



## Sunrise

Thursday, 12 January 2017

### Rates: Reflation trade (temporarily) on hold?

Investors will further digest yesterday's Trump comments. Or better: they'll remember what he didn't touch upon: details of his fiscal stimulus plans. The US Note future is back near 125-09 resistance. We await the outcome of the test, but expect that some investors are willing to put the "reflation trade" at least temporary on hold.

### Currencies: Dollar extends correction after Trump press conference

Yesterday, the dollar traded strong early in the session, but lost ground as president elect Trump failed to give concrete guidance on its policy. Today, the eco calendar is again thin. If investors turn more cautious on the post-Trump reflation trade, the dollar correction might still go further.

### 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** recovered initial losses on disappointment about Trump and closed with modest to moderate gains. **Asian stocks trade** mixed with Japanese equities in the red on a stronger yen. China underperforms as well.
- The US dollar closed lower overnight as president-elect **Donald Trump, in a press conference, gave no further clarification** about his proposed fiscal stimulus and infrastructure spending plans.
- **Brent crude rose 2.7% to \$55.08/barrel**, after two days of heavy selling. A weaker dollar and record amount of processed oil apparently trumped the higher inventories, suggesting that sentiment and technicals played a role.
- **The Brazilian central bank cut its policy rate by 75 bps**, exceeding the consensus call for a 50 bps cut and sharply picking up the pace on an easing cycle it began with 2 cuts of 25 bps each in October and November.
- **Japan's trade surplus shrank to ¥313.4B in November** from ¥587.6bn in October, driven by an 8.1% rise in imports. Exports still managed to carve out a 2.5% gain, suggesting overseas demand for Japanese products is still solid.
- **The political deadlock in Poland extended into the new parliamentary term** that began on Wednesday, amid continued failure to reach a compromise deal that would end a sit-in by opposition MPs that has lasted throughout the break.
- **US Secretary of State nominee Tillerson** has set the stage for a major diplomatic clash between Washington and Beijing after he said China should not be allowed to access islands it has built in the South China Sea. **Trump also criticized China in harsh wordings.**
- **Today's eco calendar** remains thin with EMU production, US import & initial claims. There is a barrage of Fed speakers and Dec. ECB Minutes.

# Rates

## Bund curve flattens, while Treasuries end little changed

*Flattening German curve on supply-related items*

*US Treasuries cannot hold on to gains after Trump & stellar 10-yr Note auction*

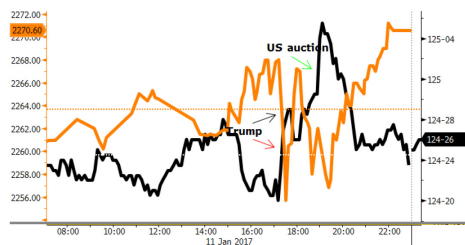
*Strong performance peripheral bonds*

	US yield	-1d
2	1,16	-0,03
5	1,83	-0,05
10	2,32	-0,05
30	2,92	-0,05

	DE yield	-1d
2	-0,72	0,01
5	-0,48	-0,01
10	0,33	-0,04
30	1,03	-0,03

Yesterday, global core bonds traded with an upward bias. US Treasuries first lagged Bunds. After catching up, they eventually returned most of the gains, despite a strong US 10-yr Note auction. The German Bunds performed well for supply-related reasons, but surprisingly enough peripheral (and semi-core) bonds did even better. Some country specific news for Italy (rejection referendum) and Portugal (strong auction) may explain part of outperformance. In a daily perspective, the German yield curve bull flattened with yield changes ranging between +0.9 bps (2-yr) and -3.2 bps (30-yr). Benchmark changes distorted the 6-to-10 yr part of the German curve. US yields fell at most 1 bp (30-yr).

Regarding the Bund gains, the German's 10-yr Bund auction was well received, German Finance Ministry's chief economist Schuknecht renounced suggestions that Germany has leeway issue more debt for fiscal spending and finally Reuters reported that the country ended 2016 with a €5-7B budget surplus. **Trump's press conference** lacked details on economic policies, even as his protectionist mind-set was crystal-clear in comments on US firms potentially moving to Mexico. **That caused some temporary disappointment in riskier assets of which bonds profited.** Finally the **US 10-yr Note auction was a bumper.** It pushed bonds immediately to intraday highs, but was followed by a selling wave. **Higher oil prices** may have played a role, even as the rally in oil started much earlier. **Recovering equities** may also caused the US Treasury sell-off.



