



Sunrise

Friday, 28 October 2016

Rates: Core bonds sold off for second day.

Investors decided to take some chips off the table as the monetary/economic environment looks at the cusp of changing. Today's US GDP and German inflation may decide whether the sell-off continues or whether pre-weekend profit taking and end of quarter buying occurs. Longer term we stick to a bearish view

Currencies: USD/JPY propelled beyond 105 mark

Yesterday, the rise in core bond yields was again the key driver for trading. USD/JPY profited the most. The impact to EUR/USD was diffuse. Today, the focus is on the US Q3 GDP. A good report might reinforce the rise in core yields and support further USD gains. Sterling failed to profit from strong Q3 UK growth. Has the rebound of sterling run its course?

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 slightly lower with Nasdaq underperforming. Overnight, Asian stock markets trade mixed with Japan outperforming due to a weaker yen.
- **Amazon** said high spending on warehouses and video production would drag on profits in the holiday quarter, disappointing investors who are weary of roller-coaster results from the e-commerce giant and sending its shares down 6%.
- **Japan's** consumer prices fell for a seventh straight month and household spending slumped 2.1% in September, underscoring the challenges to revive the country's economy. However, the jobless rate fell to 3%, the lowest level since 1995 and the October Tokyo CPI unexpectedly printed in positive territory.
- **ECB Linde** said it was important that any reduction in the bond-buying programme be done slowly and not abruptly. **ECB Nowotny** confirmed that the ECB will decide in December on the mechanism for prolonging its QE programme.
- **French GDP disappointed in the third quarter** as the economy grew by 0.2% Q/Q and 1.1% Y/Y, a tad slower than expected. Consumption remains flat and net exports were negative.
- **U.K. households** are starting to feel the pain from Brexit-induced pressure on their finances. Multiple reports showed consumer confidence falling and a weakening of households' spending power. The reports -- from GfK, YouGov and Asda -- all cited sterling as a factor in the changing mood in the U.K.
- **The EMU's rescue fund could give a Spain-style bailout** if a fresh banking crisis were to unfold, the head of the ESM said. Regling's remarks may reassure investors by showing how Europe could respond any future emergency, including in a larger country such as Italy.
- **Today's eco calendar contains EC confidence data, German inflation and US Q3 GDP.** The Italian treasury holds a BTP auction..

Rates

“Panic in needle park”: Core bonds hammered

Yesterday, core bonds sold off for a second consecutive session with German Bunds underperforming. A stronger than expected UK Q3 GDP triggered the selling. Nervousness on European bond markets increased since a Bloomberg article suggested early October that an informal consensus was building amongst ECB policymakers that asset purchases would have to be tapered, but not necessarily immediately after the end of March. Appetite of other central bankers for an ever softer policy also wanes. At the same time headline inflation moves higher (albeit due to base effects) and inflation expectations are climbing. Given the one-side positioning of the market, it makes sense that some investors take some chips from the table. Interestingly, these sharp sell-offs occurred in very high volume sessions. **Technical elements played a role too.** The Bund future fell through the key 163 support level and dropped even below 162.56 (intraday low on a failed test in September). The German 10-yr yield rose above 10 bps yield resistance, adding weight to the technical break of the Bund. The Bund ultimately set an intraday low at 161.71, before closing at 162.05. The US T-Note closed at 129-16+ with a new low a 129-09+. **The technical picture of US Treasuries became bearish too. The 5, 10- and 30-yr US yields trade above key yield resistance at 1.27%, 1.75% and 2.5% respectively. Next key resistances stand at 1.42%, 2% and 2.75%.**

In a daily perspective, the German curve bear steepened with yields between 1.5 (2-yr) and 11.2 bps (30-yr) higher. The US curve steepened as well with yields 1.7 bp (2-yr) to 7.3 bps (30-yr) higher. Sterling yields increased by 2.4 bps (2-yr) to 10.1 bps (10-yr).

