



Sunset

Friday, 13 October 2017

Headlines

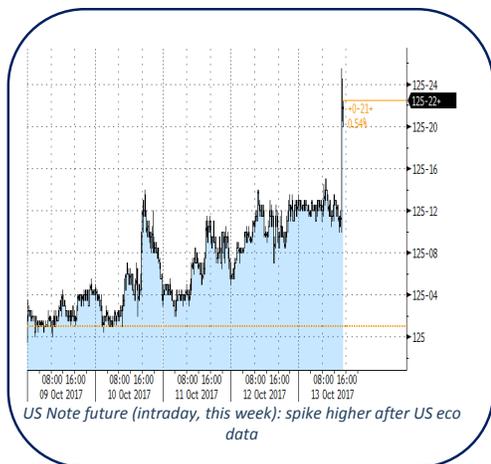
- **European equities are slightly lower and US ones open slightly higher, as EUR/USD moves higher.**
- **A spike in energy prices in the aftermath of Hurricane Harvey boosted the US cost of living by the most since January** (0.5% M/M & 2.2% Y/Y vs 0.6% M/M 2.3% Y/Y consensus), while inflation excluding food and fuel stabilized at 1.7% Y/Y (vs 1.8% Y/Y forecast).
- **US retail sales jumped last month by the most in more than two years (1.6% M/M)** as motor vehicles lost to hurricanes were quickly replaced and higher prices lifted receipts at gasoline stations. Core retail sales rose by 0.5% M/M. Both were close to expectations, but August figures were upwardly revised.
- **EU Commission chairman Juncker has warned Brexit will take longer than the UK government thinks**, calling on Westminster to pay if it wants to accelerate talks to its future relationship. He said there was no agreement over the UK's exit bill which would stop negotiations from moving on to trade talks before next week's EU Summit.
- The **Bank of England** should hold off raising interest rates as Britain's economy shows little sign of encouraging growth, the British Chambers of Commerce argued.
- **Bank of America has reported a 13% rise in quarterly profits**, as growth in consumer banking and wealth management offset a sharp decline in bond trading revenues. **Wells Fargo** is still counting the cost of the sham account scandal more than a year since it erupted as it reported a decline in revenues and profits.
- **Hungary's base interest rate will stay unchanged at 0.9% until at least 2020**, central bank deputy governor Nagy said, adding that downward risks to inflation had increased. The National Bank of Hungary, the most dovish in central Europe, cut its overnight deposit rate in September and announced more steps to ease monetary conditions.

Rates

Core bonds profit from slightly disappointing US CPI

Global core bonds gained ground today, boosted by ECB rumours, slightly disappointing US eco data and political risk ahead of the weekend. At the time of writing, US yields decline by 1.2 bps (2-yr) to 2.7 bps (10-yr). German yields shift 1.2 bps (2-yr) to 3 bps (10-yr) lower. On intra-EMU bond markets, 10-yr yield spread changes versus Germany are nearly unchanged with Portugal underperforming (+3 bps).

Bunds opened the session on a positive note, but soon reached a temporary high, before turning sideways till the US economic releases. We suspect some technical inter-market positioning was behind the move as also in other markets some moves occurred simultaneous. However, news agencies referred it to an article based on ECB sources. The ECB would consider cutting the monthly bond buying by half (to €30 bn) and keep the programme active for at least nine months. It isn't obvious to us why that should push the Bund higher. The €30 bn



looks lower than markets expectations (negative), while the 9 month is probably a bit longer than expected (positive). **Of course, if (forward guidance on) rates are the key driver, then the 9 months extension may have more weight than the €30 bn pace and push back rate expectations.** The rise of the bund and the decline of the euro make sense along the lines of that reasoning. At the same time, **ECB Hansson**, admittedly a super-hawk, suggested according to a news agency that the **ECB could tweak its guidance on rates and even raise them before the bond-buying stops.** The main move of today's session occurred during US dealings, after slightly **disappointing CPI data.** While headline inflation rose by 0.5% M/M and 2.2% Y/Y, it was slightly below expectations. Core CPI stabilized at 1.7% Y/Y while consensus expected a small acceleration. **Retail sales** were strong, but close to forecasts. **Core bonds surged higher, in line with this week's performance** (downside exhausted after last week's payrolls). Geopolitical risk drew some safe haven flows as well (eg. US Iran nuclear deal).

Currencies

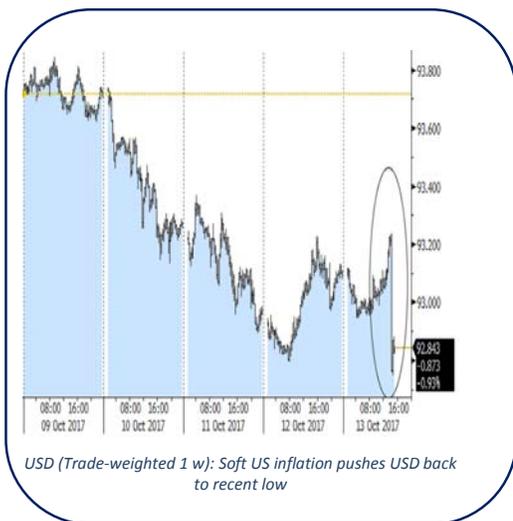
Dollar faces uphill battle on soft US CPI data

Early this morning, FX markets faced a technical repositioning with EUR/USD, USD/JPY and EUR/USD pushed lower. However, calm returned soon as investors awaited the US CPI and retail sales data. Retail sales were strong, but inflation was slightly softer than expected. The latter proved to be the more important factor for (FX) markets, putting the dollar under pressure. EUR/USD rebounded off the low 1.18 area and trades currently around 1.1870. USD/JPY dropped below 112 (currently 111.75).

