



Sunrise

Thursday, 20 October 2016

Rates: Draghi in the spotlights

We expect the ECB to keep policy unchanged, but Draghi will be grilled at the Q&A about the approaching end of the QE-programme. We only expect official communication in December, so Draghi will try to remain as neutral as possible. Any slip of the tongue could trigger more nervousness/volatility at the long end of the European yield curve.

Currencies: EUR/USD nears next support area

Yesterday, the dollar traded mixed, holding strong against the euro, but losing ground against the yen. EUR/USD nears next support (1.0952/13). Today, the focus is on the ECB meeting. If Draghi postpones communication to the December meeting, established trends might continue. Sterling entered calmer waters, but today's retail sales may move sterling.

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** closed with modest gains (S&P +0.22%). According to Bloomberg, **Asian stocks rise together with the peso** as the US presidential debate was seen as strengthening Clinton's prospects to win the elections.
- Trump refused to say during the **last US presidential debate** he'd accept the election's results if he loses, an extraordinary statement. We haven't yet seen polls of the viewer's appreciation of the candidates, but observers said Trump's performance won't close the big gap between both.
- The big mover among major currencies is the **Aussie dollar**, which was down 0.4% following a soft labour report, confirming a RBA concern about considerable uncertainty. The economy shed a net 9,800 jobs in Sep.
- The **ECB will announce its policy decision today**, against a delicate political backdrop. Put bluntly, the EMU economy is underperforming despite the ECB's policies, but there is political resistance to extending its ultra-loose policy.
- **Brazil's central bank has cut interest rates** for the first time in four years (to 14%) as the country struggles to emerge from its deepest recession on record.
- **Economic activity in the US continues to expand and the labour market remains tight**, the Fed said in its **Beige Book**. However, it also highlighted **uncertainty surrounding the 2016 US presidential election**.
- **Oil jumped higher yesterday** with Brent setting an intraday high at \$53.14/barrel and testing key resistance on the back of lower US inventories. Oil is slightly lower overnight.
- **Today**, full attention goes to the **ECB meeting**, but **US claims, Philly Fed and Existing home sales** are worth looking at. In the **UK**, **retail sales** will be the focus.

Rates

Core bonds rally runs out of steam ahead of ECB

Core bonds virtually unchanged

Outperformance Portugal still intact

Beige Book shows slightly stronger conditions and point to election uncertainty

	US yield	-1d
2	0,8068	0,0042
5	1,2361	-0,0016
10	1,7486	0,0018
30	2,5077	0,0046

	DE yield	-1d
2	-0,6650	0,0050
5	-0,4970	-0,0010
10	0,0370	0,0020
30	0,6581	-0,0122

Yesterday, the two-day core, counter-trend, bond rally ran out of steam around European noon. Volumes traded in the Bund and the T-Note contract were well below average. The intraday price action was unrelated to equities and oil. Euro area data were second tier and US housing starts and permits mixed. The Fed's Beige Book showed slightly stronger conditions and pointed to election uncertainty. In a daily perspective, German yields ended 0.2 bps higher (2-yr) to 1.2 bps (30-yr) lower. Changes on the US yields were of similar magnitude: 0.4 bps lower (2-yr) to 0.4 bps (10-yr) higher. On intra-EMU bond markets, 10-yr yield spread changes versus Germany closed nearly unchanged, except for the ongoing outperformance of Portugal (-5 bps). DBRS will give its rating verdict on Friday.

ECB meeting and US eco data eye-catchers of the day

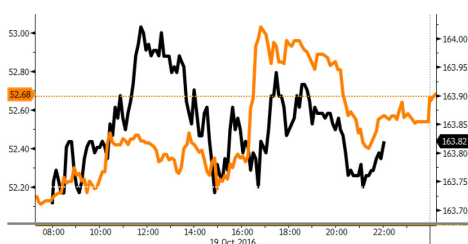
There are still a lot of uncertainties in the euro area, UK and elsewhere, which may affect monetary policy, if they lead to destabilising outcomes-as has been the tendency in recent years. However, we think that markets are beginning to consider whether monetary policy has now reached a turning point. Change will be very gradual though and become only visible after some time. Fiscal policy will become the focus of efforts to push inflation higher. Inflation expectations show tentative signs of such a development as does the steepening of the yield curves. In this context, we think markets could move away from any expectation of another rate cut and begin to focus instead on the possible implications of the ECB announcing a reduction in the amount of its asset purchases. This should steepen the curve further in the euro area. For today though, we don't expect any concrete signal from the ECB or Mario Draghi. They bought time tasking the ECB Committees with evaluating options to ensure "a smooth implementation" of the asset programme. We expect communication in December. For a full preview of the ECB meeting, see our Flash report.