Very busy calendar

Both in the US and in EMU, the eco calendars are busy. In EMU, **EU economic sentiment** is expected to have stabilized at 104.9. Given the better PMI's and IFO, we see **risks on the upside of consensus.** **German HICP inflation** is expected to climb to 0.7% Y/Y from 0.5% Y/Y. It would be the highest level in about two years. Any upward surprise wouldn't go unnoticed in the current climate. **In the US, Q3 GDP** is expected to be up 2.5% Q/Qa, but after the trade and inventory data, **it could be closer to 3%. Markets shouldn't be too surprised by such an outcome.** PCE and core PCE deflators are expected a bit lower at 1.4% and 1.6% respectively. **Michigan consumer sentiment** (final figure) is expected to have gone up slightly versus the preliminary figure, but given the crash in the Conference board measure, we see **risks on the downside of expectations.**

Sharp bear steepening German curve with yields up to 11.2 bps higher

Milder shift up for US yield curve with yields up to 7.3 bps

Technical pictures deteriorate

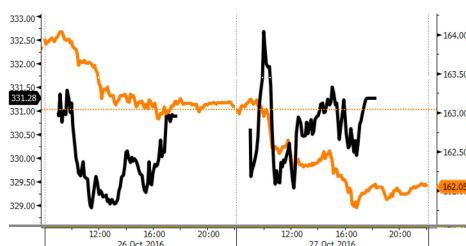
	US yield	-1d
2	0,8882	0,0118
5	1,3472	0,0357
10	1,8593	0,0572
30	2,6162	0,0687

	DE yield	-1d
2	-0,6200	0,0170
5	-0,3970	0,0310
10	0,1670	0,0750
30	0,8290	0,0983

Upside risks US GDP & EMU confidence

Downside risks Michigan consumer sentiment

German HICP inflation expected to have climbed higher



Bund future (orange) and EuroStoxx (black) (intraday 2 days): Bund sells off and drops 200 ticks in two sessions, while equities digest it well



German 10-yr yield jumps above 120 bps yield resistance opening the way for additional move towards 30 bps.

R2	164,3	-1d
R1	163	
BUND	162,05	-0,9900
S1	161,72	
S2	161,11	

Tepid demand at Italian auctions?

The Italian debt agency launches a new 7-yr floating rate note and taps the on the run 5-yr BTP (€2.25-2.75B 0.35% Nov2021) and 10-yr BTP (€2-2.5B 1.25% Dec2026). Both bonds on offer cheapened slightly in ASW spread terms in the run-up to the auction, but are expensive on the Italian curve. Demand could be tepid today as question marks about the health of the financial system remain and as we approach Renzi’s referendum.

Yesterday, the US Treasury ended its end-of-month refinancing operation with an average \$28B 7-yr Note auction. The auction stopped nearly on the 1:00 PM bidding deadline. The bid cover was near this year’s average (2.49). Bidding details were also very close to the averages of the prior year.

Important technical breaks suggest more downside

Overnight, Asian stock markets are mixed. Brent crude ekes out small gains while the US Note future continues to trade with a downward bias suggesting that the Bund could rapidly run into trouble again.

Today’s calendar contains German CPI data and US Q3 GDP. Risks for the latter are on the upside of expectations, while German inflation should rise which could add fuel to the core bond sell off. Towards the end of dealings, some profit taking can occur ahead of the weekend.

Technical pictures deteriorated and suggest more downside. Rising inflation expectations and central banks’ change of tone (extraordinary policy won’t last forever) triggered the sell-off which started at the beginning of the month. The US 10-yr and 30-yr yields held above key resistance levels at 1.75% and 2.5%, while the US Note future dropped below 129-26 support. The German 10-yr yield moved the 0.10% resistance. This break is very relevant from a technical point of view and unlocks a new trading range (0.10%-0.30%). The Bund fell below the 163 support area and is also prone to more losses.



