



Sunrise

Tuesday, 28 February 2017

Rates: Implied probability of March rate hike hits 50%

US Treasuries sold off after European trading after voting FOMC member Kaplan said that the Fed should hike rates sooner rather than later which means in the near future. Odds of a March rate hike hit 50% for the first time. Today, investors will probably take a wait-and-see approach ahead of President Trump's speech in Congress.

Currencies: USD still in a limbo, even as Fed rate expectations rise

The dollar struggles to move away from short-term lows even as markets discount a rising probability of a Fed rate hike. EUR/USD is holding in the 1.06 area. USD/JPY struggles not to drift back lower in the established trading range. Will Trump's statement be convincing enough to support Fed rate hike expectations and trigger renewed USD buying?

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 ended marginally higher going into today's key Trump speech before Congress.** Overnight, the majority of Asian stock markets also trades with minor gains.
- **President Trump**, in an address to Congress tonight, **will call for a \$20B boost in current military spending and sharp cuts in other programs**, and insist on raising budget caps that call for future cuts to defence outlays.
- **Industrial output in Japan staged an unexpected reversal** in January (-0.8% M/M) and contracted for the first time in six months. **Japanese retail sales (0.5% M/M) returned to growth** in January giving the best result since November.
- **Australia boasted the smallest current account deficit in 15 years last quarter** as booming resource exports delivered a whopping turnaround of A\$8 billion to the nation's finances, boosting company profits and economic growth.
- **Dallas Fed Kaplan** reiterated his view that policy makers should raise interest rates **"sooner rather than later", which "means in the near future", and without paying excessive attention to market expectations.**
- **The odds that the Fed will lift rates at its next meeting hit 50%** in an indication that there is an increasing likelihood the central bank will tighten policy next month, according to calculations on federal funds futures by Bloomberg.
- **Today's eco calendar heats up in the US** with the second reading of Q4 2016 GDP, trade balance, Chicago PMI, consumer confidence and Richmond Fed manufacturing index. **US President Trump addresses Congress.**

Rates

Core bonds tread water at start of the week, before...

US yields higher on hawkish Fed talk

US yield supports safe-guarded for now

French tensions ease further

	US yield	-1d
2	1,19	0,04
5	1,86	0,04
10	2,36	0,02
30	2,97	0,01

	DE yield	-1d
2	-0,93	0,02
5	-0,58	0,01
10	0,20	0,01
30	0,97	0,03

US eco data not too important ahead of Trump speech and ISM report

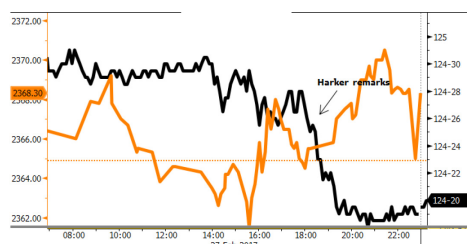
National EMU data pointer for EMU HICP

Spanish CPI still points to slight rise EMU HICP to 1.9% Y/Y

Yesterday, global core bonds moved sideways in a tight range during much of the European and US session, digesting last week's strong gains. Investors stayed side-lined ahead of more important data releases and some key events and were also held back by **key yield support** in the 10-yr US and German sovereign bonds. **Eco releases couldn't** inspire traders neither. After European trading, voting **FOMC member Kaplan said that the Fed should hike rates sooner rather than later which means in the near future**, but not necessarily in March. Newcomer Kaplan already on February 6 ("I think March is on the table") and on February 21 ("I would not take March off the table at this point") showed his preference for a March rate hike. It remains to be seen how the Board of governors thinks. It is certainly a possibility, but we shouldn't draw too many conclusions from the remarks of this single regional governor. **Markets were receptive to his message after last week's rally. Odds of a March rate hike hit now 50% for the first time.** It raises the importance of further Fed comments and especially the Fischer/Yellen remarks on Friday. We don't think it will have a major impact on today's data ahead of the key Trump speech.

In a daily perspective, US yields ended 5.2 bps (2-yr) to 6.1bps (5-yr) higher, the short end underperforming on Kaplan's comments. German yields added 1.3 bps (5-yr) to 2.9 bps (30-yr). **On the intra-EMU bond markets**, peripheral yield spreads narrowed 5-to-7 bps with Italy outperforming after a decent auction. The French 10-yr yield spread narrowed 6 bps, outperforming its OLO peer (-3 bps). Polls showed continuing progress for Macron, the centre-candidate.

