



Sunrise

Thursday, 01 September 2016

Rates: Cautiousness going into tomorrow's payrolls?

Risks for the final EMU manufacturing PMI, but especially US manufacturing ISM, are on the downside of expectations. That could underpin core bonds today, especially if oil prices correct further down. Nevertheless, going into tomorrow's crucial payrolls report we don't expect investors to place big new bets.

Currencies: Dollar "rally" stops ahead of tomorrow's payrolls

The dollar moves higher ran yesterday/overnight into resistance. Some late pre-positioning ahead of the payrolls might still occur, but we stick towards dollar strength as we think the payrolls will bolster rate hike expectations. Sterling's correction higher will today be tested as the UK manufacturing PMI is released.

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** dropped lower in the first hours of trading, but reversed most of their losses after the European close. The S&P ended down by 0.24% led by losses in energy shares. This morning, **Asian shares trade narrowly mixed**.
- **Activity in China's manufacturing sector unexpectedly accelerated to its fastest pace in nearly two years in August**, the official manufacturing PMI showed. Growth of smaller manufacturing firms however stalled, according to the Caixin measure. In the non-manufacturing sectors, activity growth slowed from the previous month due to a softening in the construction sector.
- **Spanish lawmakers rejected a second term for acting Spanish Prime Minister Rajoy** with 170 votes in favour and 180 against. A second vote will be held tomorrow, where a single majority is needed, but another failure is expected.
- **The Brazilian Senate voted yesterday with an overwhelming majority to impeach President Rousseff**, ending nearly 14 years of rule by her leftist Workers' party. The dismissal of Rousseff is causing rifts elsewhere in Latin America with governments of Venezuela, Ecuador and Bolivia calling it a coup.
- **Crude oil prices dropped 3.5% yesterday with the Brent closing below \$47/barrel** as US crude stockpiles rose much more than expected last week. Saudi Arabia said yesterday it does not target a specific level of oil production, but its output is based on customers' needs, adding that demand for crude in China remains very healthy.
- Today, the **eco calendar** contains the euro zone (final) and UK manufacturing PMI, the US manufacturing ISM and US initial claims. Fed's Mester and ECB's Nowotny are scheduled to speak.

Rates

	US yield	-1d
2	0,8133	0,0119
5	1,201	0,0114
10	1,5851	0,0085
30	2,2363	-0,0022

Hawkish Rosengren and solid ADP balanced by dovish Evans, disappointing Chicago PMI and crashing oil

	DE yield	-1d
2	-0,6160	0,0000
5	-0,4970	0,0180
10	-0,0560	0,0290
30	0,4683	0,0339

Downside risks US Manufacturing ISM, second reading EMU PMI

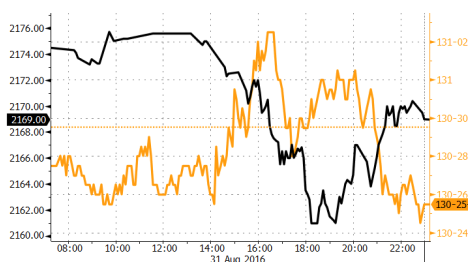
A lot of input, but no market reaction

Core bonds continued to tread water yesterday despite sensible US market information. Voting FOMC member Rosengren warned for high commercial real estate valuations and the risks of keeping rates too low for too long. Furthermore, the ADP employment report was solid and could be a herald for tomorrow's payrolls release. US Treasuries didn't cede much ground though. The flip side of the coin showed dovish comments by non-voting FOMC member Evans, a disappointing Chicago PMI and crashing oil prices. Brent crude temporarily dipped below \$47/barrel on rising inventories in the US and vanishing hopes over an OPEC-led production freeze.

