KBC

Sunrise

Thursday, 21 September 2017

Rates: Flattening US yield curve after Fed verdict

US Treasuries lost ground yesterday after the FOMC decision, flattening the yield curve. We conclude that US Treasuries re-entered a sell-on-upticks phase after the Fed confirmed his view on 2017/2018 interest rate policy. A December rate hike isn't fully discounted yet. Short term though, we could get some correction higher after a nine straight days decline.

Currencies: Will Fed's 'normalization commitment' finally support the dollar?

The dollar jumped higher across the board yesterday as the Fed indicated that it wants to continue a gradual rate hike cycle. Of late markets hardly believed the Fed's intentions. Will this time be different? A break below the EUR/USD 1.1823 correction is needed soon in order to create a more constructive sentiment on the US currency.

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 dropped on the FOMC decision,** but it was a knee-jerk reaction and main indices closed narrowly mixed. A **similar picture in Asia overnight,** as markets have difficulties to find a firm direction (firmer dollar).
- **The Fed indicated it remained on track to raise short-term rates** later this year and said it would **begin shrinking its portfolio of bonds next month**, starting to close the books on an unprecedented and controversial policy experiment.
- The **Bank of Japan kept monetary stimulus unchanged**, but a dovish new board member opposed the decision in his first meeting, an unexpected dissension on a board chosen entirely by Prime Minister Shinzo Abe.
- **Spain's government is willing to discuss giving Catalonia more money and greater financial autonomy** if the region backs down from its demands for independence, one of Madrid's senior ministers has told the Financial Times.
- **Greece is considering swapping 20 small bond issues for a few new ones**, as it prepares to exit its bailout. It would consolidate the secondary market into a few liquid benchmark issues.
- Shares in Australian gold miners were down as the **price of the precious metal neared a one-month low after the US central bank** said it would start to reverse its crisis-era stimulus programme from next month.
- **Today's calendar** contains the Philly Fed business survey and EMU consumer confidence. ECB Praet and Smets speak. France, Spain and the US tap the bond markets. The Norges Banks meets and the Riksbank publishes Minutes.

Rates

US yield curve bear flattens as Fed sticks to its plan

US curve flattens after FOMC decisions

Fed starts BS run-off

Fed sticks to 2017/2018 dots, while lowering the neutral rate

	US yield	-1d
2	1,44	0,04
5	1,87	0,04
10	2,27	0,02
30	2,81	-0,01

	DE yield	-1d
2	-0,69	0,00
5	-0,25	0,00
10	0,44	-0,01
30	1,30	-0,02

German bonds moved modestly higher before the FOMC meeting ended, ignoring hawkish comments of ECB Knot. Following the steep decline in the past week, there were apparently some bottom fishers at work. **However, the real deal yesterday was the FOMC meeting.** The FOMC, as expected, kept rates unchanged and announced the start of a gradual and predictable balance sheet run-off. **The FOMC struck nevertheless a rather hawkish tone, especially when compared to the market's view. It has no big concerns about the decline in inflation,** which was characterised as due to cyclical unrelated one-off factors. Yellen re-affirmed that the **Phillips curve was still valid** and tighter labour market conditions would push wages and inflation higher. (see KBC Flash)

The **FOMC explicitly said the damage of the hurricanes would cause only some volatility in the data**, but wouldn't' t affect the moderate underlying momentum. **The FOMC's message of sticking to the course was reflected in the dot plot.** The median rate for the end of 2017, 1.375%, still discounts one more 25 bps rate increase. For end 2018, the median suggests 3 additional 25 bps rate increases (to 2.125%), unchanged from June. The median projection for end 2019 fell from 2.93% in June to 2.68% now. That means 2 rate increases in 2019. For 2020, the median rate projection is 2.875%, which suggests one final rate increase to lift the FF rate above its projected long run rate of 2.75%, which was lowered from 3% in June. **The Fed actually suggests that its policy will get really restrictive by putting the 2020 projection above the neutral rate.** US Treasuries reacted promptly, as did other markets. The gap between the Fed's rate projections and market expectations remains wide as ever though, despite the increase in yields. **The curve bear flattened** with yields up about 4 bps at the shorter end and up 2.1 bps at the 10-yr tenor, while the 30-yr yield fell 1.2 bps.