Overnight, Asian equities mostly extended the established uptrend. Chinese trade data were OK, suggesting good activity and supporting positive sentiment in the region. There was again a 'disconnect' between rising Japanese equities and USD/JPY. The latter struggled not to fall below 112 even as the Nikkei surpassed 21K. The dollar also lost a few ticks against euro. EUR/USD traded in the 1.1845 area.

There was some **nervous repositioning in several major cross rates** at the start of European trading. We didn't see a clear explanation. Core yields, especially German ones, declined. USD/JPY dropped below 112. The decline spilled over into EUR/JPY and even put downward pressure on EUR/USD. The pair dropped to the 1.1815 area. However, this 'stop-loss' repositioning soon petered out as there was no further guidance from interest rate markets or equities.

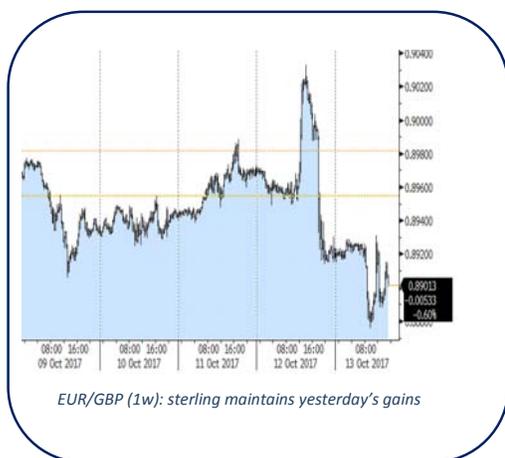
US investors eagerly awaited key US CPI and retail sales data. (Core) retail sales were marginally stronger than expected. The CPI was slightly softer than consensus with the headline CPI rising from 1.9% Y/Y to 2.2% Y/Y (2.3% Y/Y expected) and core inflation stable at 1.7% Y/Y (1.8 Y/Y expected). **The dollar hesitated upon the publication of the data, but the small miss in inflation finally prevailed.** US yields declined and so did the dollar. EUR/USD rebounded off the low 1.18 area, reached just before the US data release. The pair trades currently in the 1.1870 area. **So a return below the 1.1800/23 support area is unlikely, which is disappointing for USD bulls.** USD/JPY is also drifting below the 112 big figure. Lower interest rates outweigh positive equities. USD/JPY trades in the 111.75 area. A further decline below the 111.50 area would deteriorate the short-term picture in this cross rate.



Hope on 'EU concession' supports sterling

Yesterday's roller-coaster ride of sterling finally turned out in favour of the UK currency. Sterling initially sold off as EU Barnier said that the negotiations on a divorce bill ended in a stalemate. However, sterling reversed initially losses on rumours/comments that the EU would consider to start preparations for a transition period.

(FX) markets saw the glass half full rather than half empty this morning on headlines that the EU would consider a transition period, something is aiming for. EUR/GBP dropped below the 0.89 barrier. Enthusiasm eased later in the session on comments from Germany and EU's Juncker who highlighted that the Brexit process remains extremely difficult. EUR/GBP rebounded (temporary?) back above 0.89. In the end, sterling maintained yesterday's rebound. **Will sterling enter calmer waters, awaiting new signs from next week's EU summit?** EUR/GBP trades in the 0.8910 area. Cable extended gains north of 1.33, partially due to USD weakness after the 'soft' US inflation.



Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.31%			0.41%			1.26%		
Greece (2-10-20)	3.15%	346	0.7	5.55%	515	1.1	6.48%	522	3.0
Portugal	0.94%	125	3.2	2.32%	191	3.7	3.60%	234	3.7
Italy	0.80%	111	0.2	2.07%	166	-1.0	3.21%	195	-0.7
Spain	0.31%	62	1.3	1.60%	119	-0.1	2.84%	158	0.7
Ireland (4-10-30)	-0.19%	12	0.1	0.64%	23	-0.5	1.78%	52	-1.0
Belgium	-0.23%	8	0.0	0.68%	27	-0.2	1.75%	49	-0.1
France	-0.04%	27	-0.2	0.82%	41	-0.6	1.78%	52	-0.4
Austria	-0.20%	11	0.4	0.59%	18	-0.3	1.55%	29	0.4
Netherlands	-0.35%	-4	0.3	0.51%	11	-0.3	1.27%	1	0.1
Finland	-0.20%	11	-0.1	0.56%	16	-0.6	1.36%	10	-0.0
US	1.90%	221	-0.4	2.28%	188	0.4	2.83%	157	1.4
UK	0.81%	112	3.1	1.37%	96	2.5	1.93%	67	1.9

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