Sunrise

Thursday, 19 January 2017

Rates: US Treasuries suffer from Yellen comments

US Treasuries sold off at the end of US trading as Fed chairwoman Yellen warned of a nasty surprise if the Fed doesn't continue tightening its policy. The US economy is close to full employment and inflation head to the 2%-target, she added. Today, the ECB holds its first policy meeting of the year, but we think it will be irrelevant for trading.

Currencies: Dollar rebounds as Fed chair Yellen reiterates gradual rate hike scenario

Yesterday, the dollar bottomed out as the correction on the reflation trade eased. Later in the session, the rebound accelerated as Fed's Yellen was positive on the US economy. Today, the focus is on the ECB press conference. Will Draghi be soft to support a further decline of EUR/USD?

Calendar

Headlines

- **US equity markets ended mixed, withstanding higher US rates and a stronger dollar after "hawkish" Yellen comments. Overnight,** most Asian bourses are in positive territory with China underperforming.
- **Janet Yellen, the Fed chair, has warned that the US risks a "nasty surprise" if it waits too long to continue raising interest rates,** adding that she expects the US central bank to tighten monetary policy a few times a year until 2019.
- **Australian employment rose moderately in December (13.5k)** as full-time jobs increased for a third straight month (9.3k), though **the unemployment rate still ticked up to its highest since June (5.8%)** as more people went looking for work.
- The BoC kept its policy rate unchanged at 0.5% and said significant uncertainties from the U.S. are weighing on the economic outlook. **BoC Governor Poloz said he's prepared to cut rates if needed.** USD/CAD surged from 1.305 to 1.325.
- The **Spanish government is to give banks three months to reach agreements with customers** who were sold mortgages with an interest rate floor or face a wave of legal claims as well as a potential multi-billion euro hit.
- The **Czech National Bank still believes the right time to lift its cap on the crown is the middle of the year**, board member Lubomir Lizal said, adding that investors had overbought the currency.
- The latest **Beige Book** noted that price pressures have intensified "somewhat", though wages increased only modestly on slight to moderate employment gains. Overall, economic growth was reported only as modest across most regions.
- **Today's eco calendar** contains US housing starts, building permits, weekly jobless claims and Philly Fed Business outlook. **The ECB holds its policy meeting.** Spain and France supply the market.

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	→

Rates

German yields modestly higher

US Treasuries sell off on various factors amongst other Yellen and technicals.

	US yield	-1d
2	1,21	0,05
5	1,93	0,08
10	2,42	0,08
30	3,00	0,06

Also Fed Kaplan wants debate on the future of Fed's balance sheet

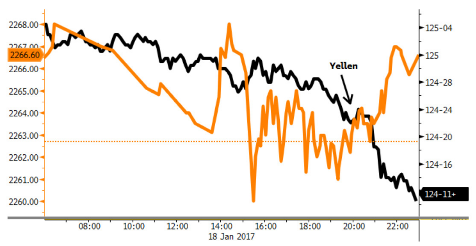
Yellen emphasizes the December rate path and confirms Fed's targets are nearly reached

	DE yield	-1d
2	-0,72	0,02
5	-0,45	0,04
10	0,39	0,07
30	1,11	0,05

Core bonds gradually decline throughout the session

Yesterday, global core bond slid gradually lower. US inflation data increased to above 2% in December, but printed in line with expectations. Other US eco data (production, NAHB homebuilders sentiment) had no specific impact. **Fed Yellen basically repeated the message from the Dec FOMC statement and press conference (see below), but that might have been enough to push US Treasuries one more time lower, even as the last down-move of the day didn't match time-wise with her policy sensitive comments. The outperformance of the 5-yr, suggests that Yellen might have convinced markets to price the curve a bit closer to the Fed's dots rate path. In a daily perspective,** the German yield curve bear steepened till the 15-yr tenor with yields 1.6 bps (2-yr) to 3.9 bps (15-yr) higher. Changes on the US yield curve ranged between +6.9 bps (2-yr) and +11.9 bps (5-yr). Technically, 125-09 resistance proves to be a tough nut to crack and might have contributed to selling by the speculative longs. **On intra-EMU bond markets,** 10-yr yield spreads barely changed except for a 4/5 bps narrowing for Greece & Portugal.

Dallas Fed Kaplan's said that having a discussion and **debate on the Fed's balance sheet sometime this year** would be healthy. He is not the first governor to suggest such debate. The outcome of that debate is important for the shape of the curve. Stopping with re-investing maturing issues and/or selling US Treasuries would steepen the curve and remove some pressure to raise FF rates (too) much. **Fed chairwoman Yellen's** most policy sensitive comments came well ahead of the final down-leg of US Treasuries. She said she can't give the timing of the next rate hike, which will be data-dependent, but noted that "as of last month" the FOMC expected to increase the Fed rates a few times a year, until by the end of 2019, it is close to the estimate of its neutral rate (3%). This is exactly the description of the dots rate path, **but it is true that after the FOMC meeting she downplayed the slight increase of the rate path, while now she emphasized it.** Yellen also said economy is close to full employment and inflation is going towards target.



