

Thursday, 21 February 2019

### Rates: Fed wants to end BS run-off later this year

FOMC Minutes revealed that most participants want to end the balance sheet run-off by the end of the year. We expect communication on the subject at the March 20 Fed meeting. Core bonds lose ground overnight on rumours of significant progress in US-Sino trade talks. We'd be cautious to join the risk rally. EMU PMI's are expect to bottom out in February.

### Currencies: Dollar stays in wait-and-see modus despite positive headlines on trade

The dollar showed no clear trend yesterday. The Fed minutes didn't change the broader picture for the US currency. Today, the eco calendar is well filled. Will EMU PMI's bottom and provide some downside protection for the euro? Or will US data again disappoint? For now the consequences of (US-Sino) trade talks for the USD or the euro are still unclear.

### 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** posted modest gains yesterday. **Asian equity markets** are trading mixed as China/US progress lifted sentiment at first but China's central bank signalling not being ready to cut rates weighed on sentiment afterwards.
- **The US and China are working on multiple pacts**, covering topics from agriculture to intellectual property, **that would form the basis of a final trade deal** and (temporarily) avert higher tariffs on Chinese imports on March 1.
- **US President Trump threatened to impose tariffs on EU car import again**, if the US can't reach a trade deal with the EU. The threat follows a report by the Commerce Dept. that investigated the national-security risks of auto imports.
- **The Australian dollar erased earlier gains** on strong labour data (+39.1k jobs in January) following a report that **one of China's main ports had banned imports of Australian coal**. AUD/USD dropped below 0.71.
- **Japan's Manufacturing PMI dropped from 50.3 to 48.5 in January, the lowest reading since June 2016**. Both production output (from 49.4 to 47) and new orders fell, suggesting Japan's underlying business conditions remain poor.
- **Rating agency Fitch said it might cut the UK's sovereign rating** as it sees mounting risks of a no-deal Brexit. Meanwhile, PM May reports **constructive talks on a solution for the Irish backstop** with EU Commission leader Juncker.
- **Today's eco calendar** contains EMU PMI's, US weekly jobless claims, Philly Fed Business sentiment and durable goods orders. The ECB releases the January meeting minutes, while Praet speaks. France and Spain sell bonds.

# Rates

## Fed wants to end BS run-off by the end of the year

|    | US yield | -1d  |
|----|----------|------|
| 2  | 2,50     | 0,01 |
| 5  | 2,48     | 0,01 |
| 10 | 2,64     | 0,01 |
| 30 | 3,00     | 0,02 |

|    | DE yield | -1d   |
|----|----------|-------|
| 2  | -0,57    | 0,00  |
| 5  | -0,35    | 0,00  |
| 10 | 0,10     | 0,00  |
| 30 | 0,73     | -0,01 |

Global core bonds hovered up and down near opening levels yesterday. The eco calendar only contained a slightly stronger than expected rebound in February EMU consumer confidence. The US yield curve bear steepened marginally with yields gaining 0.9 bps (2-yr) to 1.7 bps (30-yr). The German yield curve slightly bull flattened with yields 0.1 bp (2-yr) to 0.9 bps (30-yr) lower. 10-yr yield spread changes vs Germany ended nearly unchanged with Italy underperforming (+8 bps).

Minutes of the January FOMC meeting revealed after the European close that almost all participants wanted to announce a plan soon to end the balance sheet run-off later this year. That's a U-turn compared to Fed chair Powell's December comments of a run-off on "autopilot". Since the start of the year, Fed governors started massaging the message to markets, but the clarity in the FOMC Minutes is striking. A staff presentation suggested that commercial bank reserves, the flip side of asset holdings, may "begin to approach an efficient level later this year". Most participants judged that the level of bank reserves would probably be "somewhat larger than necessary for efficient and effective implementation of monetary policy". Taking all of this into account, we expect the Fed on March 20 to announce details to end the balance sheet run-off by the end of the year. The Fed's balance shrank from around \$4.5tn at the end of Q3 2017 to around \$4tn currently. Keeping the current pace of letting \$50bn/month of assets mature, results in a balance of around \$3.5tn by the end of the year. Afterwards, the Fed still has the possibility of letting eg MBS mature while reinvesting them in US Treasuries and keeping the balance sheet total.

Asian risk sentiment is rather positive overnight. Reuters reported that US-Chinese trade negotiators are working on several memorandums of understanding for a potential deal. Core bonds lost ground and US equity futures gain around 0.5%. Chinese indices threw away gains in the final trading hour after Reuters said that the PBOC isn't ready to cut its benchmark interest rates to boost the slowing economy. US President Trump warned again of imposing tariffs on EU car imports if both fail to reach a new trade deal. So overall, news overnight is mixed. We'd be cautious to be carried away by a stronger European stock market opening. Today's eco calendar contains EMU February PMI's. We expect a further bottoming out after the 2018 slide in PMI's. That could help facilitate and end to the Bund's rally since early October and trigger more sideways action ahead. ECB Minutes might give more insight on the ECB's willingness for additional action (eg new TLTRO's, delaying forward guidance). Several US eco data will be released as well.



