KBC Market Research Desk - Havenlaan 12, 1080 Brussel

Sunset

Tuesday, 21 February 2017

Headlines

- **European equities** eked out moderate gains despite strong business sentiment, as uncertainty about upcoming elections lingers. **US stock markets** returned from the long weekend with opening gains of around 0.2%.
- **The UK will have to foot a "hefty bill" when it leaves the European Union,** EC President Juncker said, further raising the tension around one of the most contentious elements of the Brexit negotiations.
- **Opec's Secretary General has predicted greater compliance** from the world's biggest producers with a supply cut deal to curb excess inventories. *"All countries involved remain resolute in the determination to achieve a higher level of conformity."* Brent oil rose to intraday high of $57.31/barrel from $56.20/barrel this morning.
- Bumper performances from France and Germany helped the **eurozone's recent healthy growth accelerate further** in February. The headline **euro area PMI business sentiment** leapt unexpectedly to 56.0 from 54.4 in January, its highest level in almost six years. New orders surged and the outlook improved, suggesting growth is still accelerating.
- A JPM survey of its US corporate customers showed that **80% of middle-market executives said they felt optimistic about the US economy.** That is the highest reading yet, up from a miserable 39% one year ago. Respondents belief that the Trump administrations' focus on regulation, tax reform and infrastructure investment will bring good things.
- The **yield on Greece's short term debt** maturing in April 2019 has dropped by a thumping 1.3 percentage points after the country's **creditors said they had made encouraging headway** on resolving their latest set of bailout tensions.
- **EU finance ministers have struck a deal on how to apply international rules to curb tax avoidance.** The new rules, which will phase in by 2022, will tackle hybrid mismatches – a loophole that allows multinationals to exploit differences in national rules to hide money from the taxman.
- **A senior Socialist minister, Le Foll, said he might back centrist Emmanuel Macron** in France's presidential election, a blow to his party's official candidate and a potential boost for Macron, who is battling to stay favourite in opinion polls. **Foreign Minister Ayrault, No 2 in the cabinet rankings, has also said he might back Macron.**

Rates

Bonds lose ground, as EMU confidence sky-rockets

Today, global core bonds lost modest to moderate ground as EMU business sentiment surged, suggesting that euro area growth is still accelerating. Gains in US regional surveys and Japanese and Chinese business sentiment suggest that global growth is doing well too. The Bund, which was nearing the key 164.90 level (or the German 10-yr yield support at 0.29%) has now reverted a bit deeper into the large sideways range. **The decline went gradual and hand in hand with rising equities and higher oil prices (see headlines). All in all, the decline remains modest till now, partly as uncertainties about the European election season, and especially the French presidential race, are still omnipresent.** The French curve bear flattened with 2- and 5-yr yields 4.8 and 5.2

German/French 2-yr yield & yield spread (lower chart): Spread widening shorter end points not to insolvency risk, but to redenomination risk (Le Pen)

bps higher. The 2-yr yield spread between Germany and France (see graph) even moved as high as 45 bps. **That means that investors start to price in redenomination risk. A similar underperformance of the shorter end was visible on the Italian curve, but less so on the Spanish one. Nevertheless, the only worth mentioning development - socialist ministers Le Foll and Ayrault contemplating voting for Macron - looks a market positive as it raises the chances of moderate candidate Macron.**

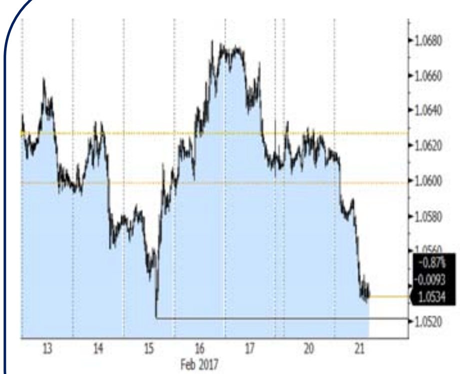
At the time of writing, the German yield curve steepens with yield changes ranging from flat (2-yr) to +3.3 bps (30-yr). US yields are 3.1 to 4.7 bps higher, the belly of the curve underperforming. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany were modest (+1 bp to -2 bps), as the action, concerned the shorter end of the curve. Greece (-34 bps) outperformed as IMF/EU agree now on structural reforms instead of austerity measures, which if put into place by Greece, open the road to a conclusion of the review and the ability to pay the maturing Greek bonds in July (about €6B).

Currencies

.

Dollar extends gains as reflation trade resumes

Today, the EMU PMI's were stronger than expected. Core (German and US) yields and equities rose after the PMI release. However, it didn't help the euro. On the contrary, the resumption of the reflation trade supported the dollar. EUR/USD trades currently in the 1.0525 area. USD/JPY changes hands at about 113.70.