T-Note future (black) and S&P future (orange) (intraday): Trump and US Note auction push T-notes higher, but all gains lost again as equities recover and oil rises



Oil price rebounds after two day sell-off on statistics that show refineries process record amount of crude and dollar weakens

## Fed speakers and again few data

*EMU production to start recovering*

*US claims higher on holiday distortion*

*US import prices up on higher oil*

*Many Fed speakers on the docket, but most have already given their opinion*

**November EMU industrial production** is expected at 0.6% M/M and 1.6% Y/Y, following a dismal -0.1% M/M and 0.6% Y/Y in October. The manufacturing surveys showed improving sentiment, suggesting that production will accelerate in November and beyond. In the **US, import prices** are expected to have recovered further in December on the back of higher oil and commodity prices, while **initial claims** are expected to have jumped higher by 20K to 255K in the most recent week. The previous very low figure included the holiday period and was thus likely distorted. **Fed governors Harker, Evans, Kaplan and Lockhart speak.** The first three will vote at the 2017 FOMC meetings. Evans is a dove but supports 3 rate hikes in 2017. Kaplan is a centrist and will most likely vote with the majority. Harker said already he is in for the 3 hikes, while Lockhart (non-voter) sees 2 rate hikes as appropriate in 2017.

## Italy and US tap market

**The Italian debt agency taps the on the run 3-yr BTP (€2.5-3B 0.05% Oct2019), 7-yr BTP (€2.25-2.75B 0.65% Oct2023) and 20-yr BTP (€1-1.5B 2.25% Sep2036).**

Only the Oct2019 BTP cheapened in ASW-spread terms going into the auction while the Oct2023 and especially Sep2036 BTP trade rather expensive on the Italian curve. Ahead of Friday's key rating decision by DBRS (a cut means "BBB" at all agencies and thus larger haircuts if BTP's are used as collateral, etc.), we expect plain vanilla demand at best.

R2	165,48	-1d
R1	164,90	
<b>BUND</b>	<b>163,48</b>	<b>0,35</b>
S1	162,62	
S2	159,91	

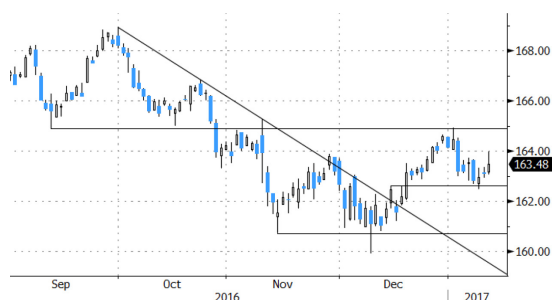
**The US Treasury continued its mid-month refinancing operation with a tremendous \$20B 10-yr Note auction which stopped more than 2 full bps through the 1:00 PM bid side with a strong bid cover (2.58).** Bidding details showed that the indirect bid was responsible for the strength. Is the strong auction a sign that the Trump reflation trade is prone for correction? **Today, the US Treasury holds a \$12B 30-yr Bond auction. The WI trades around 2.92%.**

## Reflation trade on hold?

**Overnight,** Asian stock markets trade mixed with China and Japan in negative territory. The Japanese yen and US note future gain ground, suggesting risk aversion at the start of dealings which could also result in a stronger opening for the Bund.

**Today's eco calendar** contains some second tier eco data while most scheduled Fed governors already spoke earlier this year. We think that rate markets will further digest yesterday's Trump comments. **Or better: they'll remember what he didn't touch upon: details of his fiscal stimulus plans. The US Note future is back near 125-09 resistance. We await the outcome of the test, but expect that some investors are willing to put the "reflation trade" at least temporary on hold. If confirmed today and tomorrow (after US retail sales), we would change our short term bias for US Treasuries from negative to neutral. Risk aversion also benefits core bonds in a daily perspective.**

**Longer term, we expect US markets to further align with the Fed's scenario of 3 rate hikes this year. In EMU, the German Bund bounced into 164.9 resistance at the start of the year and fell prey to profit taking on higher German inflation data. As the underlying economic picture in EMU improves further, we also expect more downside in the Bund despite the ECB's bond buying programme.**



German Bund: New trading band between 160.72 and 164.90



US Note future: back near 125-09+ resistance. Reflation trade on hold?