Calendar contains eco data, auctions & ECB speakers

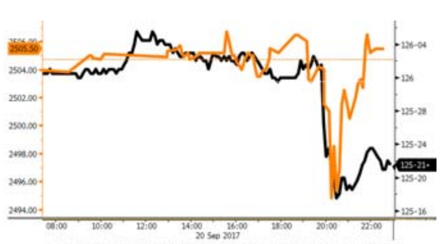
Philly Fed survey wildcard

EMU consumer confidence to be strong, but as expected

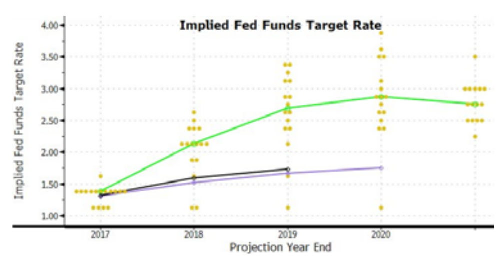
Riksbank and ECB to publish Minutes and bulletin

Norske Bank to decide on rates

EMU Consumer confidence is expected to have stabilized in September, just below its cyclical highs. We have no reasons to expect a decline in confidence. The debate surrounding the ECB's APP programme is in full swing. Various national governors already showed their preferences, but the outcome is far from certain. **ECB Smets and Praet** are close to Mario Draghi and key players inside the ECB. So, any comments from them on the fate of APP won't go unnoticed. The monthly **ECB bulletin** probably won't touch upon the current key issues (APP, euro). **US initial claims** are expected to rise further as a result of the tropical storms. Markets will ignore the increase as noise. The **Philly Fed business survey** is expected to show a stable, but strong headline figure (17.1).



T-Note future (black) & S&P future (orange) (intraday): Clear-cut downward reaction of bonds on FOMC outcome



Sept Fed dot plot: December hike well supported by Fed governors, but gap with market expectations remain very wide.

R2	163,43	-1d
R1	161,66	
BUND	160,94	0,23
S1	160,49	
S2	160,5	

France and Spain conclude EMU bond supply

France and Spain conclude this week's scheduled EMU bond supply. **The French Treasury taps two OAT's (0% Feb2020 & 1.75% Nov2024) and launches a new one (0% Mar2023) for a combined €6-7B.** The relatively low amount on offer should be easy to digest for investors. Additionally, France will try to raise €1.5-22B via tapping three inflation-linked notes. Th**e Spanish debt agency auctions a 3-yr Bono (0.05% Jan2021) and taps three Obligacions (1.3% Oct2026), 5.15% Oct2028 & 5.15% Oct2044)** for a total amount of €4-5B. Tensions between Madrid and Barcelona over the Catalan secession referendum had only limited impact on Spanish bonds so far, but we nevertheless believe that they could hamper demand today.

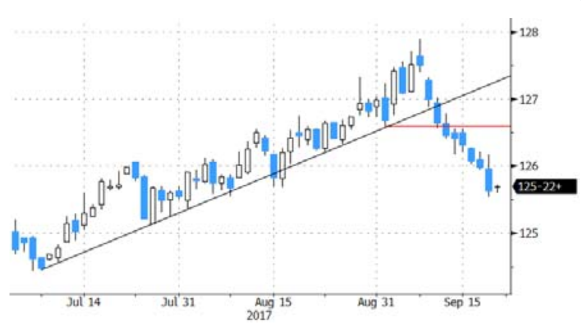
Flattening US yield curve after Fed verdict

US Treasuries lost ground yesterday after the FOMC decision, flattening the yield curve. Overnight, the decline in the US Note future halted, as did the rise in USD/JPY. Asian risk sentiment is mixed. We expect the Bund to open near levels reached in after-market trading.

