Sunrise

Wednesday, 24 May 2017

Due to National Holidays, there will be no KBC Sunrise on Thursday the 25th and Friday the 26th of May 2017. Next KBC Sunrise will be published on Monday the 29th of May 2017.

Rates: Range trading remains in vogue

Yesterday, some modest further losses, which pushes core bonds back lower in the reach, while equities recaptured the highs. Today, the calendar is thin. Surprises are possible from the ECB speakers or FOMC Minutes, but overall we bet on another technical driven bond session.

Currencies: Dollar decline shows tentative signs of slowing

Yesterday, the dollar finally rebounded supported by a rise in equities and US yields; Today, the focus is on the Minutes of the May FOMC meeting. More signs that the Fed normalization process will continue might help to put a floor underr the dollar. Equities remain a wild card.

Calendarok

Headlines

- **US equities** rallied for the fourth day in a row, leaving the S&P 500 within striking distance of its all-time high at the close. Financials outperformed and recouped last Wednesday's rout. **Asian equities area trading mixed**. Japanese equities outperform on weaker yen, while Chinese ones lose on a rating downgrade**.**
- **China's credit rating has been downgraded by Moody's from Aa3 to A1 (stable)** on expectations the country's financial strength will "erode somewhat" over coming years as debt rises, but its outlook was lifted to stable from negative.
- **New Zealand reported its largest monthly trade surplus** since 2015 in April as dairy, wood and wine exports grew. Its trade deficit year to date decline to NZD 4.4B. The Kiwi dollar was little changed around NZD/USD 0.70
- **S&P Global Ratings has placed the ratings of 38 Brazilian financial institutions on negative watch** amid a political scandal that rocked the country's markets. It may delay an economic recovery and increases the risks for credit fundamentals.
- **Philadelphia FED Harker** said June *"is a distinct possibility"* for the U.S. central bank's second interest-rate increase of 2017. He still sees 3 hikes in 2017 as appropriate and expects **an balance-sheet unwinding as likely to start in 2017.**
- **Ben Bernanke subtly criticized the BOJ**: It's disappointing the 2% CPI target had to be pushed back, policy transmission channels are near their limits and the government and BOJ have to do better coordinating fiscal and monetary policy.
- **Today calendar is light** with speeches of ECB Praet and Draghi, a US 5-yr Note auction and the FOMC Minutes.

Rates

Strong US equities weigh on bonds; Schatz auction fails.

US curve steepens as equities approach highs

Short end German curve hit by Schatz failure

Greece underperforms, as deal with IMF on debt relief faltered

Yesterday, core bonds continued to lose modest (Germany) to moderate (US ground. Strong EMU data (PMI, IFO) weighted in the morning session on the Bund and helped equities higher. From noon onwards, the Bund struggled higher without much conviction and approached in after-trading again the intra-day lows. The Schatz auction went very poorly, while the Belgium new 20-year syndicated OLO attracted strong demand and was priced sharply. **US data were mixed** with a slightly stronger services PMI, but sharply weaker than expected New Home sales and Richmond Fed manufacturing sentiment. It couldn't give Treasuries firm direction. Later, equities took off with the S&P coming within a few points of record highs, dragging US Treasuries lower. While equities retreated slightly and started to move sideways, US Treasuries made a final move lower amid an avalanche of fresh corporate bond supply and positioning ahead of today's 5-yr Note auction and despite a strong 2-yr Note auction. **In a daily perspective,** US yields rose by 2.1 bps (2-yr) to 3.7 bps (30-yr), steepening the curve. The German 2-yield increased 2.9 bp, while yields at the remainder of the German curve ended 0.9 to 1.3 bp higher.

What will the Fed Minutes tell us?

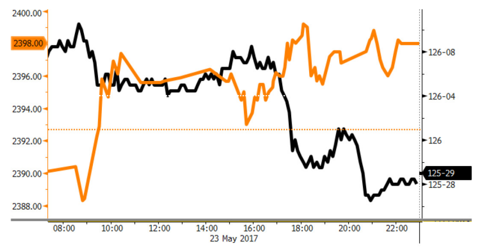
Weaker Existing Home sales?