# Currencies

*Dollar reverses early gains as investors take profit after Trump press conference*

R2	1,0874	-1d
R1	1,0653	
<b>EUR/USD</b>	1,0634	0,0075
S1	1,0341	
S2	1,0000	

*Dollar remains in the defensive as core bond yields decline overnight*

*Eco data modestly interesting.*

*Will the lack of concrete guidance from Trump weigh on the reflation trade/dollar?*

## USD profit taking after Trump press conference

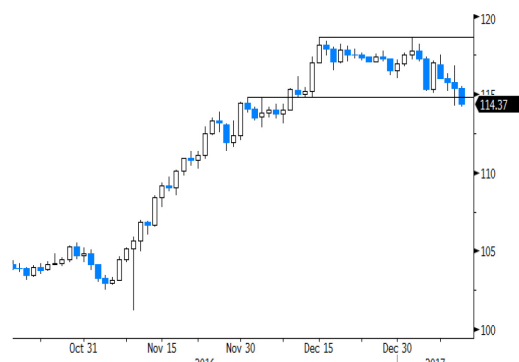
On Wednesday, the dollar set intraday highs against the euro and the yen just before the press conference of President elect Donald Trump. Trump didn't provide much detail on the economic policy he wants to implement. The reaction on various markets differed. Equities held up well, while the dollar declined as some FX investors took some profit on the reflation trade. EUR/USD closed the session at 1.0582 from 1.0554 (but compared to an intraday low of 1.0454). USD/JPY finished the session at 115.41 (from 115.77).

**Overnight**, Asian equities trade mixed. Japanese and Chinese markets trade in negative territory. The dollar remains in the defensive. However it is not sure whether this is due to investors' disappointment after the Trump press conference. US yields are also declining after yesterday's late session rebound. USD/JPY trades currently at 114.34/40, near the recent low. The dollar is also in the defensive against the euro (1.0625).

**Today**, the EMU **November industrial production** is expected to have rebounded by 0.6% M/M and 1.6% Y/Y. In the **US, import prices** are expected to have recovered further in December, while **initial claims** are expected to have jumped higher by 20K to 255K after an extremely low figure in the previous week. In addition, several Fed members will speak. The eco data will only be of second tier importance for currency trading. **We also keep an eye how markets react to the communication from the president elect Trump.** For now, there is no clear sign that the markets are already at a point of aggressively reversing bets on the reflation trade. Even so, there might be a growing risk that markets, including the dollar, turn more cautious on the Trump trade, at least until the administration provides better information on its policy. **Over the previous days, the dollar was already a bit in the defensive even after decent US payrolls. This correction might go a bit further.** In this respect, we keep an eye on the interest rate developments as spreads between the US and Europe show signs of topping out.



