



Sunrise

Wednesday, 22 February 2017

Rates: Bund resistance should hold, underperformance US Treasuries?

Risks for the German IFO are on the upside of expectations which should keep the Bund below key resistance (164.90). EMU markets remain sensitive to French election news, which is a wildcard. The FOMC Minutes aren't expected to reveal much new info after last week's Yellen testimony. We nevertheless think that US Treasuries will underperform Bunds.

Currencies: EUR/GBP tests 0.8450 support

The dollar remains in the drivers' seat as the reflation trade continues. EUR/USD tests the short-lows in the low 1.05 area, but this decline is also for an important part due to euro weakness. For now, this pattern might continue. Euro weakness also pushes EUR/GBP for a new test of the 0.8450 support area.

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 extended their record race**, gaining more than 0.5% after Monday's public holiday. **Overnight**, Asian equity sentiment is less bullish, with most indices recording small gains.
- **Shares in Fannie Mae and Freddie Max tumbled by more than a third** on after a court struck a blow to a group of investors in their quest to overturn the government's decision to take all of the US mortgage giants' profits.
- **China home prices increased last month in the fewest cities in a year**, signalling property curbs to deflate a potential housing bubble are taking effect. New home prices, excl. subsidized housing, gained last month in 45 of the 70 cities
- **BoJ Governor Kuroda said the chance the central bank will deepen negative interest rates is low for now**, backing market expectations that no additional monetary easing is forthcoming in the near future.
- The head of Australia's central bank, **Lowe, gave the clearest signal yet that further cuts in interest rates would not be in the national interest** as the danger of a debt-fuelled boom and bust was just too severe.
- **Political uncertainty is slowing trade growth, a World Bank report has concluded**, indicating that the rise of Donald Trump may already be casting a shadow over the global economy.
- **Cleveland Fed Mester said policy makers don't want to surprise the market** on interest rates and they have to be "nimble" to adjust their outlook amid global and domestic risks.
- **Today's eco calendar** contains German IFO, the second reading of UK Q2 GDP, finale EMU CPI data, US existing home sales and **FOMC Minutes**. **Fed Powell** speaks on the economic outlook and **Germany and the US tap the market**.

Rates

Bonds recoup losses despite strong equities & higher oil

Core bonds profit from French election uncertainty which compensates strong PMI's.

Short end French and peripheral curves underperform as redenomination risk is priced in.

Yesterday, global core bonds lost modest to moderate ground in the European and US morning session, as EMU business sentiment surged, suggesting that euro area growth is still accelerating. The initial decline went gradual and hand in hand with rising equities and higher oil prices. All in all, the decline remained modest, partly as uncertainties about the European election season, and especially the French presidential race, were omnipresent. **The turnaround was triggered by a weak US Markit PMI, which is usually completely ignored and by another French poll showing that Le Pen's chances for winning the second round, while still a long shot, are improving. Core bonds erased initial PMI-initiated losses. At that time, the cash markets were closed.** The French curve bear flattened with 2- and 5-yr yields 3 and 4 bps higher. The 2-yr yield spread between Germany and France even moved as high as 45 bps, suggesting that **investors start to price in redenomination risk. A similar underperformance of the shorter (but here also longer) end was visible on the Italian curve.**

	US yield	-1d
2	1,24	0,03
5	1,94	0,02
10	2,45	0,01
30	3,05	0,01

	DE yield	-1d
2	-0,86	-0,02
5	-0,49	-0,01
10	0,30	-0,01
30	1,13	0,02

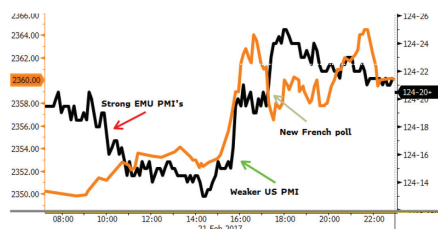
In a daily perspective, the German yield curve was little changed and marginally steeper with yield changes varying between -1.5 bps (2-yr) and +1 bp (30-yr). US yields ended 1.4 to 1.8 bps higher. **On intra-EMU bond markets,** 10-yr yield spread changes versus Germany ranged from +3 bps for France to +6/7 bps for Italy and Spain (see higher). Greece (-33 bps) outperformed as the probability of a successful conclusion of the bail-out review and the ability to pay the maturing Greek bonds in July (about €6B) increases. .