Fed comments on low core inflation and unemployment rate key

What about balance sheet tapering

Will ECB Praet and Draghi start managing markets expectations for next ECB meeting?

Only the US **Existing Home sales (April) on the calendar**. Sales were very strong last month and reached its highest level since early 2007. A slight decline is expected, but as the trend is still firmly up and as sales are again reaching levels registered before the housing bubble, **markets should take a more pronounced decline into stride**. The **FOMC Minutes** might be interesting because few governors spoke on the economy or policy since the FOMC meeting. The meeting statement was "hawkish" and pushed the probability of a rate hike to nearly 100%. It contained a few hawkish elements like "the slowdown in Q1 growth was seen as likely transitory" and despite the consumer spending slowdown the "fundamentals for consumption remained solid". On the other hand, the Fed statement acknowledged the decline in core inflation in March and that was confirmed in the April inflation report. We look in the Minutes **whether the Fed gave more consideration to the declining and very low unemployment rate than to the core inflation decline**. Second point of attention is the **balance sheet tapering**. Most governors recently indicated that it will start before the end of the year, even as NY Fed Dudley opened the possibility of early 2018. We look out how opinions evolve about the ultimate size of the balance sheet after tapering, the duration of the tapering and the mix between MBS and Treasuries, even if until now the Fed said it aimed at a balance sheet with only Treasuries. **It is not excluded that the Fed will publish its balance tapering master plan**, even if that may be reserved for the September meeting. **In the former case, the tapering may start in Q4 2017, while in case of the latter, Q1 2018 is likely.**



T-Note future (black) and S&P future (orange) intraday: US Treasuries lower on good run equities and later on supply (despite good 2-yr auction

S&P approaches again record highs, but a test was just avoided.

US to tap the market.

The US $26B 2-yr T-Note auction went very well. The auction stopped at 1.316%, well below the 1.324% bid at the time of the stop. The 2.9 bid/cover was the highest since last May. The buy-side was very strong. The Treasury will continue its financing operation with a $13B 2-yr FRN and a $34B 5-year T-Note. It trades currently in the WI at 1.82%.

Range trading or will ECB speakers or Minutes surprise?

Overnight, Asian equities trade mixed with Japan outperforming on a weaker yen and Chinese equities lower on rating downgrade. **Fed Harker said overnight that a June hike is a distinct likelihood (is discounted).** USD/JPY is nearly unchanged and the T-Note future is fractionally higher**. We conclude that the risk sentiment is neutral at the start of European trading, pointing to a neutral Bund opening.**

Today's market calendar contains 3 potential drivers. Speeches of ECB Praet (mid-morning), Draghi (early afternoon) if they would prepare markets for the June 8 ECB meeting. Draghi speaks on financial stability though, while subject Praet's speech is unknown to us. In case of no surprise, the European session will be sentiment and technically driven (see lower). Later in US trading the 5-yr Note and the FOMC Minutes will get attention. A June rate hike is discounted. So the eventual surprise should come from the balance sheet tapering. All in all we expect the FOMC to wait till the June or September meeting to unveil crucial details. So also here technical and sentiment may dominate trading.

We expect the Bund to stay in a range we define between 160 (recent sell-off low) and 162.15/49 (recent highs/gap) with risks for a test of the downside.

The US Note future tested the contract high (126-20) last week (2.16% support for US 10-yr yield), but a break higher didn't occur. Once the dust settles, we would use those levels to enter new short position, given that we're on the brink of another Fed rate hike and the balance sheet tapering is nearing.

German Bund: Range-trading in 160-to-162.15/49 band preferred, but with downward risks ahead of ECB meeting

US Note future: Failed test of 126-20 resistance, suggests some space to decline with first support area at 125/124-23 Time to enter new short posititions?

