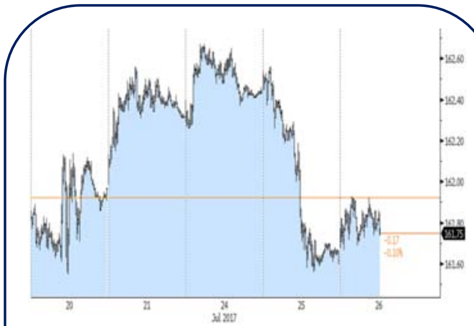
Sunset

Wednesday, 26 July 2017

Headlines

- **Gains in commodities** from oil to copper **lent momentum to European stocks as positive corporate results continued to feed into markets.**
- **GDP-growth in the UK edged up in Q2, in line with expectations.** The ONS estimates the economy expanded by 0.3% Q/Q, up from 0.2% Q/Q in Q1. The year on year growth slowed to 1.7% from 2%.
- **The INSEE office released figures showing French consumer confidence fell from 108 in June (a 2007 high) to 104 in July while a stabilisation was expected.** The survey also revealed concerns over rising unemployment while inflation expectations also leapt among consumers.
- **Copper prices have jumped** to the highest level in two years **following reports China could move to ban imports of scrap metal by the end of next year, a move that would likely boost demand for refined metals** in China.
- The **UK government says it will ban sales of fossil-fuelled vehicles by 2040**, two weeks after France announced a similar plan.
- **Poland, Hungary and the Czech Republic suffered a double blow as the EU mounted a legal fightback to force them to comply with EU refugee quotas.** The EU forged ahead to enforce the law, as it prepared to sign-off legal suits against hold-out countries and separately won a favourable opinion at Europe's top court.
- The **European Commission stands ready to trigger fresh legal action against the Polish government** despite the country's president vetoing two out of four controversial reforms to the Polish judiciary. The EC vice president said the approval of the remaining measures still undermined the independence of the country's judges.

Rates



German Bund (intraday, 5 days): Pause today following sell-off yesterday brings Bund back to levels from five days ago

Core bonds move sideways ahead of FOMC decision

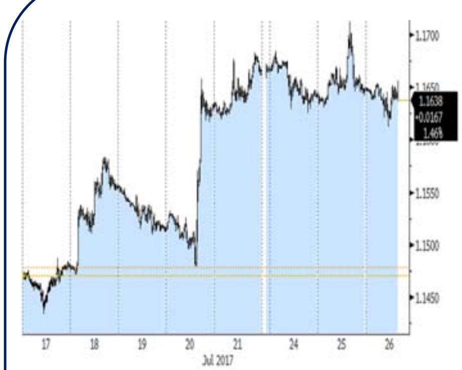
Global core bonds took a breather today following yesterday's sell-off and ahead of the FOMC decision later this evening. Equities traded with a positive bias, while **oil** moved sideways keeping yesterday's steep gains intact. No firm directional moves either on the **main FX crosses. None of these other market had a noticeable impact on bond trading.** The **eco calendar** was thin with UK Q2 GDP weak, but as expected at 0.3% Q/Q and French consumer confidence disappointing. The bond movements were also **technically irrelevant.** Needless to say that **bond volumes traded** were very light. **Summarizing, dull trading across the board during the Summer holidays before the FOMC decision.**

At the time of writing, US yields fell between 0.3 bps (30-yr) and 1.2 bps (5-10yr), the belly marginally outperforming the wings. Changes on the German yield curve were slightly bigger (-1.4 to -1.8 bps). **On intra-EMU bond markets,** 10-yr yield spread changes versus Germany varied between -2 bps (Italy) and +2 bps (Greece). Dull trading continued. The Italian small IL and zero coupon auctions went well.

Later today, the Treasury holds its 5-year T-Note auction and the FOMC concludes its meeting. The **FOMC has little incentive to inject volatility** in these thin Summer markets and may wait for the September meeting to take some decisions. At that time, new eco and rate projections will be available and chair Yellen will hold a press conference to explain eventual new decisions. **Two items nevertheless need to be watched** in the FOMC statement this evening. First, **will the FOMC announce the start of the tapering of its balance sheet?** September is the more likely announcement date, but there is a small chance it will be announced today (to start in October?). It would underline that the Fed considers this tapering as a background event that will continue independent of temporary developments in the economy, for which its main tool, the FF rate, will be used. Second, **will the Fed show more concerns about the low inflation readings of the past four month?** Depending on the outcome of these questions, there might be some moves in the US Treasury market. **Overall though, these should be subdued and temporary.**

Currencies

Fed to decide on next USD-move?



