



Sunrise

Wednesday, 30 May 2018

Rates: Have bond markets reached some kind of ST exhaustion move?

Bond markets faced a sharp repositioning yesterday as investors adapted investments to the latest developments in Italy. German and US core bond yields (10-y) are nearing key support. Today, the focus remains on Italy, especially on a BTP auction. Eco data are probably second tier. Even so, we keep an eye at the German inflation data and US ADP report.

Currencies: Italian risk-off trade hammers euro. Yen resumes its safe haven role

Italian uncertainty kept EUR/USD, USD/JPY and EUR/JPY on a downward trajectory yesterday. EUR/USD is extensively testing the mid 1.1550 support. The test is ongoing. For now we see no reason to fight the Italian-driven risk-off repositioning on global FX markets.

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 markets suffered losses of more than 1% yesterday** with Nasdaq (-0.5%) outperforming after renewed tariff talk. **Asian indices lose ground as well this morning with China and Japan underperforming (> -1.5%).**
- **Italy may hold repeat elections as early as July** after the man asked to be PM failed to secure support from political parties for even a stop-gap government, sources said, as markets tumbled on the growing political turmoil. (Reuters)
- **The US sent a sudden, harsh message to its Chinese counterparts**, saying the US was moving forward with its threat to apply tariffs on Chinese imports and other actions to restrict Beijing from accessing sensitive US technology. (WSJ)
- **EU officials are weighing a much stronger warning on the risk of Brexit talks collapsing** without a deal if the UK fails to lay out its Irish border position in more detail next month. A firm, written proposal is regarded as necessary to move forward. (BB)
- **The RBNZ said financial system is better prepared to weather any unforeseen global shocks** that could push up borrowing costs, but emphasised that **more needed to be done to reduce high household and dairy sector debts.** (Reuters)
- **Weaker growth in the Eurozone would “significantly affect Portugal”**, the IMF warned, saying “lingering domestic vulnerabilities” would amplify any external shock to the former bailout country’s economic recovery. (FT)
- **Today’s eco calendar** contains the US ADP employment report, EC confidence data, the German labour market report and German CPI. Italy taps the bond market, the OECD releases new forecasts and the Fed publishes the Beige Book.

Rates

Short term exhaustion move?

	US yield	-1d
2	2,32	-0,16
5	2,64	-0,18
10	2,78	-0,15
30	3,00	-0,12

	DE yield	-1d
2	-0,77	-0,09
5	-0,39	-0,10
10	0,26	-0,08
30	1,00	-0,05

The Italian-related sell-off accelerated yesterday morning after a rare intervention of Bank of Italy governor Visco who warned that the country was “a few steps away” from losing the “asset of trust”. The panic move slowed around European noon, but regained vigor as US traders returned from the long weekend. **The magnitude suggests a short term exhaustion move.** The Italian yield curve bear flattened with yields 183 bps (!!) (2-yr) to 47 bps (10-yr) higher. The 10-yr yield spread vs Germany exploded to 290 bps, **the highest since 2013** and coming from 122 bps early May. Other peripherals suffered too. The Greek spread added 40 bps, the Portuguese one 21 bps and the Spanish one 18 bps. (Semi-) core spreads added 4 to 7 bps. German Bunds significantly outperformed with German yields 5.4 bps (30-yr) to 10.4 bps (5-yr) lower. **US Treasuries profited from safe haven flows as well.** The US unexpectedly sharpened trade rhetoric against China, lifting Treasuries further. US yields dropped by 11.7 bps (30-yr) to 18.1 bps (5-yr) compared to Friday’s close.

Asian stock markets record similar losses endured by Europe and the US yesterday. USD/JPY stabilizes and the US Note future loses some ground, suggesting a slightly weaker opening for the Bund as well. **Overnight comments give conflicting signals** with Lega leader Salvini hinting at early elections as soon as end of July (instead of September/October) while 5SM leader Di Maio suggested cooperating with President Mattarella to solve the crisis and avoid a new ballot. Recent polls suggest huge gains for Lega, outgrowing 5SM. **It’s hard to predict the outcome of political discussions, but we still expect fresh elections.**

