



Sunrise

Tuesday, 30 May 2017

Rates: Inflation key, but investor's won't lose their nerves

Today's calendar heats up. We focus on German (CPI) and US (PCE) inflation readings. Markets will probably be most sensitive to hawkish surprises in EMU and dovish ones in the US. This week's backloaded eco calendar suggests that investors' won't rush into hurried conclusions though. Sentiment on EMU bond markets is a wildcard for trading.

Currencies: EUR/USD declines on soft Draghi comments and return of political risk

Yesterday and this morning, the euro was in the defensive as soft Draghi comments and uncertainty on Greece and Italy provided a good reason to take further profit on the recent EUR/USD rally. Today, the focus will be on price data in the US and Germany. The euro looks more vulnerable than the dollar if sentiment turns risk-off

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 and UK investors return from the long weekend** today after yesterday's Memorial Day and Spring Bank Holiday. **Overnight, Asian stock markets trade mixed.**
- **Big banks are throttling back from the \$1.2T US car loan market**, fearing that consumers have taken on more debt than they can handle. Data released last week showed the 1st sequential drop in car loans outstanding in at least 6 years.
- **Japan's unemployment rate** held steady at 2.8% in April, at a **23-yr low**. Japan's **household spending pushed further into contraction**, but **retail sales rose** at a faster rate thanks to a boost from department stores and supermarkets sales.
- **St. Louis Fed Bullard** says jury is still out on whether government policies will meet expectations that have been priced into equity markets.
- **Greece's government** is preparing to possibly **go without next bailout payment if creditors don't agree on debt relief** for the country, **Bild** reports, without saying where it obtained the information.
- **North Korea's** latest missile launch is its 3rd apparent breakthrough in missile technology in less than 3 weeks. Kim Jong Un expressed the conviction that it would make **a greater leap forward** in the spirit to send a bigger 'gift package' to the Yankees in retaliation for American military provocation, according to **KCNA**.
- **Today's eco calendar heats up** with EC confidence data, German (CPI) and US (PCE) inflation readings, US personal income/spending data and consumer confidence. Italy taps the market and ECB Liikanen and Fed Brainard speak.

Rates

Draghi kept a rather soft tone, supporting Bunds in extremely thin trading conditions

	US yield	-1d
2	1,29	0,00
5	1,78	-0,01
10	2,24	-0,01
30	2,90	-0,01

	DE yield	-1d
2	-0,72	-0,03
5	-0,44	-0,05
10	0,30	-0,03
30	1,14	-0,03

German Bund profits from Draghi speech in thin trading

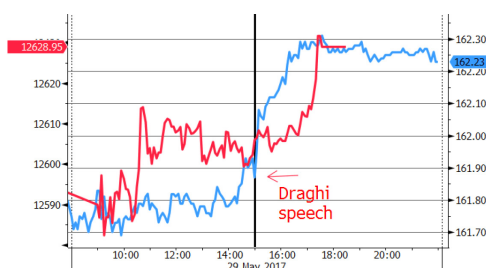
US (Memorial Day) and UK (Spring Bank Holiday) markets were closed yesterday. The Bund surged higher during the afternoon session in low-volume conditions after Draghi's speech in European Parliament. The ECB president sounded fairly dovish, saying that the central bank remains convinced that the euro area still needs an extraordinary amount of support even if downside risks to growth are firmly diminishing. The Bund broke above first minor resistance at 162.15. At the end of the day, the German yield curve shifted 3.8 bps (5-yr) to 2.4 bps (30-yr) lower. On intra-EMU bond markets, 10-yr yield spread changes versus Germany widened 5 bps for Greece/Portugal/Spain and 12 bps for Italy. **Supply (today) and increasing odds of a fall election weighed on BTP's.**