EUR/USD (2-w): dollar trades off the recent lows ahead of the Fed policy statement

Today, trading in the major USD cross rates was somewhat paralysed as investors kept side-lined ahead of this evening's Fed policy statement. The dollar tried to extend yesterday's rebound during European trading, but the bid faded later in the session. EUR/USD trades in the 1.1635 area. USD/JPY is changing hands in the 111.80/0 area. The Fed holds the key to unlock this stalemate.

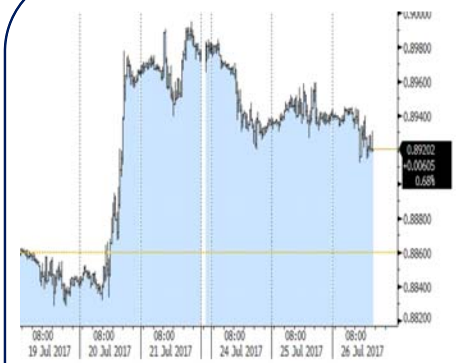
Asian equities traded mixed to slightly lower. **Japan and Australia outperformed on a decline of their currencies.** USD/JPY maintained yesterday's gain and traded just below 112 going into European trading. The dollar also held its gains against the euro with EUR/USD trading in the 1.1635 area.

There were no important data in Europe. Trading in the major dollar cross rates was order-driven as investors awaited the Fed policy statement. The dollar initially kept a slightly positive bias. Especially EUR/USD lost a few more ticks and filled bids in the 1.1615 area mid-morning. USD/JPY didn't go anywhere. Changes in interest rate differentials were insignificant and no driver for USD trading. Sentiment on the dollar turned a bit softer going into the start of US dealings. EUR/USD returned to the mid 1.16 area. USD/JPY lost a few ticks to the 111.75 area. US investors didn't place big USD bets ahead of the Fed policy statement. EUR/USD trades in the 1.1640 area and USD/JPY is changing hands in the 111.80 area.

We expect the Fed to be **more concerned on inflation** but to keep the door open for a December rate hike. The market implied probability of a December rate hike is less than 50%. We don't expect the Fed to be so soft that markets reduce their expectations further. **With US interest rates already at very low levels, one could assume that there is quite some negative news discounted**

for the dollar. US eco news has to be very good before it can trigger a sustained USD rebound. **However, assuming that the Fed statement won't be overly soft, we expect no sustained break of the key 1.1714/35 resistance for now.**

Sterling doesn't react to soft UK Q2 growth



EUR/GBP (1-w): sterling ignores soft UKQ2 growth

Today's **UK Q2 GDP estimate** was one of the last important data series ahead of next week's BoE policy decision. UK Q2 GDP growth printed at 0.3% Q/Q and 1.7% Y/Y, exactly as expected. EUR/GBP was under slight pressure going into the GDP report, but this was euro softness rather than GBP strength. EUR/GBP temporarily dropped to the 0.8915 area, but rebounded slightly after the data. T The sterling correction didn't go far as global markets were in some kind of lethargy ahead of the Fed policy decision. The market implied probability of a BoE rate hike was and remains low (about 10 %). There probably is additional negative news (or spill-overs from other cross rates) needed to trigger additional sterling losses. EUR/GBP trades in the 0.8920 area. Cable trades near 1.3050.

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0.16%			0.56%			1.32%		
Greece (2-10-20)	3.28%	343	-7.0	5.31%	475	1.5	6.52%	520	1.7
Portugal	1.20%	135	1.9	2.97%	241	-0.3	3.91%	259	1.1
Italy	0.79%	95	-1.5	2.12%	156	-1.9	3.25%	193	-0.8
Spain	0.32%	48	-0.9	1.54%	98	-0.6	2.83%	151	0.9
Ireland (4-10-30)	-0.28%	-12	-1.7	0.86%	30	-0.2	1.93%	61	0.5
Belgium	-0.07%	9	-0.4	0.83%	27	0.1	1.82%	50	0.0
France	-0.06%	9	-0.8	0.82%	26	0.8	1.86%	54	0.3
Austria	-0.16%	0	-0.4	0.72%	16	-0.4	1.65%	33	0.2
Netherlands	-0.22%	-6	-0.4	0.67%	11	-0.6	1.38%	6	-0.2
Finland	-0.13%	3	0.5	0.55%	-1	-0.2	1.46%	14	0.0
US	1.88%	204	0.5	2.33%	177	0.1	2.92%	160	0.8
UK	0.59%	75	-0.9	1.24%	68	-1.5	1.87%	55	-0.9

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

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