



Sunrise

Wednesday, 26 October 2016

Rates: Range-bound trading, but support could come into focus

Today's eco calendar is uneventful. We favour more range-bound trading on core bond markets, but expect a new test of the lower bound in the run-up to next week's FOMC meeting with some investors hoping on a clear hint of a December rate hike. The market implied probability of such move increased further, to 72.5%.

Currencies: Dollar fails to clear recent highs against the euro and the yen

The dollar set minor new highs against the euro and the yen, but the gains could not be sustained. This suggests the dollar rebound might be ripe for a pause. Sterling traded volatile, but found a bottom as BoE's Carney suggested that the decline of sterling and higher inflation might get more weight in the BoE's assessment.

Calendar

Headlines

S&P	↓
Eurostoxx50	→
Nikkei	→
Oil	→
CRB	→
Gold	↗
2 yr US	→
10 yr US	→
2 yr EMU	→
10 yr EMU	→
EUR/USD	→
USD/JPY	→
EUR/GBP	↗

- **US equities** ended up to 0.5% lower yesterday as several beltweather companies warned on the outlook and as consumer confidence disappointed. Overnight Asian stock markets decline as well following mixed Apple results.
- **Apple posted its first annual revenue decline in 15 years**, but projected a return to growth in the current quarter because of strong sales of its new iPhone 7.
- **The Australian dollar** rose 0.7% to \$0.7699 as data showed **headline inflation rose by a stronger-than-expected 1.3% Y/Y** in the September quarter. The gain was underpinned by strong gains for fruit and vegetable prices, which had been affected by adverse weather.
- **Bank of England Governor Carney** said that there were limits to the central bank's ability to ignore the effect of sterling's slide on inflation, as policymakers consider whether to cut interest rates next week.
- **The EU asked Italy to explain why its 2017 structural budget deficit is rising** instead of falling as requested by EU finance ministers and why the headline budget gap is to be much higher than Rome promised in May.
- **ECB President Draghi** defended the central bank's easy-money policies, arguing that ultralow interest rates haven't harmed German households and stressing that the ECB would keep its policies in place until it reaches its inflation target.
- The leader of the Spanish conservative Popular party will **formally submit his candidacy** today, followed by a first round of voting tomorrow that **Mr Rajoy** is expected to lose. On Saturday, parliament will hold the second and decisive vote, this time requiring only a simple majority of deputies.
- **Today, the eco calendar** is uneventful with only US advance goods trade balance and several auction (Italy, Germany, Portugal, US). Q3 earnings reports include Bayer, Coca Cola and Boeing.

Rates

US curve bear flattens, as Dec hike looks unavoidable

Bond sell-off in US mid-morning trading erased by weak consumer confidence and declining equities/oil

	US yield	-1d
2	0,8645	0,0165
5	1,271	-0,0016
10	1,7472	-0,0176
30	2,4893	-0,0286

	DE yield	-1d
2	-0,6480	0,0030
5	-0,4720	0,0100
10	0,0340	0,0060
30	0,6580	0,0013

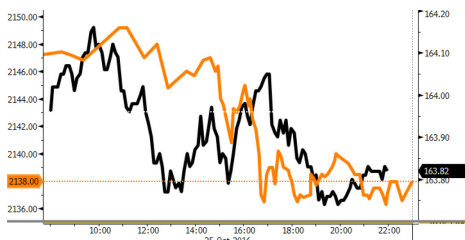
Yesterday, global core bonds ended narrowly mixed after trading with a negative bias during the European morning session. German bonds ended slightly lower, while US Treasuries turned lower at the short end of the curve and higher at the longer end. The probability of a US December rate hike increased to 72.5% without a strong driver. Weaker consumer confidence helped US Treasuries in US mid-morning recover from European-induced weakness, but the gains evaporated and the **US short end was hit again after a weak 2-yr US Note auction**, another sign that investors expect a Fed rate hike in December. **Supply** weighed already on core bonds in European trading (70yr Austria deal; UK 50-yr). The EMU eco calendar contained a strong German IFO-indicator, which was ignored completely. Equities and oil traded initially sideways but both fell in US mid-morning, helping US Treasuries to recover. **In a daily perspective**, changes on the German yield curve ranged between -0.1 bp (30-yr) and +1.2 bps (5-yr). US yields changed between +1.2 bps (2-yr) and -1.9 bps (30-yr) lower. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany ended nearly unchanged with Greece outperforming (-3 bps) and Portugal underperforming (+3 bps).

