



## Sunrise

Monday, 25 September 2017

### Rates: Short term Bund gains after German elections?

German elections ended with a Pyrrhic victory for Merkel's CDU/CSU and create some uncertainty. The SPD's voluntary move to the opposition paves the way for a coalition with Liberals and Greens, but is maybe less "European friendly". Peripheral spread widening could be the result today, while the Bund could eke out some short term gains.

### Currencies: German election outcome to erode euro positive momentum

Last week, USD softness prevailed. The German election outcome dominates headlines this morning and is considered as less EU friendly. This weighs on the single currency. Sterling was sold after a Moody's downgrade late on Friday', but the UK currency shows resilience as the dollar and the euro trade soft this morning.

### 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 Friday's dull sideways session virtually unchanged. **Asian equities, excluding Japanese ones, trade down** in the opening session.
- **German chancellor Merkel gained** a 4th term but her party's result was the worst since 1949. A far-right party entered parliament in a sign of the growing polarization. Social democrats refuse to hold coalition talks, so **Merkel will have to forge an agreement with the Liberals and Greens, creating uncertainty.**
- **A Republican attempt to repeal and replace Obamacare appeared headed for defeat** after senator Collins said she doesn't see herself backing the plan and Senator Cruz said he's currently "not a yes." However, uncertainty remains.
- **Moody's cut the UK Aa1 rating to Aa2, outlook stable.** The outlook for public finances has "weakened significantly," with fiscal consolidation plans in question and debt burden expected to continue to rise, Moody's justified. **It may hit sterling, as Fitch and S&P have a negative outlook on their UK rating.**
- **Republican tax negotiators are targeting a corporate tax rate of 20%**, according to people familiar with the matter. That would be higher than President Donald Trump wants -- setting up a key decision for the president.
- **New Zealand PM English has claimed a mandate to form the next government** after winning the biggest slice of the vote in Saturday's election, even as opposition leader Ardern refuses to concede defeat. **NZD/USD trades lower.**
- **The Republicans cemented control over the French Senate**, a setback for president Macron. However, it has only limited powers and its composition reflects the 2015 municipal elections (municipal councillors elect Senate).
- **Today**, attention goes to the IFO survey and manifold central bank speakers.

# Rates

## German bonds slightly underperform US Treasuries

US Treasuries eked out some gains in the Asian session, as risk-aversion linked to North-Korean nuclear test threats, dominated trading. They kept the gains, but moved sideways further out. The Bund opened higher, reflecting US Treasury gains, but soon slid lower as risk sentiment improved and EMU PMI business confidence largely exceeded expectations. It confirms the buoyancy of the euro area economy. The Bund bottomed even before noon and struggled higher to erase all losses, maybe partially helped by declining equities. All in all, the bond moves were minor, but more than half of the post FOMC losses on Wednesday have now been recouped. Central bankers (Williams, Constancio, see Friday's KBC Sunset) gave a number of interesting comments that were however largely ignored.

In a daily perspective, US yields declined between 0.7 bps (2-yr) and 2.7 bps (10-yr), while German yields are little changed (between flat and -0.7 bps). On intra-EMU bond markets, 10-yr yield spreads versus Germany are unchanged.

## IFO business confidence and Central Bank speakers

German IFO business Climate is expected virtually unchanged in September at the highest level since the start of the series in 1991. Needless to say that the German economy is thriving. We have no signals that the German economy is over its peak. The Markit PMI's improved quite strongly in September, but they were a bit weaker in June/July, contrary to the IFO. German equities have done well in September, but the stronger euro is a potential negative, even if firms didn't complain yet. Therefore, we dare not put the risks on the upside of expectations. The Dallas Fed business confidence indicator is likely distorted by the tropical storms.

The event calendar is busy. ECB Constancio, Mersch, Draghi and Coeuré take stage. Constancio gives a welcome address at an ECB research conference and Mersch speaks on risk management. Whether Draghi will give markets some guidance on future policy is unclear as well. Coeuré chairs a panel on the exit from non-standard monetary policy, a theme markets currently focus on. This might bring interesting insights. From the Fed side, NY Fed Dudley and Chicago Fed Evans are speakers on duty. The title of Dudley's speech suggests that monetary policy will not be the topic. We strongly suspect Dudley was amongst the eleven governors who expect still a rate hike in 2017. Evans is a dove and he probably was one of the four governors who doesn't expect a rate hike anymore in 2017. He is concerned about the low inflation.

Small drop in US yields, while nearly flat German yields.