German IFO and US Fed Minutes eye-catchers today

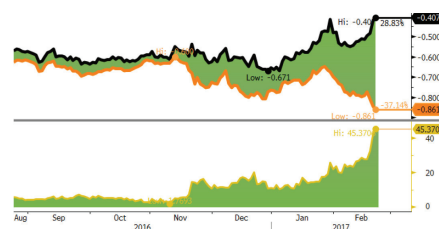
Upside risks IFO business sentiment

Will Minutes surprise? We don't think so

The German IFO is expected marginally weaker in February at 109.6 (from 109.8) after a heavy drop in January. However, after very strong German PMI's yesterday, **we put the risks on the upside of consensus.** In the US, attention goes to **the January FOMC Minutes.** We don't expect the Minutes to be shocking, as they follow chairwoman Yellen's (rather hawkish) testimony before Congress last week. They probably won't give us new insight in the timing of the next rate hike. The January FOMC statement showed no hints of a nearby rate increase and the decision to keep rates unchanged was unanimous. However, **the economic data have been very strong and inflation surprised on the upside recently.** Yellen was more hawkish at her testimony when she said *"it would be unwise to wait too long before tightening"* and a number of governors like Harker, Kaplan, both voters explicitly pointed to the possibility of a March rate hike. We still think a June hike (even as May is a possibility) is more likely, because Trump's fiscal plans aren't known yet, but surprises aren't excluded. We are curious whether there are some hints about the balance sheet tapering.



T-Note future (black) & S&P (orange) (intraday): Both up. Core bonds erase initial losses on weak US ISM and election uncertainty



German-French 2-yr yield spread up sharply, as some investors fear redenomination.

German and US auctions

R2	165,48	-1d
R1	164,90	
BUND	164,38	-0,12
S1	160,72	
S2	159,91	

The German Finanzagentur taps the off the run 30-yr Bund (€1B 2.5% Jul2044).

Total bids at the previous 4 30-yr Bund auctions averaged only €1.27B. The Bund traded rather stable in ASW spread terms going into the auction, but is the cheapest German bond at the very long end of the curve. We expect a plain vanilla auction.

The US Treasury started its end-of-month refinancing operation with a strong \$26B 2-yr Note auction. The auction stopped through the 1:00 pm bid side with the strongest bid cover since August (2.82). Bidding details were very strong, especially the indirect and direct bids. Today, the US Treasury continues its operation with \$13 2-yr FRN and \$34B 5-yr Note auctions. Currently, the WI of the latter trades around 1.94%.

Underperformance US Treasuries vs Bunds?

Overnight, most Asian stock markets eke out small gains, but risk sentiment is less bullish than yesterday in US dealings. The US Note future nevertheless trades with a downward bias and Brent crude is a tad higher. We expect a softer opening for the Bund as well.

Today's eco calendar contains German IFO. Risks are tilted to the upside of expectations, which should keep the Bund away from nearby 164.90 resistance (0.29% support for German 10-yr yield). In US dealings, focus shifts to the FOMC Minutes. Last week's Yellen's testimony suggests that they won't reveal new info: the Fed doesn't want to wait too long to hike rates, but the impact of future fiscal policy remains uncertain. French election worries could continue to dampen (EMU) equity and bond sentiment (spread widening) and are a wildcard for trading, while the Eurogroup put the Greek issue to bed for some time.

US Treasuries start underperforming Bunds. Last week's Yellen testimony, hawkish Fed comments and strong US eco data temporary raised odds of a March rate hike to 44% (currently 38%). We don't expect a March move and feel comfortable by comments of Fed Mester who said that the Fed doesn't want to surprise markets. In the run-up to Trump's phenomenal fiscal stimulus plans (Feb 28?), the US Note future could return towards the December low around 122-14+.



German Bund: EMU worries push Bund back towards key 164.90 resistance. We don't expect a break higher.