T-Note future (black) and S&P future (orange) (intraday): US Treasuries hit the skid while equities remain strong

US 10-yr yield: Is correction lower over? At least rebound came after test first yield support.

ECB meeting in focus today

Mario Draghi should defend December's many important decisions, which still need to be partially implemented. He might downplay the higher inflation by pointing to subdued core prices and the temporary nature of an energy shock. **If he deviates from the script of being dull by giving markets no chance to start questioning December's decisions, the market reaction should be strong.**

We think there is little chance that he will give markets food to start questioning the duration or size of the APP though. **(See KBC FLASH)**

R2	165,48	-1d
R1	164,90	
BUND	162,98	-0,92
S1	162,62	
S2	159,91	

France and Spain conclude scheduled supply

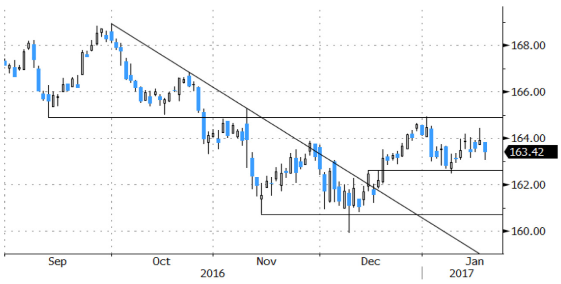
The French Treasury taps the 0% May2022 OAT and creates a new 0% Feb2020. They aim to raise €7-8B and additionally hold a €1.5-2B inflation-linked bond auction. Grey trading suggests that the new 3-yr OAT will be priced (MS - 38.4 bps) with a 8.3 bps pick-up in ASW spread terms compared with the previous benchmark (0% Feb2019). That corresponds with a 16 bps pick-up in yield terms. **The Spanish debt agency sells the on the run Bono (0.25% Mar2019), launches a new 5-yr Bono (0.4% Apr2022) and taps one off the run Obligacion (4.4% Oct2023) for a combined amount of €4-5B.** Grey trading suggests that the new 5-yr Bono will be priced (MS+24.6 bps) with a 13.9 bps pick-up in ASW spread terms compared with the previous benchmark (0.75% Jul2021). That corresponds with a 23 bps pick-up in yield terms. We expect both French and Spanish supply to be well digested.

US CPI and Yellen able to cement 125-09 resistance?

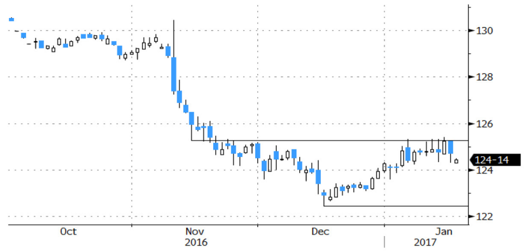
Overnight, most Asian stock markets trade in positive territory with Japan outperforming (weaker yen) and China underperforming. The US Note future stabilizes near the lows reached at the end of WS's trading session following a day-long slide lower and some Yellen comments. We expect the Bund to open near levels reached yesterday in after-trade (163.04).

Today's eco calendar contains several less relevant US eco data and the ECB's policy meeting. **We fear that none of them will leave a stamp on trading.** US eco data will be dwarfed by tomorrow's Trump inauguration. On top, in light of Yellen's comments (see higher), we only expect a negative reaction on the ECB meeting if Mario Draghi would sow doubts on its, yet partially to implement, APP programme, which is unlikely. **After the umpteenth failed test of 125-09 resistance in the US Note future, we feel again comfortable to set up new short positions around this level. We expect US markets to further align with the Fed's scenario of 3 rate hikes this year.**

ECB Draghi will face some awkward questions about higher EMU growth and inflation, but this won't already alter the ECB's policy view at this stage (see KBC FLASH). Therefore, we expect the press conference to be irrelevant for trading, unless we are wrong. Technically, the German Bund bounced into 164.9 resistance. The short-term trading range is 162.62-164.90. As the underlying economic picture in EMU improves further, we also expect more downside in the Bund despite the ECB's bond buying. programme.



German Bund: Trading band between 160.72 and 164.90



US Note future: Another failed test of 125-09 resistance helped by Yellen's comments

Currencies

Can USD extend its rebound?

