KBC

Sunrise

Tuesday, 13 December 2016

Rates: Higher oil pushed Bunds lower, but US Treasuries resilient

It looks like markets are awaiting the FOMC meeting before giving core bonds an eventual new direction. Core bonds remain under pressure, but key technical levels hold for now. We expect little from the eco calendar today, but look to oil and equity markets for eventual surprises that nevertheless might move core bonds.

Currencies: Dollar rally takes a breather ahead of the Fed decision

Yesterday, the dollar fell prey to modest profit taking as investors adapted positions going into tomorrow's Fed decision. Today, more consolidation might be on the cards as the eco data is uninspiring. In the UK, the inflation data will be published. Higher import/PPI prices filtering through into the consumer prices might be slightly sterling supportive.

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** ended the session mixed (Dow/S&P) to lower (NASDAQ). **Asian equities turned early losses into modest gains.** Tokyo outperforms on yen weakness.
- **Chinese retail sales surprised on the upside** in November, rising to 10.8% Y/Y from 10.2% Y/Y previously. **Industrial production** rose by 6.1% Y/Y, just above October's 6% Y/Y, which was also the consensus. **Investment** was unchanged at 8.3% Y/Y in line with expectations.
- In Australian, the NAB business condition survey fell to 5 in November, from a downwardly revised reading in October of 6 (previously 7). This was the lowest reading since April 2015 and the third monthly decline.
- **UK chancellor Hammond** called for transitional arrangements to "smooth" Britain's exit from the EU, the most senior cabinet figure to publicly suggest that there might not be a clean break with Brussels in 2019.
- **Donald Trump is poised to name Rex Tillerson, CEO of ExxonMobil as his secretary of state**, ignoring criticism that the oil and gas man is too close to Russian president Vladimir Putin and the Kremlin.
- **U.S. household inflation expectations** ticked up in November and the share of consumers expecting higher interest rates over the coming year surged, according to a monthly survey from the Federal Reserve Bank of New York.
- **Today's calendar** contains US small business confidence and import prices. In the UK, inflation and house prices get attention while in EMU attention focus on the ZEW survey.

Rates

Higher oil prices lift Bund yields higher

US Treasuries outperform as investors buy the dip

German bonds offered less resilience, closing with modest losses (curve steeper)

Italian bonds underperform

Oil drove core bond yields higher early in the Asian and European sessions after opening around $57/barrel in Asian trading. The rest of the European trading session lacked economic data or events. Oil rapidly slid in sideways trading mode and so did most other markets including the Bund and equities. US Treasuries showed some more appetite and erased the oil-induced losses during technically inspired dip buying in the US session to close the session nearly unchanged. The 3-yr T-Note auction was poor and the 10-yr Note auction were mixed at best. Oil gave gradually returned the oversized gains to end around $55.45/barrel. **Technically**, both the Bund and the T-Note future are near key support (sell-off lows), but a break didn't occur. Similarly, US and German yields are also near key levels, but a trigger is missing for a real test. Are traders awaiting Wednesday's FOMC meeting? **In a daily perspective, the US curve showed little movement with yield changes between -0.5 bps and +0.8 bps. The German yield curve bear steepened, with German yields up between 1.7 bps (2-yr) and 4.2 bps (30-yr). After a two-day sell-off in the peripheral bond markets, calm returned and** 10-yr yield spreads versus Germany narrowed by 5 bps(Portugal/ Spain) to 8 (Italy) bps.

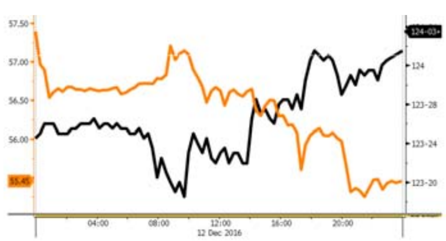
	US yield	-1d
2	1,1453	-0,0120
5	1,8875	-0,0348
10	2,475	-0,0292
30	3,1597	-0,0338

	DE yield	-1d
2	-0,7430	0,0160
5	-0,4170	0,0050
10	0,3980	0,0090
30	1,2055	-0,0049

Eco calendar remains thin and uneventful.