On a daily basis, the German yield curve bear steepened with yields up to 3.1 bps higher (30-yr). Changes on the US yield curve varied between +0.3 bps (30-yr) and +2.1 bps (5-yr). **On intra-EMU bond markets,** 10-yr yield spread changes versus Germany range between -2 bps and +1 bp with Spain underperforming (+4 bps) in the run-up to the confidence vote on Rajoy's bid to form a new government. Eventually, Rajoy lost the vote in parliament, winning 170 out of 350 votes. On Friday, a second vote takes place in which Rajoy needs to secure a simple majority rather than an absolute one like yesterday. Nevertheless, it doesn't look like one of the opposition parties is going to abstain. **The prospect of more political uncertainty could weigh on Spanish bonds this week.**

Business surveys for manufacturing sector on agenda

As traditionally at the 1st working day of the month, **business surveys for the manufacturing sector** are on the agenda globally. According to the first estimate, the **euro zone manufacturing PMI** weakened slightly in August, from 52.0 to 51.8, while a stabilization was expected. For now, the euro zone manufacturing sector is apparently the most affected by the Brexit decision, although the impact remains subdued for now. After also a weaker IFO and Commission indicators, we see risks for a downward surprise. Also in the US, **the manufacturing ISM** is expected to have weakened for a second straight month in August, with the consensus looking for a drop from 52.6 to 52.0. Regional indicators were almost all a good deal weaker than expected and therefore we believe the ISM might surprise on the downside too. Finally, **US initial jobless claims** are expected to have picked up slightly in the week ending the 27th of August, from 261 000 to 265 000. We continue to see downside risks for the claims as labour market conditions are improving further while claims are somewhat off their recent lows.



US Note future (orange) and S&P future (black) intraday: Treasuries tread water



Brent crude (intraday, this week): significant downward correction

Spanish and French auctions

R2	170	-1d
R1	168,86	
BUND	167,24	-0,4000
S1	165,63	
S2	163,61	

The French debt agency creates a new 10-yr OAT (0.25% Nov2026) while also tapping the 1.25% May2036 OAT and 3.25% May2045 OAT for a total amount of €8-9B. Grey market trading suggests that the new OAT will be launched with a 1.9 bps pick-up in ASW-spread terms compared with the previous 10-yr benchmark (0.5% May2026). That corresponds with a 6 bps pick-up in yield terms. The longer-dated OAT's traded stable going into the auction in ASW-spread terms and are normal on the French curve. We expect plain vanilla auctions. The Spanish treasury taps the on the run 3-yr Bono (0.25% Jan2019), 10-yr Obligacion (1.3% Oct2026) and 30-yr Obligacion (2.9% Oct2046) for a combined €3.5-4.5B. The bond cheapened in ASW spread terms going into the auction given the political uncertainty (see above). Of late, investors often profited from such cheapening to add positions as the ECB's QE programma outweighs any domestic issues. On the Spanish curve, the Oct2026 and Oct2046 bonds are rather expensive.

Cautiousness ahead of US payrolls?

Overnight, most Asian stock markets trade mixed, between -0.5% and +0.5%. Chinese PMI data painted a mixed picture though both the official and the Caixin manufacturing PMI's are now back above the 50-mark. Brent crude and the Note future stabilise around yesterday evening's levels suggesting a rather neutral opening for the Bund.

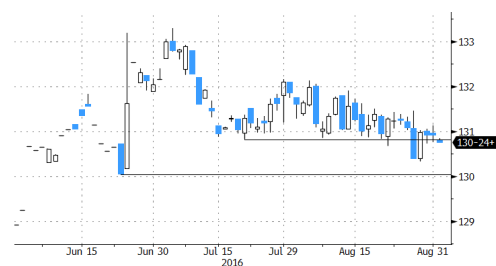
Today's eco calendar contains final EMU manufacturing PMI, weekly US jobless claims and manufacturing ISM. Risks for both business surveys are on the downside of expectations. That could support US Treasuries somewhat especially if oil prices correct further lower. Nevertheless, going into tomorrow's payrolls, we don't expect investors to place big new bets today. Fed Mester speaks during US trading, but she already suggested to be in favour of a September rate hike.

