



Sunset

Tuesday, 21 March 2017

Headlines

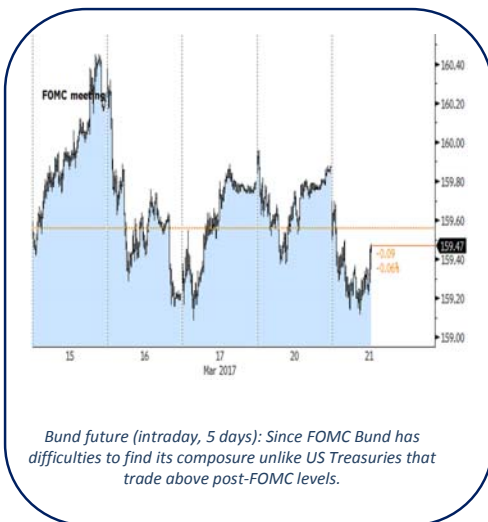
- **US equities** opened higher, but slid into the red, as all-time highs (NASDAQ) seem one step too far in a news-poor session. European equities traded positive but lost a large part of the gains since the US open.
- The latest data on the **UK's inflation** showed **consumer prices (2.3% Y/Y) rose at their fastest rate in three and a half year in February**. After last week's more hawkish than expected comments from the Bank of England, today's figures will raise further questions over whether the Bank will raise rates to try to temper rising prices.
- The **US current account deficit** shrank to \$112.4bn in Q4 2016, the Commerce Department said. That was better than a deficit of \$129bn the market was expecting and compares to a shortfall of \$116bn in the third quarter. The deficit represents 2.4% of GDP, compared with 2.5% in the previous quarter.
- The **European Union will hold a summit of leaders** to conclude its response to the UK's notification of exit on April 29, in the middle of France's presidential elections, Donald Tusk has said..
- The **Mexican peso hit its strongest level since the US election** on Tuesday morning, as the dollar's recent slide continued to benefit emerging market currencies. Donald Trump's pre-election promises to tear up free trade agreements and build a wall on the US-Mexican border battered the Mexican currency, but it has recovered as the new administration's softened its rhetoric.

Rates

Bunds cannot find their composure

Today, in a session again devoid of US and EMU economic data, the Bund came under more downside pressure and the German yield curve bear steepened, as lingering doubts on the timing and sequence of the ECB exit policy triggered selling. Fresh French election news (see below) and growing chances on a solution for Greece played a role too. Even the unexpected rise in UK inflation was a good reason enough to sell Bunds. Bunds bottomed when US traders joined the fray. US Treasuries, which held up well in the morning session, started to rally but the reaction of the Bund was tepid. Towards the closing of our report, the Bund finally shows signs of recovering some lost ground. Weakening equities probably play a role. **At the time of writing**, US yields are flat (2-yr) to -0.9 bp lower, while German yields are 5.1 bps (2-5-yr) to 2.1 bps (30-yr) higher. **In the intra-EMU bond market** 10-yr yield spreads versus German Bunds are 4 (France/Ireland, Portugal) to 7 bps (Italy) lower. Belgian spread is 1 bp lower, suggesting that indeed the TV debate helped French bonds outperform.

Intraday, the Bund opened weak and declined after a brief uptick due to a mild risk-on sentiment linked to a strong performance of **centrist Macron** at the first



French election debate. This lowered further the (already) unlikely chance that Le Pen would win the election. The French-German spread declined 5 bps, even if it had to give back some of the initial narrowing. Signals that **Greece** was coming closer to secure an agreement with its creditors on the rescue package also might have contributed to the mild risk on. **Underlying sentiment on German bonds already deteriorated in previous sessions**, as some ECB governors continued to discuss various possible changes to the future exit policy of the ECB. Some saying rates might be hiked before the end of QE, some saying rates will be hiked after the end of QE, but not as long after than previously thought. This is spoiling the positive Bund sentiment and is reflected in an underperformance versus US Treasuries and sometimes in a bear flattening of the curve.

Currencies

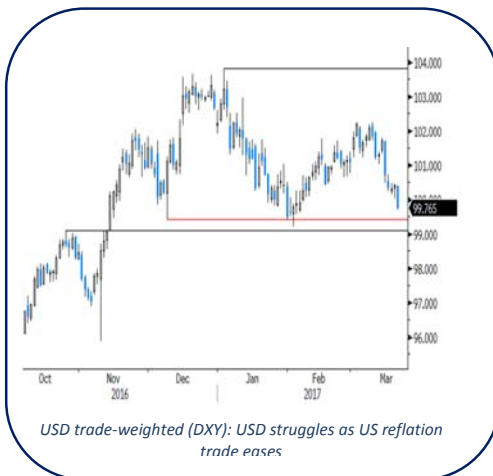
Trade-weighted dollar drops below 100 level

Today, the euro initially profited as polls showed a receding chance of a Le Pen victory in the French Presidential election race. Later in the session, dollar softness returned as investors took profit on 'the US reflation trade'. European rates rose more than US ones and equities fell prey to intraday profit taking. In this move, USD/JPY dropped to the 112.15 area. EUR/USD settled north of 1.08. The trade-weighted dollar dropped below the psychological barrier of 100.

