KBC Market Research Desk - Havenlaan 12, 1080 Brussel

Sunset

Thursday, 21 September 2017

Headlines

- **European equities eked out modest to moderate gains** after WS held up well post FOMC and as the euro weakened versus the dollar (yesterday eve). **US stock markets** open with tiny losses.
- **S&P has cut its rating on China by one notch to A+** weeks before the country is expected to launch a rare dollar bond, with the ratings agency citing rising economic and financial risks after a long period of heavy credit growth. The decision brings S&P's rating in line with those of Moody's and Fitch. No immediate impact on markets is expected.
- **Norway's central bank** kept its key deposit rate unchanged at 0.50%, but i**ndicated it could raise interest rates sooner** than earlier anticipated after taking stock of the country's improved economic outlook and growing signs of tightening by its counterparts around the world. EUR/NOK fell to 9.32 from 9.37 before the decision.
- **The ECB announced plans to launch a new reference point for overnight interest rates**, opening up a new alternative to the private-sector benchmarks that have been hit by scandal and are in the process of reform. Its new transaction-based overnight rate will serve as backstop to private sector benchmark rates and finalized before 2020.
- The **Minutes of the Polish central bank meeting** showed that the majority of its members were comfortable with keeping rates stable in coming quarters. Inflationary pressures remained limited despite favourable economic conditions, good labour market conditions and gradual wage growth. There were no imbalances building. Some members suggested any rise in inflation might be met with a rate hike, fearing the effects of negative real rates.
- **Applications for unemployment benefits in the US unexpectedly declined last week, from 282k to 259k,** as the Hurricane Harvey-related surge in Texas filings continued to reverse. The **September Philly Fed Business outlook also beat forecasts, rising from 18.9 to 23.8 (vs 17.1 expected).**

Rates

Lack of follow-through action after FOMC

Lack of follow-through selling characterized today's trading session. Market participants aren't convinced yet to buy into yesterday's hawkish FOMC message. They probably want evidence from the inflation front first before taking up additional bets on higher rates. Technical considerations could be at play as well given the US Note future's 9 straight day decline. Weekly jobless claims and Philly Fed Business outlook both printed on the positive side of expectations, but couldn't change the direction of core bonds which is marginally upward.

US Note future (intraday, this week): no follow-through selling on hawkish FOMC

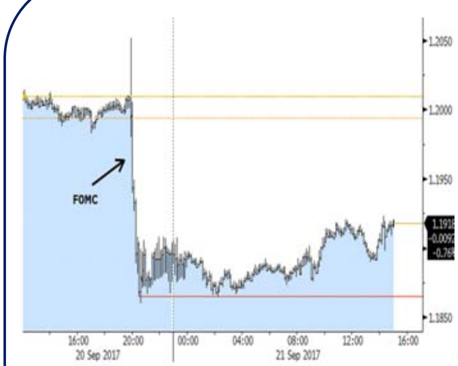
At the time of writing, US yields decline about 0.8 bps across the curve. German yields rise up to 1.8 bps (5-yr). The underperformance of the 30-yr yield (+6 bps) is due to a BB benchmark change. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany are nearly unchanged with an underperformance of the periphery (+2/3 bps).

France and Spain concluded this week's scheduled EMU bond supply. **The French Treasury tapped two OAT's (€0.99B 0% Feb2020 & €2.45B 1.75% Nov2024) and launched a new one (€3.55B 0% Mar2023) for a combined €7B, the maximum on offer.** The auction bid cover was strong (2.32). Additionally, France raised €1.85B via tapping three inflation-linked notes. **The Spanish debt agency auctioned a 3-yr Bono (€ 1.15B 0.05% Jan2021) and tapped three Obligacions (€1.3B 1.3% Oct2026), €1B 5.15% Oct2028 & €1.22B 5.15% Oct2044).** The total amount sold (€4.67B) was in the upper end of the eyed €4-5B. The auction bid cover (1.79) looks solid on first sight, but excluding demand for the short term bono, it drops to 1.52. Tensions between Madrid and Barcelona over the Catalan secession referendum probably hampered demand somewhat today

Currencies

No follow through gains for the dollar

Dollar bulls will be rather disappointed in the greenback's inability to build out yesterday's post FOMC gains. Investors clearly didn't buy into the Fed's "hawkish" stance on policy normalisation. Strong US eco data couldn't give the dollar a push in the back either. Admittedly, the US yield rally fell apart too with US yields marginally lower (<1bp). **Prices changes were small though, meaning the jury is still out about the near term direction of the Greenback.** EUR/USD trades around 1.1910, 20 ticks above opening levels, while USD/JPY changes hands around 112.40 from a 112.20 opening.

