



Sunset



Friday, 20 October 2017

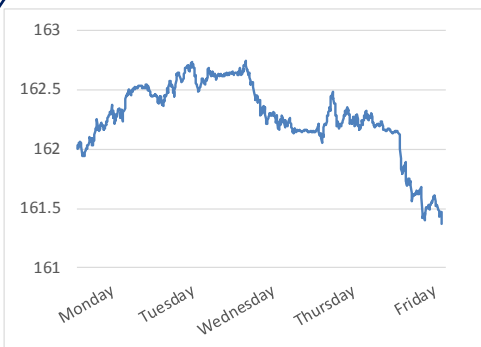
Headlines

- **European equities** maintain only marginal gains as the US budget vote failed to trigger a protracted risk-on rally. US equities open with modest gains between 0.2% and 0.4%, the Nasdaq outperforming.
- **UK prime minister Theresa May has left a two-day EU summit in Brussels facing demands that she must make a "firm and concrete commitment" to increase Britain's Brexit "divorce" payment** before talks can move on to a future trade deal.
- **The eurozone current account surplus with the rest of the world rose in August to its highest level since May last year (€33.3 bn).** The increase was driven by a jump in the surplus for services from €2.6bn in July to €7.2bn in August, and a smaller deficit in secondary income, which fell to €12.4bn from €14.8bn the previous month.
- **US President Trump signalled optimism for the passage of Republicans' sweeping tax cut plan**, saying a key senator who rejected the party's budget blueprint a day earlier would back the proposed tax measure when it comes up for a vote.
- **The Spanish government has secured opposition support to dissolve Catalonia's parliament and hold new elections there in January** in an effort to defuse the regional government's push for independence.
- **Jacob Zuma sacked the head of the Communist party from his cabinet in a reshuffle** critics said was carried out to purge dissenters and consolidate his power weeks before the ruling African National Congress votes on his replacement.
- **Canadian eco data disappointed. Inflation accelerated less than anticipated (1.6% Y/Y from 1.4% Y/Y) in September and August retail sales unexpectedly declined by 0.3% M/M.** The loonie lost ground with USD/CAD rising above 1.2550 ahead of next week's BoC meeting.

Rates

US Senate revives reflationary spirits

Global core bonds lost ground today. The main move occurred overnight for the US Note future and in the European opening for the Bund. The US Senate adopted a fiscal budget for next year which is critical for implementing tax reforms. Reflationary spirits took control of trading and pushed yields higher. The sell-off slowed throughout the day, but core bonds held a slight downward bias. The eco/event calendar didn't impact trading. We expect volumes to decline from now on with investors eying next Thursday's ECB policy meeting. Draghi is expected to deliver clarity on the future of the central bank's asset purchase programme. **Consensus has been building around a 9-month APP extension while lowering monthly purchases from the start of 2018 from €60 bn to €30 bn. We agree with the reduction in purchases, but think that underlying growth developments argue for a shorter, 6-month extension.**



German Bund (intraday, this week): US-induced sell-off in the European open

At the time of writing, US yields increase by 3.8 bps (2-yr) to 5.4 bps (5-yr). The German yield curve bear steepens with yields 1.3 bps (2-yr) to 5.9 bps (30-yr) higher. On intra-EMU bond markets, 10-yr yield spread changes versus Germany are nearly unchanged with the periphery outperforming (-3 bps to -5 bps).

Currencies

Dollar hardly profits from Senate budget vote

Overnight, the dollar profited from a budget vote in the US Senate that might also pave the way for a US tax reform. However, the USD rally slowed soon. There were no follow-through gains in Europe or in the US. The US currency didn't receive additional interest rate support. EUR/USD trades in the 1.18 area. USD/JPY is changing hands at around 113.25. .

