

Friday, 13 July 2018

Rates: Core bonds rather resilient despite improvement risk sentiment

Core bonds oscillated near opening levels yesterday despite US CPI (2.9% Y/Y), a further improvement in risk sentiment and bullish economic comments of Fed Chair Powell. Q2 earnings and risk sentiment probably remain the key market theme today. The US S&P 500 tests final resistance ahead of the all-time high.

Currencies: Dollar holding strong even as risk sentiment improves

Yesterday, the dollar remained will bid even as demand for safe haven assets eased. A further rise in the US CPI and rising short-term yields supported the US currency. This trend can continue today. Sterling didn't profit from the publication of the Brexit White paper as the final result of the Brexit process still faces plenty of political hurdles.

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	→

- After Wednesday's dull performance, **American bourses ended in green** yesterday, with the Nasdaq (+1.4%) outperforming its peers (+0.9%). **Asian equity markets currently extend gains**. Japans' Nikkei index is leading (+2%).
- **US president Trump lashed out at May's Brexit proposal**, saying it "will probably kill" any UK-US-trade agreement as the US under such a Brexit deal "would be dealing with the EU instead of dealing with the UK".
- **Chinese exports/imports in June rose 11.3%/14.1% YoY**, resulting in a \$41.61bn trade surplus. The June trade surplus with the US climbed to \$28.97bn, the highest since 1999, underlining the US-China trade conflict.
- After China on Tuesday, **the US signalled they were open to resuming talks over trade**. US Treasury Secretary Mnuchin said that "to the extent that China wants to make structural changes, I and the administration are available" for talks.
- **Fed Chair Powell showed confident about the US economy**, Tax cuts and spending increases could give a "significant" boost to the economy for the next 3 years at least. Trade poses a risk with stagflation the worst case outcome.
- **Germany declined to sign off the €15bn final aid payment to Greece** that would end the country's 8 yr bailout regime after the Greek government postponed a planned tax increase on islands that were hit by migration flows.
- US **Michigan's consumer sentiment** is published today. The Fed releases its **semi-annual monetary policy report** to Congress. JP Morgan Chase, Wells Fargo and Citigroup kick off the **Q2 earnings season**. Fed's Bostic speaks.

Rates

Improving risk sentiment, but core bonds resilient

	US yield	-1d
2	2,59	0,01
5	2,76	0,00
10	2,85	0,00
30	2,96	-0,01

	DE yield	-1d
2	-0,64	-0,01
5	-0,29	-0,02
10	0,36	-0,01
30	1,02	0,00

Global core bonds oscillated near opening levels yesterday with US Treasuries slightly underperforming German Bunds. Core bonds put up a decent performance given the further improvement in risk sentiment with US stock markets eventually gaining around 1%. The oil price deepened losses intraday, but rebounded into the close. **US CPI inflation moves further above the Fed's 2% goal, both for the headline (2.9% Y/Y) and core (2.3% Y/Y) measure and explains the further flattening of the US yield curve.** US yield changes ranged between +0.8 bps (2-yr) and -0.6 bps (30-yr). The US 2-yr yield tested the 2.6% cycle top. German yields declined by 0.2 bps (30-yr) to 1.5 bps (5-yr). 10-yr yield spread changes vs Germany narrowed up to 2 bps yesterday with Italy outperforming (-5 bps) after a good BTP auction.

US Fed chair Powell appeared in a radio interview just before the US close. He said that the US economy was in a very good position right now. It could profit the next three years from the fiscal boost from tax reforms and spending. That should allow the Fed to gradually keep raising interest rates. **The market implied probability of a September rate hike amounts 86%. The chance of two more hikes this year, our preferred scenario, is around 60%.** In his most direct comments on the issue so far, Powell warned on a worst case stagflation scenario resulting from a trade war. The Fed chair testifies on Capitol Hill next week in semi-annual congressional hearings.