Dollar rebounds as Yellen indicates that US economy is near Fed goals

R2	1,0874	-1d
R1	1,0719	
EUR/USD	1,0644	-0,0035
S1	1,0341	
S2	1,0000	

On Wednesday, the correction on the reflation trade petered out. The (albeit modest) decline of equities halted, core yields bottomed out and so did the dollar. Later in US dealings, the dollar made further gains as Fed Chair Yellen reiterated that the US economy is nearing the Fed goals and that it would makes sense for the Fed to gradually reduce policy stimulation. At the same time, Yellen mentioned the impact of the stronger dollar. USD/JPY finished the session at 114.65 (from 112.62). EUR/USD closed the day at 1.0630 (from 1.0713)

Asian markets trade with a slightly positive bias

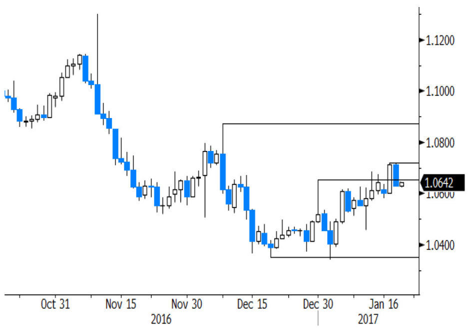
Dollar maintains yesterday's late session gains, but no follow-through action yet.

Overnight, the rise of the dollar is a mixed factor for Asian markets. Japanese equities profit from the rise of USD/JPY, but the pair shows no follow-through gains and trades in the 114.55 area. Chinese markets show modest losses. Australian job data were OK, but close to expectations. The Aussie dollar is gaining slightly ground after yesterday's USD driven setback. AUD/USD is trading in the 0.7525 area. As is the case for most other USD cross rates, there are no follow-through gains of the dollar against the euro. EUR/USD is changing hands in the 1.0635 area.

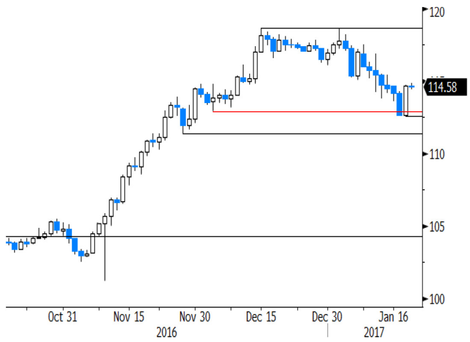
Draghi's press conference in focus today

Will the ECB president be soft enough to push EUR/USD lower

Today, the US housing starts and permits, the jobless claims and the Philly Fed Business outlook are scheduled for release. Housing data are expected to rebound after a poor performance in November. Jobless claims hover near cycle lows and the Philly Fed is expected to soften slightly after the recent improvement (15.0 from 21.5). The data will probably only be of intraday significance for USD trading. **The focus for EUR/USD trading will be on the ECB press conference.** Coming after a December meeting with many important decision, Mario Draghi should defend those decisions. He might downplay higher inflation by pointing to subdued core prices and the temporary nature of an energy shock. **So, we expect the ECB president to maintain a soft tone.** That said, he will receive questions on higher inflation and on recent good eco data. **If he would acknowledge some progress, it might push European yields and the euro higher. This is not our preferred, but a risk scenario. In-day-to-day perspective,** the dollar bottomed out, but this morning's USD momentum is a bit disappointing. **So, we stay neutral on EUR/USD** (ECB risks). The base/upside in USD/JPY is maybe a bit more solid.



EUR/USD topside test rejected?



USD/JPY: USD rebounds on higher US yields

Global context: Two weeks ago, EUR/USD touched a multi-year low (1.0341). **After the Trump rally, plenty of good USD news is discounted. Interest rate differentials between the dollar and the euro narrowed (correction), causing a dollar correction. Longer-term,** the absolute interest rate support should provide a USD floor if US data remain good and as long as there are no profound doubts on Trump's pro-growth policy. **A buy USD on dips strategy remains preferred. EUR/USD traded temporary above the 1.0670/85 resistance, but no sustained break occurred. A return north of 1.0874 would question the USD positive momentum.** On the downside, **EUR/USD 1.0341 is the first key support.** USD/JPY is trading well off post-Trump highs (118.60/66). Yesterday', the pair rebounded, suggesting a bottoming out process, but the jury is still out. We look out whether the 112.61 correction low will hold. 111.16 marks the 38% retracement of the 99.02/118.66 rally and might be a tough support. An equity correction or a further decline in core bond yields might be short-term negatives for USD/JPY.