US Note future: new test of 125-09/16 resistance failed. Yellen's testimony & strong data cap the topside and suggest move lower in range ahead of Trump's fiscal stimulus plans

Currencies

'By default' USD buying continues

Dollar stays in the drivers' seat as the reflation trade continues.

R2	1,1145	-1d
R1	1,0874	
EUR/USD	1,0528	-0,0058
S1	1,0341	
S2	1,0000	

Asian equities extend rally

Dollar loses a few ticks and comments from Fed's Mester

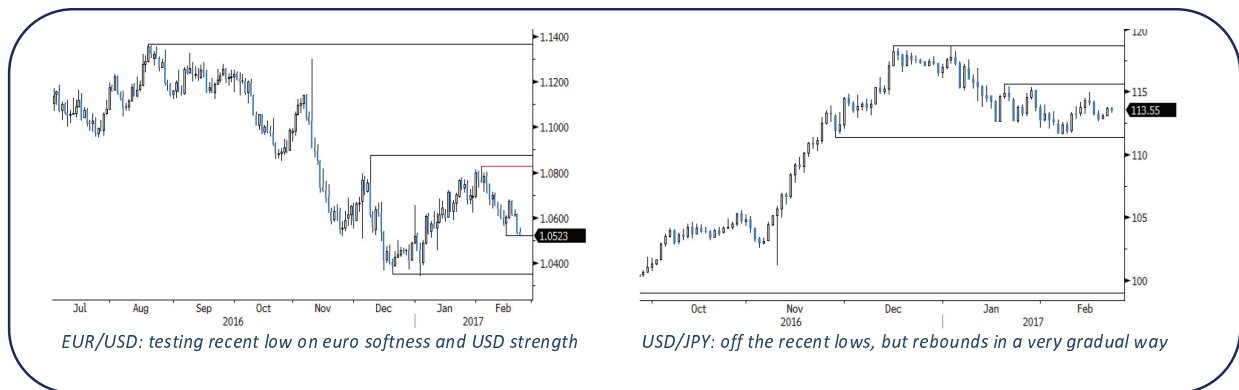
Eco calendar moderately interesting

Fed minutes in focus

EMU PMI's were stronger than expected yesterday. Core (German and US) yields and equities rose after the PMI release, but didn't help the euro. France remained a euro negative and the resumption of the reflation trade supported the dollar. The rally slowed later in the session as US bond yields softened. Even so, the US currency still closed the session with decent gains. EUR/USD closed the session at 1.0536 (from the 1.0614) area. USD/JPY finished the day at 113.68 (from 113.10).

Overnight, most Asian equities indices follow the rally from the US yesterday. Japanese equities struggle to avoid loses as USD/JPY lost modest ground. In a speech in Singapore, Fed Mester sounded a bit dovish as she said that the Fed doesn't want to surprise markets on interest rates. The dollar, especially USD/JPY, softened a bit. At the same time, US bond yields maintain a slightly upward bias. So, there is again a slight discrepancy across markets. USD/JPY is trading near 113.50. EUR/USD changes hands in the 1.0525 area. RBA's Lowe warned on the debt load of Australian households. At the margin, the risk of too high debt might make the RBA cautions to cut rates further. AUD/USD rises slightly overnight, currently trading in the 0.7690 area.

Today, the German IFO is expected slightly softer at 109.6 (from 109.8). After strong German PMI's, an upward surprise is possible. In the US, the Minutes of the January FOMC meeting are in focus. They probably won't give us new insight in the timing of the next rate hike. However, since the meeting, **economic data have been very strong and inflation surprised on the upside**. Yellen was more hawkish at the testimony before Congress as she said "it would be unwise to wait too long before tightening". Several governors pointed to the possibility of a March rate hike. A slightly hawkish tone in the Minutes shouldn't come as a surprise. **Over the previous days**, French election worries fuelled uncertainty on European markets (French spread widening). It weighed on the euro and supported USD/EUR gains, as the global/US reflation trade continues. Call it by default USD buying/euro selling. USD/JPY underperformed the USD/EUR gains. The political uncertainty in Europe will continue to play its role. At the same time, the focus in the US will turn to Trump's fiscal plan and Fed comments. **The combination of both factors suggests further USD buying against a weak euro**. We maintain a more cautious bias on USD/JPY. Selling pressure from EUR/JPY might continue to weigh.