Upside risk ZEW expectations

The US eco calendar contains only **November small business sentiment (NFIB) and import prices**. US import prices are expected to have dropped in November (-0.3% M/M), but that would improve the Y/Y reading to about flat. The outcome, if confirmed, should be neutral for markets. **Small business sentiment is expected to be strong** mirroring the strength in the ISM surveys. However, it is also no market mover. **In Germany, the November ZEW economic sentiment** survey is published. Both expectations (14 from 13.8) and current situation (59 from 58.8) indices are expected little changed. Expectations improved since August, and the current expectations are at a rather high level. We see **some risk on the upside for the expectations.**



T-note future (black) and Brent oil (orange) (intraday): Oil starts sharply higher, putting bonds under pressure, but US Treasuries gradually recoup losses as oil gave back most of its gains.

German 10-yr yield remains under upward pressure near sell-off highs

Austria and US tap market

The Austrian debt agency kicks off this week's limited EMU bond supply (only Spain on Thursday). They tap the off the run 10-yr RAGB (1.2% Oct2025) and on the run 10-yr RAGB (0.75% Oct2026) for a combined amount of €1.1B.

In the run-up to the auction, both bonds slightly cheapened in ASW-spread terms. We expect a plain-vanilla auction.

The US Treasury started its mid-month refinancing operation with a disappointing $24B 3-yr Note auction and a mixed $28B 10-yr Note auction. The 3-yr Note auction stopped with a small tail and with the smallest bid cover since July 2009 (2.65). The upcoming Fed meeting and probable rate hike weighed on demand. Bidding details showed little demand from all categories (direct, indirect and dealer bid). The 10-yr Note auction stopped right on the 1:00 PM bid side, but the bid cover was light (2.39 vs 2.43 average over the past six months). Bidding details also showed weakness across all categories. **Tonight, the Treasury ends its refinancing operation with a $12B 30-yr Bond auction.** Currently, the WI trades around 3.16%.

US yields at key levels ahead of the Fed

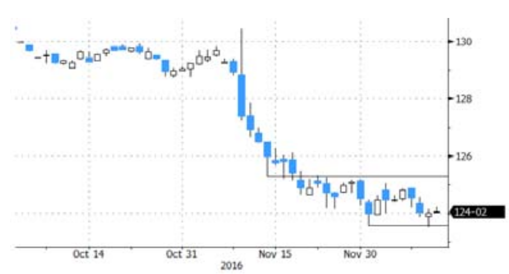
R2	163,36	-1d
R1	162,08	
BUND	**161,27**	0,1200
S1	159,91	
S2	159,14	

Overnight, Asian stock markets trade mixed to slightly higher. China slightly underperforms despite better than expected retail sales. Brent crude and the US Note future are stable, suggesting a neutral opening for the Bund.

Today's eco calendar contains US NFIB small business optimism and German ZEW. **We don't expect them to influence markets ahead of tomorrow's FOMC meeting. A rate hike is discounted, but will the Fed governors wait for Trump's inauguration before changing their dots for next years in a hawkish way? This factor of uncertainty might prevent a break of key technical levels.** The US 2-yr yield broke above 1.1% resistance. Key resistance levels in the US 5-yr yield (1.85-1.9%) and 10-yr yield (2.5%) remain under attack. The US 30-yr yield reached a new post-Trump high (3.18%) and approaches 3.25% resistance. We wait for specific news (e.g. a hawkish Fed) before anticipating a break higher (5-yr & 10-yr). We hold our sell-on-upticks approach in US Treasuries.