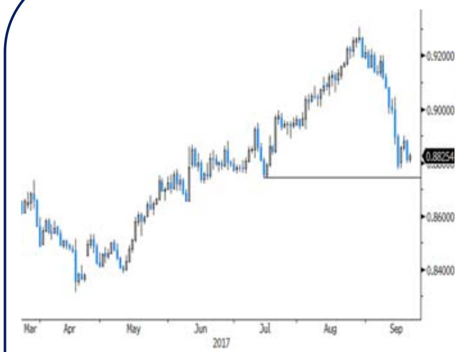


EUR/USD (2 days) No follow through dollar buying is a disappointment for dollar bulls.

Overnight, the BOJ, as expected, left its policy (target rates and asset purchases) unchanged. A new member, Kataoka, dissented as he saw little chance of the BOJ reaching its target in 2019. So, there was a soft note in the policy decision. **USD/JPY made only modest additional gains after yesterday's Fed-inspired rally.** USD/JPY set a post FOMC high at 112.72, but eased afterwards. EUR/USD cautiously went for a test of the FOMC lows, but never really tested it.

European FX trading (EUR/USD) was confined to a tight range, but on the upside of opening levels. Also European investors weren't ready to embrace the FOMC message and buy the dollar against the euro. There were no eco releases and we didn't see quotes of ECB members Smets and Praet, who figured on the event calendar. **During the US session,** the **initial claims** surprised sharply on the downside (259K versus 302K) and the **Philly Fed business confidence exceeded consensus by** a large margin (23.8 versus 18.9 in August and a 17.1 consensus). **However, EUR/USD made a knee-jerk reaction to below 1.19 on the release and immediately rebounded again to levels closer to 1.1920.** We wouldn't make too much of the positive US eco surprises as the claims consensus estimate incorporated hurricane effects and the Philly Fed is notoriously volatile. **At the margin though the knee-jerk react should be seen as a dollar negative.**

Sterling consolidates



EUR/GBP (2w): sterling consolidates near the correction lows and north of first resistance.

Sterling couldn't repeat yesterday's strong performance when it rallied versus the euro and stabilized versus the dollar despite the dollar rally. Overnight, EUR/GBP tested yesterday's lows, but sterling missed the power to steam ahead. After a stabilization, EUR/GBP made some marginal gains during European technical-oriented trading. There were better than expected UK public finance results for August, but these played no role in trading. Afterwards, EUR/GBP stabilized again to trade at 0.882 from 0.884 at the opening. Cable consolidated too and trades at 1.3504, barely off opening levels.

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.26%			0.46%			1.29%		
Greece (2-10-20)	2.95%	321	-10.3	5.58%	512	-1.2	6.64%	535	-5.8
Portugal	0.93%	119	1.7	2.43%	197	3.1	3.60%	231	-3.6
Italy	0.72%	98	0.5	2.11%	166	2.7	3.31%	202	-1.3
Spain	0.28%	53	1.3	1.62%	116	2.3	2.88%	158	-2.0
Ireland (4-10-30)	-0.38%	-12	-1.7	0.74%	29	0.8	1.88%	59	-2.6
Belgium	-0.18%	8	-0.7	0.74%	28	-0.2	1.80%	50	-5.3
France	-0.15%	10	-0.6	0.74%	28	-0.3	1.84%	55	-5.2
Austria	-0.24%	2	-0.3	0.63%	18	-0.4	1.60%	30	-4.9
Netherlands	-0.30%	-5	-0.5	0.58%	12	-0.3	1.30%	1	-5.5
Finland	-0.14%	12	-0.4	0.62%	17	-0.3	1.40%	11	-5.2
US	1.86%	212	-2.8	2.25%	180	-2.8	2.79%	150	-7.3
UK	0.78%	104	0.8	1.37%	92	1.7	1.95%	65	-4.1

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