



Monday, 19 March 2018

Rates: More divergence between US Note future and Bund?

Last week's technical break in the Bund/German 10-yr yield suggests further outperformance vs the US Note future, also taking into account Wednesday's FOMC meeting. We expect a hawkish shift in the new dot plot, reflecting a strong assessment of the US economy by Fed governors.

Currencies: EUR/USD drifts south ahead of FOMC decision

FX markets traded on some potential divergence between the US and Europe last week. Soft ECB comments and low inflation might delay ECB policy normalization. At the same time, investors don't want to be positioned short dollar ahead of the FOMC decision. EUR/USD 1.2155 support might again come on the radar.

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 stock markets closed Friday's trading session flat (Nasdaq) to 0.3% higher (Dow). Asian risk sentiment is mixed overnight with Japan and Korea underperforming** after rumours that Apple is developing its and producing its own device displays for the first time.
- **Russian President Putin won re-election by a wide margin (76.1%)** strengthening his hand amid an escalating confrontation with the West. He will start a new six-year term after already 18 years in power.
- **Three ECB policymakers (Villeroy de Galhau, Knot and Weidmann) struck an optimistic tone on the EMU inflation outlook** despite stubbornly slow price growth so far this year.
- **Iron ore is losing altitude fast.** Futures in Singapore are heading for the lowest close in more than three months as investors fret about record holdings at China's ports and concern that demand may disappoint.
- **China named Yi Gang to run its central bank**, elevating a long-serving deputy governor with deep international links to the forefront of efforts to clean up the nation's financial sector and modernize monetary policy.
- **The US Congress, facing yet another government shutdown deadline at midnight on Friday**, will try this week to approve a massive spending bill that would end lawmakers' nettlesome budget infighting, at least through Sept. 30.
- **Today's eco calendar** contains only second tier EMU eco data. Belgium holds an OLO auction. G20 Finance Ministers meet in Buenos Aires.

Rates

More underperformance of T-Note future ahead of Fed?

	US yield	-1d
2	2,29	0,01
5	2,65	0,02
10	2,84	0,02
30	3,08	0,02

	DE yield	-1d
2	-0,59	-0,01
5	-0,04	-0,01
10	0,57	-0,01
30	1,22	-0,01

Core bonds traded mixed on Friday with US Treasuries underperforming German Bunds. The main downleg in the Note future occurred after stronger than expected US eco data. Subcomponents of Michigan consumer confidence showed further accelerating inflation expectations. **Technical factors were at play as well** after the US 10-yr yield's failed test of 2.8% support on Thursday. The German 10-yr yield on the other hand confirmed the break below 0.62%.

At the end of the day, changes on the German yield curve ranged between -0.6 bps (10-yr) and -1.1 bp (2-yr). The US yield curve bear steepened with yields 0.6 bps (2-yr) to 1.9 bps (30-yr) higher. 10-yr yield spread changes versus Germany were virtually unchanged with Greece & Portugal outperforming (-3 bps). After trading, **Fitch and S&P affirmed the ratings of Italy (BBB, stable) and Portugal (BBB-, stable) respectively.**

The US Note future trades flat overnight. Most Asian equity and commodity markets are downwardly oriented. We expect a neutral opening for the Bund. Three ECB governors sounded more confident on the inflation outlook, but the March ECB meeting showed that they are still a minority. Today's eco calendar is empty. **Last week's technical break in the Bund/German 10-yr yield suggests further outperformance vs the US Note future, also taking into account Wednesday's FOMC meeting.** Several Fed heavyweights suggested that they will upgrade their economic forecasts while showing additional confidence that inflation will move to the 2% target. **We expect the Fed to hike rates and changing the dot plot. More specifically, we expect a higher estimation of the neutral rate (3% from 2.75%) and a potential shift already in 2018 (4 from 3) and/or 2019. This hawkish scenario isn't discounted in prices, suggesting that it could trigger a new upleg in US yields.**

Technically, the trading band for the US 10-yr yield is 2.64%-3.05%. A test of 2.8% intermediate support failed. **The German 10-yr yield lost 0.62% support. The break suggests a return to 0.46%/0.48% support (gap open/62% retracement)** unless we get a sudden shift in sentiment.

The Belgian debt agency taps 4 OLO's today for a combined €3-3.6 bn: OLO 79 (0.2% Oct2023), OLO 85 (0.8% Jun2028), OLO 84 (1.45% Jun2037) and OLO 80 (2.15% Jun2066). It's the first regular auction this year after two syndications. The Kingdom already completed more than 30% of this year's funding plan (€31bn). We expect no difficulties at today's auction.



German 10-yr yield loses 0.62% support, suggesting a technical return to 0.46%-0.48%



US 10-yr yield bounced off first intermediate support around 2.8% ahead of the FOMC meeting

