



Sunrise

Thursday, 16 March 2017

Rates: Fed hikes rates, but markets wanted more

The Fed raised its policy rate by 25 bps to 0.75%-1%, but the median rate projections for 2017-2019 and the long run remained broadly unchanged. While Yellen indicated that the Fed would step up its tightening pace, markets were positioned for a more hawkish message. The US yield curve shifted up to 12.5 bps lower, the belly outperforming.

Currencies: Dollar declines as Fed hikes rates. Euro gains on Dutch election result

The dollar ceded ground across the board after the FOMC decision. The market was apparently positioned for a more aggressive Fed signal. The euro also gained as there is no role for Wilders in the formation of a new Dutch government. How far will the post-FOMC repositioning go? We assume key USD support levels to hold.

Calendar

Headlines

| | |
|--------------|---|
| S&P | ↘ |
| Eurostoxx 50 | ↘ |
| Nikkei | ↘ |
| Oil | ↘ |
| CRB | ↘ |
| Gold | ↗ |
| 2 yr US | ↘ |
| 10 yr US | ↘ |
| 2yr DE | ↘ |
| 10 yr DE | ↘ |
| EUR/USD | ↗ |
| USD/JPY | ↘ |
| EUR/GBP | ↘ |

- **US equities rallied after the Fed hiked rates, but without turning hawkish towards the near future.** **Overnight**, Asian stock markets receive a boost with Japan underperforming on the back of a lower USD/JPY
- The **Fed** said it would **raise short-term interest rates** and **keep lifting them this year**, moving the central bank into a new, more aggressive phase of draining easy money from the financial system as the economy improves.
- **The BoJ kept monetary policy on hold** as it battles to reach 2% inflation. Short-term interest rates will stay at -0.1%, 10y bond yields will be capped near 0%, and asset purchases remain at about ¥80T/year.
- **Rutte looks certain to form the Netherlands next government**, with his party projected to secure a clear victory over rivals including populist challenger Wilders. A **scattered political landscape** will make it hard to form a coalition.
- **China's central bank has raised interbank interest rates** in a move designed to limit investors' interest in moving money from China to the US following the Federal Reserve's interest rate rise overnight.
- **Australia's jobless rate climbed to a 13-month high** in February and employment unexpectedly fell, a risk to the outlook for wage growth and inflation that will likely keep open the possibility of another interest rate cut.
- **Today's eco calendar** contains final EMU CPI, US initial jobless claims, Philly Fed Business Outlook and auctions in Spain & France. The Swiss National Bank, Norges Bank and Bank of England hold policy meetings.

Rates

Bonds rally sharply on FOMC decisions

| | US yield | -1d |
|----|----------|-------|
| 2 | 1,30 | -0,07 |
| 5 | 2,00 | -0,13 |
| 10 | 2,49 | -0,11 |
| 30 | 3,10 | -0,07 |

German bond changes limited

US Treasuries rally on FOMC

Belly curve outperforms

| | DE yield | -1d |
|----|----------|-------|
| 2 | -0,82 | -0,01 |
| 5 | -0,36 | -0,02 |
| 10 | 0,39 | -0,05 |
| 30 | 1,16 | -0,04 |