Asian stock markets build on WS gains with Japan outperforming on a weaker yen. The Chinese trade surplus hit the highest level since December, but catch remarkably few headlines. The US Note future treads water. Powell's comments have no direct market impact. We expect a neutral opening for the Bund.

Today's eco calendar is thin with US import/export prices and Michigan consumer confidence (July). Price are second tier following US PPI and CPI earlier this week. Michigan confidence is expected to stabilize near historically high levels. The trading session could be colored by the start of Q2 earnings season with major US banks posting results. The US S&P 500 tested 2800 resistance, the final hurdle before the all-time high at 2872. **A break higher would further improve risk sentiment and could extend the topping off pattern on core bond markets with US Treasuries underperforming German Bunds.** Technically, the German 10-yr yield tested support just below 0.3%. A break didn't occur, suggesting room to move higher in the 0.3%-0.5% range. **The US 10-yr yield hovers near the middle of the sideways range between 2.71% and 3.12**



US 2-yr yield tests cycle high as US inflation moves further above the Fed's 2% target



US S&P 500 tests final resistance before returning to all-time high

Currencies

USD stays strong even as risk sentiment improves

R2	1,2155	-1d
R1	1,1996	
EUR/USD	1,1672	-0,0002
S1	1,1510	
S2	1,1448	

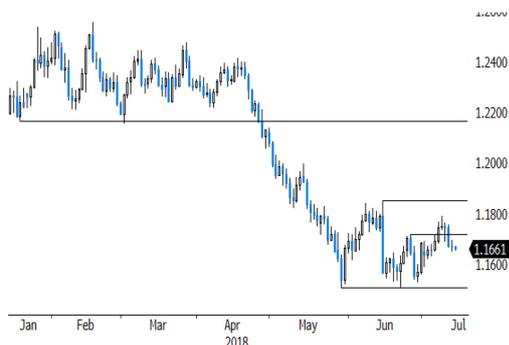
R2	0,9033	-1d
R1	0,8968	
EUR/GBP	0,8837	-0,0003
S1	0,8628	
S2	0,8548	

Yesterday, calm returned to global markets. Tentative signs that the US and China might return to the negotiation table reversed Wednesday's risk-off trade. **Still, the risk rebound didn't hurt the dollar much.** Interest rate differentials widened slightly in favour of the USD. US inflation rose further north of 2% reaching 2.9% Y/Y. The US 2-y yield nears the cycle top. EUR/USD finished little changed at 1.1672. USD/JPY extended Wednesday's upside break and closed the day at 112.55.

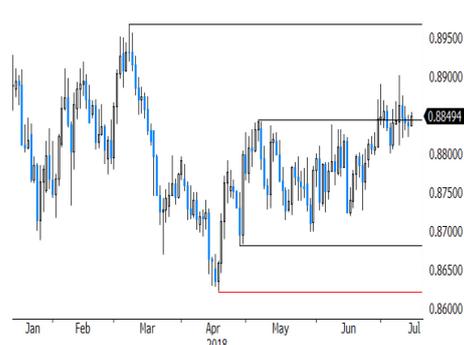
This morning, most Asian equities mostly join the risk rebound with China still underperforming. Yesterday's global FX 'trends' remain more or less in place. The CNY is holding rather soft (USD/CNY 6.67). The dollar remains well bid. EUR/USD is changing hands in the 1.1655 area. USD/.JPY gains a few more tics (112.70 area). Overnight, Fed Powell remained optimistic on the US economy and saw no reason for the Fed to change to path of gradual policy normalisation.

Today, US import prices and Michigan consumer confidence will be published. Markets will also keep an eye at the first **bank earnings**. Michigan confidence is expected little changed at a high level (98 from 98.2). **Corporate earnings** are expected strong. Interesting to see firms forward guidance and the subsequent market reaction. Markets apparently assume that the US economy is rather resilient for impact of the trade war. In this context, positive US earnings and US equity outperforms shouldn't be too negative for the dollar. Yesterday, we indicated that the **day-to-day momentum of the USD improved. This is still, the case. However, in somewhat broader perspective we keep the working hypothesis that the EUR/USD 1.15 range bottom is solid.** USD/JPY confirmed the break 111.40 with further gains.

