



Sunrise

Friday, 09 December 2016

Rates: With ECB gone, focus turns to Fed

Markets will further digest yesterday's ECB policy decisions. They cemented the front end of the European yield curves for longer, but we're not sure whether they cap the upward potential for long term yields. Global markets will also start counting down to next week's FOMC meeting, suggesting neutral trading.

Currencies: Euro weakness and USD strength post-ECB

The topside test of EUR/USD was rejected as the ECB decision suggests that the euro will continue to suffer a big interest rate disadvantage against the dollar. The confirmation that the Fed will continue to take the lead in the monetary policy normalization process also supports the dollar across the board.

Calendar

Headlines

- **Another record setting day on WS** as US stocks profited to some extent from strong European bourses. They gained up to 0.5%. Overnight, Asian stock markets trade mixed.
- **Chinese wholesale inflation jumped** by the most in five years in November (3.3% Y/Y) on the back of rising industrial commodities prices that also helped consumer goods inflation to continue gaining steam (2.3% Y/Y).
- **Large Japanese manufacturers turned more optimistic** about economic conditions in the fourth quarter but **they lowered their capital expenditure plans** for the current fiscal year, suggesting firms remain wary over future business conditions.
- President-elect Donald Trump said **the US needed to improve its relationship with China**, which he criticized for its economic policies and failure to rein in North Korea.
- **Only five of 14 non-OPEC oil producers** (Russia, Oman, Mexico, Azerbaijan and Kazakhstan) have agreed so far to meet the group on Saturday for talks aimed at widening a deal to reduce output, casting doubt on OPEC's agreement.
- **The EU should aim to keep as close a relationship with Britain as possible after Brexit**, German Economy Minister Gabriel said.
- An **EU/IMF review of Greece's performance** against bailout targets can be wrapped up by the end of the year, but Athens cannot adopt austerity measures now for implementation after its programme ends, the country's FM said.
- **Today's eco only contains US Michigan consumer confidence and UK trade data. ECB governors Smets, Knot and Rimsevics are scheduled to speak.**

Rates

	US yield	-1d
2	1,1248	0,0166
5	1,8525	0,0481
10	2,4273	0,0781
30	3,1261	0,0948

	DE yield	-1d
2	-0,7370	-0,0510
5	-0,3910	-0,0290
10	0,3800	0,0260
30	1,1464	0,1186

ECB to extend programme beyond March 2017 till end 2017, but at a reduced €60B/month

ECB lowers maturity constraint to 1-yr and drops the deposit-rate constraint

Sharp curve steepening

Portuguese bonds hammered as issuer limit is not raised, but Ireland may underperform too

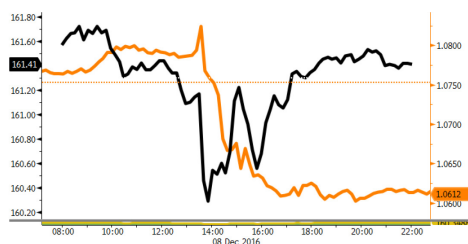
Impact on peripherals modestly negative, but needs watching

Dovish ECB: slower, but longer

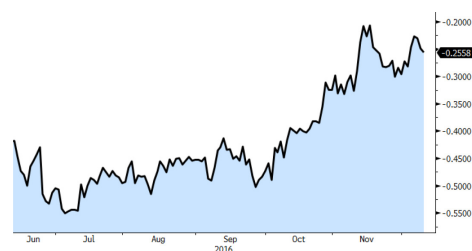
Yesterday's ECB decisions contained a number of surprises. Some additional (dovish) Draghi comments pushed markets in the ECB's desired direction. Core bonds eventually found their composure after an initial hawkish reaction in a volatile environment. When dust settled, the curve had steepened sharply via substantial lower ST yields and considerably higher very long term yields. Together with the drop of the euro and the rise of equities, it suggests that markets interpreted the ECB's decision as dovish.

For an in-depth analysis, see our flash report.

