



Sunrise

Tuesday, 25 October 2016

Rates: 129-26 support US Note future back in play?

Risks for US eco data are on the upside of expectations. In combination with upcoming US supply and a rising probability of a December rate hike, we expect a new test of 129-26 support in the US Note future. The one-off correction higher in the Bund following last week's ECB meeting has probably run its course.

Currencies: Dollar rally slows, but no correction yet

Yesterday, the dollar rally shifted into a lower gear, but there was no real profit taking. USD/JPY even nears the recent highs. Today, the US data probably won't change the broader picture for the dollar. However, markets gradually raise the probability for a December rate hike, putting a solid floor under the US currency.

Calendar

Headlines

S&P	↗
Eurostoxx50	↗
Nikkei	↗
Oil	→
CRB	→
Gold	→
2 yr US	→
10 yr US	↗
2 yr EMU	→
10 yr EMU	↗
EUR/USD	→
USD/JPY	↗
EUR/GBP	↘

- US equities** eked out good gains with the Nasdaq outperforming (Telecom). **Asian equities can't follow up on WS gains yesterday and trade mixed.** Japanese equities outperform on yen weakness.
- The **offshore yuan traded near a record low** as Chinese policy makers signalled they are willing to allow greater currency flexibility amid a slump in exports and an advance in the dollar. USD/CNH traded at 6.7836.
- When the Fed next raises rates it should be more explicit about how it will respond to new economic info about the economy going forward, said **Fed Evans**. He envisage 3 rate hikes by end 2017 if growth comes in as he forecasts.
- South Korea's economic growth** slowed in the third quarter as corporate woes such as Samsung's smartphone recall, Hyundai Motor's strike and Hanjin Shipping's bankruptcy took a toll on the export-dependent nation.
- Market expectations of a 2016 Fed rate rise have climbed to the highest level since early June (70%) amid growing anxiety over the potential side-effects of historically low interest rates and easing tension about the US election.
- According to the Bundesbank, **German inflation** may rise to more than 1% by the end of 2016. It would be the first time in two and a half year that it rises more than 1%. Some pressure on the ECB to lower its QE purchases?
- New Zealand's central bank will publish its forecasts for the Official Cash Rate** from next month, increasing the transparency of how it communicates future interest-rate moves.
- Today, the eco calendar** contains the German IFO indicator, US consumer confidence & Richmond Fed survey. ECB Mario Draghi and BoE Carney speak. Finland, US and Austria supply the market while the earnings season continues.

Rates

Lacklustre start to trading week

Bond sell-off in US mid-morning trading

US & German curves bear steepen

	US yield	-1d
2	0,848	0,0164
5	1,2726	0,0297
10	1,7648	0,0353
30	2,5179	0,0409

	DE yield	-1d
2	-0,6510	0,0160
5	-0,4820	0,0200
10	0,0280	0,0290
30	0,6567	0,0438

Global core bonds traded lacklustre during the European session, ignoring both a strong PMI business survey and stronger equities, but came alive once the US session got going. **US Treasuries and German bonds faced selling pressure because of several reasons.** First, US traders prepared for the Treasury's end-of-month refinancing operation (which starts today) and corporate supply. Second, the usually ignored US ISM surprisingly jumped to the highest level of the year (53.2). Third, US equities traded strong. **Thin trading conditions may have exacerbated the move. Once European traders closed the books, equities and US Treasuries/the Bund stabilized. The oil price spiked lower, but recovered. In a daily perspective,** the German yield curve bear steepened with yields 0.7 bps (2-yr) to 3.1 bps (30-yr) higher. The US yield curve shifted in similar fashion with yields 1.6 bps (2-yr) to 3.2 bps (30-yr) higher. On **intra-EMU bond markets,** Portugal (-6 bps) and Spain (-3 bps) outperformed. Portuguese bonds profited from DBRS's decision to keep the BBB- rating unchanged, while Spanish bonds advanced as the political stalemate could end as the Socialists' party will no longer veto a Rajoy-led minority government.