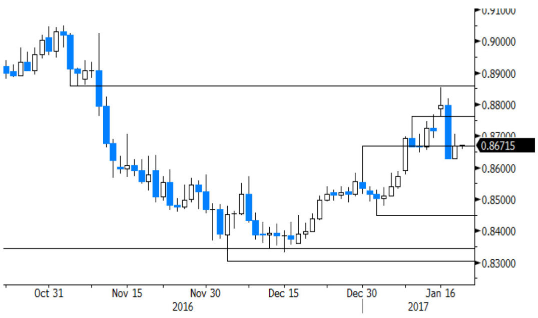
Sterling declines only slightly after May short-squeeze

R2	0,9047	-1d
R1	0,8881	
EUR/GBP	0,8661	0,0012
S1	0,8450	
S2	0,8304	

Yesterday, sterling had to look for a new equilibrium after Tuesday's post-May short squeeze. **EUR/GBP hovered in a sideways range in the 0.8645/90 area early in Europe.** The UK labour data were mixed, but the rise in wage growth (2.8% Y/Y) was slightly above consensus. The positive impact on sterling was limited and short-lived. Sterling nevertheless maintained quite a substantial part of its post-May gains. EUR/GBP filled offers just north of 0.87, but closed the session at 0.8670 (from 0.8629). Cable finished the day at 1.2261, but part of this decline was due to USD strength.

Overnight, the RICS house price balance softened to 24% from 29%. Later today, there are no important UK eco data. So, sterling trading will be driven by global factors and by Brexit headlines.

Yesterday, sterling corrected slightly lower, but the move was limited given the fact that PM May hinted on a hard Brexit which was usually a negative for sterling. Despite yesterday's price action**, we still don't see a big case for a sustained further rebound of sterling. We look to sell sterling into strength as long as there is no clear indication that the BoE will take action to fight rising inflation.** EUR/GBP 0.8579 marks the 50% retracement of the 0.8304/0.8854 rebound. EUR/GBP 0.8515 is the 62% retracement level with a correction low coming in at 0.8451. This 0.8515/0.8451 area should provide a strong support.



EUR/GBP rebounds (slightly) after May speech

GBP/USD: off the recent lows, but topside blocked on USD strength

Calendar

Thursday, 19 January		Consensus	Previous
US			
14:30	**Housing Starts / MoM (Dec)**	**1187k/8.9%**	**1090k/-18.7%**
14:30	**Building Permits / MoM (Dec)**	**1225k/1.1%**	**1212k/-3.8%**
14:30	**Initial Jobless Claims**	**252k**	**247k**
14:30	Continuing Claims	2075K	2087k
14:30	**Philadelphia Fed Business Outlook (Jan)**	**15.10**	**21.5**
UK			
01:01	RICS House Price Balance (Dec)	A: 0.24	0.29
EMU			
10:00	ECB Current Account SA (Nov)	--	28.4b
13:45	**ECB Main Refinancing Rate**	**0.000%**	**0.000%**
13:45	ECB Marginal Lending Facility	0.250%	0.250%
13:45	**ECB Deposit Facility Rate**	**-0.400%**	**-0.400%**
13:45	**ECB Asset Purchase Target (Jan)**	**EU80b**	**EU80b**
Events			
	IBM (22:00), American Express (22:05) announce Q4 earnings		
10:30	Spain to Sell Bonds (0.25% 2019, 0.4%2022 & 4.4% 2023)		
10:50	France to Sell Bonds (0% 2020, 0% 2022, 0.1% I/L 2021 & 1.85% I/L 2027)		

10-year	td	-1d		2-year	td	-1d	Stocks	td	-1d
US	2,42	0,08		US	1,21	0,05	DOW	19804,72	-22,05
DE	0,39	0,07		DE	-0,72	0,02	NASDAQ	5555,654	16,93
BE	0,67	0,03		BE	-0,57	0,00	NIKKEI	19072,25	177,88
UK	1,34	0,03		UK	0,19	0,01	DAX	11599,39	59,39
JP	0,08	0,02		JP	-0,22	0,00	DJ euro-50	3294	8,96
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	td	-1d
3y	-0,09	1,72	0,73	Eonia	-0,3520	0,0000			
5y	0,11	1,98	0,92	Euribor-1	-0,3720	0,0000	Libor-1	0,7694	0,0017
10y	0,73	2,30	1,32	Euribor-3	-0,3290	0,0000	Libor-3	1,0248	0,0011
				Euribor-6	-0,2400	-0,0010	Libor-6	1,3324	-0,0006
Currencies	td	-1d		Currencies	td	-1d	Commodities	td	-1d
EUR/USD	1,0644	-0,0035		EUR/JPY	121,93	0,92	CRB	193,36	-1,78
USD/JPY	114,55	1,24		EUR/GBP	0,8661	0,0012	Gold	1200,80	-12,00
GBP/USD	1,2289	-0,0058		EUR/CHF	1,0715	-0,0010	Brent	54,45	-1,09
AUD/USD	0,7537	-0,0005		EUR/SEK	9,5186	-0,0032			
USD/CAD	1,3256	0,0182		EUR/NOK	9,0352	-0,0182			

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