



Sunset

Friday, 28 April 2017

Headlines

- **European equity markets traded in a narrow range today, losing slightly ground. US equity markets** opened nearly unchanged with Nasdaq outperforming (+0.3%).
- **EMU inflation rebounded in April**, with the annual rate **climbing to 1.9%** after taking a surprisingly large tumble in the previous month. Encouragingly for policymakers, a **core measure of inflation** which strips out changes for oil and food prices also shot up, **rising from 0.7% in March to 1.2%. That is its highest reading since 2013.**
- **The US economy's output grew at the slowest pace in three years during the first quarter**, underscoring the challenges facing the Trump administration as it seeks to rev up economic growth. Growth slackened to 0.7% Q/Q annualised from 2.1% in Q4 2016 and below 1% consensus. **Price indicators surprised on the upside though.**
- **The Chicago PMI rose from 57.7 to 58.3 in April, the highest level since early 2015**, while consensus predicted a decline to 56.2.
- **The UK economy slowed sharply in the first quarter as consumers pared back spending**, a warning sign on growth ahead of a national election in June and the start of Britain's exit talks with the EU. Q1 GDP printed at 0.3% Q/Q, down from 0.7% Q/Q in Q4 2016 and below 0.4% Q/Q expectations.
- **Russia's central bank cut its key interest rate by 0.5% to 9.25% on Friday**, citing the country's continued emergence from a two-year recession. The bank said inflation, currently at 4.3%, remained on track to hit its longstanding target of 4% by year's end, allowing for further gradual cuts in rates over the course of the year.
- **US President Trump said a "major, major conflict" with North Korea was possible over its nuclear and ballistic missile programmes**, while China said the situation on the Korean peninsula could escalate or slip out of control.
- Major dealers have backed the broader use of a BoE interest rate benchmark as an alternative to Libor, a rate that was tarnished by a rigging scandal. **Support for SONIA, the sterling overnight index average, as its preferred "near risk-free" interest rate benchmark in sterling derivatives and other financial contracts, will improve the resilience of the financial system**, the BoE said.

Rates

Core inflation conflicts with Draghi's message

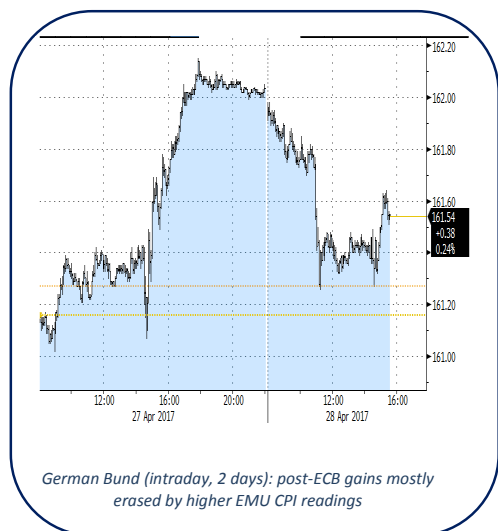
Global core bonds lost some ground today. Two events clearly coloured trading. First, EMU inflation printed higher than expected at 1.9% Y/Y in April. Core inflation surged from 0.7% Y/Y to 1.2% Y/Y, above 1% Y/Y consensus and the highest reading since 2013. The higher inflation contradicted with Draghi's soft message at yesterday's ECB press conference. The ECB president did his utmost best not to trigger speculation on a nearby process of policy normalisation by the central bank. Subdued core inflation was one of his strongest arguments to defend the ECB's very accommodative policy. The Bund lost ground after the inflation readings, underperforming US Treasuries. **The**



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second defining moment for today's trading session was the **US Q1 GDP release**. Growth slowed more than expected to only 0.7% Q/Q annualised. **US Treasuries nevertheless declined, this time underperforming Bunds, because price indices rose to 2% or even higher, suggesting that the Fed could easily continue its gradual tightening cycle in June**. Trump's hostile talk on North Korea and the (European) long weekend ahead hampered investors from putting up more short positions.

At the time of writing, changes on the US yield curve range between +2 bps (2-yr) and +2.6 bps (5-yr). The German yield curve bear steepens with yields 2.5 bps (2-yr) to 4.9 bps (30-yr) higher. On intra-EMU bond markets, 10-yr yield spreads versus Germany narrow up to 3 bps with Greece outperforming (-6 bps) and Portugal underperforming (+4 bps).

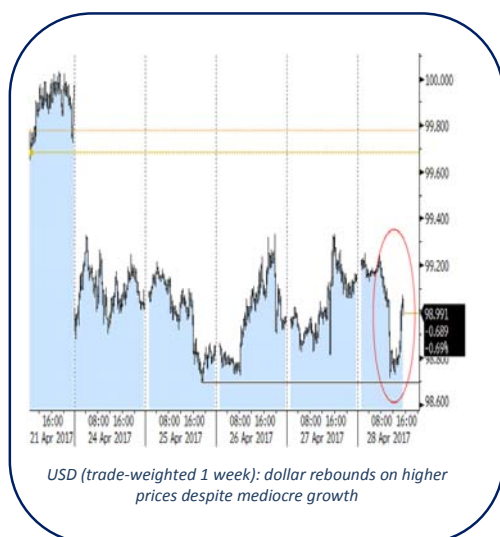
Currencies

Dollar rises on higher inflation despite poor growth

Trading in the major FX cross rates was driven by conflicting signals today. The euro jumped higher this morning on a unexpected sharp rise in EMU inflation. **EUR/USD came within reach of this week's top**. In the afternoon, the dollar rebounded. **US Q1 GDP was disappointing, but the price components were higher than expected, supporting US yields and the dollar**. **EUR/USD trades currently in the 1.09 area**. **USD/JPY changes hands in the 111.60 area, within reach of this week's top (111.78)**.