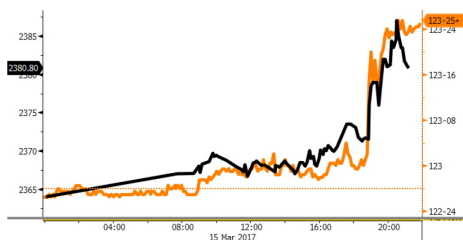
Fed raised rates by 25 bps

Little textual changes

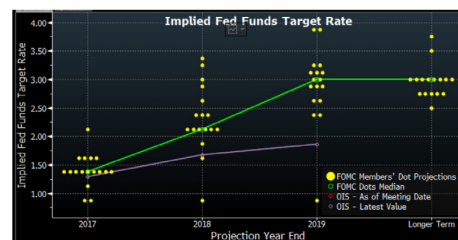
Eco projections unchanged

Median Fed rate path little changed, but underlying dots tell other story

Core bonds gained gradual ground ahead of the FOMC in thin trading conditions US economic releases printed close to consensus. ECB chief economist, **Peter Praet** said that the inflation outlook doesn't warrant an ECB policy change. He hoped to counter expectations that an ECB turnaround in policy looms ahead. Modestly higher equities and oil played no noticeable role in bond trading. It all changed after the publication of the **FOMC statement and economic and rate projections. US Treasuries shot higher (the belly outperforming), the dollar was sold and equities jumped higher.** The FOMC raised as expected its target range by 25 bps to 0.75%-1%. The economic projections and the median rate projections for 2017 and 2018 were unchanged, while the 2019 rate projection increased marginally. This means 2 extra rate hikes in 2017, 3 in 2018 and 3.5 in 2019. **The underlying dots told a bit different story.** The lower dots all moved higher and now 14 of the 17 governors expect at least three rate hikes. Similarly for 2018, 14 governors expect at least another three rate hikes. **The market hadn't yet incorporated the Fed rate path (2018-2019) and shifted further away during the rally.** In 2019, the gap between the median Fed dot of 3% and the market expectation is a wide 120 basis points. **Yellen also suggested much more than before that the rate path was a good indication of what would happen with policy,** of course under the assumption the economy evolves as they expect. In previous years, they didn't as a fundamental re-assessment of the neutral rate and of the natural unemployment rate took place. The text of the statement was little changed, but it introduced the **symmetric nature of the inflation target,** but we don't think that it means that the FOMC would allow the economy to become red hot. Yellen confirmed that persistent overshoots of inflation would not be tolerated. The Fed scrapped the word **only** in the sentence that *"The Committee expects that economic conditions will evolve in a manner that will warrant (only) gradual increases in the federal funds rate"* **For a full review, see our flash. In a daily perspective, US yield curve shifted lower, the belly outperforming with yields 7.7 bps (2-yr) to 12.5 bps (5-yr) lower. The 30-yr yield fell 6.8 bps.**



T-Note future (black) & S&P future (orange) (intraday): Bonds and equities surge after FOMC meeting



MarchDec Fed dot plot (green = median) and market pricing (blue): While medians are little changed, 14 out of 17 governors expect at least the median rate path or higher

Heavy US eco calendar

US housing starts and permits are expected mixed, but remain at high levels. They are volatile on a monthly basis, but surprises don't get much market traction. The initial claims are expected to have declined slightly to 240K, but remain close to trend. The headline **Philly Fed sentiment** index is expected to have dropped in March to 30 from 43.3 in February. That seems a big decline,

but the February spike (from 23.60 in January) to a historically high level was probably an outlier. The expected outcome is still very high. We are cautious to put a risk assessment on the Philly Fed consensus.

Spain and France conclude scheduled supply

The French treasury taps the on the run 3-yr OAT (0% Feb2020), on the run 5-yr OAT (0% May2022) and off the run OAT (2.25% Oct2022) for a combined €6-7B. The bonds on offer cheapened slightly in ASW-spread terms going into the auction. The Feb2020 is rather cheap on the curve, the other OAT's trade normal. **We expect a decent auction as French election risk eased with Macron becoming the clear frontrunner. The Spanish debt agency sells the on the run 5-yr Bono (0.4% Apr2022), on the run 30-yr Obligacion (2.9% Oct2046) and two off the run Obligacions (1.3% Oct2026 & 5.15% Oct2028) for a combined €4-5B.** Bonds on offer traded rather stable going into the auction. The Oct2026 and Oct2046 Obligacions are expensive on the Spanish curve, while the Oct2028 bond is cheap. **Overall, we expect vanilla demand.**

| | | |
|-------------|--------|------|
| R2 | 164,40 | -1d |
| R1 | 163,12 | |
| BUND | 160,3 | 0,79 |
| S1 | 158,28 | |
| S2 | 157,28 | |

Range trading in US/GE yields until French elections?