Eco calendar heats up with German/US inflation

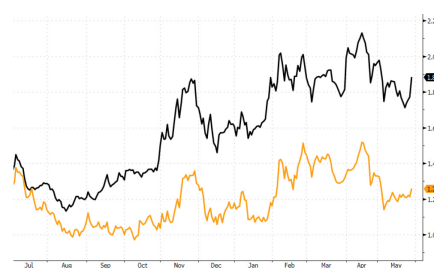
Today's eco calendar heats up. EMU EC economic confidence is expected to hit the 110 mark for the first time since the Summer of 2007. German inflation readings could be a harbinger for tomorrow's EMU release. A decline from 2% Y/Y in April to 1.5% Y/Y is expected. If so, it would warrant ECB President's seemingly lack of urgency to start normalizing monetary policy. Markets will probably be mainly sensitive to higher-than-expected readings going into next week's ECB meeting. The main event for today is probably the US PCE deflator, the Fed's main inflation gauge. Consensus expects a slight slowdown from 1.8% Y/Y to 1.7% Y/Y in April. Given that a June rate hike is baked in the cake, it will probably need a very negative surprise to put markets/investors in doubt. US personal income & spending data are both expected to accelerate to 0.4% M/M in April while US consumer confidence is forecast to continue to hover around the highest levels since 2000 (drop from 120.3 to 119.8 in May).

ECB Liikanen and Fed Brainard are today's scheduled central bank speakers.

Finnish central bank governor Liikanen has a more hawkish profile and probably argues in favour of putting the normalization process in motion. Washington-based Fed governor Brainard is an influential voice at the FOMC. She shifted from the dovish wing to the center, but remains concerned about the lack of progress on core inflation. On the other hand, she's encouraged by the brightening economic outlook and thinks that the margins of labor market slack have narrowed. We expect Brainard to stick to the scenario of two more rate hikes this year in combination with the start of the BS run-off around the turn of the year.



German Bund (blue) and Dax (red) (intraday: Bund profits from rather dovish Draghi speech in thin trading)



Italian (black) and Spanish (orange) 10-yr yield spread vs Germany: Italian underperformance on supply and early election jitters

R2	163,99	-1d
R1	162,49	
BUND	162,23	0,48
S1	160	
S2	158,73	

Italian auction hampered by early election talk?

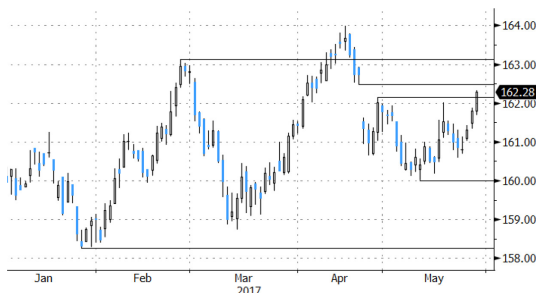
The Italian debt agency kicks off this week's EMU bond supply by tapping the on the run 5-yr BTP (€2.5-3B 1.2% Apr2022) and 10-yr BTP (€2.25-2.75B 2.2% Jun2027). Both bonds cheapened in ASW spread terms going into the auction, but the 5-yr BTP sits rather expensive on the Italian curve. Yesterday's early election jitters could keep some investors at bay and weigh on demand today. Nevertheless, the relatively low amount on offer should normally be easily covered. Additionally, Italy will try to raise €1.25-1.75B via the floating rate CCTeu (Oct2024).

Inflation key, but investors won't lose their nerves

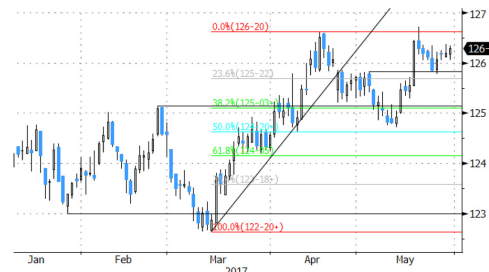
Overnight, Asian stock markets trade mixed with China still closed. The US Note future moves stable, suggesting a neutral opening for the Bund.