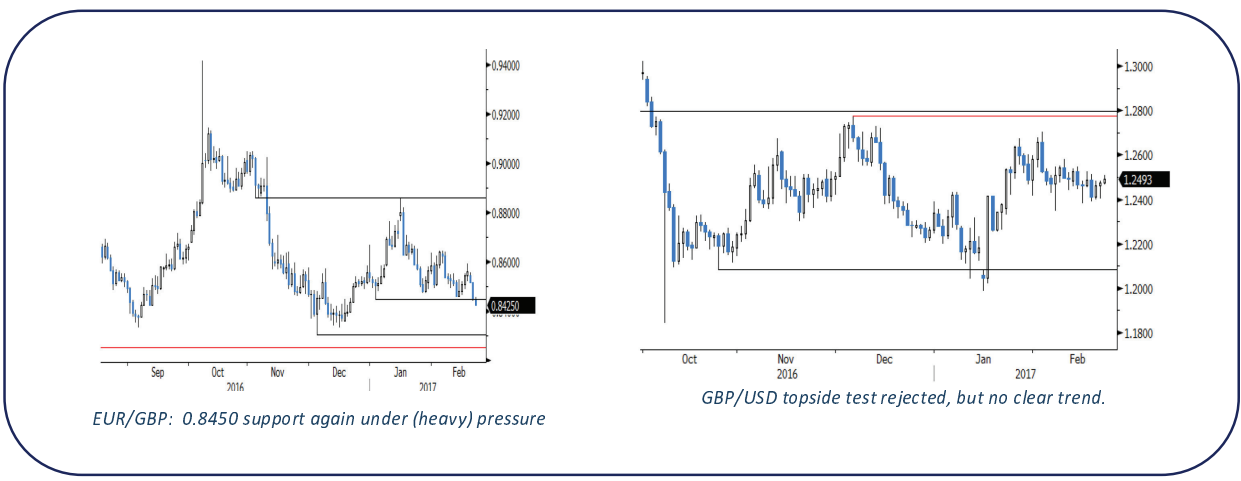
Global context. The dollar corrected lower since the start of January as the Trump reflation trade slowed down. **Two weeks ago, the dollar bottomed out, supported by Trump’s tax promise. Underlying euro weakness due to political uncertainty in the area is a factor too. We see 1.0874 as solid resistance and favour a sell EUR/USD on upticks approach. The downside test of USD/JPY is also rejected.** USD/JPY 111.16 (38% retracement of the 99.02/118.66 rally) remains a key support. The comments of Yellen before Congress (and of other Fed members) were USD supportive, but had little lasting impact on yields. We keep a cautious USD positive bias, but remain more cautious on the upside potential of USD/JPY compared to USD/EUR.

EUR/GBP sliding below 0.8450 support.

Yesterday, sterling gained ground against an overall weak euro, but stabilized against broadly strong dollar. At a hearing before Parliament, BoE’s Carney defended the assessment of the February inflation report. The central bank raised its growth forecast, but kept its inflation forecast unchanged as the BoE said that unemployment could decline further before wages rise. Some BoE governors disputed Carney’s assessment. Even so, sterling remained well bid. Especially, **EUR/GBP was pressured by the decline of EUR/USD. The pair closed the session at 0.8448, testing the key 0.8450 support. Cable close the session at 1.2474 (from 1.2463).**

R2	0,8645	-1d
R1	0,8592	
EUR/GBP	0,8427	-0,0073
S1	0,8304	
S2	0,8117	

Overnight, EUR/GBP is extending its test beyond the 0.8450 support. Euro weakness remains the driver. The first stage of the Brexit debate in the House of Lords didn’t bring any new roadblocks for PM May. The next step is scheduled for early next week. The risk-on context is also a ST sterling supportive. Later today, the details of the UK GDP Q4 GDP will be published. A confirmation of the 0.6% Q/Q and 2.2% Y/Y growth is expected. We don’t expect a lasting impact on sterling trading. **EUR/GBP recently hovered in a tight range north of the 0.8450 support.** Sterling sentiment softened slightly as the market feels that a BoE rate hike is still very far away. At the same time, euro softness weighed on EUR/GBP. **Longer term, we have a sterling negative view as the Brexit still has to (negatively) impact the UK economy.** However, this is no issue at this stage. Euro weakness prevails. A sustained break below the **0.8450 might trigger additional stop-loss selling. The EUR/GBP 0.8304 correction low is the next key support.**