Last week, the ECB **cemented the front end of the European yield curves for longer though we're not sure whether they cap the upward potential for long term yields.** From a technical point of view, the German 30-yr yield tested key resistance (1.2% area). **We watch out how the market assess the change of the guard in Italy and the endgame in the Monte dei Paschi thriller. Are the ECB's surprises discounted in peripherals?**

German Bund: no change to technical picture after ECB meeting



US Note future (March contract): Break lower ahead of the Fed normally unlikely, but sentiment remains negative

Currencies

Modest USD profit taking ahead of the Fed

Little hard news to guide USD trading on Monday

R2	1,0851	-1d
R1	1,0809	
EUR/USD	**1,06385**	0,0074
S1	1,0506	
S2	1,0458	

On Monday, the post-ECB repositioning slowed. Ongoing high core bond yields still supported the dollar in Asia, but the rally petered out in Europa. There was little hard news to guide trading. Interest rate differentials between the euro and the dollar didn't change much. Even so, the dollar fell prey to cautious profit taking. The move continued in US trading, as US yields softened a few basis points. EUR/USD rebounded north of 1.06 and closed the session at 1.0635 (from 1.0561 on Friday). USD/JPY also drifted off the Asian top (116+) and finished the day at 115.02 (from 115.32).

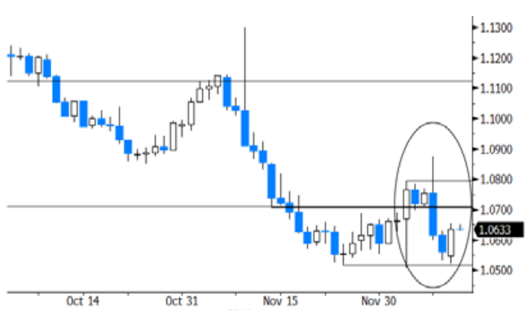
EUR/USD holding in the mid 1.0630/50 area.

Overnight, Asian equities show a mixed picture. Chinese equities are again underperforming. Higher domestic yields and technical factors are probably behind the move. Most other regional markets show modest gains with Japan outperforming on the yen. USD/JPY traded temporary below 115 early in Asia, but is currently again trading in the 115.35 area. EUR/USD is locked in a tight range in the 1.0629/1.0650 area, holding with reach of yesterday's correction top (1.0652).

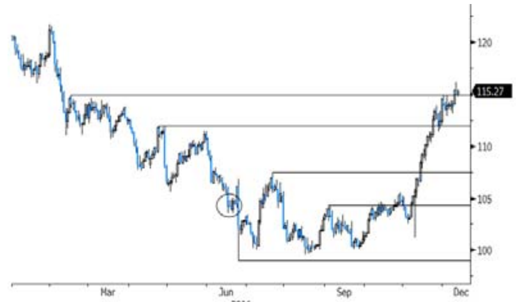
Calendar is again thin

Dollar rally slows going into the Fed decision.

Today, the US eco calendar contains only the November small business sentiment (NIFB) and import prices. Small business sentiment is expected to be strong mirroring the ISM surveys. However, it is no market mover and neither are import prices. **In Germany,** the November **ZEW economic sentiment survey** will be published. Both expectations (14 from 13.8) and current situation (59 from 58.8) indices are expected little changed. **An upward surprise is possible, but** the market reaction will probably be limited. So**, USD traders will continue to count down to tomorrow's Fed decision.** Yesterday, investors took some profit on the recent USD rally, but losses were modest. **Today, some more consolidation ahead of tomorrow's Fed decision might be on the cards.** It will probably be difficult for the dollar to take out its recent highs against the euro (EUR/USD 1.0506 area) and the yen (USD/JPY 116.12) before the Fed policy announcement. Even so, **the USD uptrend remains intact.**