Today's market calendar heats up (see above). We mainly focus on German (CPI) and US (PCE) inflation readings. Investors' current framework ahead of key ECB (June 8) and Fed (June 14) policy meetings is one of subtle changes in EMU (embracing underlying growth momentum) and a new 25 bps rate hike in the US. Therefore markets will probably be most sensitive to hawkish surprises in EMU and dovish ones in the US. This week's backloaded eco calendar suggests that investors' won't rush into hurried conclusions though. **We have a neutral view for today.** Sentiment on EMU bond markets is a wildcard for trading. Italian early election jitters and Greek debt relief talk could spoil sentiment for BTP's and GGB's.

Technically, we expect the Bund to stay in a range defined between 160 (recent sell-off low) and 162.15/49 (recent highs/gap) even if we tested the upside yesterday in extremely low volume trading. **The US Note future remains near the contract high (126-20) which could be used 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. First test upside in thin trading conditions



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 positions?

Currencies

Soft Draghi comments cap EUR/USD topside

Asian markets open with a cautious bias

Yen is holding strong. USD/JPY, EUR/JPY and EUR/USD are ceding ground

The eco calendar heats up

Focus will probably be on the US PCE deflators and on German inflation

Will EMU political risk again play a role?

EUR/USD eases further off last week's top

Trading in EUR/USD and USD/JPY was confined to tight ranges yesterday with US and UK markets closed. ECB's Draghi maintained a soft approach in his appearance before the EU parliament. EUR/USD reversed modest gains after Draghi's testimony. EUR/USD closed the session at 1.1164, near the intraday low. USD/JPY finished an uneventful session at 111.27.

Overnight, Asian markets started with a cautious risk-off bias, but the losses are limited and eased as the session proceeds. Chinese markets are closed. Japanese eco data were mixed. The jobless rate (2.8%) is holding at a multi-year low and the Job-to-applicants ratio rose to the highest level since 1974. For now the favourable job market didn't lead to a pick in consumer spending. **The yen holds strong.** USD/JPY dropped below 111 and is testing last week's low. The move is in the first place due to the cautious risk sentiment, but Japanese factors might also play a secondary role (recent rise in short-term yields, decent eco data). The USD/JPY decline also pressured EUR/JPY (123.40) and EUR/USD (1.1130).

The eco calendar is well filled today. Confidence data from the European Commission are expected to confirm the improvement seen in other confidence indicators. German CPI is expected to decline 0.1% M/M to be up 1.5% Y/Y (from 2.0% in April). The swings are partially driven by technical factors, but a decline in German/EMU inflation might be seen as supporting the case for a cautious ECB approach. **In the US, the personal income and spending data are expected at a decent 0.4%, but the deflators are expected slightly softer from March** (1.7% from 1.8 for the overall deflator). US consumer confidence (conference board) is expected to decline slightly from a very high level.



EUR/USD: correction off last week's top continues on soft Draghi comments and as EMU political risk returns to the radar



USD/JPY: downside pressure persists. Test of the 110.24 correction low might be on the cards

R2	1,1428	-1d
R1	1,1268	
EUR/USD	1,1114	-0,0054
S1	1,0839	
S2	1,0778	

The price data (both in the US and Europe) and global risk sentiment are probably key for global/FX trading today. We don't expect the US data to be that poor that they will question a June Fed rate hike. Soft German inflation data have the potential to reinforce the recent euro correction. EMU political risk is also again on the radar (speculation on Italian elections and Greece looking for confirmation on debt relief). The soft Draghi comments might have a slightly negative impact on the euro.

So, the EUR/USD correction off last week's top might continue. USD/JPY, EUR/JPY and EUR/USD might feel more downside pressure if sentiment turns more risk-off.