Little on the EMU calendar

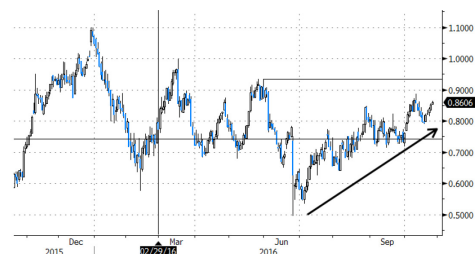
Busy US calendar but without strong market drivers

Eco calendar unattractive

In EMU, **French consumer confidence** is expected slightly higher in October (98 versus 87), but it won't affect markets. In the US the dataflow is busier with the Sep Goods trade balance, the Oct. Markit Services PMI, the Sep wholesale inventories (Sep) and the Sep New Home sales. **We don't expect these to change the environment for core bonds in a lasting way**. The markets expect a small widening of the trade deficit and a minimal increase in the wholesale inventories, which might cancel each other out in terms of impact on Q3 GDP. The **Sep New Home sales** are likely the most important release. A small 1.5% decline to 600K is expected in September, following an already steep 7.6% decline in August. However July and the months before were strong. **The level of 600K (Sep) should still be the third highest of the cycle and up from 457K one year ago**. Following a strong manufacturing PMI (Markit) a slight 0.2-point increase in the October services PMI (52.5) is expected.



Bund future (black) and S&P future (orange) intraday: Bund trades with negative bias in European morning, tries to fight back, but ultimately closes near day lows (with minor losses though)



US 2-yr yield: climbs gradually higher as Dec rate hike becomes ever more likely, but the expected shallow rate path keeps its below levels reached earlier this year and late last year

Germany, Portugal and US tap market

R2	166,36	-1d
R1	164,29	
BUND	163,82	-0,1200
S1	163	
S2	162,56	

The **German Finanzagentur** holds a small Bobl auction (€3B 0% Oct2021). Total bids averaged €4.51B at the previous 4 Bobl auctions. The bond trades stable in ASW spread terms going into the auction, but is cheap on the German curve compared to surrounding off the run bonds. We expect a plain vanilla auction given the small hurdle to clear (€3B). The **Portuguese debt agency** taps the off the run OT (3.85% Apr2021) for €0.75-1B. With DBRS's rating decision out of the way, we expect good demand today. The bond offers a significant pick-up over swap/other peripherals given its relatively short maturity.

The US Treasury started its end-of-month refinancing operation with a weak \$26B 2-yr Note auction. The auction stopped with a slight tail and the bid cover (2.53) was light. Bidding details showed very little buy-side interest, anticipating a December Fed rate hike. Today, the Treasury holds a \$15B 2-yr FRN auction and a \$34B 5-yr Note auction. Currently, the WI of the latter trades around 1.27%.

Looking to oil and equity markets today?

Overnight, Asian stock markets lose more ground than WS yesterday evening as Apple stocks are down in after-trade following disappointing results. Brent crude slides towards \$50/barrel mark as more and more non-OPEC members bail out on the production cut agreement. Despite weaker stocks and oil, the US Note future trades stable overnight.

Today's eco calendar is uneventful suggesting sentiment-driven trading. If stocks and commodities remain under downward pressure it could slightly underpin core bonds within their established ranges. Nevertheless, **in the run-up to next week's FOMC meeting, the US Note future could test 129-26 support again, anticipating hints on a December move.** Yesterday, the market implied probability of December rate hike increased to 72.5%. **In such scenario, the US 10-yr and 30-yr yields should be able to hold above key resistance levels at 1.75% and 2.5% though.** Earnings could influence core bond markets via risk sentiment.

We think that the correction higher in the Bund following the ECB meeting has run its course. ECB president Draghi said that the ECB will deliver key policy guidance in December. QE won't last forever, but also won't stop immediately after March 2017, suggesting that the central bank has a tapering scenario in mind, but not necessarily just after March. **We expect the Bund to remain in the sideways trading range (163 area – 165.63).**



German Bund: sideways trading



US Note future: Extensively tested the downside, but break didn't occur so far

Currencies

R2	1,1366	-1d
R1	1,1123	
EUR/USD	1,08875	0,0008
S1	1,0826	
S2	1,0711	

Dollar fails to extend gains beyond next resistance area.