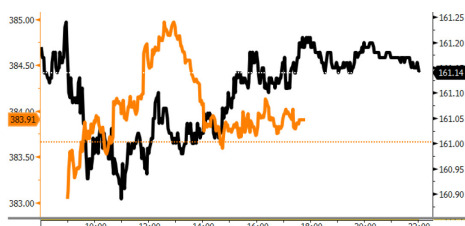
Small spread widening periphery

	US yield	-1d
2	1,43	-0,01
5	1,86	-0,02
10	2,25	-0,03
30	2,78	-0,02

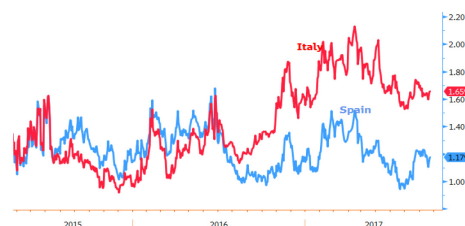
Strong German IFO

Many Fed & ECB speakers

	DE yield	-1d
2	-0,68	0,00
5	-0,26	0,00
10	0,45	-0,01
30	1,27	-0,01



Bund future (black) & EuroStoxx (orange) (intraday): Bund down on strong PMI's and diminishing risk aversion, but losses recouped later on



10-yr yield spreads versus Germany: Will the German election result negatively affect peripheral spreads?

## Germany, Italy and the US supply market

R2	163,43	-1d
R1	161,66	
<b>BUND</b>	161,22	-0,02
S1	160,49	
S2	160,5	

**This week's scheduled EMU bond supply is low with only Germany and Italy on the agenda.** The German Finanzagentur holds a €4B 2-yr Schatz auction tomorrow (0% Sep2019). Italy holds zero-coupon and inflation-linked bond auctions tomorrow and its regular BTP-auction on Thursday. Lines and amounts on offer still need to be announced, but normally it will be 5-yr and 10-yr BTP taps, eventually supplemented with off the run LT BTP's. **The US starts its end-of-month refinancing operation** tomorrow with a \$26B 2-yr Note auction. They continue on Wednesday with \$13B 2-yr FRN and \$34B 5-yr Note auctions. On Thursday, the Treasury concludes with a \$28B 7-yr Note auction.

### Short term Bund gains after German elections?

**Risk aversion reigns overnight with Asian stock markets up to 1% lower.**

EUR/USD loses some points. The US Note future gains a few ticks and we expect a stronger opening for the Bund as well. German elections ended with a Pyrrhic victory for Merkel's CDU/CSU and creates some uncertainty. The SPD's voluntary move to the opposition paves the way for a coalition with Liberals and Greens, but is less "European friendly". Peripheral spread widening could be the result today.

**Today's eco calendar** contains German Ifo. We expect a near consensus outcome, suggesting that it won't be the main impetus for trading. A plea of central bank speakers are wildcards (see above), but most won't touch on monetary policy. The front end of the US yield curve can nevertheless underperform if Fed governors stress their willingness to hike rates in December (especially dove Evans). ECB heavyweight Coeuré can touch on the future of APP. **Risk sentiment and German elections will dominate trading, suggesting more room to take some profit on short positions in the German Bund.** US supply is negative for Treasuries this week.

**After the FOMC meeting, we concluded that US Treasuries re-entered a sell-on-upticks phase after the Fed confirmed its view on 2017/2018 interest rate policy.** A December rate hike isn't fully discounted yet. **Short term though, we expect some correction higher.** We hold a sell-on-upticks view in the Bund as well as the ECB's normalisation process slowly takes off. **From a technical point of view, both the Bund and the US Note future fell below uptrend lines (early September) since the start of summer, making the picture neutral from bullish.**



German Bund: Draghi delays key decisions to October. Speculation on APP announcement could inflict more losses, but ST gains on German election uncertainty?



US Note future: Hawkish Fed inflicts more losses on US Treasuries. Correction higher possible on stretched move, but sell-on-upticks

# Currencies

*Dollar traded with a soft bias Friday*

*The Fed didn't help.*

*Asian equity markets ex japan trade negatively*

*The yen weakens as investors expect new fiscal stimulus*

*German election outcome weighs slightly on the euro.*

*Will German election outcome erode to recent positive sentiment on the euro?*

R2	1,2225	-1d
R1	1,2167	
EUR/USD	1,1951	0,0010
S1	1,1662	
S2	1,1311	

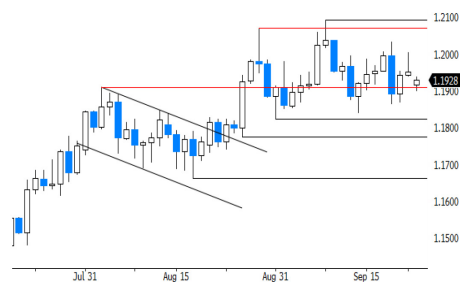
## German election to weigh on the euro ?