The ECB will extend its APP beyond March 2017, but at a lower amount of €60B/month (from €80B/month) till at least December 2017, or beyond if necessary. The maturing bond proceeds will be reinvested. The monthly amount of purchases may be raised again or the duration of APP increased if the outlook becomes less favourable or if financial conditions are inconsistent with further progress towards the inflation objective. Draghi not once mentioned the possibility of a tapering in case of the inverse situation, namely stronger growth and faster rising inflation. He shunned the word tapering, fearing it could cause a tantrum. **The change in some technical parameters of the programme affected markets too, as they weren't neutral for all EMU countries.** Bonds with a maturity of 1-to-2-yr become eligible and if needed bonds yielding less than the depo-rate (-0.4%) may be bought too. This means that more short-term bonds will be bought than before. These changes helped steepen the curve, in line with the Japanese curve after the recent BOJ decisions. A helping hand for the banking sector? The measure will support especially Germany, Netherlands and Finland to fulfil their part of the bond buying (scarcity problem). **The decisions surely better anchor short term rates and generate a steeper curve. A weaker euro is an additional gain.** So, Draghi certainly succeeded for now in his mission to dissociate the EMU situation from the US one and the ECB's policy from the Fed's one. **They can now let the current programme run till the end of 2017, before eventually changing track and start tapering, even if one can never exclude an improving situation which warrants earlier tapering (low risk). While their actions cement the front end of the European yield curves for longer, we're not sure whether they cap the upward potential for long term yields. The jury is still out.**



Bund future (black) and EUR/USD (orange) (intraday): It took time before markets were convinced that yesterday's ECB decisions were a dovish move. However, was it?



1-month 2-year forward eonia: Discounts first rate high by end 2018. It suggests that the ECB hasn't yet convinced markets of its dovishness

In a daily perspective, the **German yield curve steepened sharply** with 2-yr yields down 6.5 bps, while 10 and 30-yr yields ended 3.7 to 10.4 bps higher. The US yield curve bear steepened with yields 1 bp (2-yr) to 7.2 bps (30-yr) higher.

On intra-EMU bond markets, 10-yr yield spread changes versus Germany ended close to unchanged with the periphery underperforming. The Spanish spread added 5 bps, the Italian one 8 bps and the Portuguese one 21 bps. **Portugal and Ireland (+2 bps)** suffer as the **ECB didn't raise the issuer limit**, which is the biggest constraint for both countries in the APP and might result in reduced buying and likely ultimately in a premature end of APP for these countries' bonds. For other peripherals, the reduced amount of buying may have a negative effect too and especially Italy and its banking problems need to be watched closely.

With ECB gone, focus turns to Fed

R2	163,36	-1d
R1	162,08	
BUND	161,11	-0,5200
S1	159,91	
S2	158,67	

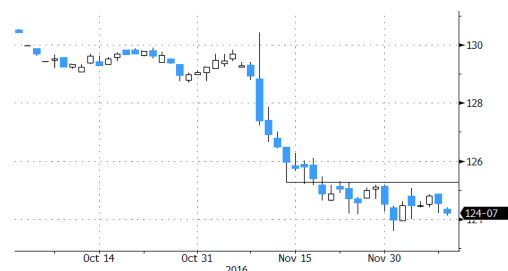
Overnight, Asian stock markets trade mixed. The US Note future is slightly lower while Brent crude gains limited ground. If any, it suggests a slightly weaker opening for the Bund.

Today's eco calendar is thin with only US Michigan consumer confidence. We don't expect that figure to impact trading as markets will further digest yesterday's ECB policy decisions. **They cement the front end of the European yield curves for longer, we're not sure whether they cap the upward potential for long term yields.** From a technical point of view, the German 30-yr yield tested key resistance yesterday. **Overall, global markets will also start counting down to next week's FOMC meeting. A rate hike is discounted, but will the Fed governors already changes their dots for next years in a hawkish way? This factor of uncertainty might keep some investors side-lined, suggesting some sideways trading.**

Technically (US), the US 2-yr yield broke above 1.1% resistance. The test of the US 5-yr yield to break above the 1.85% area and the test of 2.5% resistance in the US 10-yr yield currently didn't succeed. The US 30-yr yield remains below a similar 3.25% mark. We wait for specific news (e.g. a hawkish Fed next week) before anticipating a break higher (5yr & 10 yr). We hold our sell-on-upticks approach in US Treasuries.