Profit talking on Asian equity markets

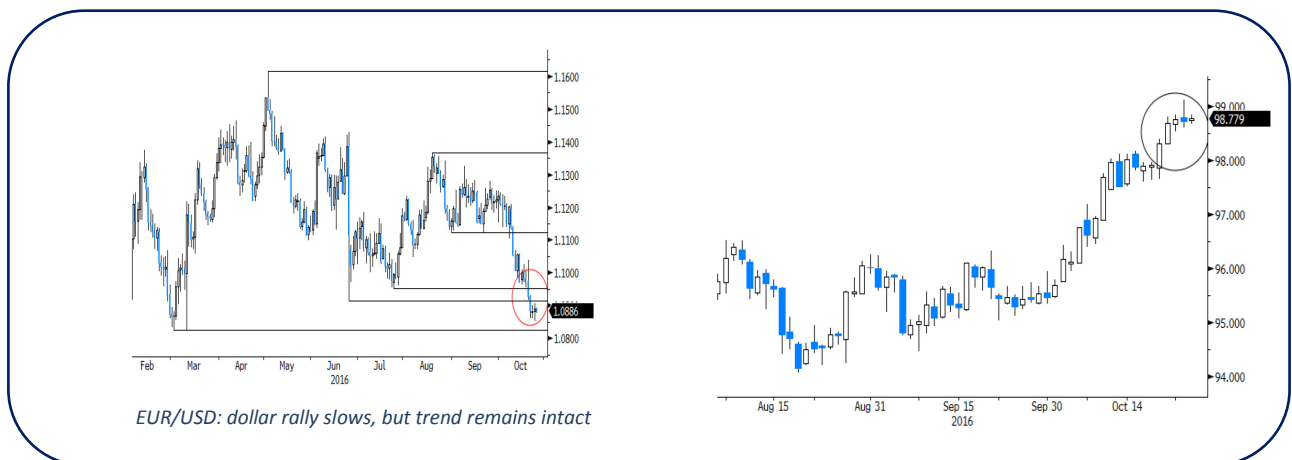
Dollar trades off the recent highs

AUD gains on higher inflation

USD fails to clear next resistance against euro and yen

On Thursday, the USD held near the recent highs, but without a clear directional trend. In technical trade EUR/USD dropped temporary below 1.0860. USD/JPY traded temporary north of the 104.64 top. However, the gains could not be sustained. The dollar fell prey to profit taking. An intraday decline in core bond yields and US equities were an excuse the take some USD profits. USD/JPY closed the session at 104.22 (from 104.18). EUR/USD finished the session at 1.0889 (from 1.0887).

Overnight, most Asian equity indices trade with modest to moderate losses, joining the correction at WS. The trade-weighted dollar (DXY 98.77) still trades within reach of the recent highs, but yesterday's price action paints a doji-like pattern (trend reversal?) on the chart. USD/JPY holds well north of 104 (currently 104.35). EUR/USD trades in well-known territory in the 1.0885 area. Overnight, oil and some other commodities are in the defensive. Even so the Aussie dollar rebounds after higher than expected (headline) Q3 inflation. The report suggests that the bottom in inflation might have been reached and that the further rate cuts might not be needed. AUD/USD trades just below 0.77, within reach of the recent top.



EUR/USD: dollar rally slows, but trend remains intact

US data won't change the broader picture for the dollar.

Dollar rally to shift into a lower gear?

Today, there are only second tier eco data in Europe. In the US, the Sep Goods trade balance, the Oct. Markit Services PMI, the Sep wholesale inventories (Sep) and the Sep New Home sales will be published. The market expects a small widening of the trade deficit and a minimal increase in the wholesale inventories, which might cancel each other out GDP-wise. September New Home sales are expected to have declined 1.5%, following an already steep 7.6% decline in August. However July and the months before were strong. Following a strong manufacturing PMI (Markit) a slight 0.2-point increase in the services PMI (52.5) is expected. Today's US data won't derail market expectations for a December Fed rate hike. Question is whether they will be able to sustain the recent gradual rise in US bond yields and of the dollar. Over the previous two days, the dollar held close to the recent highs, but more gains were not registered. December Fed rate hike expectations put a solid floor

under the US dollar. However, a pause/modest USD correction is possible especially if the rise in core bonds slows or in case of a risk-off correction.

So, **in a day-to-day perspective, we turn a bit more neutral on the USD, even as the MT trend remains USD-positive.** Apparently, there is some additional USD positive news needed to push the dollar beyond the recent highs against the euro and the yen.

From a technical point of view, EUR/USD finally dropped below 1.0952/13 support. The break is an extra USD positive and opens the way to next intermediate support (1.0822/1.0711). USD/JPY struggles to break north of 104.32/64. A break would paint a double bottom formation on the charts with targets in the 108/109 area. We stay cautious on sustained USD/JPY gains beyond the 104.32/65 resistance especially as global volatility/uncertainty intensifies. A new test of the recent highs looks to be in store.