Our preferred scenario for the Fed is a September rate hike. If confirmed by incoming eco data and/or Fed speak, this should weigh on US Treasuries and trigger a further (bear) flattening of the US yield curve.

Despite Monday's technical rebound, we expect that the US Note future could break below strong support (130-26) in case of good payrolls on Friday. This would deteriorate the technical picture and pave the way for more losses. The Bund will take a similar direction as the Note future, but the sideways range between 168.54 and 165.68 looks safe.



German Bund: sideways range between 165.63 and 168.86 remains intact



US Note future (Dec contract!!): Strong payrolls should be able to push contract below 130-26 support

Currencies

Dollar stabilizes versus euro ahead of US payrolls

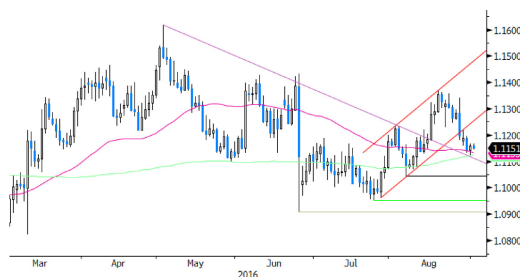
Dollar resumed its ascend after a one day pause, but gains still technically irrelevant

Dollar little changed overnight. Neutral risk sentiment at start European trading

R2	1,1428	-1d
R1	1,1366	
EUR/USD	1,11495	0,0001
S1	1,1046	
S2	1,0992	

Yesterday, initially the dollar was well bid, especially against the yen (thanks also to Kuroda's softness in the weekend). The USD held also its bid versus the yen during the session to close at a post Yellen high of 103.43. However, against the euro, EUR/USD first went for a test of the technically minor support of 1.1130, with a new short term low of 1.1123, but the tide turned the later in the US session. The pair edged back up to close the session at 1.1158, a daily euro gain of an insignificant 15 pips. The inability to take out support brought the upward reaction. Interest rate differentials barely moved and played no role, as did weaker-than-expected euro area inflation or a solid, but as expected ADP report. The weaker Chicago PMI might have been a trigger for the correction, but a steep fall in the oil price, which triggered some US equity weakness, may have played a role too. **Whatever, the EUR/USD daily change was minimal, but it ended a three day winning streak.**

Overnight, Japanese data, investment, company profits/sales, were mostly soft with only car sales doing better. Chinese PMI's were mixed. The official manufacturing PMI rose unexpectedly to 50.4 from 49.9, but the Caixin manufacturing PMI fell to 50 from 50.6. The non-manufacturing PMI dropped to 53.5 from 53.9. **So, inconclusive picture. Asian equities are narrowly mixed, suggesting a neutral sentiment for the European open.** This is confirmed by stabilizing oil and gold prices and little changed T-Note future. USD/JPY is slightly off yesterday's highs, while EUR/USD is virtually unchanged. The **outgoing Spanish PM Rajoy** failed to win the confidence vote in the parliament and needs to look for more support if he wants to avoid another election. It had little impact on the euro though.



EUR/USD: Dollar upturn came to a standstill yesterday. Ahead of tomorrow's payrolls we don't expect big moves. Red line is 200 dma



USD/JPY: Dollar climbed nicely higher, but the uptrend stopped overnight. A pause is needed ahead of the payrolls.

All eyes on business sentiment surveys

Downside risks euro area and US PMI/ISM business sentiment

ECB's Nowotny and Fed's Mester are scheduled to speak

Downside risk US initial claims

As traditionally at the first working day of the month, **business surveys for the manufacturing sector** are on the agenda. According to the first estimate, the **euro zone manufacturing PMI** weakened slightly in August, from 52.0 to 51.8, while a stabilization was expected. For now, the euro zone manufacturing sector is apparently the most affected by the Brexit decision, although the impact remains subdued for now. After also a weaker IFO and Commission indicators, **we see risks for a downward surprise.** Also in the US, **the manufacturing ISM** is expected to have weakened for a second straight month in August,

with the consensus looking for a drop from 52.6 to 52.0. Regional indicators were almost all a good deal weaker than expected and therefore we believe **the ISM might surprise on the downside too**. Finally, **US initial jobless claims** are expected to have picked up slightly in the week ending the 27th of August, from 261 000 to 265 000. We continue to see **downside risks** for the claims as labour market conditions are improving further while claims are somewhat off their recent lows.