German Bund: no change to technical picture after ECB meeting as yesterday's intra-day low should currently only be considered as a test



US Note future (March contract): consolidation ahead of the Fed?

Currencies

EUR/USD declines off key resistance post ECB

The euro reversed an initial post-ECB spike as a reduction of APP went hand in hand with lower short-term EMU yields

USD/JPY profited from higher core bond yields.

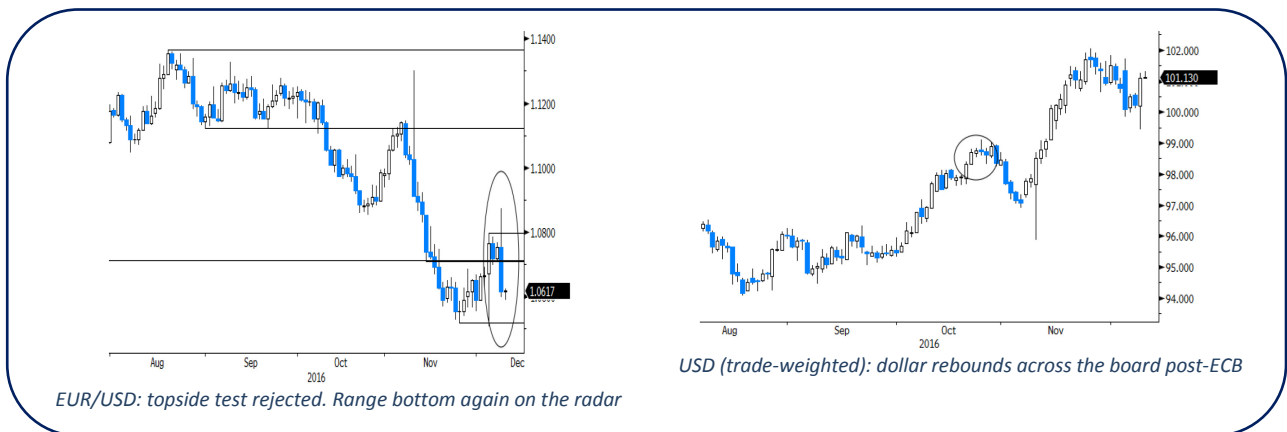
Dollar holding strong in Asia

R2	1,0874	-1d
R1	1,0796	
EUR/USD	1,0613	-0,0152
S1	1,0506	
S2	1,0458	

On Thursday, EUR/USD traded with a cautious upward bias going into the ECB decision. The euro spiked higher as the ECB announced to reduce to amount of Asset purchases to € 60 bln from April. However the gains were soon reversed into a substantial loss as ECB's Draghi remained very soft on growth and inflation and as the ECB allowed to buy bonds below the deposit yield (if necessary) and now also between 1- and 2-yr maturity. The programme is prolonged to the end of 2017. EUR/USD dropped to low 1.06 area and closed the session at 1.0615 (from on Wednesday). USD/JPY gained on overall USD strength as LT core/US yields rose. USD/JPY finished the session at 114.04, from 113.77.

Overnight, Asian equities trade mixed. The dollar is holding near the post-ECB highs. The trade-weighted dollar (DXY) is holding north of 101. The China November price data were above consensus with the CPI rising from 2.1% Y/Y to 2.3% Y/Y and the PPI increase was even more aggressively rising at 3.3% Y/Y (2.3% Y/Y expected). The data are another indication that inflation is trending higher globally. Japanese equities outperform again as USD/JPY rebounded. It trades in the 114.40 area. EUR/USD is near the post-ECB low (low 1.06 area).

Today, empty EMU calendar, and US wholesale inventories and the **Michigan consumer confidence on the US calendar**. The Michigan sentiment is interesting as it will give further evidence on the consumer mood in the early post-Trump era and going into the Holiday season. The consensus expects a modest rise from 93.8 to 94.1, but the index already rebounded substantially last month. Even so, we expect a good figure. We don't expect a big market reaction, but a good report might nourish the USD constructive sentiment.



Michigan consumer confidence market mover intraday

Some consolidation after yesterday's USD gains?