Currencies

EUR/USD drifts lower ahead of FOMC

R2	1,2598	-1d
R1	1,2555	
EUR/USD	1,2290	-0,0015
S1	1,2165	
S2	1,2055	

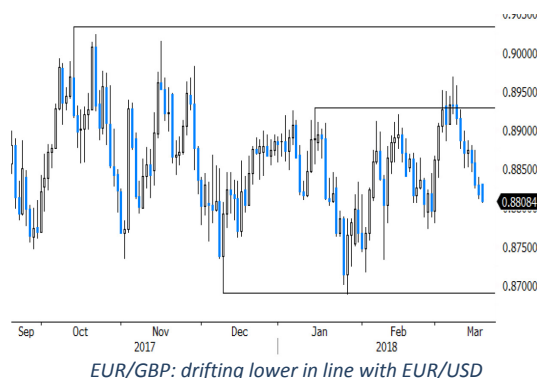
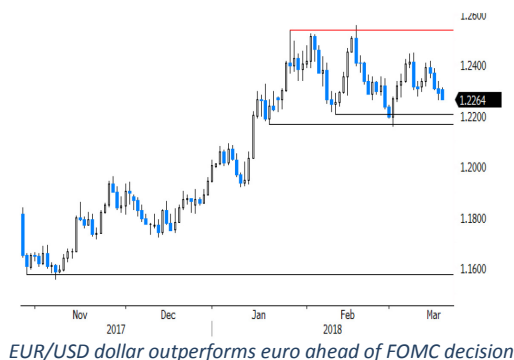
EUR/USD extended its gradual decline on Friday. EMU February inflation was revised from 1.2% to 1.1%, confirming recent analysis of ECB's Draghi and Praet that there is still work to do on inflation. **At the same time, investors remained a bit cautious on USD shorts going into this week's FOMC meeting.** US data including production and Michigan consumer confidence were good. The dollar maintained the benefit of the doubt. EUR/USD closed the session modestly lower at 1.2290. USD/JPY hovered up and down to close the session at 106.01.

R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8817	-0,0013
S1	0,8690	
S2	0,8657	

Sentiment on Asian markets is fragile to slightly negative this morning. China outperforms. Investors maintain a cautious approach ahead of upcoming event risk including trade frictions between the US and its trading partners and the FOMC policy decision. The trade-weighted dollar is holding near last week's ST recovery top (currently 90.30 area). EUR/USD is drifting further south (1.2265 area). Comments from some less dovish ECB members this weekend (Knot/Weidmann) didn't change the euro dynamics. The yen slightly outperforms the dollar. USD/JPY trades in the 105.74. Overall market uncertainty rather than Japanese politics are probably to blame.

Today's EMU and US eco calendars are thin. Last week, soft ECB talk was reinforced by poor EMU inflation data. Even with those data, the debate on further ECB policy normalization will have to start further down the road. **However, it is too early for the ECB to catch up with the Fed anytime soon. Interest rate differentials between the dollar and the euro widened further.** For now, this presumed policy divergence is weighing slightly on EUR/USD. The pair tries to break intermediate support at 1.2273. EUR/USD 1.2155 might again come on the radar. We keep a close eye on USD/JPY & EUR/JPY. EUR/JPY breaking below 129.35 support could weigh further on EUR/USD, too.

UK news flow was mixed on Friday, but sterling remained well bid. **EUR/GBP declined further to the low 0.88 area**, partially due to euro softness. This week's UK data might be mixed. Markets will keep a close eye at the EU summit looking for any progress on Brexit. The combination of a soft euro and hope on some Brexit progress might pull EUR/GBP a bit lower in the established 0.8950/0.8690 consolidation range.



Calendar

Monday, 19 March		Consensus	Previous
Japan			
00:50	Trade Balance Adjusted (Feb)	A: -¥201.5b	¥352.3b
00:50	Exports YoY / Imports YoY (Feb)	A:1.4%/16.5%	12.3%/7.7%
China			
02:30	China February Property Prices		
UK			
01:01	Rightmove House Prices MoM / YoY (Mar)	A: 1.5%/2.1%	0.8%/1.5%
EMU			
11:00	Trade Balance SA (Jan)	22.3b	23.8b
11:00	Construction Output MoM / YoY (Jan)	--/--	0.1%/0.5%
Italy			
10:00	Industrial Production MoM / WDA YoY (Jan)	-0.6%/4.5%	1.6%/4.9%
Belgium			
15:00	Consumer Confidence Index (Mar)	--	1
Events			
11:30	Belgium sells 0.2% 2023, 0.8% 2028, 1.45% 2037 and 2.15% 2066 Bonds		
14:40	Fed's Bostic Speaks on Community Reinvestment Act		

10-year	<u>Close</u>	<u>-1d</u>		2-year	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	2,84	0,02		US	2,29	0,01	DOW	24946,51	72,85
DE	0,57	-0,01		DE	-0,59	-0,01	NASDAQ	7481,988	0,25
BE	0,86	0,00		BE	-0,54	0,00	NIKKEI	21480,9	-195,61
UK	1,43	-0,01		UK	0,81	0,00	DAX	12389,58	44,02
JP	0,04	0,00		JP	-0,15	0,00	DJ euro-50	3437,4	23,27
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>-1d</u>	<u>-2d</u>
3y	0,04	2,72	1,17	Eonia	-0,3660	0,0000			
5y	0,40	2,80	1,33	Euribor-1	-0,3700	0,0010	Libor-1	1,8221	0,0139
10y	1,01	2,89	1,54	Euribor-3	-0,3280	0,0000	Libor-3	2,2018	0,0242
				Euribor-6	-0,2720	-0,0010	Libor-6	2,3636	0,0219
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>	Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1,2290	-0,0015		EUR/JPY	130,28	-0,57	CRB	194,46	0,57
USD/JPY	106,01	-0,33		EUR/GBP	0,8817	-0,0013	Gold	1312,30	-5,50
GBP/USD	1,3942	0,0005		EUR/CHF	1,1701	-0,0006	Brent	66,21	1,09
AUD/USD	0,7713	-0,0085		EUR/SEK	10,0698	0,0054			
USD/CAD	1,3096	0,0044		EUR/NOK	9,4815	-0,0101			

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