German 10-yr yield: break below 0.15% suggests return to 0%.



US 10-yr yield: 2.49%-2.78% sideways range

# Currencies

|                |               |                |
|----------------|---------------|----------------|
| R2             | 1,1815        | -1d            |
| R1             | 1,1621        |                |
| <b>EUR/USD</b> | <b>1,1338</b> | <b>-0,0003</b> |
| S1             | 1,1187        |                |
| S2             | 1,1119        |                |

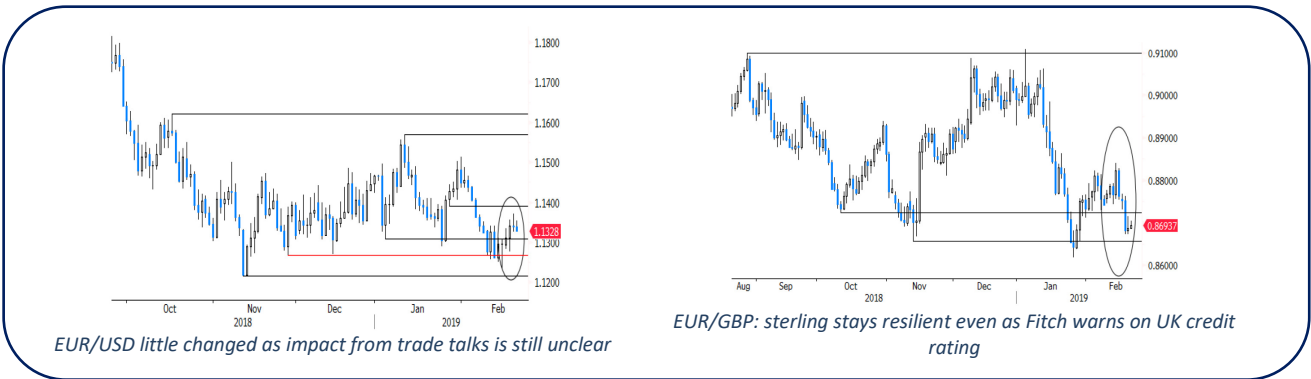
|                |               |               |
|----------------|---------------|---------------|
| R2             | 0,93067       | -1d           |
| R1             | 0,91          |               |
| <b>EUR/GBP</b> | <b>0,8687</b> | <b>0,0007</b> |
| S1             | 0,8620        |               |
| S2             | 0,8314        |               |

## EUR/USD little changed despite progress on trade

The dollar showed **no clear trend yesterday**. EUR/USD (close 1.1338) and the trade-weighted USD (DXY close at 96.45) finished little changed. USD/JPY (close 110.85) gained modest ground, mainly on yen weakness after soft comments from BOJ's Kuroda. The Fed Minutes showed Powell and Co will be patient as they try to find out whether further rate hikes are needed. The balance sheet roll-off will likely end this year. **The USD lost ground before the release of the minutes, but rebounded afterward**. Some investors maybe hoped for hints on possible rate cuts, but this sign didn't come, preventing further USD losses. **Overnight**, Asian equities are (modestly) supported by headlines that the US and China are making good progress on a trade deal (MOU's, a list of products that China will buy to reduce the trade deficit ....). The valuation of the yuan is rumoured to be part of a deal. **The yuan strengthens further** (USD/CNY 6.70 area). The yen reversed earlier strength as the Japan manufacturing PMI fell into contraction territory. EUR/USD is little changed. **The Aussie dollar** initially gained on strong labour market data. However, the Aussie dollar **nosedived** later on an analyst call for rate cuts. Finally, headlines on a Chinese port blocking Austrian coal imports pushed AUD/USD back to the 0.71 area. The calendar is well filled today. EMU February PMI's are expected to stabilize near recent low levels. Are there finally signs that the worst may be over? US data include the Philly Fed business outlook, durable goods orders and existing home sales. **USD traders might be alert for more signs of US eco softness** after last week's poor sales & production data. Headlines on the Sino-US trade talks are a tentative euro positive, but it is **counterbalanced by uncertainty on US import tariffs** on autos.