Today's eco calendar contains some EMU/US eco data, but these won't be relevant for trading. **Digesting the FOMC statement will be key. We conclude that US Treasuries re-entered a sell-on-upticks phase after the Fed confirmed his view on 2017/2018 interest rate policy. A December rate hike isn't fully discounted yet. Short term though, we could get some correction higher after a nine straight days decline.** ECB speakers are a wildcard today. They could give first guidance of what to expect at the October policy meeting (future APP). We hold a sell-on-upticks view in the Bund as well.

From a technical point of view, both the Bund and the US Note future fell below uptrend lines (early September) since the Start of Summer, making the picture neutral from bullish.

German Bund: Draghi delays key decisions to October. Speculation on APP announcement could inflict more losses, especially with Fed also staying on normalization course



US Note future: Hawkish Fed inflicts more losses on US Treasuries. Correction higher possible on stretched move, but sell-on-upticks

Currencies

Dollar jumps as Fed maintains course

Dollar profits as Fed continues its policy normalization

R2	1,2225	-1d
R1	1,2167	
EUR/USD	1,1892	-0,0102
S1	1,1662	
S2	1,1311	

Yesterday, the Fed, as expected, announced the start of the run-off of its balance sheet, while the policy rate was left unchanged. The Fed kept its rate path (median dots) of one more 25 bps rate increase this year and three next year. The process of gradual policy normalisation will continue even as several uncertainties remain. US yields rose modestly and the curve flattened. The dollar reacted accordingly. EUR/USD tumbled from about 1.20 to the 1.1862 area and closed the session at 1.1892. USD/JPY jumped to the mid 112 area and finished at 112.22.

Asian equities trading mixed

BOJ keeps policy unchanged. Policy divergence with other major CB's persists

USD maintains post-Fed gains

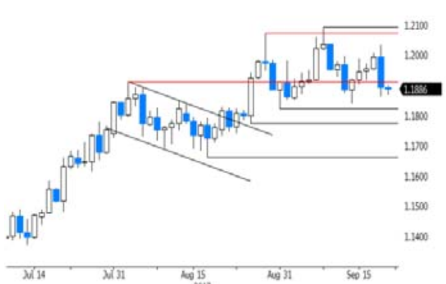
Yen weakens slightly further

Overnight, Asian equities are trading mixed. A stronger dollar and higher US yields are a mixed factor for Asian/EM markets. **The BOJ, as expected, left its policy (target rates and asset purchases) unchanged.** A new member, Kataoka, dissented as he saw little chance of the BOJ reaching its target in 2019. So, there was a soft note in the policy decision. Even so, USD/JPY makes only modest additional gains after yesterday's post-Fed rally. USD/JPY trades at 112.43. EUR/USD stabilizes around 1.1885.

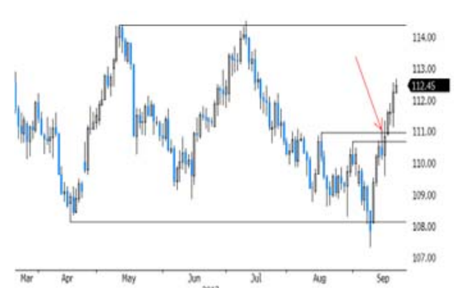
Today, the calendar contains EMU consumer confidence and speeches of ECB Praet and Smets. **Consumer confidence** is expected stable, just below its cyclical highs. The debate on the ECB's APP programme is in full swing. **Smets and Praet** are close to Mario Draghi and key players inside the ECB. So, any comments from them on the fate of APP won't go unnoticed. **In the US**, **initial claims** are expected to rise as a result of the tropical storms. Markets will ignore the increase as noise. The **Philly Fed business survey** is expected to show a stable, but strong headline figure (17.1). The headline index was volatile since the start of the year, but on the positive side. A good report might be slightly USD supportive.

Will markets give more credence to Fed-message; opening the way for a modest USD comeback?