USD downside well protected

Yesterday, the euro declined as even has the ECB policy decision brought some mixed signals. **Lower short-term EMU yields** was an important driver for the euro decline. At the same time, there was **underlying USD strength** supported by higher LT core yields. **With the ECB prolonging substantial bond buying at least till end 2017, the Fed keeps the lead in the policy normalization process**. This puts a strong floor under the dollar and triggers additional by default USD bond buying, both against the yen and the euro. In a day-to-day perspective, the dollar rally might take a breather after yesterday's rebound and as markets assess the

impact of yesterday's ECB measures. **In a longer term perspective, the downside of the dollar looks well protected.** Short-term interest differentials will remain wide and might even widen more as the Fed extends its gradual normalization process into 2017. **From a technical point of view, yesterday's rejected test of the 1.0795/1.0809 area suggests that the topside of EUR/USD is well capped** going into next week's Fed meeting. We reinstall a sell EUR/USD on up-ticks bias for return action to the 1.0506 correction low and even to the 1.0458 cycle low.

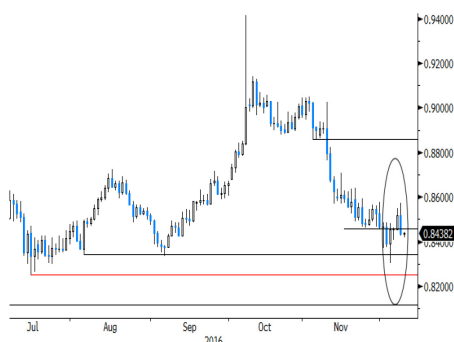
The technical picture for USD/JPY improved some time ago. The pair took out the key resistance at 111.45/91. Next key resistance at 114.50/115 was tested, but the test was rejected. **The pair is currently working through overbought conditions. However, the downside in USD/JPY looks well protected as long as sentiment on risk remains constructive. Even in case of an equity correction, the damage for USD/JPY might be less than previously, as interest rate differentials have become more important.**

Sterling shows mixed picture post-ECB

R2	0,8708	-1d
R1	0,8578	
EUR/GBP	0,8432	-0,0075
S1	0,83	
S2	0,8117	

Yesterday, EUR/GBP hovered in a tight sideways range close to mostly slightly north of 0.85. Cable regained some ground on global dollar softness, but the rebound did run into resistance in the 1.27 area. **The big moves in EUR/GBP occurred after the ECB policy announcement. EUR/GBP spiked to the 0.8570 area, but in line with EUR/USD almost immediately nosedived back below 0.85 .** The pair closed the session at 0.8433 (from 0.8517) Overall USD strength in the wake of the ECB policy decision also weighed on cable. It closed the session at 1.2586 (from 1.2626).

Today, the UK calendar contains the UK trade balance data and the construction out. The trade balance is interesting. The consensus expects a modest narrowing of the trade deficit in October after a big widening in September. **Markets might look of indications that the weaker pond helps to ease the negative impact from the external sector on UK growth.** However, we don't expect a big positive reaction of sterling on these data. Yesterday, EUR/GBP declined again substantial, but this was a euro move. **Sterling sentiment eased earlier this week as Brexit returned as a factor for trading. For now, we see no clear driver from a sterling point of view.** However, the recent comeback of sterling seems to have run its course and some consolidation might be on the cards. The topside in sterling is tough. EUR/GBP extensively tested the 0.8333 support on Monday, but a sustained break didn't occur. The 0.8333/05 area has become an important point of reference. It won't be easy for EUR/GBP to drop below this area and a bottoming out is likely. At least EUR/GBP is still well off this area, even after yesterday's euro setback.