The eco calendar heats up today, but German inflation data (significant pick-up expected!; 0.3% M/M, 1.8% Y/Y) and US ADP employment (190k) will likely be overshadowed by Italian developments. The BTP auction is relatively small in size (€4bn; 2023 & 2028), but will be an important gauge to see whether the first repositioning move is really over or not. **We remain cautious even if yesterday’s session resembled an exhaustion move. We wouldn’t buy into any short term peripheral bond rally.** The German 10-yr yield tested key 0.18% support, while the US yield approached 2.7%. Breaks lower, especially in Germany, would signal that market’s take into account a new institutional crisis in Europe. We don’t position for such scenario. If tensions temporary ease, focus could turn to the expected inflation rebound in Europe and **this week’s busy US eco calendar. Will they confirm Q2 eco data strength and end the correction lower in US yields?**



German 10-yr yield tests key support (0.18%). A break lower suggests markets expecting a new European institutional crisis



US 10-yr yield approaches 2.7% support. Can US eco data and Fed speakers divert attention?

Currencies

Euro near recent lows, awaiting next step from Italy

R2	1,2598	-1d
R1	1,2555	
EUR/USD	1,1540	-0,0085
S1	1,1812	
S2	1,1718	

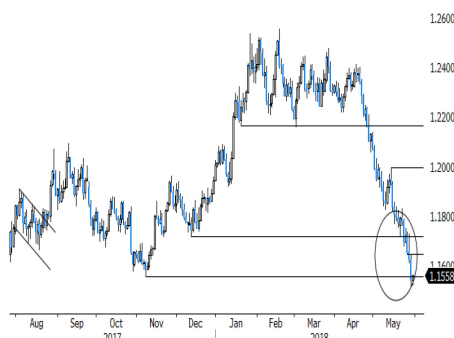
R2	0,9307	-1d
R1	0,9033	
EUR/GBP	0,8710	-0,0023
S1	0,8627	
S2	0,8541	

Yesterday, the Italian risk-off trade continued. This sell-off also had a bigger fall-out on non-Italian markets than was the case lately. EUR/USD slipped to the low 1.15 area. Temporary, it looks that repositioning on Italy had reached some kind of exhaustion move. However, selling resumed as efforts to form a short-term Italian government stalled. At the same time, the US stepped up its rhetoric regarding import tariffs on China. Treasury yields nosedived as the risk-off trade ever more affected US markets. It didn't help the euro much. EUR/USD closed at 1.1540. The upward pressure on the yen also intensified as the risk-off became more broad-based. USD/JPY fell to 108.10, but closed at 108.77.

Overnight, Asian markets are joining the global risk-off trade. For now, it doesn't translate in further gains of US Treasuries. Also the major euro and USD cross rates (USD/JPY, EUR/USD and EUR/JPY) are taking a breather. EUR/USD hovers around yesterday's close. USD/JPY trades near 108.60. EUR/JPY returned north of 125 after yesterday's sell-off.

Today, the calendar is well filled with, amongst others, EC confidence, German inflation and the US ADP labour report. We see an asymmetrical risk especially for the EMU data. A negative surprise in EC confidence will add to investor nervousness on Europe. At the same time, we are keen to see the reaction of EMU yields and the euro on a substantial up-tick in German inflation. **In the current environment, we doubt that it will help the euro much.** The focus will remain Italian politics and on the BTP bond auction. The outcome of the attempt to form a ST government is highly uncertain, but it's difficult to see a scenario that eases the uncertainty. **If the auction fails, it would add to the crisis momentum.** Yesterday, the euro sell-off slowed temporary, but there is absolutely no indication of an imminent rebound. The downtrends in EUR/USD, EUR/JPY and USD/JPY remain in place and for now we see no good reason to catch those falling knives. Next intermediate resistance in EUR/USD is the mid 1.14 area (50% retracement).

Yesterday, EUR/GBP to some extent followed the decline of EUR/USD. However, gains of sterling remained modest. Today, we see no high profile UK topics issues on the agenda. The decline of EUR/GBP remained within the established ranges. Some further selling might occur if the Italian crisis persists, but we don't expect **sterling to become a major beneficiary of EMU/Italian uncertainty.**



EUR/USD: test of 1.1550 support continues as Italian crisis develops.



EUR/JPY decline mirrors EMU/Italian risk-off trade.