German Bund: Break below 163 support area means more downside



US Note future: Post-Brexit downtrend continues

Currencies

R2	1,1366	-1d
R1	1,1123	
EUR/USD	1,0902	-0,0009
S1	1,0826	
S2	1,0711	

Rising core bond yields drove global markets yesterday

USD/JPY jumped north of 105

Asian equities lose slightly ground on higher yields/stronger dollar

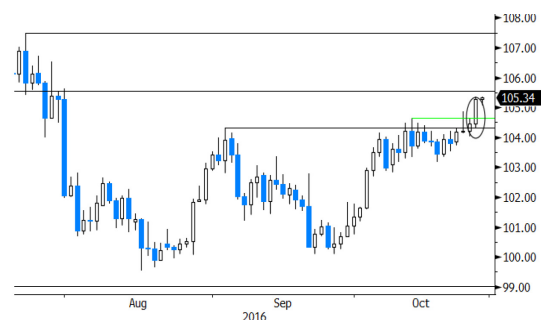
Can USD profit further from higher yields/good data?

Yesterday's trading dynamics were in line with Wednesday's price action. Core bonds yields rose again sharply. Interest rate differentials moved in favour of the euro as the bond sell-off hit Bunds harder than Treasuries. EUR/USD rose modestly early in the session, but the gains evaporated later. The pair closed the session at 1.0897, even marginally lower compared to Wednesday (1.0908). USD/JPY was again outright beneficiary of the rise in core bond yields. The pair broke beyond the recent highs and closed the session north of the 105 barrier (105.29 from 104.47).

Overnight, Asian equities trade mixed. Most indices show modest losses as investors ponder the potential impact of a strong dollar and higher (core) yields. Japanese eco data were stronger than expected. Above consensus inflation data particularly caught the eye. Japanese yields traded marginally higher, but the rise remains modest given what happened in the US and Europe yesterday. USD/JPY trades in the 105.15 area. Japanese equities outperform on the weaker yen/stronger dollar. EUR/USD shows no clear direction and holds near 1.09.



EUR/USD: no clear trend despite rising global yields



USD/JPY: propelled north of 105 due to higher US/EMU yields

Strong eco data might reinforce rise in core yields and support the dollar

US Q3 GDP will be key today

Today, the eco calendar is well filled. In EMU, **EU economic sentiment** is expected to have stabilized at 104.9. Given the better PMI's and IFO, we see **risks on the upside of consensus.** **German HICP inflation** is expected to climb to 0.7% Y/Y from 0.5% Y/Y previously. It would be the highest level in about two years. Any upward surprise wouldn't go unnoticed in the current climate. **In the US, Q3 GDP** is expected to be up 2.5% Q/Qa, but after the trade and inventory data, **it could be closer to 3%.** **Markets shouldn't be too surprised by such outcome.** PCE and core PCE deflators are expected a bit lower at 1.4% and 1.6% respectively. **Earlier this week, the eco data had only limited impact on global trading. However, this will probably be different today. If the data, especially the US Q3 growth data are stronger than expected, it might reinforce the uptrend in core bond yields.** This will probably **support the dollar further.** Of late, USD/JPY profited most from the rise in global yields. After yesterday's break above 104.85/105, this trend might continue. The reaction of EUR/USD to rising yields was less straightforward. Wednesday's/yesterday's uptick in EUR/USD was limited even as interest rates moved in favour of the euro. **In case**

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of good US eco data, the dollar might again take the lead, also against the euro. The recent low around EUR/USD 1.0850 might again come under pressure. Whatever the outcome of the data, the Fed rate hike expectations put a solid floor under the US currency. So, the MT trend remains USD-positive. The US data have to be really bad to reverse USD sentiment in a profound way