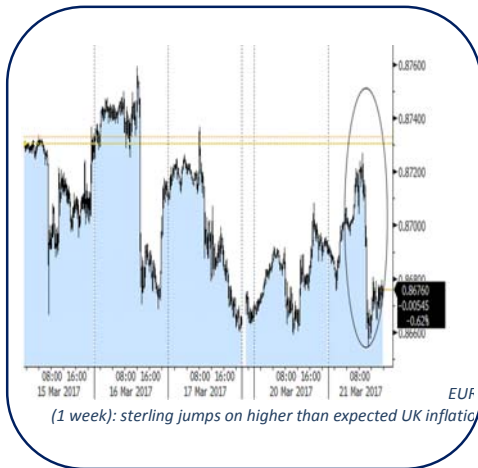
Overnight, Asian equity sentiment remained constructive. The dollar traded mixed. Recent Fed comments confirmed investor perception that the Fed normalisation will be gradual. USD/JPY reversed an early session dip, trading in the 112.80 area. The pattern of EUR/USD is slightly different. The euro regained ground as Macron solidified his lead over Le Pen after the first French election debate. EUR/USD was well bid and traded in the 1.0775/80 area start in Europe.

Declining chances of a Le Pen victory in France supported a risk-on trade in Europe with French assets outperforming. Interest rate differentials between the US and Germany narrowed further and triggered broad-based euro strength. **EUR/USD rebounded temporary north of 1.08 around noon. USD/JPY didn't profit from the European risk-on trade or higher core yields.** The pair even reversed an earlier uptick and returned to the mid 112 area. Euro (and sterling) strength was the dominant factors on the FX market.

The **US Q4 current account deficit** substantial smaller than expected. The dollar gained very temporary a few ticks but the report was no game changer at all for the dollar. The 10-year interest rate differential between US and Germany dropped below 200 bps. USD/EUR and USD/JPY soon drifted back south. US equities opened in positive territory, but soon reversed the initial gains. **Still this was a negative rather than a positive for the dollar.** USD/JPY dropped to the low 112.15 area (currently 112.25). EUR/USD trades in the 1.0815 area. **The US-driven reflation trade shows some fatigue and this is currently weighing on the dollar.**



Sterling jumps as UK inflation surpasses 2.0% barrier



Early in European trading, sterling gained a few ticks against the dollar but ceded ground against a broadly stronger euro. The euro rallied as polls showed that Macron took the lead in the presidential race after yesterday's TV debate. EUR/GBP filled offers in the 0.8725 area. However, mid-morning, the focus turned to the UK side of the story as the UK inflation jumped to 2.3%, well above the BoE inflation target. Core inflation (2.0% Y/Y) was also well above the consensus. Last week, some BoE members warned that they could consider a rate hike of inflation and/or growth would accelerate. **UK yields and sterling jumped higher upon the release. EUR/GBP dropped to the 0.8655 area.** Overall euro strength prevented further EUR/GBP losses. The pair trades currently in the 0.8670 area. The combination of sterling strength and USD softness also propelled cable. The pair returned to the upper half of the 1.24 big figure (currently 1.2465).

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.29%			0.46%			1.19%		
Greece (2-10-20)	8.25%	854	-38.0	7.45%	700	-4.3	7.73%	654	-10.2
Portugal	2.44%	273	-6.7	4.21%	375	-4.5	4.78%	358	-4.8
Italy	0.95%	124	-7.9	2.31%	185	-6.9	3.43%	223	-3.3
Spain	0.56%	85	-6.1	1.80%	135	-5.9	3.04%	185	-3.9
Ireland (4-10-30)	-0.11%	19	-3.4	1.13%	67	-3.6	2.22%	102	-2.6
Belgium	0.02%	31	-3.8	0.96%	51	-0.9	1.93%	73	-1.8
France	0.24%	53	-5.5	1.10%	64	-3.9	2.07%	87	-3.3
Austria	-0.21%	8	-1.4	0.66%	21	-0.2	1.57%	38	0.5
Netherlands	-0.21%	9	-0.6	0.70%	24	-1.2	1.28%	9	0.2
Finland	-0.06%	23	-1.6	0.56%	11	-1.8	1.39%	19	0.3
US	1.98%	227	-4.9	2.44%	199	-3.4	3.05%	186	-2.7
UK	0.63%	92	-0.2	1.25%	80	0.2	1.82%	63	0.6

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