US initial claims are expected to have slightly risen to 250K for a very low 246K in the previous two weeks. Claims continue to surprise on the downside, but given the very low levels we would indeed expect a slight increase in the past week. The Philly Fed manufacturing sentiment index surprised in September by jumping to 12.8 from 2 in August. However, the details showed a much more mixed picture. Therefore, we think that the index will drop in October, but still stay in positive territory. Finally, the Existing home sales are expected to be marginally higher in September at 5.35M, up 0.4% M/M. That would leave the upward trend intact, even as the highs were reached in June at 5.57M.

Initial claims to remain at low levels

Philly Fed to give back some of previous' month super gains

Existing Home sales to be little changed



Bund future (black) and S&P future (orange) intraday: Core bond rally ran out of steam, but no noticeable losses



Oil (Brent) Lower US inventories push oil higher, retesting key resistance, but no break yet

R2	166,36	-1d
R1	164,29	
BUND	163,82	0,0300
S1	163	
S2	162,56	

Spain and France complete this week's issuance

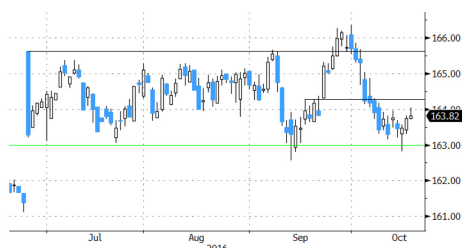
The French Treasury taps the on the run 5-yr OAT (0% May2021) and off the run OAT (3% Apr2022) for a combined €5-6B. The bonds didn't cheapen in ASW spread terms going into the auction. On the French curve, the May2021 OAT trades cheap while the Apr2022 OAT is expensive. The auction will be supported by a French OAT redemption (€26B) next week. Additionally, the French treasury aims to raise €0.5-1B via inflation-linked bonds. We expect the French auctions to run smooth, especially given the relatively low amount on offer. **The Spanish debt agency auctions the on the run 3-yr Bono (0.25% Jan2019), off the run Obligation (5.9% Jul2026) and on the run 50-yr Obligation (3.45% Jul2066) for a total amount of €3-4B.** The Jul2026 and especially Jul2066 Obligations cheapened in the run-up to the auction in ASW spread terms and the Jul2026 bond trades really cheap on the curve. The auction could also already get some support from an upcoming redemption at the end of the month. We expect the auctions to go well.

Can Draghi keep quiet?

Overnight, Asian stock markets eke out small gains with Japan outperforming on the back of a weaker yen. After the final presidential debate, Clinton remains in pole position to secure the job which slightly supported sentiment. The US Note future and Brent crude trade stable though and we expect a neutral opening for the Bund.

Today's eco calendar contains some US eco data, but attention will turn to the ECB's policy meeting. We expect an unchanged policy decision while Draghi will probably try to duck any question about the end of QE. Technical committees are studying the ECB's options and will report back by December. Any hint or mentioning of a future end of QE will trigger more nervousness/weakness at the long end of European yield curve. **Technical support levels in the Bund (163) and US Note future (129-26) held earlier this week, but could come back in play in such scenario. If Draghi manages to stay neutral, we don't expect much reaction in the Bund.**

In yield terms, the US 10-yr yield (1.75%) and 30-yr yield (2.5%) broke above important resistance levels last week. We are currently testing those levels again, but from a support point of view. If we manage to stay above them, it would send an important technical signal that (long term US yields could rise further).



German Bund: key support back in play if Draghi talks about ending QE.



US Note future: Extensively testing downside. Break more likely if US 10-yr yield manages to stay above 1.75%

Currencies

R2	1,1366	-1d
R1	1,1279	
EUR/USD	1,0961	-0,0020
S1	1,0952	
S2	1,0913	

Dollar shows mixed picture.

EUR/USD holds near the lows

USD/JPY trades in the defensive

US election debate supports cautiously positive equity sentiment

Dollar profits slightly

AUD and CAD ceding ground

Sentiment on risk and US data might be slightly USD supportive.