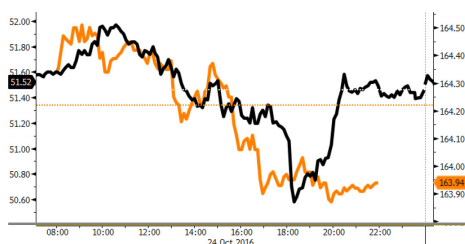
Eco calendar modestly interesting

In the euro area, French business confidence (102) is expected to have stabilized in October, just like the German IFO business sentiment (109.6). Coming after the PMI reports of these countries yesterday, market attention should be less outspoken. The October German PMI was very strong following a decline in September, but the IFO jumped sharply in September. **This suggests that the PMI played catching up with the IFO and is probably not the precursor of another substantial move higher of the IFO in October. However, recent better data from the industrial side suggest that an upward surprise is possible.** The French manufacturing PMI did well in October, while services PMI disappointed, but following a good September reading. This suggests **risks for an upward surprise** in French manufacturing sentiment for October. **Mario Draghi** speaks in Berlin on stability, equity and monetary policy. An interesting theme, but it is unlikely he will give strong hints on policy a few days after the ECB meeting. In the US, **consumer confidence** is expected to have dropped to 101 from 104.1 in October, a post crisis high. There is no particular reason to expect a decline except that it often falls in October, it is at a high and elections are looming. So, a decline looks indeed more likely. Nevertheless, it is an upward surprise that would get attention and weigh on core bonds. The **Richmond Fed manufacturing index** is expected to improve from -8 in September to -4 in October.

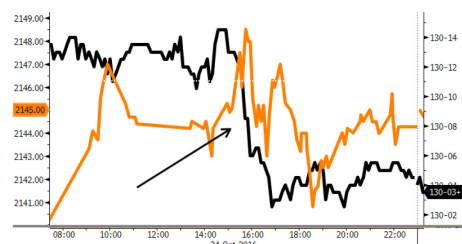
IFO to surprise again?

US Consumer confidence is expected to decline, but increase would get more attention in markets.

Slight improvement Richmond Fed expected



Bund future (orange) and oil (black) intraday: Uneventful morning followed by move lower in mid-US trading. Oil price of little impact



T-Note Future (black) and S&P 500 (orange): Sharp drop mid session on complex of (minor) drivers and amid thinner trading.

R2	166,36	-1d
R1	164,29	
BUND	163,94	-0,4200
S1	163	
S2	162,56	

Finland, Austria and US supply market

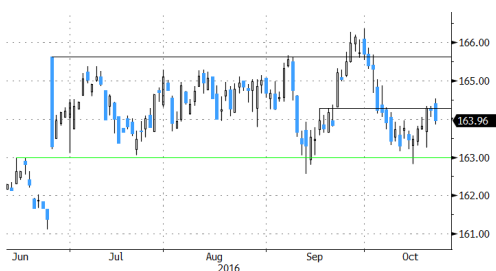
The **Finnish Treasury** sells up to €1B 15-yr bonds (0.75% Apr2031). The bond traded stable in ASW-spread terms going into the auction, but is the cheapest bond on the Finnish curve, supporting demand from a relative point of view. Austria mandated bank to manage a new 7-yr syndication (Jul2023) in the near term, likely today, and also explored the possibility of a 70-yr (!) tranche. **The US Treasury starts its end-of-month refinancing operation** with \$26B 2-yr Note auction. Currently, the WI trades around 0.85%.

Sentiment-driven trading at start of the week?

Overnight, Asian risk sentiment is mixed. The US Note future and Brent crude trade stable, suggesting a neutral opening for the Bund.

Today's eco calendar contains German IFO, US consumer confidence and US Richmond Fed manufacturing index. We see risks on the upside of expectations, which could especially affect US Treasuries. Upcoming supply is negative as well for Treasuries. Yesterday, the market implied probability of December rate hike increased above 70% for the first time in the close. **In the run-up to next week's FOMC meeting, the US Note future could test 129-26 support again, anticipating hints on a December move. In such scenario, the US 10-yr and 30-yr yields should be able to hold above key resistance levels at 1.75% and 2.5% though.** ECB's Draghi's speech in Berlin is a wildcard today, but we expect him to keep close to last week's comments at the press conference. Earnings (Caterpillar, GM, Apple) could influence core bond markets via risk sentiment.

We think that the correction higher in the Bund following the ECB meeting has run its course. ECB president Draghi said that the ECB will deliver key policy guidance in December. QE won't last forever, but also won't stop immediately after March 2017, suggesting that the central bank has a tapering scenario in mind, but not necessarily just after March. **We expect the Bund to remain in the sideways trading range (163 area – 165.63).**



German Bund: Correction away from 163 support as Draghi signals that the QE-programme won't stop immediately after March 2017



US Note future: Extensively tested the downside, but break didn't occur so far

Currencies

R2	1,1366	-1d
R1	1,1123	
EUR/USD	1,08795	0,0004
S1	1,0826	
S2	1,0711	

USD holds near the recent highs, but limited additional gains, for now.