Calendar

Wednesday, 30 May		Consensus	Previous
US			
14:15	ADP Employment Change (May)	190k	204k
14:30	Wholesale Inventories MoM	0.5%	0.4% R
14:30	GDP Annualized QoQ (1Q S)	2.3%	2.3%
14:30	Personal Consumption (1Q S)	1.2%	1.1%
14:30	Core PCE QoQ (1Q S)	2.5%	2.5%
Canada			
16:00	Bank of Canada Rate Decision (May 30)	1.25%	1.25%
Japan			
01:50	Retail Sales MoM/Trade YoY (Apr P)	1.4%/1.6% A	-0.7%/1.0%
07:00	Consumer Confidence Index (May)	43.9	43.6
UK			
01:01	BRC Shop Price Index YoY (May)	-1.1%	-1.0%
EMU			
11:00	Economic Confidence (May)	112.0	112.7
11:00	Business Climate Indicator (May)	1.29	1.35
11:00	Industrial Confidence (May)	6.8	7.1
11:00	Services Confidence (May)	14.3	14.9
11:00	Consumer Confidence (May F)	0.2	0.2
Germany			
	CPI Baden Wuerttemberg MoM/YoY (May)	--	0.0%/1.7%
08:00	Retail Sales MoM /YoY (Apr)	0.5%/1.6%	-0.3% R/1.3%
09:00	CPI Saxony MoM/YoY (May)	--	0.0%/1.6%
09:55	Unemployment Change (000's) (May)	-10k	-7k
09:55	Unemployment Claims Rate SA (May)	5.3%	5.3%
10:00	CPI Brandenburg MoM/YoY (May)	--	-0.1%/1.6%
10:00	CPI Hesse MoM/YoY (May)	--	0.0%/1.5%
10:00	CPI Bavaria MoM/YoY (May)	--	-0.1%/1.7%
10:30	CPI North Rhine Westphalia MoM/Yoy (May)	--	0.0%/1.5%
14:00	CPI MoM/YoY (May P)	0.3%/1.9%	0.0%/1.6%
14:00	CPI EU Harmonized MoM/YoY (May P)	0.3%/1.8%	-0.1%/1.4%
France			
08:45	Consumer Spending MoM/YoY (Apr)	0.2%/1.8%	0.1%/2.3%
08:45	GDP QoQ/YoY (1Q P)	0.3%/2.1%	0.3%/2.1%
Norway			
08:00	Manufacturing Wage Index QoQ (1Q)	--	0.1%
Spain			
09:00	Retail Sales SA YoY (Apr)	1.8%	2.5% R
09:00	CPI EU Harmonised MoM/YoY (May P)	0.5%/1.7%	0.8%/1.1%
Sweden			
09:30	GDP QoQ/WDA YoY (1Q)	0.5%/3.3%	0.9%/3.3%
Events			
11:00	OECD Economic Forecasts		
20:00	U.S. Federal Reserve Releases Beige Book		
11:00	Italy to Sell 0.56% 5Y and 1.70% 10Y Bonds		

10-year	Close	-1d	2-year	Close	-1d	Stocks	Close	-1d	
US	2,78	-0,15	US	2,32	-0,16	DOW	24361,45	-391,64	
DE	0,26	-0,08	DE	-0,77	-0,09	NASDAQ	7396,594	-37,26	
BE	0,72	-0,05	BE	-0,57	-0,02	NIKKEI	22001,4	-357,03	
UK	1,20	-0,12	UK	0,60	-0,09	DAX	12666,51	-196,95	
JP	0,03	-0,01	JP	-0,14	0,00	DJ euro-50	3428,14	-54,50	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,04	2,64	1,01	Eonia	-0,3630	0,0040			
5y	0,22	2,71	1,19	Euribor-1	-0,3710	0,0000	Libor-1	1,9756	0,0000
10y	0,86	2,82	1,43	Euribor-3	-0,3210	0,0010	Libor-3	2,3181	0,0000
				Euribor-6	-0,2690	0,0000	Libor-6	2,4819	0,0000
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1540	-0,0085	EUR/JPY	125,51	-1,68	CRB	201,82	-1,53	
USD/JPY	108,77	-0,65	EUR/GBP	0,8710	-0,0023	Gold	1304,10	-4,90	
GBP/USD	1,3249	-0,0062	EUR/CHF	1,1439	-0,0114	Brent	75,39	0,09	
AUD/USD	0,7505	-0,0041	EUR/SEK	10,3392	0,0815				
USD/CAD	1,3018	0,0025	EUR/NOK	9,5597	0,0319				

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