EUR/USD rebounded off last week lows after some poor US data but sentiment on the euro remains fragile. Of late, we assumed progress on **trade issues** and better EMU data are needed for a more protracted EUR/USD comeback. There are **hopeful signs on trade, but the jury is still out**. EUR/USD 1.1216 marks the Nov low. EUR/USD 1.1287 is 61% retracement (2016 low/2018 top).

**Sterling** maintained most of Tuesday's gains yesterday. EUR/GBP hovered near the 0.87 pivot. The pair is still trading in that area even as Fitch put the UK AA credit rating on negative watch due to the potential negative impact of Brexit. Some headlines suggest progress on the backstop has been made after yesterday's meeting between PM May and EU's Juncker was labelled 'constructive'. Of late, markets tended to be positioned for a scenario that a no-deal Brexit could be avoided. **EUR/GBP 0.8621/17 is key MT support**.



# Calendar

| Thursday, 21 February |  | Consensus  | Previous    |
|-----------------------|--|------------|-------------|
| <b>US</b>             |  |            |             |
| 14:30                 | <b>Philadelphia Fed Business Outlook (Feb)</b>                             | 14.0       | 17.0        |
| 14:30                 | <b>Initial Jobless Claims</b>  | 228k       | 239k        |
| 14:30                 | Continuing Claims  | 1743k      | 1773k       |
| 14:30                 | Durable Goods Orders (Dec P)   | 1.7%       | 0.7%        |
| 14:30                 | Durables Ex Transportation (Dec P)   | 0.3%       | -0.4%       |
| 14:30                 | Cap Goods Orders Nondef Ex Air (Dec P)                                     | 0.2%       | -0.6%       |
| 14:30                 | <b>Cap Goods Ship Nondef Ex Air (Dec P)</b>                                | 0.0%       | -0.2%       |
| 15:45                 | Markit US Manufacturing PMI (Feb P)  | 54.8       | 54.9        |
| 15:45                 | Markit US Services PMI (Feb P)   | 54.3       | 54.2        |
| 15:45                 | Markit US Composite PMI (Feb P)  | --         | 54.4        |
| 16:00                 | Existing Home Sales Total/MoM (Jan)  | 5.00m/0.2% | 4.99m/-6.4% |
| <b>Japan</b>          |  |            |             |
| 01:30                 | <b>Nikkei Japan PMI Mfg (Feb P)</b>  | 48.5A      | 50.3        |
| 05:30                 | All Industry Activity Index MoM (Dec)                                      | -0.4%A     | -0.5%       |
| <b>UK</b>             |  |            |             |
| 10:30                 | Public Finances (PSNCR) (Jan)  | --         | 21.3b       |
| 10:30                 | PSNB ex Banking Groups (Jan)   | -10.0b     | 3.0b        |
| <b>EMU</b>            |  |            |             |
| 10:00                 | Markit Eurozone Manufacturing PMI (Feb P)                                  | 50.3       | 50.5        |
| 10:00                 | Markit Eurozone Services PMI (Feb P)                                       | 51.3       | 51.2        |
| 10:00                 | <b>Markit Eurozone Composite PMI (Feb P)</b>                               | 51.1       | 51.0        |
| <b>Germany</b>        |  |            |             |
| 08:00                 | CPI EU Harmonized MoM/YoY (Jan F)  | -1.0%/1.7% | -1.0%/1.7%  |
| 09:30                 | Markit/BME Germany Manufacturing PMI (Feb P)                               | 49.8       | 49.7        |
| 09:30                 | Markit Germany Services PMI (Feb P)  | 52.9       | 53.0        |
| 09:30                 | <b>Markit/BME Germany Composite PMI (Feb P)</b>                            | 52.0       | 52.1        |
| <b>France</b>         |  |            |             |
| 08:45                 | Business Confidence (Feb)  | 102        | 102         |
| 08:45                 | CPI EU Harmonized MoM/YoY (Jan F)  | -0.6%/1.4% | -0.6%/1.4%  |
| 09:15                 | Markit France Manufacturing PMI (Feb P)                                    | 51.0       | 51.2        |
| 09:15                 | Markit France Services PMI (Feb P)   | 48.5       | 47.8        |
| 09:15                 | <b>Markit France Composite PMI (Feb P)</b>                                 | 48.9       | 48.2        |
| <b>Italy</b>          |  |            |             |
| 10:00                 | CPI EU Harmonized YoY (Jan F)  | 0.9%       | 0.9%        |
| <b>Events</b>         |  |            |             |
| 02:00                 | <b>San Francisco Fed's Daly Speaks in Stanford, California (non-voter)</b> |            |             |
| 09:00                 | <b>ECB's Praet Speaks in Luxembourg</b>                                    |            |             |
| 10:00                 | Publication of the financial statements of the ECB for 2018                |            |             |
| 10:45                 | Spain to Sell Bonds  |            |             |
| 10:50                 | France to Sell Bonds   |            |             |
| 13:30                 | <b>ECB Accounts of the Governing Council's January Meeting</b>             |            |             |
| 14:30                 | <b>ECB's Praet Speaks in Brussels</b>                                      |            |             |
| 13:50                 | <b>Fed's Bostic Speaks on Economy and Monetary Policy (non-voter)</b>      |            |             |
| 19:00                 | US to Sell USD8 Bln 30-Year TIPS   |            |             |