The **US eco calendar** is well filled, but only moderately important for markets. **Q4 GDP** is expected to be upgraded to 2.1% from 1.9%, a small change and already outdated. **House prices** continue to rise, but at 5.3% Y/Y, it is no danger for stability and will be ignored. The **Chicago PMI** is quite volatile and dropped sharply from 57.2 in November to 50.3 in January, after having risen from 51.8 in October. A rebound to 53 in February is expected. For **the Richmond Fed business sentiment index**, a small decline to 10 in February is expected from 12 previously. **These business sentiment surveys fall a bit short with other, already released surveys** (NY/Philly Fed, Kansas). However, we suspect markets won't react too much to deviations from consensus, as the national ISM business confidence will be published tomorrow. **Consumer confidence** (Conference board) is expected to have declined modestly to 111 in February from 111.8 in October. That would keep confidence near the highest levels since mid-2001. A small decline would be in line with the Michigan measure of confidence. **The Trump speech before the Joint Congress on Tuesday night will keep investors wary of reacting strongly to the data.**



T-note future (black) & S&P future (orange) (intraday): Dull session until Kaplan speaks



Odds for Fed March rate hike 50/50

R2	168,93	-1d
R1	166,84	
BUND	166,07	-0,07
S1	163,13	
S2	161,31	

Difficult German Schatz auction

The German Finanzagentur launches a new 2-yr Schatz (€5B 0% Mar2019). Grey trading suggests that the bond will be priced with a 0.7 bps pick-up in ASW spread terms compared to the previous 2-yr benchmark (0% Dec2018) which corresponds with a 1.5 bps pick-up in yield terms. Total bids at the previous 4 Schatz auctions averaged only €5.22B. Given the record-low yield level (-0.95%), this auction will struggle to meet with sufficient demand.

Probability of March rate hike hits 50%

Overnight, most Asian stock markets trade mixed anticipation tonight's speech by US president Trump before Congress. The US Note future hovers around yesterday's closing level. Risk barometers like the gold price, oil or the Japanese yen give no clue for the start of trading. We expect the Bund to open near levels reached yesterday in after-trading. (<166).

Today's eco calendar heats up in the US (see above). We don't expect them to move markets ahead of tonight's speech by US President Trump before Congress. **However, given the rising probability of a March rate hike (50%), the risk scenario is that the US Treasury is nevertheless vulnerable to stronger eco data**. Regarding Trump's speech, we think that he shouldn't blast markets with details over his fiscal stimulus plans to keep the odds of a March tightening at 50% (or more?). **The bar for disappointment (and higher US Treasuries) seems rather low. Fed chairwoman Yellen (speech on Friday) will decide on the Fed's intentions in March**. Technically, the US 10-yr yield bounced off key 2.3% support yesterday.

The German 10-yr yield reached similar support around 0.17%. Sentiment on stock markets and EMU bond markets could be crucial to decide on the test. Equity markets are prone for correction (eg last Friday) while tensions on EMU bond markets are easing. **We won't fight the current trend though on German yield markets as collateral scarcity and other technical factors might be at play as well and interfere with positive underlying growth and inflation dynamics.**



German Bund: EMU worries push Bund above 164.90 and 165.48 resistance. In yield terms, 0.17%/0.20% is key support



US Note future (June contract!!!): Rising probability March rate hike caps topside US Treasuries

Currencies

Dollar tried to rebound off the ST lows on Trump plans and (slightly) higher US bond yields

R2	1,1145	-1d
R1	1,0874	
EUR/USD	1,0596	0,0028
S1	1,0341	
S2	1,0000	

Asian equities show limited gains

Dollar struggles not to lose overnight gains

US eco calendar overshadowed by Trump's appearance before Congress

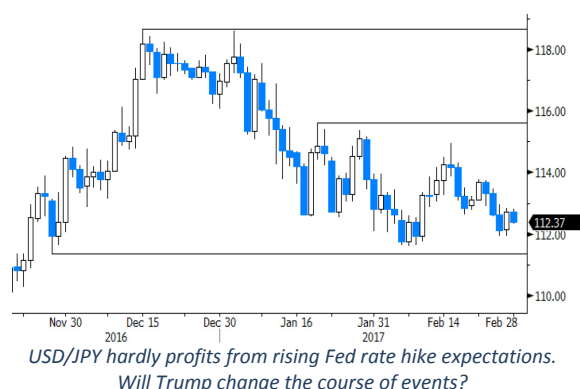
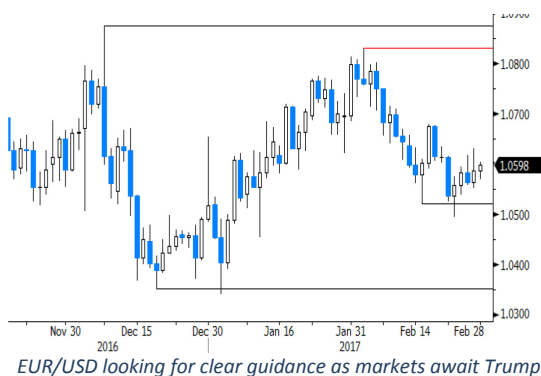
Will Trump's message be strong enough to put a floor on the recent USD correction

Dollar stays soft even as Fed rate expectations rise

On Monday, investors kept mostly side-lined ahead of the testimony of US president Trump before Congress today. Investor caution initially held the dollar near the recent lows. Later in US dealings, a rise in US yields reinstalled a cautious USD bid. The release of some details on Trump's budget plans and comments from Fed Kaplan probably caused this bid. Whatever the reason, EUR/USD dropped from 1.06+ levels and closed the session at 1.0587. USD./JPY finished the day at 112.70 (after trading in the low 112 area for most of the day).