EUR/USD: dollar in the defensive post-Trump



USD/JPY: USD drops below a first support area

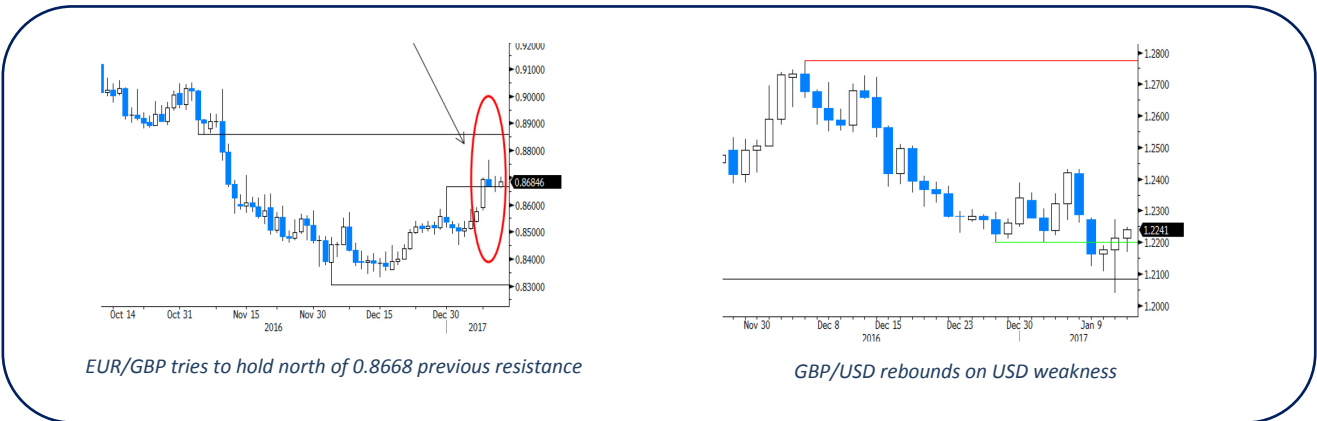
**Global context:** EUR/USD touched a multi-year low at 1.0341 last week. **After the Trump rally, there is a lot good USD news discounted. Interest rate differentials between the dollar and the euro remain very high, but didn't widen anymore of late, slowing the rise of the dollar.** The absolute interest rate support should provide a USD floor as long as US data remain good and as there are no profound doubts on the ability of the new government to execute its pro-growth agenda. **A buy the dollar on dips strategy remains preferred. EUR/USD 1.0653/70 is a first resistance. A return north of 1.0874 would question the USD positive momentum.** On the downside, **EUR/USD 1.0341 is still the first key support. A test of parity remains possible MT.** USD/JPY started a correction last week and remains in the defensive. A first important support at 114.74/115.07 has been broken, if confirmed this is a USD/negative short-term. We stay USD/JPY positive long-term, but are in no hurry to rush in right now. An equity correction or a further decline in core yields might be a short-term negatives for USD/JPY.

**EUR/GBP holding in the 0.86/0.87 area.**

R2	0,9047	-1d
R1	0,8851	
<b>EUR/GBP</b>	<b>0,8682</b>	<b>-0,0005</b>
S1	0,8450	
S2	0,8304	

**On Wednesday,** UK November production data printed stronger than expected, but **the trade deficit widened much more than expected as imports rose more than exports. Sterling lost temporary ground after the trade data and EUR/GBP returned to the 0.87 area, but the move had no strong legs.** The intraday decline of EUR/USD also capped the topside of EUR/GBP. BoE's Carney suggested that the BoE could raise its growth forecast, but still saw risks to the Brexit process. Sterling didn't react much to the comments. Sterling basically followed the USD movements post-Trump. Cable and EUR/USD rebounded. Cable closed the session at 1.2213. EUR/GBP finished the session at 0.8665

**Today,** there are no important UK eco data. So, trading in the major sterling cross rates will be driven by the global market context. EUR/USD is well bid this morning. The global deflation trade, which supported sterling more than the euro, is a bit in the defensive. This context might be more favourable for the euro than for sterling short-term. **Sterling held strong in November and December, but lost some momentum in the second half of last month.** EUR/GBP held a sideways trading pattern in the 0.85 area. Uncertainty on the next steps in the Brexit debate are again weighing on sterling in the run-up to the end of March article 50 deadline. We prefer a buy-on-dips strategy for EUR/GBP. If the break beyond 0.8668 is confirmed, it would improve the EUR/GBP picture.