Of late, the dollar traded soft. US data were a bit disappointing, markets turned more cautious on Trump's pro-growth agenda and US yields declined, keeping the dollar in the defensive. At the same time, the euro profited of reduced political risk on the region. This picture hasn't profoundly changed, but last week, there were tentative signs that the dollar decline could slow. Is enough USD softness discounted? This week's payrolls and manufacturing ISM might be important in this assessment. At the same time the euro positive momentum is also fading.

Technical picture

The USD/JPY rebound ran into resistance early May. A mini-sell-off pushed the pair back below the 112.20 previous top and made the short-term picture negative. Return action lower in the 108.13/114.37 range is possible.

Earlier this month, it looked that EUR/USD could revisit 1.0821/1.0778 support (gap). However, poor US data and political upheaval finally propelled EUR/USD north of the 1.1023 range top. The pair reached a short-term correction top at 1.1268. The correction top at 1.1300/1.1366 is next resistance. USD sentiment will have to be extremely negative to clear this hurdle short-term. Further ST EUR/USD gains might become tougher. A return below 1.1023 would indicate that the upside momentum has eased.

Focus for sterling trading remains on the opinion polls

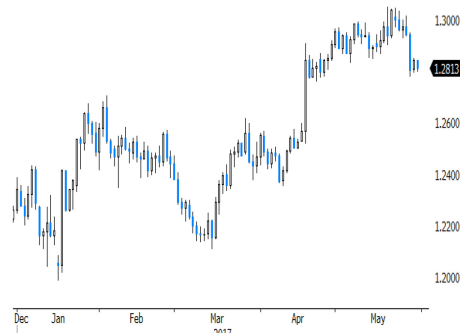
UK markets were closed for the Spring bank holiday yesterday. Markets are keen to see whether PM May's conservative party can stop the erosion of its lead in the opinions polls for the June 08 elections. Political uncertainty didn't cause additional harm on sterling yesterday even as polls during the weekend confirmed the narrowing gap with Labour. Cable closed a thinly traded session at 1.2840. EUR/GBP finished the day at 0.8695. Post-Draghi euro softness also weighed slightly on EUR/GBP.

There again no important eco data in the UK today. Focus will remain on the UK political scene. Uncertainty on the lead of the conservative party is a negative for sterling short-term. Contrary to what was the case of late, this might in the first place be visible in cable (rather than in EUR/GBP). The picture for EUR/GBP is more mixed as the single currency is also in the defensive. EUR/GBP trades off last week's top in the mid 0.87 area. Further consolidation/correction on the May rally might be on the cards.

R2	0,8854	-1d
R1	0,8787	
EUR/GBP	0,8673	-0,0031
S1	0,8383	
S2	0,8314	



EUR/GBP: euro weakness dominates even as UK political uncertainty continues to play a role