EUR/GBP: tentative signs of a bottoming out process



GBP/USD: running into resistance

Calendar

Friday, 9 Dec		Consensus	Previous
US			
16:00	Wholesale Inventories MoM (Oct F)	-0.4%	-0.4%
16:00	Wholesale Trade Sales MoM (Oct)	0.7%	0.2%
16:00	U. of Mich. Sentiment (Dec P)	94.5	93.8
16:00	U. of Mich. 1 Yr Inflation (Dec P)	--	2.4%
16:00	U. of Mich. 5-10 Yr Inflation (Dec P)	--	2.6%
Japan			
00:50	BSI Large All Industry QoQ (4Q)	A 3-	1.9
00:50	BSI Large Manufacturing QoQ (4Q)	A 7.5	2.9
00:50	Money Stock M2 YoY (Nov)	A 4%	3.7%
00:50	Money Stock M3 YoY (Nov)	A 3.4%	3.2%
UK			
10:30	Visible Trade Balance GBP/Mn (Oct)	-£11800	-£12698
10:30	Trade Balance Non EU GBP/Mn (Oct)	-£3450	-£3969
10:30	Construction Output SA MoM / YoY (Oct)	0.2%/-0.1%	0.3%/0.2%
10:30	BoE/TNS Inflation Next 12 Mths (Nov)	--	2.2%
Germany			
08:00	Trade Balance (Oct)	22.0b	24.2b
08:00	Current Account Balance (Oct)	22.0b	24.2b
08:00	Exports SA MoM / Imports SA MoM (Oct)	0.9%/1.1%	-1.2%/-0.7%
08:00	Labor Costs SA QoQ / WDA YoY (3Q)	--/--	0.2%/1.8%
France			
08:45	Industrial Production MoM / YoY (Oct)	0.6%/-0.6%	-1.1%/-1.1%
08:45	Manufacturing Production MoM / YoY (Oct)	0.7%/0.1%	-1.1%/-0.9%
China			
02:30	CPI YoY (Nov)	A 2.3%	2.1%
02:30	PPI YoY (Nov)	A 3.3%	1.2%
Norway			
08:00	CPI MoM / YoY (Nov)	0.2%/3.5%	0.5%/3.7%
08:00	CPI Underlying MoM / YoY (Nov)	0.1%/2.9%	0.2%/2.9%
08:00	PPI including Oil MoM / YoY (Nov)	--/--	2.3%/-4.5%
Events			
09:00	ECB's Smets Speaks at Banking Conference in Brussels		
10:45	ECB's Knot Speaks in Maastricht		
13:00	ECB's Rimsevics speaks		
17:00	ECB's Smets Gives NBB Forecasts in Brussels		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	2,43	0,08	US	1,12	0,02	DOW	19615 19614,81
DE	0,38	0,03	DE	-0,74	-0,05	NASDAQ	for Exch - NQI #VALUE!
BE	0,71	0,05	BE	-0,63	-0,02	NIKKEI	18996 18996,37
UK	1,38	0,03	UK	0,09	0,01	DAX	11179,42 11179,42
JP	0,06	0,01	JP	-0,15	0,00	DJ euro-50	3186 3185,79

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,346 0,003
3y	-0,082	1,531	0,734	Euribor-1	-0,37	0,00	Libor-1 USD	0,26 0,26
5y	0,135	1,843	0,932	Euribor-3	-0,32	0,00	Libor-3 USD	0,38 0,38
10y	0,783	2,270	1,340	Euribor-6	-0,22	0,00	Libor-6 USD	0,54 0,54

Currencies		-1d	Currencies		-1d	Commodity	CRB	GOLD	BRENT
EUR/USD	1,0613	-0,0152	EUR/JPY	121,41	-0,92		191,4124	1169,64	54,08
USD/JPY	114,4	0,74	EUR/GBP	0,8432	-0,0075	-1d	0,56	-5,26	1,17
GBP/USD	1,2584	-0,0063	EUR/CHF	1,0785	-0,0052				
AUD/USD	0,7468	-0,0015	EUR/SEK	9,6893	-0,07				
USD/CAD	1,3197	-0,0030	EUR/NOK	8,9586	-0,03				

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		

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBCCORPORATES.COM/RESEARCH

This non-exhaustive information is based on short-term forecasts for expected developments on the financial markets. KBC Bank cannot guarantee that these forecasts will materialize and cannot be held liable in any way for direct or consequential loss arising from any use of this document or its content. The document is not intended as personalized investment advice and does not constitute a recommendation to buy, sell or hold investments described herein. Although information has been obtained from and is based upon sources KBC believes to be reliable, KBC does not guarantee the accuracy of this information, which may be incomplete or condensed. All opinions and estimates constitute a KBC judgment as of the data of the report and are subject to change without notice.