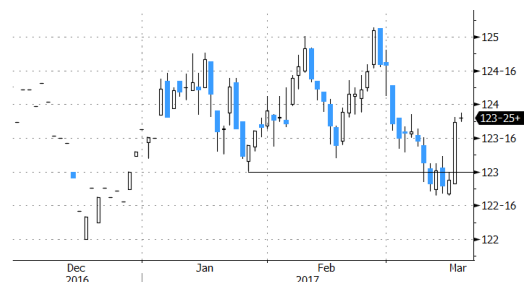
Overnight, Asian stock markets receive a boost from WS's positive reaction after the Fed meeting. Japan underperforms on yen strength. The US Note future trades stable near yesterday's high. The Bund could nevertheless open slightly weaker, taking into account the election defeat of Wilders. Apart from the opening, we don't expect the reaction on the Dutch elections to drag far.

Today's eco calendar contains several US eco data, but we don't expect them to influence trading much. Markets will further digest the Fed's policy decisions. US yields failed to break key technical levels in the run-up to the meeting and suffered a significant setback afterward. **We expect the US 10-yr yield to trade in the 2.3%-2.64% range, perhaps even until after the French elections. In the near-term, the US Note future probably has more upward potential. Longer term, we keep our scenario of 4 rate hikes in 2017 unchanged.**

Last week's ECB meeting and Bund sell-off comforted our call that another "calibration" of the ECB's QE programme will happen in H2 2017. Therefore, we have a long term bearish view on Bunds as well. Technically, the German 10-yr yield moved at a rapid pace from the 0.2% lower bound of the sideways range towards the 0.5% upper bound, but a break didn't occur. **Like in the US, we expect range trading ahead of the French elections.**



German Bund: Sell-off after ECB meeting halts. No strong reaction expected on Dutch election outcome.



US Note future: Fed less hawkish than markets expected. Downside protected ahead of French elections?

Currencies

Dollar declines as Fed hikes policy rate

Dollar eases as Fed hikes rates, but market sees no acceleration of normalization process

Euro profits as pro-European parties win Dutch elections

Asian equities join the post Fed rebound

Dollar remains in the defensive

BOJ decision has little impact on the yen

Eco calendar is moderately interesting

How far will post-Fed USD correction go?

| | | |
|---------|--------|--------|
| R2 | 1,1145 | -1d |
| R1 | 1,0874 | |
| EUR/USD | 1,0734 | 0,0106 |
| S1 | 1,0341 | |
| S2 | 1,0000 | |

Yesterday, the dollar drifted sideways ahead of the FOMC decision. The Fed as expected raised its policy rate by 25 bps. Yellen indicated a further gradual policy normalisation as the Fed meets its objectives. The market was apparently positioned for more aggressive communication. The dollar ceded ground across the board. Later, the euro found support as the first Dutch exit-polls made clear that the populist PVV party has no role in the formation of a new government. EUR/USD closed the session at 1.0734, the highest level in more than a month. USD/JPY finished the session at 113.38 (from 114.75 on Tuesday).

Overnight, Asian markets joined the post-Fed trends from the US. The dollar holds near the recent lows. The decline of core bond yields and of the dollar supports equities. Regional indices gain about 1%. Commodities/commodity related assets perform well. Japan underperforms on USD/JPY weakness (currently in the 113.25 area). The BOJ left its policy rate (-0.1%) and the target level for the 10y government bond yield (0.0%) unchanged. The market reaction was very limited. Eco data in Australia (labour market report) and in New-Zealand (Q4 GDP) disappointed. The Aussie (AUD/USD 0.7690) and the kiwi dollar (NZD/USD 0.70 area) returned a small part of the post-Fed gains. EUR/USD hovers in the 1.0720/45 area this morning, maintaining the post-Fed gain.