Overnight, Asian equities basically stay in wait-and see modus and are divided between small gains and limited losses. Japanese eco data were mixed (retail data) to soft (production), but had no lasting negative impact on the yen. USD trading still faces conflicting signals. Futures are discounting a 50 % of a March Fed rate hike. Still, investors are uncertain whether Trump will provide enough details to continue to reflation trade. **The dollar is trading off the overnight highs against the yen and, to a lesser extent, against the euro.** USD/JPY is again trading in the 112.50 area. EUR/USD changes hands just below 1.06.

Today, the **US eco calendar** is well filled, but probably only of moderate importance for markets. **US Q4 GDP** is expected to be upgraded to 2.1% from 1.9%, a small change and outdated. The **Chicago PMI** dropped sharply in January. A rebound to 53 is expected. For **the Richmond Fed business sentiment**, a small decline is expected. **These business sentiment surveys fall a bit short with other surveys** (NY/Philly Fed, Kansas). Even so, they won't really change the broader picture ahead of the key ISM confidence tomorrow. **Consumer confidence** (Conference board) is expected to have declined from 111.8 to 111, still a very high level. Markets will also keep a close eye at the **price indicators of the surveys**. In globo, US eco data shouldn't question the continuation of the reflation trade or the scenario of a Fed rate hike in the near future. **In theory that should help to put a floor for the dollar. Of course, the focus for markets will remain on Trump's appearance before Congress.** For US yields and for the dollar, we look out whether Trump's message will be strong/convincing enough to keep the probability of a March rate hike at 50% (or higher). **Of late, investors reduced USD longs. So, there is probably room for some USD buying on dips if Trump gives a reasonable prospect on a pro-growth policy.**



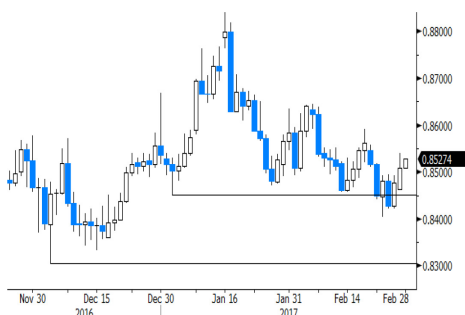
Global context. The dollar corrected lower since the start of January as the reflation trade slowed down. **Two weeks ago, the dollar bottomed out, supported by Trump's tax promise. Underlying euro weakness due to political uncertainty** in the area is a factor too. **We see 1.0874 as solid resistance and favour a sell EUR/USD on upticks approach. The downside test of USD/JPY was rejected.** USD/JPY 111.60/111.16 (Range bottom/38% retracement of the 99.02/118.66 rally) remains key support. Recent Fed comments were USD supportive, but had no lasting impact on yields. We keep a USD positive bias longer term, as the dollar might still get additional interest support if the Fed continues its normalisation process. For now, the momentum of USD/EUR is more convincing than in USD/JPY.

R2	0,8645	-1d
R1	0,8592	
EUR/GBP	0,8523	0,0010
S1	0,8304	
S2	0,8117	

EUR/GBP still going nowhere near 0.85 barrier

Yesterday, sterling traded with a slightly negative bias, as press headlines indicating that the UK government is preparing a strategy to handle a new referendum on Scottish independence. A spokesman of PM May said that there was no need for a new Scottish referendum. **EUR/GBP initially gained some further ground on the broader rebound of EUR/USD, but the rally stalled later in US dealings. EUR/GBP closed the session at 0.8509.** Cable basically hovered sideways in the 1.24 big figure to close the session at 1.2442.

Overnight, the Lloyds business Barometer remained strong at 40, but was as usual ignored. No further eco data today. End of month repositioning might be slightly supportive for EUR/GBP. The EUR/USD trend will remain important. In the House of lords a detailed review of the Article 50 bill continues. Markets will keep an eye on any headwinds for the PM May's Brexit strategy, but we assume that the impact on sterling will be limited. **Earlier last week, the (temporary) acceleration of the euro sell-off pushed EUR/GBP to the 0.84 area. However, a sustained break lower didn't occur. As is the case for EUR/USD (and for several other markets), there is currently no clear driver for sterling trading. Longer term, we have a sterling negative view, as the Brexit will negatively impact the UK economy.** A sustained break below **0.8450 opens the way for a return to the 0.8304 correction low. We maintain a neutral bias on sterling short-term.**



EUR/GBP: drifting higher from the recent lows, but to sustained trend.