Currencies

USD finally gets (modest) interest rate support

EUR/USD touches now correction top on strong data

Dollar rebounds as US yields rise later in the session

On Tuesday, the trends of the previous days initially persisted. USD/JPY (111.10) struggled to avoid further losses even as sentiment on risk remained constructive. The euro remained well bid supported by very strong EMU data. Finally, the dollar received interest support later in the session, lifting the USD currency off the recent lows. EUR/USD dropped below 1.12 to close session at 1.1183. USD/JPY rebounded higher in the 111 big figure to finish the day at 111.78 (from 111.30).

Dollar maintains yesterday's gain.

China downgrade weighs on Aussie dollar.

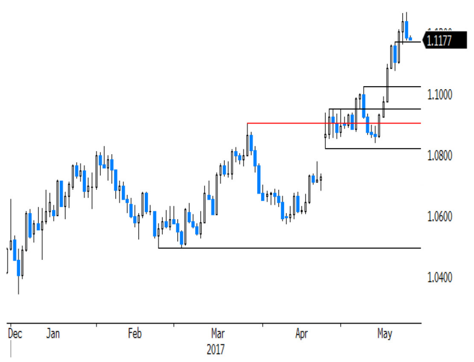
Overnight, Asian equities show a mixed picture. Japanese equities are supported by a weaker yen. USD/JPY trades currently at 111.85. Chinese markets underperform after Moody's cut the China debt rating to A1 from Aa3, stable outlook. The China rating downgrade also put additional pressure on the Aussie dollar. AUD/USD trades currently in the 0.7450 area (top around 0.7517 yesterday). EUR/USD is holding a tight range in the 1.1180 area.

The eco calendar is again thin

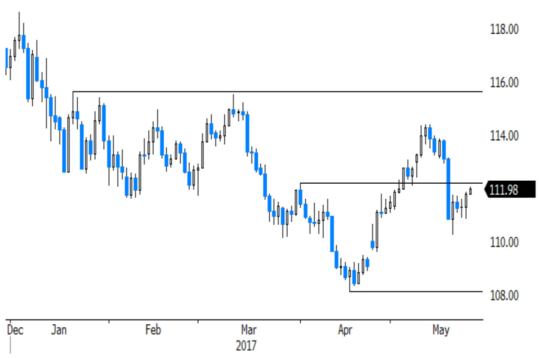
Moderately hawkish Fed minutes might support the dollar

Equities remain a wildcard for USD trading.

Today, in the US the Existing Home sales (April) will be published. A slight decline at a high level is expected. **This evening, the focus will turn to the minutes of the May FOMC meeting.** For an in dept analysis see the fixed income part. We expect the report the confirm the Fed's intention to raise rates in June. If the Fed would give concrete hints on the roadmap for its balance sheet reduction, it would be hawkish and USD supportive.
Over the previous days, the dollar hardly profited from the post-Turmp rebound of equities. Euro strength prevailed. Yesterday afternoon, fortunes finally changed in favour of the dollar. Recently, but not yesterday, interest rate differentials drifted gradually against the dollar. If the Fed minutes confirm the Fed's intention to normalize policy further, interest rate differentials between the US and Europe shouldn't go against the dollar anymore. **The global equity performance is also a wildcard for USD trading.** Yesterday, the dollar finally profited from a better equity sentiment. A risk-off correction, if it would occur, might be mixed for the dollar. However, we are not convinced on the safe haven characteristics of the euro. Over the previous days we suggested that the **EUR/USD rebound has gone far. Yesterday's price action suggests that the upside has indeed become tougher. We look to cautiously sell EUR/USD on upticks.**



EUR/USD rally running into resistance as USD stages a comeback



US D/JPY : tentative signs of a (ST) bottoming out process

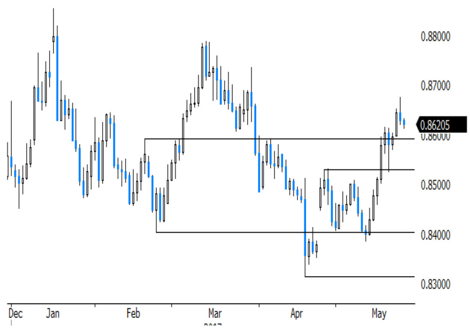
Technical picture.