Today, the eco calendar is moderately interesting. In EMU, the final February CPI will be published. In the US, the calendar is better filled with the housing starts, building permits, jobless claims and the Philly Fed business outlook. Especially the claims and the Philly Fed survey might have some intraday impact on USD trading. Claims are expected to decline slightly to 240 000. The Philly Fed is expected to decline to 30 from an extremely high 43.3. Recently, confidence indicators remained at fairly strong levels and we expect this to remain the case. The key question is whether markets will continue their soft reaction to the Fed's communication. We are a bit surprised by the substantial decline of US bond yields, even as Yellen suggested that, considering the eco developments, the Fed policy might be relatively close to the 'dot-path'. The Fed also didn't assume much fiscal easing in its assessment. The day-to-day momentum is USD negative, but if US eco data remain OK, the correction doesn't have to go far. EUR/USD might still feel some support from the outcome of the Dutch elections this morning, but we assume that this effect will peter out very soon.



EUR/USD rebounds on after FOMC decision and on pro-European outcome of Dutch elections



USD/JPY: drifting back lower in the range as dollar eases post_fed

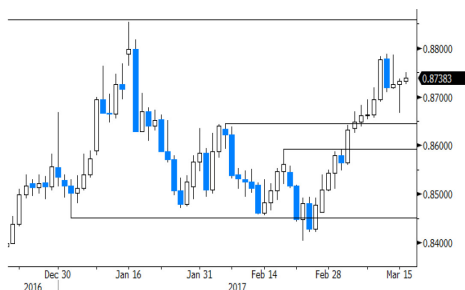
EUR/USD 1.0874 resistance remains the line in the sand with intermediate resistance at 1.0829. We maintain the view that a sustained break of EUR/USD above this area will be difficult, even after yesterday's Fed message. The US/German (EMU) interest rate differential remains at an absolute high level. Especially at the short end of the curve, the differential might even re-widen after yesterday's easing. **The fundamentals/interest rate differentials are in theory also supportive for USD/JPY, but of late the momentum/technical picture was not really convincing. We maintain the working hypothesis that the 111.60 range bottom should hold.**

BoE to keep wait-and-see approach

| | | |
|---------|--------|--------|
| R2 | 0,8881 | -1d |
| R1 | 0,8854 | |
| EUR/GBP | 0,8738 | 0,0042 |
| S1 | 0,8592 | |
| S2 | 0,8304 | |

Yesterday, **sterling showed again some sharp swings at the onset of the European session.** This time, the UK currency jumped higher, without an obvious driver. Mid-morning, the UK labour market report was fairly strong but sterling traders focused on disappointing wage growth. Sterling reversed part of the earlier gains against the euro and the dollar. **After the Fed decision, sterling mostly followed the USD moves. Cable rebounded to the 1.23 area. EUR/GBP didn't profit much from the rise in EUR/USD. The pair closed the session at 0.8733.**

Today, the BOE will announce its policy decision and published the meeting minutes. No policy change is expected. Given the recent softening in some UK data, ongoing modest price rises and the Brexit negotiations coming closer, the BOE will feel comfortable with its wait-and-see approach. In theory, this is modestly sterling negative. However, the recent price action suggest that the recent decline of sterling needs a breather. So, we don't expect the BoE meeting to change the broader picture for sterling for the better. **Sterling sentiment softened of late. EUR/GBP cleared the 0.8592 resistance, which improved the technical short-term EUR/GBP picture.** We don't expect a sustained EUR/USD rebound, but a combination of temporary euro consolidation and ongoing sterling softness as the Brexit negotiations are nearing, might trigger some more ST EUR/GBP gains. The 0.8854 correction top is the next key resistance. The nervous swings over the previous days suggest that a clear break beyond 0.8854 will be difficult without important news.



EUR/GBP; sterling shows some nervous swings as formal start of Brexit procedure is nearing