GBP/USD topside test rejected, but no clear trend.

Calendar

Tuesday, 28 February		Consensus	Previous
US			
14:30	GDP Annualized QoQ (4Q S)	2.1%	1.9%
14:30	Personal Consumption (4Q S)	2.5%	2.5%
14:30	GDP Price Index (4Q S)	2.1%	2.1%
14:30	Core PCE QoQ (4Q S)	1.3%	1.3%
14:30	Advance Goods Trade Balance (Jan)	-\$66.0b	-\$65.0b
14:30	Wholesale Inventories MoM (Jan P)	0.4%	1.0%
14:30	Retail Inventories MoM (Jan)	--	0.0%
15:00	S&P CoreLogic CS 20-City MoM SA / YoY NSA (Dec)	0.7%/5.3%	0.88%/5.27%
15:45	Chicago Purchasing Manager (Feb)	53.0	50.3
16:00	Conf. Board Consumer Confidence (Feb)	111.0	111.8
16:00	Richmond Fed Manufact. Index (Feb)	10	12
Japan			
00:50	Industrial Production MoM / YoY (Jan P)	A-0.8%/3.2%	0.7%/3.2%
00:50	Retail Sales MoM / YoY (Jan)	A0.5%/1.0%	-1.6%/0.6%
06:00	Housing Starts YoY (Jan)	A 12.8%	3.9%
06:00	Construction Orders YoY (Jan)	A1.1%	7.1%
06:00	Small Business Confidence (Feb)	A47.7	48.3
UK			
01:01	GfK Consumer Confidence (Feb)	A -6	-5
01:01	Lloyds Business Barometer (Feb)	A 40	29
01 MAR	Nationwide House PX MoM / NSA YoY (Feb)	0.2%/4.1%	0.2%/4.3%
France			
08:45	CPI EU Harmonized MoM / YoY (Feb P)	0.4%/1.7%--	-0.3%/1.6%
08:45	Consumer Spending MoM / YoY (Jan)	0.6%/1.7%--	-0.8%/1.5%
08:45	GDP QoQ / YoY (4Q P)	0.4%/1.1%--	0.4%/1.1%
Italy			
11:00	CPI EU Harmonized MoM / YoY (Feb P)	-0.1%/1.3%	-2.0%/1.0%
Belgium			
15:00	GDP SA QoQ / YoY (4Q F)	--/--	0.4%/1.1%
Sweden			
09:30	GDP QoQ / WDA YoY (4Q)	0.8%/2.3%	0.5%/2.8%
09:30	Wages Non-Manual Workers YoY (Dec)	--	2.2%
09:30	Retail Sales MoM / NSA YoY (Jan)	1.5%/2%	-2.9%/0.6%
Events			
	BoE Charlotte Hogg speaks at appointment meeting		
11:35	Germany to Sell €5B 2019 Bonds		
21:00	Fed Harker speaks on economy		
21:30	Fed's Williams Speaks in Santa Cruz (speaks also at 20:30)		

10-year	td	-1d		2-year	td	-1d		Stocks	td	-1d
US	2,36	0,02		US	1,19	0,04		DOW	20837,44	15,68
DE	0,20	0,01		DE	-0,93	0,02		NASDAQ	5861,899	16,59
BE	0,70	-0,02		BE	-0,58	-0,01		NIKKEI	19118,99	11,52
UK	1,15	0,07		UK	0,10	0,01		DAX	11822,67	18,64
JP	0,05	0,00		JP	-0,27	0,00		DJ euro-50	3309,3	5,21
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	td	-1d
3y	-0,08	1,74	0,64	Eonia	-0,3570	0,0020		Libor-1	0,7806	0,0000
5y	0,10	1,98	0,73	Euribor-1	-0,3710	0,0000		Libor-3	1,0540	0,0000
10y	0,67	2,34	1,11	Euribor-3	-0,3290	0,0000		Libor-6	1,3607	0,0000
				Euribor-6	-0,2380	0,0000				
Currencies	td	-1d		Currencies	td	-1d		Commodities	td	-1d
EUR/USD	1,0596	0,0028		EUR/JPY	119,06	0,57		CRB	189,88	-1,05
USD/JPY	112,36	0,24		EUR/GBP	0,8523	0,0010		Gold	1254,80	-3,10
GBP/USD	1,2432	0,0019		EUR/CHF	1,0671	0,0023		Brent	56,08	-0,29
AUD/USD	0,7681	-0,0012		EUR/SEK	9,5904	0,0468				
USD/CAD	1,3176	0,0077		EUR/NOK	8,8621	0,0153				

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

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