Sentiment on the dollar remained fragile on Friday as (geopolitical) uncertainty and a cautious risk-off mood deprived the dollar of highly needed interest rate support. The euro was supported by strong EMU PMI's. However, at the end of the day, the moves were modest. EUR/USD closed the day at 1.1951. USD/JPY finished the week at 111.99.

There are several stories to guide trading at the start of the new week. Japanese equities outperform as markets look out for new pro-growth measures as PM Abe is considering snap elections for next month. USD/JPY trades again in the 112.25 area, but is off the intraday top as global sentiment in the region is risk-off. Chinese markets underperform, especially the property sector, on the announcement of measures to ease speculation. EUR/USD dropped temporary to the 1.19 area on the outcome of the German election. For now, the loss of euro is modest (currently around 1.11930/35). The New-Zealand election brought also a diffuse outcome as the ruling National party didn't get a majority. NZD/USD declined from the mid 0.73 area to the mid 0.72 area.

Today, the German IFO business Climate is expected virtually unchanged at the highest level ever. We don't have strong evidence to take a different view from the consensus. There also plenty of ECB and Fed governors scheduled to speak, including ECB Constancio, Mersch, President Draghi and Coeuré. From the Fed side, NY Fed Dudley and Chicago Evans are the speakers on duty. Dudley's speech probably won't address monetary policy. Evans is a dove and was probably one of the governors who don't see a rate hike anymore in 2017.

Last week, the dollar remained soft even as the Fed reiterated its intention to continue policy normalization. The euro profited slightly from strong PMI's. Today, the focus might be on the consequences of the German election outcome. The IFO will have to bring a big surprise to have impact on euro trading. The German election outcome is less positive for the EU and intra-EMU cooperation. This might widen intra-EMU spreads and cause some euro softness. At the same time, the sources of uncertainty that weigh on the dollar have still not gone. We start the week with a slightly euro negative bias. However, it is far from sure that the outcome of the German election will start a real sustained euro down-leg. EUR/USD 1.1823 remains to first reference.



EUR/USD: Will German election cause a euro negative repositioning?



USD/JPY: yen remains in the defensive even as global sentiment on risk turns less positive.

**From a technical point of view** EUR/USD hovers in a consolidation pattern between 1.1823 and 1.2070. It was disappointing for EUR/USD bears that the recent correction didn't reach the range bottom. **More confirmation is needed that the bottoming out process in US yields and in the dollar might be the start of more sustained USD gains (against the euro). In case of a break, next support in EUR/USD comes in at 1.1774 and 1.1662**

The day-to-day momentum in **USD/JPY** remains more constructive. However, this in the first place due to yen weakness. USD/JPY regained the 110.67/95 previous resistance, a short-term positive. Unless an unexpected risk-off event, the yen might remain in the defensive. The 114.49 correction top is the next important reference.

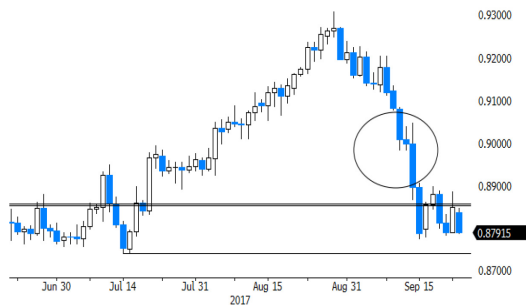
R2	0,9415	-1d
R1	0,9307	
<b>EUR/GBP</b>	<b>0,8850</b>	<b>0,0058</b>
S1	0,8743	
S2	0,8657	

### No lasting sterling damage from Moody's downgrade

On Friday, sterling was at the mercy of the broader swings in the euro and the dollar as markets awaited UK PM May's Brexit speech in Florence. UK PM May brought some general considerations on the relationship between the EU and the UK, but stressed that the UK intends to maintain the best relations with the EU. The UK PM also advocated a transition period. **Sterling initially declined, but soon regained most of the lost territory as the tone of the speech was reconciliatory.** The reactions from Europe were mildly positive. Later in the session, the sterling faced another headwind as Moody's cut the rating of the UK from Aa1 to Aa2. **This downgrade hammered sterling.** EUR/GBP closed the session at 0.8850. Cable finished the day at 1.3504

**Today**, the euro is slightly in the defensive after the German election result. EUR/GBP dropped again to 0.88 barrier. Sterling profits from both underlying euro and USD softness and this may still go somewhat further. The recent lows in EUR/GBP (0.8775 area) are within reach.