Yesterday, the publication of the White Paper on the UK Brexit strategy didn't change fortunes for sterling in any profound way. The plan aims for a relatively soft Brexit (at least for goods) but political hurdles remain high. Sterling regained a few ticks against the euro, but the gains could not be sustained. **Overnight sterling even lost slightly further ground after a press interview of Donald Trump.** He said the soft Brexit plan could kill a trade deal with the US and supported Boris Johnson in his political battle with May. For now, we still don't see a trigger for a sustained GBP comeback. More sideways EUR/GBP trading might be on the cards.



EUR/USD: dollar holding strong even as risk sentiment remains constructive



EUR/GBP is still going nowhere as UK political uncertainty remains high even after Brexit agreement.

Calendar

Friday, 13 July		Consensus	Previous
US			
14:30	Import Price Index MoM/YoY (Jun)	0.1%/4.6%	0.6%/4.3%
14:30	Import Price Index ex Petroleum MoM (Jun)	0.3%	0.1%
14:30	Export Price Index MoM/YoY (Jun)	0.2%/--	0.6%/4.9%
16:00	U. of Mich. Sentiment (Jul P)	98.0	98.2
16:00	U. of Mich. Current Conditions (Jul P)	--	116.5
16:00	U. of Mich. Expectations (Jul P)	--	86.3
16:00	U. of Mich. 1 Yr Inflation (Jul P)	--	3.0%
16:00	U. of Mich. 5-10 Yr Inflation (Jul P)	--	2.6%
Germany			
08:00	Wholesale Price Index MoM/YoY (Jun)	--	0.8%/2.9%
China			
07/13	Imports/Exports YoY (Jun)	14.1%/11.3%A	26.0%/12.2%R
Events			
13:00	Bank of England Deputy Governor Jon Cunliffe Speaks in Kendall		
17:00	Fed Releases Monetary Policy Report to Congress		
18:30	Fed's Bostic Holds Town Hall Chat in Northern Virginia		
Q2 Earnings	JP Morgan Chase & Co (12:45), Wells Fargo & Co (14:00), Citigroup Inc (14:00) ...		

10-year	Close	-1d	2-year	Close	-1d	Stocks	Close	-1d	
US	2,85	0,00	US	2,59	0,01	DOW	24924,89	224,44	
DE	0,36	-0,01	DE	-0,64	-0,01	NASDAQ	7823,916	107,31	
BE	0,66	-0,03	BE	-0,52	0,00	NIKKEI	22643,66	455,70	
UK	1,28	-0,01	UK	0,74	-0,01	DAX	12492,97	75,84	
JP	0,05	0,01	JP	-0,13	0,00	DJ euro-50	3445,49	23,14	
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0,03	2,87	1,16	Eonia	-0,3630	-0,0010			
5y	0,27	2,89	1,32	Euribor-1	-0,3700	-0,0010	Libor-1	2,0743	0,0000
10y	0,88	2,92	1,53	Euribor-3	-0,3210	0,0000	Libor-3	2,3370	0,0000
				Euribor-6	-0,2710	0,0000	Libor-6	2,5124	0,0000
Currencies	Close	-1d	Currencies	Close	-1d	Commodities	Close	-1d	
EUR/USD	1,1672	-0,0002	EUR/JPY	131,34	0,58	CRB	194,00	1,17	
USD/JPY	112,55	0,54	EUR/GBP	0,8837	-0,0003	Gold	1246,60	2,20	
GBP/USD	1,3206	0,0001	EUR/CHF	1,1697	0,0070	Brent	74,45	1,05	
AUD/USD	0,7408	0,0042	EUR/SEK	10,3567	0,0570				
USD/CAD	1,3154	-0,0055	EUR/NOK	9,4676	0,0012				

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