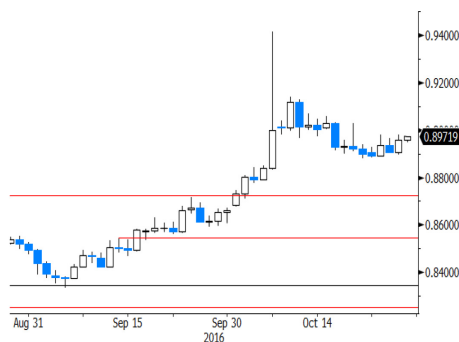
From a technical point of view, EUR/USD dropped below 1.0952/13 support. The break is an extra USD positive and opens the way to next intermediate support (1.0822/1.0711). USD/JPY tested the 104.32/64/87 several times. Yesterday the pair broke above the 105 barrier. This break paints a double bottom formation on the charts with targets in the 108/109 area. Of late we were cautious to pre-position for a break higher in USD/JPY as we feared that a rise in global (equity) volatility could prevent a further yen decline. However, currently, the rise in US/core bond yields clearly dominates as a driver for USD/JPY trading. So, we change our ST assessment on USD/JPY from cautious to positive and join the trend as long as the rise in yields continues.

Has sterling 'rebound' run its course?

R2	0,9142	-1d
R1	0,9027	
EUR/GBP	0,8958	0,0031
S1	0,8725	
S2	0,8589	

On Thursday, UK Q3 growth was again reported substantially stronger than expected (0.5% Q/Q and 2.3% Y/Y) with growth based in the services sector. Industrial production and construction contributed in a negative way. Sterling gained temporary ground after the publication, but the gains could not be sustained, even as short-term UK bond yields trended higher, too. The CBI reported sales also printed stronger than expected, but had also no lasting positive impact on sterling. Markets likely don't expect the Q3 growth rates to be sustained, as the Brexit debate continues. The ongoing rise in EMU and US yields probably also prevented sterling gains. Later in the session, the UK Secretary for Scotland again spoke harsh on the chances of the UK staying in the EU internal market. The comments may have added to the intraday correction off sterling. On a daily basis sterling even closed the day in the red both against the euro (0.8958) and the dollar. (1.2164)

Overnight, the UK GfK consumer confidence was in line with expectations (-3 from -1). Later today, there are no important eco data in the UK. Over the previous days, sterling traded on a more solid footing. However, yesterday's failure of sterling to profit from strong eco data suggests that the upward correction has no strong legs. We look out whether the recent sterling rebound has run its course. Higher core rates and rising global volatility probably won't help sterling. We look to sell sterling on more pronounced up-ticks. EUR/GBP 0.8725 remains a key reference. Political event risk remains a lasting source of sterling uncertainty.