Calendar

Wed., 22 February		Consensus	Previous
US			
16:00	Existing Home Sales / MoM (Jan)	5.55m/1.1%	5.49m/-2.8%
20:00	FOMC Meeting Minutes	--	--
UK			
10:30	GDP QoQ / YoY (4Q P)	0.6%/2.2%	0.6%/2.2%
10:30	Private Consumption QoQ (4Q P)	0.7%	0.7%
10:30	Government Spending QoQ (4Q P)	0.1%	0.0%
10:30	Gross Fixed Capital Formation QoQ (4Q P)	0.2%	0.9%
10:30	Exports QoQ / Imports QoQ (4Q P)	2% / 0.3%	-2.6%/1.4%
10:30	Index of Services MoM & 3M/3M (Dec)	0.1%/0.8%	0.3%/1.0%
10:30	Total Business Investment QoQ / YoY (4Q P)	0.1%/0.3%	0.4%/-2.2%
EMU			
11:00	CPI MoM / YoY (Jan F)	-0.8%/1.8%	0.5%/1.8%
11:00	CPI Core YoY (Jan F)	0.9%	0.9%
Germany			
10:00	IFO Business Climate (Feb)	109.6	109.8
10:00	IFO Expectations (Feb)	103	103.2
10:00	IFO Current Assessment (Feb)	116.6	116.9
Italy			
10:00	CPI EU Harmonized YoY (Jan F)	0.7%	0.7%
Belgium			
15:00	Business Confidence (Feb)	0.9	0.5
Norway			
08:00	Unemployment Rate AKU (Dec)	4.7%	4.7%
Events			
11:30	Germany to Sell €1B 2.5% 2044 Bonds		
12:00	BoE Jon Cunliffe speaks in London		
12:30	BoE Shafik in twitter Q&A (speaks also in Oxford at 31:00)		
17:30 & 19:00	US to sell \$13B 2-yr FRN Notes & \$34B 5-yr Notes		
19:00	Fed's Powell Speaks on Economic Outlook in New York		

10-year	td	-1d	2-year	td	-1d	Stocks	td	-1d	
US	2,45	0,01	US	1,24	0,03	DOW	20743	118,95	
DE	0,30	-0,01	DE	-0,86	-0,02	NASDAQ	5865,949	27,37	
BE	0,86	-0,01	BE	-0,49	0,00	NIKKEI	19379,87	-1,57	
UK	1,24	0,01	UK	0,10	0,00	DAX	11967,49	139,87	
JP	0,08	-0,01	JP	-0,26	-0,02	DJ euro-50	3339,33	26,94	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	td	-1d
3y	-0,07	1,79	0,68	Eonia	-0,3560	-0,0020			
5y	0,14	2,06	0,88	Euribor-1	-0,3700	-0,0010	Libor-1	0,7772	-0,0022
10y	0,77	2,43	1,29	Euribor-3	-0,3290	0,0000	Libor-3	1,0501	-0,0022
				Euribor-6	-0,2380	0,0000	Libor-6	1,3571	-0,0003
Currencies	td	-1d	Currencies	td	-1d	Commodities	td	-1d	
EUR/USD	1,0528	-0,0058	EUR/JPY	119,44	-0,74	CRB	192,05	-0,07	
USD/JPY	113,45	-0,07	EUR/GBP	0,8427	-0,0073	Gold	1235,10	-0,50	
GBP/USD	1,2493	0,0040	EUR/CHF	1,0640	-0,0002	Brent	56,82	0,59	
AUD/USD	0,769	0,0018	EUR/SEK	9,4541	-0,0299				
USD/CAD	1,3137	0,0000	EUR/NOK	8,8016	-0,0438				

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