ECB press conference is a wild card

EUR/USD near next support

On Wednesday, USD trading was driven by technical considerations in absence of high profile news. The dollar held strong against the euro. EUR/USD drifted further below the 1.10 handle. At the same time USD/JPY drifted lower in the 103 big figure. The reaction of the dollar to a fairly optimistic Beige Book was minimal. EUR/USD finished the session at 1.0974 (from 1.0981). USD/JPY finished the day at 103.44 (from 103.87).

Overnight, Asian equities record gains of up to 1%. Clinton cemented her advantage over Donald Trump in the last TV debate before the election. **The outcome creates a cautiously positive risk sentiment and is slightly supportive for the dollar.** USD/JPY trades in the 103.65 area. EUR/USD trades in the 1.0960/65 area, within reach of the 1.0952 support. **The Aussie dollar ceded ground as the Australian labour data disappointed.** AUD/USD dropped back below the 0.77 handle after a good rally of late. **The Canadian dollar trades slightly in the defensive, despite a higher oil price.** BOC governor Poloz indicated after yesterday's policy decision that the BOC actively discussed the option to add more stimulus. USD/CAD trades in the 1.3150 area.

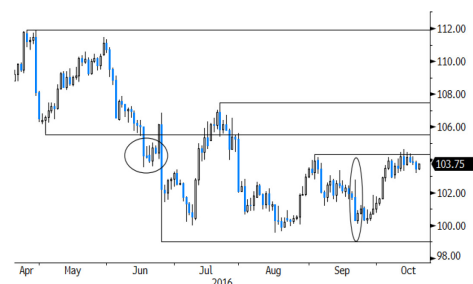
Today, the focus for EUR/USD is on the ECB press conference

For a full preview of the ECB meeting, see our Flash report.

Despite lingering uncertainty, markets are pondering whether monetary policy has reached a turning point. Inflation expectations are bottoming out and the yield curve steepens. In this context, the market focus **could move away from expectations of further easing and turn to the implications of the ECB potentially reducing its asset purchases.** This should steepen further the EMU curve and might support the euro. However, we don't expect any concrete signal from the ECB today. Draghi asked ECB Committees **evaluating the options to ensure "a smooth implementation" of the asset programme. We expect communication in December. Regarding the US data, initial claims** are expected slightly higher at 250K after a very low 246K. Claims recently surprised on the downside, but at current low level we expect a slight increase. The **Philly Fed manufacturing index** surprisingly jumped in September from 12.8 to 2, but the details were mixed. **We favour a drop in October, but expect the index to stay in positive territory.** Finally, the **Existing home sales** are expected marginally higher in September at 5.35M/M.



EUR/USD again nears 1.0952/13 support



USD/JPY holds near the recent highs, but no sustained break

Thursday, 20 October 2016

In a daily perspective, the positive risk-sentiment after the US presidential debate might be slightly USD supportive. The ECB press conference is a wildcard, but we expect Draghi to avoid making market moving remarks. We look out whether the 1.0952 support will hold. In a broader perspective, the recent dollar rally **slowed this week**. We don't expect any correction to go far unless US data would be unexpectedly soft. **Some further consolidation might be on the cards but we still see a solid bottom for the dollar as long as markets embrace the idea of a December rate hike. Selling EUR/USD on upticks is favoured.**

From a technical point of view, EUR/USD came within reach of the 1.0952/13 support, but for now it was left intact. A break below would be a USD positive and open the way for next intermediate support (1.0822/1.0711). A similar pattern is developing for USD/JPY. A sustained break north of 104.32 would paint a double bottom formation on the charts with targets in the 108/109 area. The area was extensively tested, but a sustained break didn't occur. We stay cautious on sustained USD/JPY gains beyond the 104.32/65 resistance especially as global volatility/uncertainty might intensify.

R2	0,9414	-1d
R1	0,915	
EUR/GBP	0,8933	-0,0009
S1	0,89	
S2	0,8725	

UK retail sales in focus for sterling trading

On Wednesday, cable and EUR/GBP traded in tight ranges. The UK labour data were OK, but close to expectations. Sterling initially gained a few ticks, but the rebound ran into resistance soon. During the day, there were rumours that Angela Merkel had instructed her administration not to engage in informal talks with the UK on Brexit. So, **the Brexit debate still played at the background**. Once again, the headlines had no lasting negative impact on sterling. EUR/GBP closed the session at 0.8931 (from 0.8929). Cable closed the session at 1.2285 (from 1.2298).