EUR/GBP made an impressive uptrend since April and set a MT top at 0.9307 late August. **Recent UK price data amended the dynamics** and the reversal of sterling was reinforced by hawkish BoE comments. Medium term, we maintain a **EUR/GBP buy-on-dips approach as we expect the mix of relative euro strength and sterling softness to persist. However, the prospect of (limited) withdrawal of BOE stimulus put a solid floor for sterling ST term. We look how far the current correction has to go. EUR/GBP is nearing support at 0.8743 and 0.8652, which we consider difficult to break. We start looking to buy EUR/GBP on dips.**



EUR/GBP: near recent lows



GBP/USD: sterling remains well bid despite mixed news flow

# Calendar

Monday, 25 September		Consensus	Previous
<b>US</b>			
14:30	Chicago Fed Nat Activity Index (Aug)	-0.25	-0.01
16:30	Dallas Fed Manf. Activity (Sep)	11.5	17.0
<b>Japan</b>			
02:30	Nikkei Japan PMI Mfg (Sep P)	A: 52.6	52.2
<b>Germany</b>			
10:00	IFO Business Climate (Sep)	116	115.9
<b>10:00</b>	<b>IFO Expectations (Sep)</b>	<b>108</b>	<b>107.9</b>
10:00	IFO Current Assessment (Sep)	124.7	124.6
<b>Spain</b>			
09:00	PPI MoM / YoY (Aug)	--/--	0.0%/3.2%
<b>Events</b>			
09:00	ECB Vice President Constancio speaks in Frankfurt (welcome address research conf.)		
11:15	ECB's Mersch Speaks at Lisbon Conference on Risk Management		
14:30	Fed's Dudley Speaks on Workforce Development and Q&A		
<b>15:00</b>	<b>ECB President Draghi speaks in Brussels (Third monetary dialogue)</b>		
16:45	ECB's Coeure is chairing a panel in Frankfurt (Exit from Non-standard policy)		
<b>18:40</b>	<b>Fed's Evans Speaks on Economy and Monetary Policy (Q&amp;A)</b>		

<b>10-year</b>	<u>Close</u>	<u>-1d</u>		<b>2-year</b>	<u>td</u>	<u>-1d</u>		<b>Stocks</b>	<u>Close</u>	<u>-1d</u>
<b>US</b>	2,25	-0,03		<b>US</b>	1,43	-0,01		<b>DOW</b>	22349,59	-9,64
<b>DE</b>	0,45	-0,01		<b>DE</b>	-0,68	0,00		<b>NASDAQ</b>	6426,922	4,23
<b>BE</b>	0,73	-0,01		<b>BE</b>	-0,52	-0,01		<b>NIKKEI</b>	20397,58	101,13
<b>UK</b>	1,36	-0,01		<b>UK</b>	0,45	-0,01		<b>DAX</b>	12592,35	-7,68
<b>JP</b>	0,03	-0,01		<b>JP</b>	-0,14	-0,02		<b>DJ euro-50</b>	3541,42	1,83
<b>IRS</b>	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	<b>EUR</b>	<u>-1d</u>	<u>-2d</u>		<b>USD</b>	<u>-1d</u>	<u>-2d</u>
<b>3y</b>	-0,04	1,80	0,92	<b>Eonia</b>	-0,3590	0,0070		<b>Libor-1</b>	1,2383	0,0011
<b>5y</b>	0,24	1,95	1,09	<b>Euribor-1</b>	-0,3720	0,0010		<b>Libor-3</b>	1,3294	0,0011
<b>10y</b>	0,89	2,22	1,40	<b>Euribor-3</b>	-0,3290	0,0010		<b>Libor-6</b>	1,4968	0,0058
				<b>Euribor-6</b>	-0,2710	0,0010				
<b>Currencies</b>	<u>Close</u>	<u>-1d</u>		<b>Currencies</b>	<u>Close</u>	<u>-1d</u>		<b>Commodities</b>	<u>Close</u>	<u>-1d</u>
<b>EUR/USD</b>	1,1951	0,0010		<b>EUR/JPY</b>	133,84	-0,47		<b>CRB</b>	183,57	0,17
<b>USD/JPY</b>	111,99	-0,49		<b>EUR/GBP</b>	0,8850	0,0058		<b>Gold</b>	1297,50	2,70
<b>GBP/USD</b>	1,3504	-0,0076		<b>EUR/CHF</b>	1,1581	-0,0010		<b>Brent</b>	56,86	0,43
<b>AUD/USD</b>	0,7962	0,0033		<b>EUR/SEK</b>	9,5389	0,0191				
<b>USD/CAD</b>	1,2339	0,0012		<b>EUR/NOK</b>	9,322	0,0059				



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