Asian equities show no clear trend this morning

The dollar holding near the recent highs

USD strength weighs on the yuan

Data to be only of intraday significance from USD trading

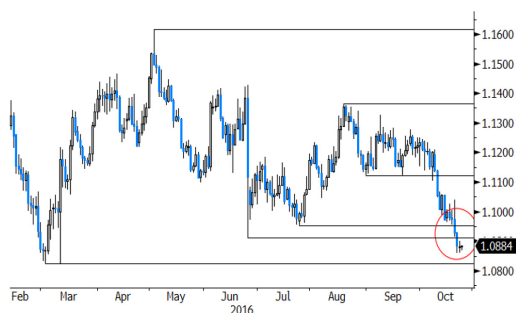
Dollar holds strong

USD/JPY nears the range top

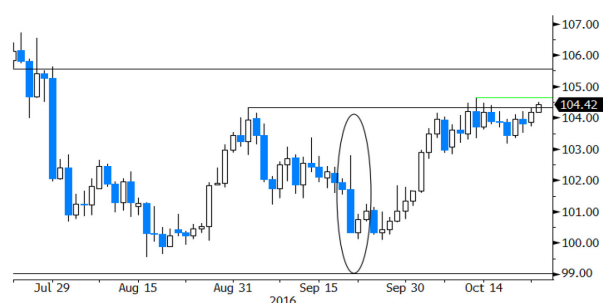
On Monday, the USD rally slowed. USD held close to the recent highs in a session devoid of important news. Risk sentiment was constructive, but the impact on the dollar wasn't that obvious. EUR/USD traded sideways in a 1.0860/1.0900 range. A good EMU PMI helped to block the downside in EUR/USD. USD/JPY initially didn't profit from the equity rally, but finally rebounded as core/US bond yields turned north later. USD/JPY closed the session at 104.18 (from 103.80). The 104.64 correction top remained intact.

Overnight, Asian indices trade narrowly mixed, despite a good close in the US. Japan outperforms as the yen remains relatively weak north of USD/JPY 104. The trade-weighted dollar holds near a 7 month top. The US currency is still supported by gradually rising expectations for a Fed rate hike. Markets currently attach a probability of more than 70 % to a December rate hike. The rise of the dollar also weighs on the yuan. The off-shore yuan is setting new lows. USD/CNY (on-shore yuan) trades at 6.7760, the weakest level for the yuan since September 2010. The global moves again have only limited impact on EUR/USD with the pair holding in the 1.0880 area.

Today, French business confidence (102) and the German IFO business confidence (109.6) are expected to have stabilized in October. Yesterday, the German PMI was strong following a decline in September, but the IFO jumped already sharply in September. An upward surprise is possible. Even if so, the reaction of the euro should be guarded. Mario Draghi speaks in Berlin on stability, equity and monetary policy. He will unlikely give strong hints on policy a few days after the ECB meeting. In the US, October consumer confidence is expected to have dropped to 101 from 104.1, a post crisis high. A decline looks more likely, but a less than expected setback /upward surprise can weigh on core bonds and support the dollar. Yesterday, the dollar rebound slowed (temporary?), but there was no real correction or profit taking. So, for now yesterday's consolidation was a pause in an established trend. Markets continue to play the policy divergence between the Fed and the ECB after the ECB press conference. December Fed rate hike expectations put a solid floor for the US dollar. The ECB is expected to maintain a loose policy beyond March 2017, capping the topside of the euro. The dollar rally won't continue forever, but for now interest rate support causes by default USD buying. There is no reason to row against the USD positive tide, especially not in EUR/USD.



EUR/USD: dollar rally takes a breather, but trend remains intact



USD/JPY new test of range top in store?

From a technical point of view, EUR/USD finally dropped below 1.0952/13 support. The break is a further USD positive and opens the way to next intermediate support (1.0822/1.0711). USD/JPY struggles to break north of 104.32/64. A break would paint a double bottom formation on the charts with targets in the 108/109 area. We stay cautious on sustained USD/JPY gains beyond the 104.32/65 resistance especially as global volatility/uncertainty intensifies. A new test of the recent highs looks to be in store.