Regarding trading today, the eco data should be about neutral for EUR/USD, but a big surprise in the US ISM outcome would prime the result of the final EMU PMI's. We know that Fed's Mester would like to hike rates and thus this shouldn't come as a surprise. ECB's Nowotny (after European closure) is a wild card, but as we got during August very little ECB comments, it would surprise us if he would steal the show today. **Initial claims may trigger some late post payrolls positioning, but overall we expect a quiet session with investors mostly sidelined before tomorrow's payrolls release. Technically, EUR/USD support (Tuesday's low and 200 moving average at 1.1123) was strong enough in recent days to withstand some attack. The pair has also lost 2 big figures in the past two weeks, which may refrain dollar bulls to force the greenback higher on the day before the payrolls. So modest dollar losses shouldn't even surprise. EUR/USD should fall below support at 1.1046 to make the technical picture dollar positive. Only a very strong payrolls report may do the trick.**

R2	0,8815	-1d
R1	0,8725	
EUR/GBP	0,8479	-0,0031
S1	0,8344	
S2	0,8251	

Sterling remains in a tight range versus EUR & USD

Yesterday, sterling traded quite volatile, but gains against the euro (0.8510) and losses against dollar (cable 1.3080) are small. UK eco data had little impact and neither had EMU ones. At the European open EUR/GBP, gradually slid lower mirroring a similar move in EUR/USD. The EUR/GBP decline accelerated when the pair broke below 0.85 level, sending it towards an intra-day low at 0.8473. At the same time cable shot higher to 1.3158 from about 1.31. **However, both moves were easily reversed at the start of US dealings, pushing both currency pairs towards opening levels. Later on, sterling remained well bid against the euro leading to a 0.8492 close from 0.8518 previously.** Cable eventually ended the day at 1.3138 versus 1.3080 on Tuesday. **While the move for cable was insignificant, the upward correction of sterling versus the euro continued with EUR/GBP touching a new correction low (from a major new high above 0.87). Overnight, EUR/GBP fell a bit further (0.8485).**

Today, attention goes to the UK manufacturing PMI. In July the index dropped sharply to 48.2 (contractionary territory) from 52.4 in June, clearly Brexit-induced. The market now expects a slight uptick to 49. Sterling is often not too sensitive for eco data, but the PMI's are market movers. A weaker figure may stop the sterling correction.



EUR/GBP: Is correction nearly finished?