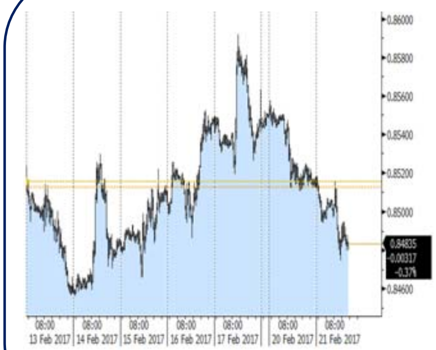
EUR/USD nears ST low as reflation reaccelerates

Overnight, Asian equities mostly showed modest gains. The dollar rallied early in Asia as Fed's Harker repeated that a rate hike in March isn't off the table. USD/JPY rebounded to the 113.70 area, but softened again towards the start of European trading. EUR/USD fell below 1.06.

European equities traded hesitant at the open as uncertainty on France kept investors cautious to engage in European/French risky assets. **However, the EMU PMI's, including sentiment among French corporates, was substantially stronger than expected.** The prospect of ongoing strong EMU growth finally pushed European equities back in the global reflation rally. Core bond yields also jumped higher. However, even as the good news came from Europe, **the rise in core bond yields supported the dollar, not the euro.** At the same time, the French yield curve bear flattened with short term French yields rising further. This is another sign of underlying investors discomfort with developments in France and is negative for the euro. EUR/USD declined from the 1.0580 area to the 1.0535 area. Presidential candidate Fillon backtracking on its reform ambitions is also euro negative longer term. **The risk on trade triggered an intraday rebound of USD/JPY, but the gains remained modest given the rise in core yields and the global positive equity sentiment.**

The risk-on /reflation trade continued in the US. The dollar maintained this morning's gains, but for now there is no sustained further up-leg. EUR/USD trades currently in the 1.0525 area. Last week's correction low (1.0521) is within reach. USD/JPY is changing hands around 113.70/75, challenging the intraday highs.

Euro weakness pushes EUR/GBP again below 0.85



Euro weakness pushing EUR/GBP again below 0.85 barrier

Sterling showed a mixed picture today. **The UK currency gained ground against an overall weak euro, but ceded ground against the dollar.** The UK January public finance data were OK, but had no lasting impact on sterling trading as technical factors were in play. At a hearing before Parliament, BoE's Carney defended the BoE's assessment of the February inflation report. The central bank raised its growth forecast. However, the higher growth forecast didn't result in higher inflation forecasts as the BoE said that unemployment could decline further before causing wage rises and higher inflation. Politicians questioned the BoE's lower 'NAIRU' at today's hearing. Even so, it lowered market expectations on a near term BoE rate hike. In this respect, the BoE basically maintained its assessment from the inflation report, even as there were clear signs of internal discord on the issue. **EUR/GBP was pressured by the decline of EUR/USD and trades currently in the 0.8485 area.** Sterling trades slightly softer against a strong dollar. Cable changes hands in the 1.2420 area.

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,47%			0,32%			1,13%		
Greece (2-10-20)	8,17%	864	-131,3	7,21%	689	-35,8	7,70%	656	-33,4
Portugal	1,87%	234	0,0	4,02%	369	0,0	4,93%	379	-3,7
Italy	0,96%	143	3,5	2,21%	189	0,2	3,29%	216	-4,4
Spain	0,34%	81	2,5	1,66%	134	2,3	2,95%	182	-0,8
Ireland (4-10-30)	-0,22%	26	-1,1	1,10%	77	-2,1	2,21%	108	-2,1
Belgium	-0,11%	36	0,1	0,86%	54	-3,4	1,90%	76	-2,0
France	0,18%	66	2,6	1,09%	77	0,4	2,10%	97	-1,2
Austria	-0,33%	14	0,2	0,62%	30	-0,8	1,60%	47	0,5
Netherlands	-0,29%	19	-0,5	0,65%	33	-0,8	1,26%	13	0,1
Finland	-0,18%	29	0,3	0,52%	20	1,0	1,40%	27	0,3
US	1,94%	241	2,4	2,45%	213	0,7	3,06%	192	0,0
UK	0,46%	93	1,4	1,26%	94	0,6	1,97%	84	-1,4

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Mathias van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research		France	+32 2 417 32 65
Austin Hughes	+353 1 664 6889	London	+44 207 256 4848
Shawn Britton	+353 1 664 6892	Singapore	+65 533 34 10
Prague Research (CSOB)			
Jan Cermak	+420 2 6135 3578	Prague	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	Budapest	+36 1 328 99 85

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBCCORPORATES.COM/RESEARCH