Investors will take a second look at yesterday's Fed policy decision. The dollar made a nice rebound, but EUR/USD still didn't break any technically important level. The Fed assessment basically remains unchanged. **Question is whether markets will gradually give more credence to the Fed rate path than they did until now**. We see a chance for a modest dollar comeback as yesterday's Fed 'guidance' suggest that there is little reason for US yields to decline again from current levels unless there comes high profile negative news. A fast break below EUR/USD the 1.1823 ST range bottom would be an indication that the USD rebound has somewhat further to go. Otherwise, doubts will soon return.



EUR/USD: will the dollar be able to capitalize on Fed normalization call?



USD/JPY remains well bid, both an USD strength and yen weakness

From a technical point of view EUR/USD hovers in a consolidation pattern between 1.1823 and 1.2070. It was disappointing for EUR/USD bears that last week's correction didn't reach the range bottom. **More confirmation is needed that the bottoming out process in US yields and in the dollar might be the start of more sustained USD gains (against the euro). In case of a break, next support in EUR/USD comes in at 1.1774 and 1.1662**

The day-to-day momentum in **USD/JPY** remains more constructive. The yen trades weak across the board and the dollar might be in better shape post-Fed. USD/JPY regained the 110.67/95 previous resistance. This a short-term positive. The yen might stay under pressure at least until the next event risk pops up. The 114. 49 correction top is the next important reference.

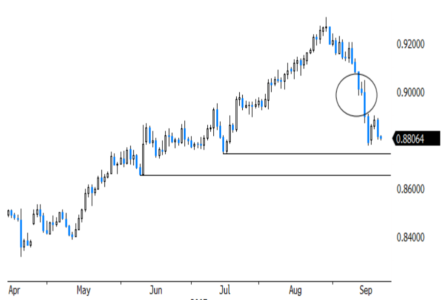
EUR/GBP nears again the correction low

R2	0,9415	-1d
R1	0,9307	
EUR/GBP	0,8813	-0,0068
S1	0,8743	
S2	0,8657	

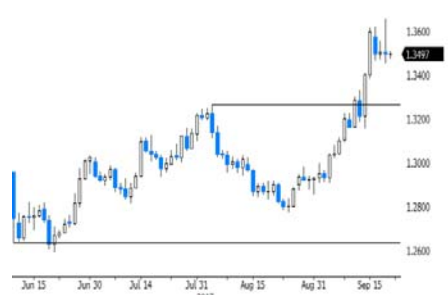
Yesterday , UK August retail sales were reported strong, supporting **the recent BoE call for a rate rise in the coming months.** A first sterling rebound after the report was short-lived and EUR/GBP returned to the 0.8880 area. This suggested that the GBP rally was losing momentum. However, EUR/GBP gradually declined again later on during the US session. The decline of EUR/GBP accelerated in line EUR/USD after the Fed policy decision. The pair closed the session at 0.8813. Cable finished the session little changed at 1.3495, a good sterling performance.

Today, the UK public finance data will be published, but they are at best only of intraday significance. **Markets will look forward to the speech of UK MP on Brexit tomorrow in Italy.** Earlier this week, it looked the speech could give the Brexit process a new positive dynamic, but recent comments sounded again sceptical. In this context, is there room for further GBP gains? Will EUR/GBP feel some pressure from a further decline in EUR/USD? Last week's correction low at 0.878 is a first key support.

EUR/GBP made an impressive uptrend since April and set a MT top at 0.9307 late August. The euro was strong and UK price data were soft enough to keep the BoE side-lined. **Recent UK price data amended this story** and the ST-trend reversal of sterling was reinforced by hawkish BoE comments. Medium term, we maintain a **EUR/GBP buy-on-dips approach as we expect the mix of relative euro strength and sterling softness to persist. However, the prospect of (limited) withdrawal of BOE stimulus put a solid floor for sterling ST term. We look out how far the current correction has to go. EUR/GBP is nearing support at 0.8743 and 0.8652, which we consider difficult to break. We start looking to buy EUR/GBP on dips.**



EUR/GBP: GBP-rebound rebound slows



GBP/USD: running into resistance?