Overnight, Asian equities ceded modest ground. Geopolitical tensions (North Korea) and end of month profit taking were probably to blame. Japanese eco data confirmed a further gradual recovery, but CPI data remained soft. The yen traded little changed. **USD/JPY held a tight range in the low 111 area**. **EUR/USD maintained yesterday's post-ECB decline and traded around 1.0865**.

Early in Europe, European yields and the euro rose slightly but the moves were very modest. However, the preliminary release of the EMU CPI didn't pass unnoticed. Headline and core inflation declined more than expected in March and ECB's Draghi yesterday mentioned low core inflation as an important factor to keep ECB policy ultra-easy. **However, the April inflation data painted quite a different picture**. EMU headline inflation jumped from 1.5% Y/Y to 1.9% Y/Y (consensus 1.8% Y/Y). The rise in core inflation was even bigger as it rose from

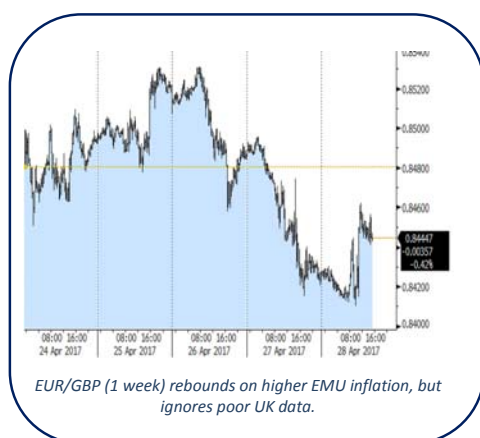


0.7% Y/Y to 1.2% Y/Y (consensus at 1.0% Y/Y). **Yesterday, European yields and the euro declined after the soft Draghi comments. So, there was some room for a countermove and that is exactly what happened.** European yields and the euro jumped higher. EUR/USD came within reach of the recent highs in the 1.0950 area but no break occurred.

The advance reading of **US Q1 GDP showed very mediocre growth at 0.7% Q/Qa.** (a decline from 2.1% to 1.0% Q/Qa was expected). However, the price data of the report were higher than expected. Some kind of stagflation can hardly be considered good news. However, markets apparently assume that rising prices will keep the Fed on its rate hike trajectory. EUR/USD declined modestly and trades near 1.09. USD/JPY trades around 111.60 area, nearing the week top (111.78).

Sterling ignores a series of soft UK data

UK eco data came out weaker than expected today. UK Q1 GDP growth slowed to 0.3% Q/Q and 2.1% Y/Y from 0.7% Q/Q in Q4 2016. The consensus expected 0.4% Q/Q. The ONS indicated that the decline was mostly driven by a slowdown in the services sector. Especially sectors that are sensitive to the declining purchasing power due to price rises were to blame. The Nationwide house prices and the number of loans for home purchases were also softer than expected. **Remarkably, the soft/weak UK data hardly impacted sterling.** Cable was well bid going into the publication of Q1 GDP. The pair stabilized in the mid 1.29 area after the Q1 GDP release. The pair trades currently in the 1.29 area, but that is due to USD strength after the US GDP data. **EUR/GBP was also moved by non-UK issues.** The pair jumped from the 0.8415 area to the 0.8450 data after the higher than expected EMU CPI. The pair trades still near that level at the moment of writing. The EUR/USD decline after the US data barely impacted EUR/GBP trading.



16:00 CET

Daily EMU spread changes (bps)

	5-yr (benchmark change GE)			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,44%			0,33%			1,11%		
Greece (2-10-20)	8,66%	909	-137,6	7,36%	703	-47,0	7,85%	674	-39,7
Portugal	2,01%	245	1,4	4,10%	377	3,1	5,03%	393	2,1
Italy	0,91%	134	6,8	2,25%	192	6,3	3,44%	233	5,7
Spain	0,32%	76	2,6	1,68%	136	4,3	3,02%	192	1,7
Ireland (4-10-30)	-0,20%	24	-0,6	1,08%	76	2,2	2,17%	106	0,8
Belgium	-0,09%	35	1,2	0,88%	56	0,5	1,89%	79	-0,3
France	0,12%	56	4,3	1,04%	71	3,5	2,07%	96	3,5
Austria	-0,35%	8	0,7	0,60%	27	1,2	1,52%	41	1,6
Netherlands	-0,28%	15	1,8	0,69%	36	2,6	1,24%	13	1,1
Finland	-0,35%	9	1,1	0,55%	22	3,3	1,26%	15	0,4
US	1,89%	232	2,1	2,42%	209	1,1	3,03%	193	-0,5
UK	0,49%	93	1,0	1,27%	94	1,0	1,96%	86	-0,8

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