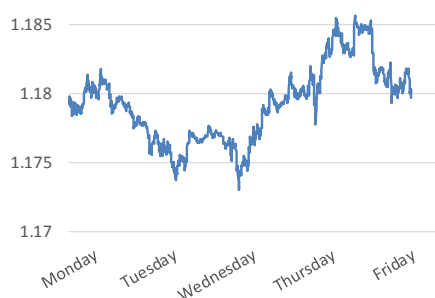
Overnight, the US Senate adopted a blueprint for the 2018 budget. The approval might also be a started point for US Republicans and the government to proceed with substantial tax reform. USD yields and the dollar rebounded after yesterday's decline. USD/JPY jumped north of 113. EUR/USD returned to the 1.18 area. **The Kiwi dollar declined further below 0.70 after the formation of a government with Labour and the New Zealand first party.**

European equity markets opened with modest gains supported by a rise in US futures after the overnight US budget vote. **However, the hope on a US tax reform wasn't able to trigger sustained further USD gains.** After some initial swings overnight, US/EMU interest rate differentials didn't widen as Bunds basically followed the price pattern of US Treasuries. In a broader perspective, global markets remained quite uncertain on what to expect from US tax reforms even after the overnight steps. European equities (and US equity futures) showed modest gains, but there was no euphoria. EUR/USD failed to sustain below 1.18 and settled in a tight range just north of the big figure. USD/JPY filled offers in the 113.45 area, but also ceded slightly later in the session.

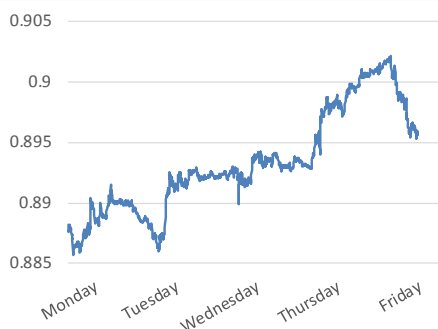
There were no important eco data in the US. Existing home sales will be published after finishing this report. The dollar still struggles to make further gains. EUR/USD trades around 1.18. USD/JPY is changing hands in the 113.25 area. Fed's Yellen gives a speech on monetary policy since the financial crisis after the close of the US markets this evening. Japanese parliamentary elections developments in Spain deserve attention this weekend.

Sterling rebounds as Brexit tensions ease (slightly)

Sterling remained in the defensive in Asia this morning, extending yesterday's decline as poor UK retail sales data questioned the room for the BoE to raise rates in the near future. However, **sentiment on the UK currency improved from the start of trading in Europe.** European investors apparently draw some comfort from reconciliatory remarks of German Chancellor Merkel after yesterday's EU summit. She saw no indications that the talks won't succeed. Later in the session, monthly UK public finance data were also better than expected. EUR/GBP drifted back below the 0.90 barrier. The pair trades currently in the 0.8960 area. Cable also rebound despite an, albeit cautious, overall USD rebound. GBP/USD trades in the 1.3180 area. **Even so, sterling still trades modestly lower against the euro and the dollar as investors grow convinced that there is only room for one BoE rate hike in the coming months, at best.**



EUR/USD (5d intra-day): dollar off the overnight low, but rebound isn't convincing at all



EUR/GBP (5d, intraday): sterling rebound on hope of more progress in Brexit negotiations.

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.27%			0.45%			1.32%		
Greece (2-10-20)	3.17%	344	-4.9	5.57%	512	-4.8	6.43%	511	-7.5
Portugal	0.92%	119	-4.3	2.32%	187	-4.9	3.63%	231	-5.9
Italy	0.75%	101	-3.2	2.06%	160	-3.0	3.21%	189	-2.7
Spain	0.34%	61	-2.3	1.66%	120	-3.6	2.90%	158	-4.2
Ireland (4-10-30)	-0.15%	12	-0.5	0.68%	22	-1.2	1.82%	51	-1.1
Belgium	-0.19%	8	0.0	0.72%	26	-0.7	1.81%	50	-0.8
France	-0.01%	26	-0.2	0.87%	41	-0.3	1.84%	53	-0.4
Austria	-0.16%	11	-0.2	0.63%	18	-0.3	1.61%	29	-0.2
Netherlands	-0.31%	-4	-0.6	0.56%	11	-0.3	1.32%	0	0.0
Finland	-0.16%	11	-0.4	0.61%	16	-0.6	1.42%	10	0.0
US	2.02%	228	2.0	2.38%	193	0.4	2.90%	158	-0.7
UK	0.77%	104	-0.9	1.33%	87	-1.2	1.90%	58	-2.0

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