GBP/USD: Test of 1.30+ area rejected

Calendar

Tuesday, 30 May		Consensus	Previous
US			
14:30	Personal Income (Apr)	0.4%	0.2%
14:30	Personal Spending (Apr)	0.4%	0.0%
14:30	Real Personal Spending (Apr)	0.2%	0.3%
14:30	PCE Deflator MoM / YoY (Apr)	0.2%/1.7%	-0.2%/1.8%
14:30	PCE Core MoM / YoY (Apr)	0.1%/1.5%	-0.1%/1.6%
15:00	S&P CoreLogic CS 20-City MoM SA / YoY NSA (Mar)	0.90%/5.61%	0.69%/5.85%
16:00	Conf. Board Consumer Confidence (May)	119.8	120.3
Japan			
01:30	Jobless Rate (Apr)	A: 2.8%	2.8%
01:30	Job-To-Applicant Ratio (Apr)	A: 1.48	1.45
01:30	Overall Household Spending YoY (Apr)	A: -1.4%	-1.3%
01:50	Retail Sales MoM / YoY (Apr)	A: 1.4%/3.2%	0.2%/2.1%
EMU			
11:00	Economic Confidence (May)	110.0	109.6
11:00	Business Climate Indicator (May)	1.11	1.09
11:00	Industrial Confidence (May)	3.1	2.6
11:00	Services Confidence (May)	14.2	14.2
11:00	Consumer Confidence (May F)	-3.3	-3.3
Germany			
	CPI Baden Wuerttemberg MoM / YoY (May)	--/--	0.0%/2.0%
08:00	Import Price Index MoM / YoY (Apr)	0.1%/6.3%	-0.5%/6.1%
09:00	CPI Saxony MoM / YoY (May)	--/--	-0.1%/2.1%
10:00	CPI Brandenburg MoM / YoY (May)	--/--	-0.1%/1.8%
10:00	CPI Hesse MoM / YoY (May)	--/--	0.0%/2.1%
10:00	CPI Bavaria MoM / YoY (May)	--/--	-0.1%/1.9%
10:30	CPI North Rhine Westphalia MoM / YoY (May)	--/--	0.1%/2.1%
14:00	CPI MoM / YoY (May P)	-0.1%/1.6%	0.0%/2.0%
14:00	CPI EU Harmonized MoM / YoY (May P)	-0.1%/1.5%	0.0%/2.0%
France			
08:45	Consumer Confidence (May)	101	100
08:45	Consumer Spending MoM / YoY (Apr)	0.8%/0.6%	-0.4%/-1.0%
08:45	GDP QoQ / YoY (1Q P)	0.3%/0.8%	0.3%/0.8%
Italy			
10:00	PPI MoM / YoY (Apr)	--/--	-0.1%/3.4%
Belgium			
	CPI MoM / YoY (May)	--/--	0.17%/2.28%
Spain			
09:00	CPI EU Harmonised MoM / YoY (May P)	-0.1%/2.1%	0.9%/2.6%
Sweden			
09:30	GDP QoQ / WDA YoY (1Q)	0.9%/2.9%	1.0%/2.3%
Events			
11:00	Italy to sell €3B 1.2% 2022, €1.75B Floating 2024 and €2.75B 2.2% Bonds		
12:15	ECB's Liikanen Speaks at Conference in Vienna		
19:00	Fed's Brainard Speaks on Economy, Monetary Policy in New York		

10-year	<u>td</u>	<u>-1d</u>		2-year	<u>td</u>	<u>-1d</u>		Stocks	<u>td</u>	<u>-1d</u>
US	2,24	-0,01		US	1,29	0,00		DOW	21080,28	0,00
DE	0,30	-0,03		DE	-0,72	-0,03		NASDAQ	6210,194	0,00
BE	0,67	-0,02		BE	-0,57	-0,02		NIKKEI	19677,85	-4,72
UK	1,01	0,00		UK	0,09	0,00		DAX	12628,95	26,77
JP	0,04	-0,01		JP	-0,17	-0,01		DJ euro-50	3578,95	-0,07
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>		USD	<u>td</u>	<u>-1d</u>
3y	-0,07	1,66	0,60	Eonia	-0,3610	-0,0020		Libor-1	1,0447	0,0000
5y	0,17	1,87	0,76	Euribor-1	-0,3720	-0,0010		Libor-3	1,2018	0,0000
10y	0,78	2,19	1,11	Euribor-3	-0,3290	0,0000		Libor-6	1,4138	0,0000
				Euribor-6	-0,2540	0,0000				
Currencies	<u>td</u>	<u>-1d</u>		Currencies	<u>td</u>	<u>-1d</u>		Commodities	<u>td</u>	<u>-1d</u>
EUR/USD	1,1114	-0,0054		EUR/JPY	123,32	-0,95		CRB	182,00	0,00
USD/JPY	110,96	-0,31		EUR/GBP	0,8673	-0,0031		Gold	1270,00	1,40
GBP/USD	1,2815	-0,0016		EUR/CHF	1,0893	0,0002		Brent	52,19	0,15
AUD/USD	0,7443	0,0006		EUR/SEK	9,7189	0,0074				
USD/CAD	1,3474	0,0014		EUR/NOK	9,3955	0,0117				

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