Today, the **UK September retail sales will be published**. There was a modest setback in August, but in general the UK consumer held strong in the wake of the Brexit vote. Sales are expected to have softened to 0.0% M/M and 4.0% Y/Y. **Of late UK data had less impact on sterling trading as it is unclear how they will affect the BoE reaction function**. Will the BoE give a bit more weight to the decline of sterling and the rise of inflation. The jury is still out. In the end we assume that growth will remain the key driver for the BoE policy. So, a really poor UK retail sales figure might still weigh on sterling. **This week sterling rebounded as markets assume that more Parliamentary involvement reduce the risk of a hard Brexit. However, we don't expect this sterling rebound to go far. We look to sell sterling on more pronounced up-ticks**



EUR/GBP: sterling rebounds, at least temporary



GBP/USD: off the multi-year low, but picture remains fragile

Calendar

Thursday, 20 October		Consensus	Previous
US			
14:30	Initial Jobless Claims	250k	246k
14:30	Continuing Claims	2060k	2046k
14:30	Philadelphia Fed Business Outlook (Oct)	5.0	12.8
16:00	Existing Home Sales / MoM (Sep)	5.35m/0.4%	5.33m/-0.9%
16:00	Leading Index (Sep)	0.2%	-0.2%
Japan			
07:30	Nationwide Dept Sales YoY (Sep)	--	-6.0%
07:30	Tokyo Dept Store Sales YoY (Sep)	--	-5.9%
08:00	Machine Tool Orders YoY (Sep F)	--	-6.3%
09:00	Convenience Store Sales YoY (Sep)	--	0.6%
UK			
10:30	Retail Sales Ex Auto Fuel MoM / YoY (Sep)	0.2%/4.4%	-0.3%/5.9%
10:30	Retail Sales Inc Auto Fuel MoM / YoY (Sep)	0.3%/4.8%	-0.2%/6.2%
EMU			
13:45	ECB Main Refinancing Rate	0.000%	0.000%
13:45	ECB Deposit Facility Rate	-0.400%	-0.400%
13:45	ECB Marginal Lending Facility	0.250%	0.250%
13:45	ECB Asset Purchase Target	EU80b	EU80b
Germany			
08:00	PPI MoM / YoY (Sep)	0.2%/-1.2%	-0.1%/-1.6%
Sweden			
09:30	Unemployment Rate SA (Sep)	6.9%	7.2%
Events			
01:45	Fed's Dudley Speaks on NYC Economic History in New York		
10:30	Spain sells bonds (0.25% Jan2019, 5.9% Jul2026 & 3.45% Jul2066)		
10:50	France sells bonds (€5-6B 0% May2021 & 3% Apr2022)		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,75	0,00	US	0,81	0,00	DOW	18203,62
DE	0,04	0,00	DE	-0,67	0,01	NASDAQ	for Exch - NQI
BE	0,27	-0,02	BE	-0,65	0,00	NIKKEI	17207,98
UK	1,09	0,01	UK	0,20	0,02	DAX	10645,68
JP	-0,06	-0,01	JP	-0,25	0,00	DJ euro-50	3056,94

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,351
3y	-0,170	1,096	0,617	Euribor-1	-0,37	0,00	Libor-1 USD	0,26
5y	-0,061	1,242	0,724	Euribor-3	-0,31	0,00	Libor-3 USD	0,41
10y	0,405	1,566	1,039	Euribor-6	-0,21	0,00	Libor-6 USD	0,56

Currencies	-1d	Currencies	-1d	Commodities	CRB	GOLD	BRENT
EUR/USD	1,0961	-0,0020	EUR/JPY	113,65	-0,33	189,7801	1270,4399
USD/JPY	103,705	-0,11	EUR/GBP	0,8933	-0,0009	-1d	0,39
GBP/USD	1,227	-0,0005	EUR/CHF	1,0853	-0,0017		9,14
AUD/USD	0,7667	-0,0004	EUR/SEK	9,6918	-0,01		0,38
USD/CAD	1,3159	0,0057	EUR/NOK	8,9294	-0,03		

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