The USD/JPY rebound ran into **resistance** two weeks ago. Wednesday's sell-off/re-break below the 112.20 previous top aborted the uptrend and made the short-term picture negative. Return action lower in the 108.13/114.37 range is possible. Yesterday, the USD/JPY decline took a breather, but the global picture didn't change fundamentally.
Earlier this month, it looked that EUR/USD could revisit the 1.0821/1.0778 support (gap). However, poor US data and political upheaval finally propelled EUR/USD north the 1.1023 range top. **The correction tops at 1.1300/1.1366 is the next resistance. We think that USD sentiment will have to be extremely negative to clear this hurdle short-term. Further ST EUR/USD gains will become tougher. A return below 1.1023 would indicate that the upside momentum has eased.**

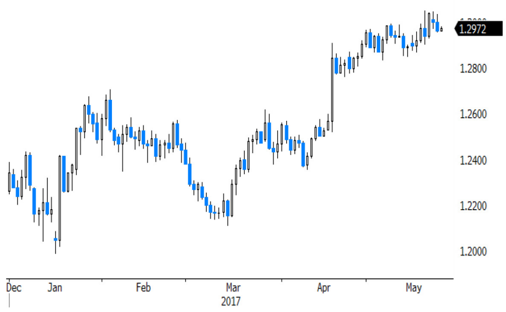
EUR/GBP rally running into resistance

Yesterday, the news flow on the UK remained sterling negative. The terrorist attack in Manchester weighed on sterling early in the session. The CBI May reported sales were also softer than expected. **EUR/GBP touched a new correction top in the 0.8675 area around noon, but this move was also driven by euro strength.** Later, EUR/USD fell prey to profit taking as the dollar rebounded. EUR/GBP closed the session at 0.8628. The decline in cable was more modest. The pair closed the session at 1.2961.

Today, the UK eco calendar is empty. So sterling trading will be driven by to global moves in the dollar and the euro. If the EUR/USD rally takes a breather, the topside of EUR/GBP will probably also be capped. So, some profit taking on EUR/GBP shorts might be on the cards.



EUR/GBP rally to take a breather



GBP/USD jumped temporary north of 1.30, but gains prove difficult to sustain

Calendar

Wednesday, 24 May		Consensus	Previous
US			
15:00	FHFA House Price Index MoM (Mar)	0.5%	0.8%
15:00	House Price Purchase Index QoQ (1Q)	--	1.5%
16:00	**Existing Home Sales / MoM (Apr)**	**5.65m/-1.1%**	**5.71m/4.4%**
20:00	**FOMC Meeting Minutes**	**--**	**--**
Canada			
16:00	Bank of Canada Rate Decision	0.50%	0.50%
Japan			
02:30	Nikkei Japan PMI Mfg (May P)	--	52.7
Germany			
08:00	GfK Consumer Confidence (Jun)	10.2	10.2
Belgium			
15:00	Business Confidence (May)	-0.5%	-0.8
Spain			
09:00	PPI MoM / YoY (Apr)	--/--	-0.8%/6.0%
Norway			
08:00	Unemployment Rate AKU (Mar)	4.3%	4.3%
Sweden			
09:00	Consumer Confidence (May)	104	103.4
Events			
10:30	ECB Executive Board member Praet speaks in Sofia		
11:30	Germany to Sell €3B 0.25% 2027 Bonds		
14:45	**ECB President Draghi speaks in Madrid**		
17:30 & 19:00	US to Sell $13B 2-yr FRN Notes & $34B 5-yr Notes		

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