Calendar

Thu., 21 September		Consensus	Previous
US			
14:30	**Initial Jobless Claims**	**302K**	**284K**
14:30	Continuing Claims	1975K	1944K
14:30	**Philadelphia Fed Business Outlook (Sep)**	**17.1**	**18.9**
15:00	FHFA House Price Index MoM (Jul)	0.4%	0.1%
Japan			
	BOJ Policy Balance Rate	**A -0.100%**	**-0.100%**
	BOJ 10-Yr Yield Target	**A 0.000%**	**0.000%**
06:30	All industry activity index (July) M/M	A-0.1%	R 0.2%%
08:00	Nationwide Dept Sales YoY (Aug)	--	-1.4%
UK			
10:30	Public Finances (PSNCR) (Aug)	--	-3.9B
EMU			
16:00	Consumer Confidence (Sep A)	-1.5	-1.5
Norway			
10:00	**Deposit Rates**	**0.50%**	**0.50%**
Events			
08:55	**ECB's Frank Smets speaks in Frankfurt (lessons of the past, lessons for the future?)**		
09:30	Riksbank Publishes Minutes from September Meeting		
10:00	ECB Publishes Economic Bulletin		
10:30	Spain to Sell Bonds (0.05% 2021, 1.3% 2026 and 5.15% 2028 bonds)		
10:50	France Sell Bonds (0% 2020 BTAN, 0% 2023 OAT and 1.75% OAT 2024 bonds and IL 2021/28/30)		
11:30	**ECB Executive Board member Praet chairs a panel in Frankfurt (see above)**		
15:30	**ECB President Mario Draghi speaks as chair of European Systemic Risk Board**		
19:00	US Treasury sells $11B 10-yr TIPS re-opening		

10-year	Close	-1d		**2-year**	td	-1d	**Stocks**	Close	-1d
US	2,27	0,02		**US**	1,44	0,04	**DOW**	22412,59	41,79
DE	0,44	-0,01		**DE**	-0,69	0,00	**NASDAQ**	6456,044	-5,28
BE	0,73	0,00		**BE**	-0,52	0,00	**NIKKEI**	20347,48	37,02
UK	1,34	0,01		**UK**	0,45	0,03	**DAX**	12569,17	7,38
JP	0,03	0,00		**JP**	-0,12	0,00	**DJ euro-50**	3525,55	-5,63

IRS	EUR	USD	GBP	**EUR**	-1d	-2d	**USD**	-1d	-2d
3y	-0,06	1,80	0,91	**Eonia**	-0,3600	0,0010			
5y	0,24	1,96	1,09	**Euribor-1**	-0,3730	0,0000	**Libor-1**	1,2372	0,0000
10y	0,87	2,23	1,39	**Euribor-3**	-0,3290	0,0010	**Libor-3**	1,3261	0,0000
				Euribor-6	-0,2710	0,0010	**Libor-6**	1,4786	0,0000

Currencies	Close	-1d	**Currencies**	Close	-1d	**Commodities**	Close	-1d
EUR/USD	1,1892	-0,0102	**EUR/JPY**	133,46	-0,39	**CRB**	184,63	2,06
USD/JPY	112,22	0,63	**EUR/GBP**	0,8813	-0,0068	**Gold**	1316,40	5,80
GBP/USD	1,3495	-0,0008	**EUR/CHF**	1,1536	-0,0012	**Brent**	56,29	1,15
AUD/USD	0,8031	0,0021	**EUR/SEK**	9,5302	-0,0079			
USD/CAD	1,2323	0,0031	**EUR/NOK**	9,3563	0,0033			

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)			
Jan Cermak	+420 2 6135 3578	Prague	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	Budapest	+36 1 328 99 85

ALL OUR REPORTS ARE AVAILABLE VIA OUR KBC RESEARCH APP (iPhone, iPad, Android)