| 10-year    | Close  | -1d     | 2-year     | Close     | -1d     | Stocks      | Close    | -1d    |        |
|------------|--------|---------|------------|-----------|---------|-------------|----------|--------|--------|
| US         | 2,64   | 0,01    | US         | 2,50      | 0,01    | DOW         | 25954,44 | 63,12  |        |
| DE         | 0,10   | 0,00    | DE         | -0,57     | 0,00    | NASDAQ      | 7489,069 | 2,30   |        |
| BE         | 0,65   | -0,02   | BE         | -0,44     | 0,00    | NIKKEI      | 21464,23 | 32,74  |        |
| UK         | 1,18   | 0,01    | UK         | 0,75      | 0,01    | DAX         | 11401,97 | 92,76  |        |
| JP         | -0,04  | -0,01   | JP         | -0,18     | 0,00    | DJ euro-50  | 3259,49  | 20,08  |        |
|            |        |         |            |           |         |             |          |        |        |
| IRS        | EUR    | USD     | GBP        | EUR       | -1d     | -2d         | USD      | -1d    | -2d    |
| 3y         | -0,09  | 2,56    | 1,12       | Eonia     | -0,3700 | -0,0010     | Libor-1  | 2,4823 | 0,0000 |
| 5y         | 0,11   | 2,54    | 1,21       | Euribor-1 | -0,3670 | 0,0000      | Libor-3  | 2,6413 | 0,0000 |
| 10y        | 0,63   | 2,67    | 1,38       | Euribor-3 | -0,3080 | 0,0000      | Libor-6  | 2,7358 | 0,0000 |
|            |        |         |            | Euribor-6 | -0,2310 | 0,0010      |          |        |        |
|            |        |         |            |           |         |             |          |        |        |
| Currencies | Close  | -1d     | Currencies | Close     | -1d     | Commodities | Close    | -1d    |        |
| EUR/USD    | 1,1338 | -0,0003 | EUR/JPY    | 125,68    | 0,23    | CRB         | 183,27   | 1,03   |        |
| USD/JPY    | 110,85 | 0,22    | EUR/GBP    | 0,8687    | 0,0007  | Gold        | 1347,90  | 3,10   |        |
| GBP/USD    | 1,305  | -0,0012 | EUR/CHF    | 1,1350    | -0,0003 | Brent       | 67,08    | 0,63   |        |
| AUD/USD    | 0,7165 | 0,0000  | EUR/SEK    | 10,5692   | 0,0093  |             |          |        |        |
| USD/CAD    | 1,3176 | -0,0035 | EUR/NOK    | 9,7387    | 0,0236  |             |          |        |        |

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## Contacts

| Brussels Research (KBC)           |                  | Global Sales Force           |                  |
|-----------------------------------|------------------|------------------------------|------------------|
| Mathias Van der Jeugt             | +32 2 417 51 94  | Corporate Desk(Brussels)     | +32 2 417 45 82  |
| Peter Wuyts                       | +32 2 417 32 35  | Institutional Desk(Brussels) | +32 2 417 46 25  |
| Mathias Janssens                  | +32 2 417 51 95  | CBC Desk (Brussels)          | +32 2 547 19 19  |
| Dieter Lapeire                    | +32 2 417 25 47  | France                       | +32 2 417 32 65  |
| <b>Dublin Research</b>            |                  | London                       | +44 207 256 4848 |
| Austin Hughes                     | +353 1 664 6889  | Singapore                    | +65 533 34 10    |
| Shawn Britton                     | +353 1 664 6892  |                              |                  |
| <b>Prague Research (CSOB)</b>     |                  | <b>Prague</b>                | +420 2 6135 3535 |
| Jan Cermak                        | +420 2 6135 3578 |                              |                  |
| Jan Bures                         | +420 2 6135 3574 |                              |                  |
| <b>Bratislava Research (CSOB)</b> |                  | <b>Bratislava</b>            | +421 2 5966 8820 |
| Marek Gabris                      | +421 2 5966 8809 |                              |                  |
| <b>Budapest Research</b>          |                  | <b>Budapest</b>              | +36 1 328 99 85  |
| David Nemeth                      | +36 1 328 9989   |                              |                  |

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