R2	0,9142	-1d
R1	0,9027	
EUR/GBP	0,8947	0,0052
S1	0,8725	
S2	0,8589	

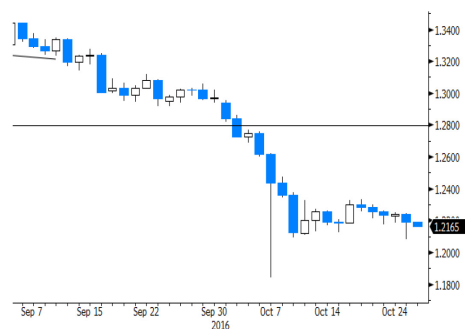
Sterling: nervousness persists

On Tuesday, in the run-up to the US trading session, the UK currency fell prey to another selling wave. UK Chancellor Hammond kept the door open for further QE if the BoE would ask for it. **Since the appointment of PM May, markets turned wary over potential political involvement in the BoE's policy. After Hammond's comments**, UK foreign secretary Johnson said that he doesn't expect a new Heathrow runway to be built, contradicting earlier messages from the Transport minister that the UK government backs the project. **It could open the first big rift in the UK's immature Cabinet.** Sterling was hammered. EUR/GBP spiked to the high 0.89 area. In a hearing, before the House of Lords, **BoE's Carney indicated that the recent decline of sterling and potential inflation risks might become more important in the BoE assessment.** This helped to put an intraday floor for sterling. EUR/GBP closed the session at 0.8934 (from 0.8892). Cable finished the day at 1.2188 (from 1.2238).

Today, the UK calendar is unattractive. Markets will ponder the impact of yesterday's comments of BoE 's Carney. They make further BoE easing less likely short-term. At the same time, political uncertainty remains a source of sterling volatility. Over the previous days, the decline of sterling slowed. Some further consolidation or even a slight further rebound might be on the cards short-term. **However, we don't expect this sterling rebound to go far and look to sell sterling on more pronounced up-ticks. EUR/GBP 0.8725 remains a key reference.**



EUR/GBP: holding below the 0.90 barrier, for now



GBP/USD: consolidation, but no sustained rebound yet

Calendar

Wed., 26 October		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	0.6%
14:30	Advance Goods Trade Balance (Sep)	-\$60.8b	-\$59.2b
14:30	Wholesale Inventories MoM (Sep P)	0.1%	-0.2%
15:45	Markit US Services PMI (Oct P)	52.4	52.3
15:45	Markit US Composite PMI (Oct P)	--	52.3
16:00	New Home Sales / MoM (Sep)	600k/-1.5%	609k/-7.6%
Japan			
01:50	PPI Services YoY (Sep)	A: 0.3%	0.2%
07:00	Small Business Confidence (Oct)	A: 48.3	47.7
UK			
10:30	BBA Loans for House Purchase (Sep)	37350	36997
Germany			
08:00	GfK Consumer Confidence (Nov)	10.0	10.0
08:00	Import Price Index MoM/YoY (Nov)	0.0%/-1.9%	-0.2%/-2.6%
France			
08:45	Consumer Confidence (Oct)	98	97
Events			
Q3 earnings	Bayer (07:30), Coca-Cola (Bef-mkt), Boeing (13:30)		
10:00	ECB Hansson speaks on outlook for Estonia, Euro Area		
11:00	Italy sells (I/L) bonds		
11:30	Germany to sell €3B 0% 2021 bonds		
11:30	Portugal to sell up to €1B 3.85% 2021 bonds		
17:30 & 19:00	US to sell \$15B 2-yr Floating Rate Notes & \$34B 5-yr Notes		
19:00	ECB Praet speaks in Brussels		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,75	-0,02	US	0,86	0,02	DOW	18169,27
DE	0,03	0,01	DE	-0,65	0,00	NASDAQ	for Exch - NQI #VALUE!
BE	0,25	-0,01	BE	-0,65	0,01	NIKKEI	17385,35
UK	1,10	0,03	UK	0,24	0,02	DAX	10757,31
JP	-0,06	0,00	JP	-0,24	0,00	DJ euro-50	3087,41

						USD			
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	td	-1d
3y	-0,155	1,145	0,646	Euribor-1	-0,37	0,00	Libor-1 USD	0,26	0,26
5y	-0,045	1,277	0,745	Euribor-3	-0,31	0,00	Libor-3 USD	0,40	0,40
10y	0,415	1,568	1,046	Euribor-6	-0,21	0,00	Libor-6 USD	0,56	0,56

Currencies			Currencies			Commoditie		
	-1d			-1d		CRB	GOLD	BRENT
EUR/USD	1,08875	0,0008	EUR/JPY	113,52	-0,06	189,4383	1273,35	50,14
USD/JPY	104,29	-0,13	EUR/GBP	0,8947	0,0052	-1d	0,04	7,36
GBP/USD	1,2162	-0,0062	EUR/CHF	1,0833	0,0017			
AUD/USD	0,7694	0,0066	EUR/SEK	9,7163	0,03			
USD/CAD	1,3351	0,0021	EUR/NOK	9,0047	0,03			

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)		Prague	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Bratislava	+421 2 5966 8820
Marek Gabris	+421 2 5966 8809		
Budapest Research		Budapest	+36 1 328 99 85
David Nemeth	+36 1 328 9989		

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