GBP/USD: 'saved' by post-Fed USD decline

Calendar

| Thursday, 16 March | | Consensus | Previous |
|--------------------|--|------------------|----------------|
| US | | | |
| 13:30 | Housing Starts / MoM (Feb) | 1264k/1.4% | 1246k/-2.6% |
| 13:30 | Building Permits / MoM (Feb) | 1268k/-1.9% | 1293k/5.3% |
| 13:30 | Initial Jobless Claims | 240k | 243k |
| 13:30 | Continuing Claims | 2050k | 2058k |
| 13:30 | Philadelphia Fed Business Outlook (Mar) | 30.0 | 43.3 |
| 15:00 | JOLTS Job Openings (Jan) | 5562 | 5501 |
| Japan | | | |
| | BOJ Policy Balance Rate (Mar 16) | -0.1% | -0.1% |
| | BOJ 10-Yr Yield Target (Mar 16) | 0.0% | 0.0% |
| UK | | | |
| 13:00 | Bank of England Bank Rate | 0.250% | 0.250% |
| 13:00 | BOE Asset Purchase Target (Mar) | 435b | 435b |
| 13:00 | BOE Corporate Bond Target (Mar) | 10b | 10b |
| EMU | | | |
| 08:00 | EU27 New Car Registrations (Feb) | -- | 10.2% |
| 11:00 | CPI MoM / YoY (Feb) | 0.4%/2.0% | --/2.0% |
| 11:00 | CPI Core YoY (Feb F) | 0.9% | 0.9% |
| Norway | | | |
| 10:00 | Deposit Rates | 0.50% | 0.50% |
| Sweden | | | |
| 09:30 | Unemployment Rate SA (Feb) | 6.8% | 6.8% |
| Switzerland | | | |
| 09:30 | SNB Sight Deposit Interest Rate | -0.75% | -0.75% |
| 09:30 | SNB 3-Month Libor Lower Target Range | -1.25% | -1.25% |
| 09:30 | SNB 3-Month Libor Upper Target Range | -0.25% | -0.25% |
| Events | | | |
| 10:30 | Spain to Sell 0.4% Apr2022, 1.3% Oct2026, 5.15% Oct2028 & 2.9% Oct2046 | | |
| 10:50 | France to Sell 0% 2020, 0% 2022, 2.25% 2022 & I/L Bonds | | |

| 10-year | td | -1d | | 2-year | td | -1d | | Stocks | td | -1d |
|------------|--------|---------|------|------------|---------|---------|--|-------------|----------|--------|
| US | 2,49 | -0,11 | | US | 1,30 | -0,07 | | DOW | 20950,1 | 112,73 |
| DE | 0,39 | -0,05 | | DE | -0,82 | -0,01 | | NASDAQ | 5900,047 | 43,23 |
| BE | 0,90 | -0,06 | | BE | -0,50 | -0,02 | | NIKKEI | 19590,14 | 12,76 |
| UK | 1,21 | -0,01 | | UK | 0,04 | -0,03 | | DAX | 12009,87 | 21,08 |
| JP | 0,07 | -0,03 | | JP | -0,26 | -0,02 | | DJ euro-50 | 3409,32 | 9,89 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| IRS | EUR | USD | GBP | EUR | -1d | -2d | | USD | td | -1d |
| 3y | -0,01 | 1,85 | 0,69 | Eonia | -0,3540 | 0,0000 | | Libor-1 | 0,9283 | 0,0161 |
| 5y | 0,25 | 2,11 | 0,88 | Euribor-1 | -0,3710 | 0,0010 | | Libor-3 | 1,1373 | 0,0061 |
| 10y | 0,83 | 2,46 | 1,25 | Euribor-3 | -0,3290 | 0,0010 | | Libor-6 | 1,4324 | 0,0003 |
| | | | | Euribor-6 | -0,2410 | 0,0000 | | | | |
| | | | | | | | | | | |
| Currencies | td | -1d | | Currencies | td | -1d | | Commodities | td | -1d |
| EUR/USD | 1,0734 | 0,0106 | | EUR/JPY | 121,6 | -0,30 | | CRB | 183,80 | 1,68 |
| USD/JPY | 113,28 | -1,42 | | EUR/GBP | 0,8738 | 0,0042 | | Gold | 1226,40 | 22,90 |
| GBP/USD | 1,2283 | 0,0061 | | EUR/CHF | 1,0719 | 0,0003 | | Brent | 52,19 | 0,61 |
| AUD/USD | 0,7695 | 0,0115 | | EUR/SEK | 9,518 | 0,0003 | | | | |
| USD/CAD | 1,3296 | -0,0162 | | EUR/NOK | 9,1171 | -0,0182 | | | | |

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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