GBP/USD: still in triangle pattern with key support at 1.2866/1.2798

Calendar

Thursday, 1 September		Consensus	Previous
US			
	Wards Domestic Vehicle Sales (Aug)	13.50m	13.77m
	Wards Total Vehicle Sales (Aug)	17.20m	17.77m
13:30	Challenger Job Cuts YoY (Aug)	--	-57.1%
14:30	Nonfarm Productivity (2Q F)	-0.6%	-0.5%
14:30	Initial Jobless Claims	265K	261k
14:30	Unit Labor Costs (2Q F)	2.1%	2.0%
14:30	Continuing Claims	2143K	2145k
15:45	Bloomberg Consumer Comfort	--	45.3
15:45	Markit Manufacturing PMI (Aug F)	52.1	52.1
16:00	Construction Spending MoM (Jul)	0.5%	-0.6%
16:00	ISM Manufacturing (Aug)	52.0	52.6
Canada			
15:30	RBC Manufacturing PMI (Aug)	--	51.9
Japan			
01:50	Capital Spending YoY (2Q)	A 3.1%	4.2%
01:50	Capital Spending Ex Software (2Q)	A 3.1%	4.3%
01:50	Company Profits / Sales (2Q)	A -10%/-3.5%	-9.3%/-3.3%
02:30	Nikkei PMI Mfg (Aug F)	A 49.5	49.6
07:00	Vehicle Sales YoY (Aug)	A 5.7%	-0.2%
China			
03:00	Manufacturing PMI (Aug)	A 50.4	49.9
03:00	Non-manufacturing PMI (Aug)	A 53.5	53.9
03:45	Caixin PMI Mfg (Aug)	A 50.0	50.6
UK			
10:30	Markit PMI Manufacturing SA (Aug)	49.0	48.2
EMU			
10:00	Markit Manufacturing PMI (Aug F)	51.8	51.8
Germany			
09:55	Markit/BME Manufacturing PMI (Aug F)	53.6	53.6
France			
09:50	Markit Manufacturing PMI (Aug F)	48.5	48.5
Italy			
	Budget Balance (Aug)	--	4.4b
09:45	Markit/ADACI Manufacturing PMI (Aug)	51.2	51.2
Norway			
09:00	Manufacturing PMI (Aug)	54.7	54.8
10:00	Retail Sales W/Auto Fuel MoM (Jul)	0.3%	-0.6%
Spain			
09:15	Markit Spain Manufacturing PMI (Aug)	50.9	51.0
Sweden			
08:30	Swedbank/Silf PMI Manufacturing (Aug)	54.0	55.4
Events			
18:00	ECB's Nowotny Speaks on Panel in Alpbach, Austria		
18:25	Fed's Mester Speaks to Kentucky Philanthropy Initiative		
Spain	Bono (€3.5-4.5B 0.25% Jan2019, 1.3% Oct2026) & IL Bono (€0.25-0.75B 1% Nov2030) Auction		
France	OAT Auction (€8-9B 0.25% Nov2026, 1.25% May2036 & 3.25% May2045)		
Sweden	IL Bond Auction (SEK0.5B 0.125% Jun2019 & SEK0.5B 0.25% Jun2022)		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS		-1d
US	1,59	0,01	US	0,81	0,01	DOW	18401	18400,88
DE	-0,05	0,03	DE	-0,62	0,00	NASDAQ	for Exch - NQI	#VALUE!
BE	0,20	0,05	BE	-0,59	0,00	NIKKEI	16927	16926,84
UK	0,64	0,00	UK	0,13	-0,01	DAX	10592,69	10592,69
JP	-0,05	0,01	JP	-0,19	0,01	DJ euro-50	3023	3023,13

						USD	td	-1d	
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,329	0,012
3y	-0,190	1,111	0,428	Euribor-1	-0,37	0,00	Libor-1 USD	0,27	0,27
5y	-0,118	1,208	0,485	Euribor-3	-0,30	0,00	Libor-3 USD	0,39	0,39
10y	0,294	1,437	0,713	Euribor-6	-0,19	0,00	Libor-6 USD	0,52	0,52

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,1149	-0,0002	EUR/JPY	115,27	0,30		180,2067	1307,72	47,12
USD/JPY	103,405	0,25	EUR/GBP	0,848	-0,0032	-1d	-2,62	-5,68	-1,20
GBP/USD	1,3143	0,0050	EUR/CHF	1,0967	0,0006				
AUD/USD	0,7532	0,0020	EUR/SEK	9,5565	0,05				
USD/CAD	1,3107	0,0017	EUR/NOK	9,2983	0,00				

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
Joke Mertens		+32 2 417 30 59	Institutional Desk		+32 2 417 46 25
Mathias van der Jeugt		+32 2 417 51 94	France		+32 2 417 32 65
Dublin Research			London		+44 207 256 4848
Austin Hughes		+353 1 664 6889	Singapore		+65 533 34 10
Shawn Britton		+353 1 664 6892			
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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