EUR/GBP tries to hold north of 0.8668 previous resistance

GBP/USD rebounds on USD weakness

# Calendar

Thursday, 12 January		Consensus	Previous
<b>US</b>			
14:30	Import Price Index MoM / YoY (Dec)	0.7%/1.8%	-0.3%/-0.1%
<b>14:30</b>	<b>Initial Jobless Claims</b>	<b>255k</b>	<b>235k</b>
14:30	Continuing Claims	2087k	2112k
<b>Japan</b>			
00:50	Trade Balance BoP Basis (Nov)	A ¥313.4b	¥587.6b
00:50	Bank Lending Incl Trusts YoY (Dec)	A 2.6%--	2.4%
00:50	Bank Lending Ex-Trusts YoY (Dec)	A 2.6%	2.4%
03:00	Tokyo Avg Office Vacancies (Dec)	A 3.61--	3.75
06:00	Eco Watchers Survey Current (Dec)	A 51.4-	48.6
06:00	Eco Watchers Survey Outlook (Dec)	A 50.9--	49.1
<b>EMU</b>			
<b>11:00</b>	<b>Industrial Production SA MoM / WDA YoY (Nov)</b>	<b>0.6%/1.6%</b>	<b>-0.1%/0.6%</b>
<b>Germany</b>			
10:00	Budget Maastricht % of GDP (2016)	0.6%	0.7%
10:00	GDP NSA YoY (2016)	1.8%	1.7%
<b>France</b>			
08:45	CPI EU Harmonized MoM / YoY (Dec F)	0.3%/0.8%	0.3%/0.8%
<b>Italy</b>			
10:00	Industrial Production MoM / WDA YoY (Nov)	0.2%/1.9%	0.0%/1.3%
<b>Norway</b>			
08:00	House Price Index QoQ (4Q)	--	3.2%
<b>Sweden</b>			
08:00	PES Unemployment Rate (Dec)	--	3.9%
09:30	CPI CPIF MoM / YoY (Dec)	0.4%/1.8%	0.1%/1.6%
<b>Events</b>			
11:00	Italian 3-7-30 BTP auctions		
13:30	ECB Publishes Account of Monetary Policy Meeting		
<b>14:30</b>	<b>Fed's Harker Speaks</b> in Malvern, Pennsylvania		
<b>14:30</b>	<b>Fed's Evans and Lockhart</b> Take Part in Panel in Naples, Florida		
19:00	US to sell \$12B 30-yr Bonds		
19:45	<b>Fed's Kaplan</b> Speaks at Dallas Regional Chamber Event		

10-year	<u>td</u>	<u>-1d</u>		2-year	<u>td</u>	<u>-1d</u>		Stocks	<u>td</u>	<u>-1d</u>
US	2,32	-0,05		US	1,16	-0,03		DOW	19954,28	98,75
DE	0,33	-0,04		DE	-0,72	0,01		NASDAQ	5563,649	11,83
BE	0,65	-0,05		BE	-0,62	-0,01		NIKKEI	19134,7	-229,97
UK	1,35	-0,02		UK	0,17	-0,03		DAX	11646,17	62,87
JP	0,05	-0,02		JP	-0,26	-0,01		DJ euro-50	3307,94	1,73
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	-0,11	1,64	0,71	Eonia	-0,3510	0,0000				
5y	0,08	1,88	0,92	Euribor-1	-0,3720	0,0000		Libor-1	0,7650	0,0017
10y	0,67	2,20	1,32	Euribor-3	-0,3260	-0,0020		Libor-3	1,0179	0,0031
				Euribor-6	-0,2330	-0,0010		Libor-6	1,3338	0,0022
Currencies	<u>td</u>	<u>-1d</u>		Currencies	<u>td</u>	<u>-1d</u>		Commodities	<u>td</u>	<u>-1d</u>
EUR/USD	1,0634	0,0075		EUR/JPY	121,56	-0,91		CRB	192,29	1,15
USD/JPY	114,31	-1,68		EUR/GBP	0,8682	-0,0005		Gold	1200,00	10,50
GBP/USD	1,2247	0,0091		EUR/CHF	1,0742	0,0010		Brent	55,28	1,51
AUD/USD	0,7479	0,0088		EUR/SEK	9,5445	-0,0309				
USD/CAD	1,3123	-0,0108		EUR/NOK	9,0532	-0,0234				

## Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	<b>Brussels</b>	
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
<b>Dublin Research</b>		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
<b>Prague Research (CSOB)</b>		<b>Prague</b>	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
<b>Bratislava Research (CSOB)</b>		<b>Bratislava</b>	+421 2 5966 8820
Marek Gabris	+421 2 5966 8809		
<b>Budapest Research</b>		<b>Budapest</b>	+36 1 328 99 85
David Nemeth	+36 1 328 9989		

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