets or on the euro. If anything, EUR/USD even traded with a negative bias at the time of the publication of the PMI's. **Towards the end of the European morning session, European bonds nosedived on headlines that the ECB might take action to address collateral shortage** (see fixed income part of this report). In this move the interest rate differentials between the US and Germany narrowed several bps. **The (currency) market apparently considered this a 'technical issue' with no significance for the euro. EUR/USD continued to drift sideways in a tight range in the lower half of the 1.06 big figure. As was the case earlier this week, any EUR/USD upticks were still considered a selling opportunity.**

The US jobless claims rose from the very low level of 233k to 250k as expected. The US durable orders printed a bit stronger than expected. The dollar strengthened already going into the publication of the US data and the move accelerated afterwards. **USD/JPY jumped to the high 111 area and finally**

**cleared the 111.45/81 resistance area (previous correction highs).USD/JPY trades currently at 112.35.** EUR/USD declined further below the 1.06 big figure and set new post-Trump lows. The pair trades around 1.0540. So, for now, it's much too early to conclude that the dollar reflation trade has run its course.

## Sterling holds strong on Budget Statement



*EUR/GBP: sterling rebounds on budget statement*

UK Finance Minister Hammond presented his first Budget statement before Parliament. The budget office lowered the 2017 growth forecast to 1.4% from 2.2% in March. The UK government will have to raise £122B extra money by 2020/21. The government also said that it remains committed to a credible fiscal policy. UK yields rose markedly during the budget statement, with the long end underperforming as the additional funding need was apparently bigger than the market expected. This yield rise slightly supported sterling. Cable hovered up and down, but held close to the 1.24 big figure even as the dollar is strong across the board. **Sterling resumed its uptrend against the euro. EUR/GBP returned back south to trade currently in the 0.8520 area.** Of course, an important part of this moves mirrors the corresponding decline of EUR/USD.

16:00 CET

**Daily EMU spread changes (bps)**

| | 5-yr | | | 10-yr | | | 30-yr | | |
|---|---|---|---|---|---|---|---|---|---|
| | Yield | Spread | Change | Yield | Spread | Change | Yield | Spread | Change |
| Germany | -0,38% | | | 0,29% | | | 0,93% | | |
| Greece | #VALUE! | #VALUE! | #VALUE! | 6,93% | 664 | -5,1 | #VALUE! | #VALUE! | #VALUE! |
| Portugal | 2,18% | 256 | -2,9 | 3,70% | 340 | -0,3 | 4,59% | 366 | -2,1 |
| Italy | 1,01% | 139 | 3,0 | 2,14% | 185 | 4,3 | 3,17% | 224 | 0,4 |
| Spain | 0,52% | 90 | -1,5 | 1,59% | 129 | -1,0 | 2,77% | 185 | -0,5 |
| Ireland | #VALUE! | #VALUE! | #VALUE! | 0,99% | 70 | 0,3 | 1,87% | 94 | -0,1 |
| Belgium | -0,25% | 12 | -1,6 | 0,69% | 40 | 0,0 | 1,62% | 69 | 0,6 |
| France | -0,01% | 36 | 0,8 | 0,80% | 51 | 2,0 | 1,60% | 67 | 1,5 |
| Austria | -0,24% | 14 | -0,5 | 0,58% | 29 | 1,1 | 1,34% | 41 | 2,2 |
| Netherlands | -0,24% | 14 | -0,1 | 0,46% | 16 | 0,8 | 1,03% | 10 | 0,9 |
| Finland | -0,33% | 4 | -0,6 | 0,48% | 19 | 0,4 | 1,03% | 11 | 1,1 |
| US | 1,84% | 221 | 0,3 | 2,38% | 208 | -0,7 | 3,05% | 213 | -2,3 |
| UK | 0,68% | 106 | -0,5 | 1,47% | 118 | 3,5 | 2,12% | 119 | 2,7 |

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