Sterling: consolidation continues

R2	0,9142	-1d
R1	0,9027	
EUR/GBP	0,8895	-0,0014
S1	0,8725	
S2	0,8589	

On Monday, trading in the UK currency was order driven and technical in nature, as eco data were ignored. The CBI data were mixed. Businesses see a rise in external competitiveness due to the weaker pound. There were also tentative signs of an improvement in investment intentions, but October orders disappointed. EUR/GBP held a tight sideways range around the 0.89 big figure. The pair closed the session 0.8992 (from 0.8900). Cable closed the day at 1.2238 (from 1.2234).

Today, the UK calendar is empty, but BoE's Carney appears before the House of Lords Economic Committee. Markets will look for clues on the BoE's short-term policy intentions. If the BoE governor turns a bit more neutral on the timing of further easing, it might be slightly supportive for sterling in a daily perspective. Political comments on the Brexit diminished allowing Sterling to enter calmer waters last week. This might continue short term. The UK currency even rebounded slightly as markets assume that more Parliamentary involvement reduce the risk of a hard Brexit. However, we don't expect this rebound to go far. We look to sell sterling on more pronounced up-ticks. EUR/GBP 0.8725 remains a key reference.



EUR/GBP: sterling enters calmer waters



GBP/USD: consolidation

Calendar

Tuesday, 25 October		Consensus	Previous
US			
15:00	S&P CoreLogic CS US HPI MoM SA / YoY NSA (Aug)	--/--	0.41%/5.1%
15:00	S&P CoreLogic CS 20-City MoM SA / YoY NSA (Aug)	0.1%/5.0%	-0%/5.02%
16:00	Consumer Confidence Index (Oct)	101.0	104.1
16:00	Richmond Fed Manufact. Index (Oct)	-4	-8
16:00	IBD/TIPP Economic Optimism (Oct)	47.5	46.7
Germany			
10:00	IFO Business Climate (Oct)	109.6	109.5
10:00	IFO Current Assessment (Oct)	114.9	114.7
10:00	IFO Expectations (Oct)	104.5	104.5
France			
08:45	Business Confidence (Oct)	102	102
08:45	Production Outlook Indicator (Oct)	8	7
08:45	Own-Company Production Outlook (Oct)	9	10
18:00	Total Jobseekers (Sep)	3518.4k	3556.8k
18:00	Jobseekers Net Change (Sep)	-16.8	50.2
Events			
Q3 earnings	Caterpillar (12:30), P&G (13:00), Under Armour (13:15), GM (13:30), Apple (22:30)		
12:00	Finland to sell up to €1B 0.75% 2031 bonds		
16:30	ECB President Draghi Speaks in Berlin		
16:35	Carney Appears at House of Lords Economic Committee		
19:00	US to sell \$26B 2-yr Notes		
19:20	Fed's Lockhart Speaks on Community Development		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,76	0,04	US	0,85	0,02	DOW	18223 18223,03
DE	0,03	0,03	DE	-0,65	0,02	NASDAQ	for Exch - NQI #VALUE!
BE	0,27	0,04	BE	-0,66	0,00	NIKKEI	17357 17356,57
UK	1,07	-0,01	UK	0,23	0,00	DAX	10761,17 10761,17
JP	-0,06	-0,01	JP	-0,23	-0,01	DJ euro-50	3094 3093,86

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,35 -0,002
3y	-0,155	1,138	0,629	Euribor-1	-0,37	0,00	Libor-1 USD	0,26 0,26
5y	-0,055	1,276	0,738	Euribor-3	-0,31	0,00	Libor-3 USD	0,40 0,40
10y	0,405	1,582	1,051	Euribor-6	-0,21	0,00	Libor-6 USD	0,56 0,56

Currencies		-1d	Currencies		-1d	Commodity	CRB	GOLD	BRENT
EUR/USD	1,08795	0,0004	EUR/JPY	113,58	0,63		189,3951	1265,99	51,38
USD/JPY	104,425	0,55	EUR/GBP	0,8895	-0,0014	-1d	0,00	0,69	-0,22
GBP/USD	1,2224	0,0021	EUR/CHF	1,0816	0,0005				
AUD/USD	0,7628	0,0006	EUR/SEK	9,6893	-0,01				
USD/CAD	1,3330	-0,0015	EUR/NOK	8,9775	-0,01				

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