EUR/GBP: sterling disappoints despite strong UK data



GBP/USD: consolidation, but no sustained rebound yet

Calendar

Friday, 28 October		Consensus	Previous
US			
14:30	Employment Cost Index (3Q)	0.6%	0.6%
14:30	GDP Annualized QoQ (3Q A)	2.5%	1.4%
14:30	Personal Consumption (3Q A)	2.6%	4.3%
14:30	GDP Price Index (3Q A)	1.4%	2.3%
14:30	Core PCE QoQ (3Q A)	1.6%	1.8%
16:00	U. of Mich. Sentiment (Oct F)	88.2	87.9
16:00	U. of Mich. Current Conditions (Oct F)	--	105.5
16:00	U. of Mich. Expectations (Oct F)	--	76.6
16:00	U. of Mich. 1 Yr Inflation (Oct F)	--	2.4%
16:00	U. of Mich. 5-10 Yr Inflation (Oct F)	--	2.4%
Japan			
01:30	Jobless Rate (Sep)	A 3%	3.1%
01:30	Job-To-Applclicant Ratio (Sep)	A 1.38	1.37
01:30	Overall Household Spending YoY (Sep)	A-2.1%	-4.6%
01:30	Natl CPI YoY (Sep)	A -0.5%	-0.5%
01:30	Natl CPI Ex Fresh Food YoY (Sep)	A -0.5%	-0.5%
01:30	Natl CPI Ex Food, Energy YoY (Sep)	A 0%	0.2%
07:00	Natl CPI Ex Fresh Food, Energy YoY (Sep)	A 0.2%	0.4%
01:30	Tokyo CPI YoY (Oct)	A 0.1%	-0.5%
01:30	Tokyo CPI Ex-Fresh Food YoY (Oct)	A -0.4%	-0.5%
01:30	Tokyo CPI Ex Food, Energy YoY (Oct)	A 0.1%	-0.1%
UK			
01:01	GfK consumer confidence (Oct)	A -3	-1
EMU			
11:00	Economic Confidence (Oct)	104.9	104.9
11:00	Business Climate Indicator (Oct)	0.46	0.45
11:00	Industrial Confidence (Oct)	-1.6	-1.7
11:00	Services Confidence (Oct)	10.0	10.0
11:00	Consumer Confidence (Oct F)	-8.0	-8.0
Germany			
	CPI Baden Wuerttemberg MoM / YoY (Oct)	--/--	0.3%/0.7%
09:00	CPI Saxony MoM / YoY (Oct)	--/--	0.1%/0.7%
10:00	CPI Brandenburg MoM / YoY (Oct)	--/--	0.4%/0.7%
10:00	CPI Hesse MoM / YoY (Oct)	--/--	0.0%/0.6%
10:00	CPI Bavaria MoM / YoY (Oct)	--/--	0.2%/0.8%
10:30	CPI North Rhine Westphalia MoM / YoY (Oct)	--/--	0.1%/0.7%
14:00	CPI MoM / YoY (Oct P)	0.2%/0.8%	0.1%/0.7%
14:00	CPI EU Harmonized MoM / YoY (Oct P)	0.1%/0.7%	0.0%/0.5%
France			
07:30	GDP QoQ / YoY (3Q A)	A 0.2%/1.1%	-0.1%/1.3%
08:45	CPI EU Harmonized MoM / YoY (Oct P)	0.2%/0.6%	-0.2%/0.5%
Belgium			
15:00	GDP SA QoQ / YoY (Q3)	--/--	0.5%/1.4%
	CPI MoM / YoY (Oct)	--/--	-0.2%/1.87%
Spain			
09:00	GDP QoQ / YoY (3Q P)	0.7%/3.1%	0.8%/3.2%
09:00	CPI EU Harmonised MoM / YoY (Oct P)	0.6%/0.3%	0.7%/0.0%
Norway			
08:00	Retail Sales W/Auto Fuel MoM (Sep)	0.3%	0.4%
08:00	Industrial Confidence (3Q)	0	-2
10:00	Unemployment Rate (Oct)	2.8%	2.8%
Sweden			
09:30	Retail Sales MoM / NSA YoY (Sep)	0.3%/2.7%	0.6%/2.8%
Events			
Q3 earnings	Total (08:00), Exxon Mobil (13:00), Anheuser-Busch Inbev		
09:30	ECB's Coeure Speaks in Frankfurt		
11:00	Italy to sell €2.75B 0.35% 2021 BTP, @2.5B 1.25% 2026 BTP, €3.25B floating Notes		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,86	0,06	US	0,89	0,01	DOW	18170 18169,68
DE	0,17	0,08	DE	-0,62	0,02	NASDAQ for Exch - NQI	#VALUE!
BE	0,40	0,07	BE	-0,63	0,02	NIKKEI	17446 17445,90
UK	1,25	0,09	UK	0,27	0,02	DAX	10717,08 10717,08
JP	-0,04	0,01	JP	-0,23	0,00	DJ euro-50	3085 3085,17

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,354 -0,003
3y	-0,121	1,180	0,700	Euribor-1	-0,37	0,00	Libor-1 USD	0,27 0,27
5y	0,014	1,351	0,853	Euribor-3	-0,31	0,00	Libor-3 USD	0,40 0,40
10y	0,517	1,696	1,195	Euribor-6	-0,21	0,00	Libor-6 USD	0,57 0,57

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0902	-0,0009	EUR/JPY	114,81	0,78		188,7198	1268,74	50,49
USD/JPY	105,34	0,81	EUR/GBP	0,8958	0,0031	-1d	0,00	0,33	0,35
GBP/USD	1,2165	-0,0054	EUR/CHF	1,0832	-0,0004				
AUD/USD	0,7590	-0,0043	EUR/SEK	9,8883	0,17				
USD/CAD	1,3381	0,0005	EUR/NOK	9,0093	-0,01				

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