EUR/USD: downside test rejected as USD investors await the Fed decision



USD/JPY: tries to sustain north of 115 barrier

In a longer term perspective, the context remains USD constructive/euro negative. Low absolute short-term EMU yields are weighing on the euro. At the same time, there is **underlying USD strength** supported by higher LT core yields**. With the ECB prolonging substantial bond buying at least till end 2017, the Fed keeps the lead in the policy normalization.** This puts a strong floor under the dollar. Short-term interest differentials will remain wide and might even widen more as the Fed extends a gradual rate hike path in 2017. **From a technical point of view, last week's rejected test of the 1.0795/1.0809 area suggests that the topside of EUR/USD is well capped**. The 1.0506 correction low and the 1.0458 cycle low are the next support levels in EUR/USD.

The technical picture for USD/JPY improved some time ago. The pair took out the key resistance at 111.45/91. Last week, the USD/JPY rally took a breather, but the pair tries to sustain north of the next resistance area at 114.50/115. For now, **the downside in USD/JPY looks well protected as long as sentiment on risk remains constructive. Even in case of an equity correction, the damage for USD/JPY might be modest, as interest rate differentials have become more important. Also for USD/JPY, we favour the upside.**

EUR/GBP hardly profits from EUR/USD rebound

R2	0,8708	-1d
R1	0,8578	
EUR/GBP	**0,839**	-0,0004
S1	0,83	
S2	0,8117	

On Monday, EUR/GBP initially rebounded from the 0.8363 Asia low and returned temporary north of 0.84, supported by the rise of EUR/USD. However, **around noon sterling again found a better bid, both against the euro and the dollar.** Trader talk also still mentioned ongoing sterling short-covering, while legal action to amend the UK government's Brexit strategy **has been slightly GBP supportive. EUR/GBP closed the session unchanged at 0.8388. Cable traded with a positive bias (dollar softness) and closed the session at 1.2679 (from 1.2572).**

Today, the UK inflation data will be published. A rise of 0.2% M/M and 1.1% Y/Y is expected for the headline CPI (from 0.9% Y/Y). Core inflation is expected at 1.3% Y/Y from 1.2% Y/Y. Until now, higher import prices due to decline of sterling didn't reach the consumer yet. However, input producer prices rose already quite sharply. **Any indications of prices rises filtering through into consumer prices might reinforce the idea that a BoE rate cut is becoming ever less likely and might be slightly positive for sterling short-term, especially as sentiment on sterling is constructive.** So, for now it still looks a bit too early to row against the sterling positive momentum. **From a technical point of view,** EUR/GBP extensively tested 0.8333/05 support early last week, but a sustained break didn't occur. This area is an important point of reference. It won't be easy for EUR/GBP to drop below it. So, despite recent sterling strength, we look for confirmation that a bottoming out process is in place.

EUR/GBP still struggling even as EUR/USD rebounds off the recent lows

GBP/USD: consolidation continues

Calendar

Tuesday, 13 Dec		Consensus	Previous
US			
12:00	**NFIB Small Business Optimism (Nov)**	**96.5**	**94.9**
14:30	Import Price Index MoM / YoY (Nov)	-0.3%/0.1%	0.5%/-0.2%
UK			
10:30	**CPI MoM / YoY (Nov)**	**0.2%/1.1%**	**0.1%/0.9%**
10:30	**CPI Core YoY (Nov)**	**1.3%**	**1.2%**
10:30	RPI MoM / YoY (Nov)	0.2%/2.1%	0.0%/2.0%
10:30	PPI Input NSA MoM / YoY (Nov)	-0.5%/13.5%	4.6%/12.2%
10:30	PPI Output NSA MoM / YoY (Nov)	0.2%/2.5%	0.6%/2.1%
10:30	PPI Output Core NSA MoM / YoY (Nov)	0.2%/2.3%	0.4%/1.9%
10:30	House Price Index YoY (Oct)	7.3%	7.7%
EMU			
11:00	Employment QoQ / YoY (3Q)	--/--	0.4%/1.4%
11:00	ZEW Survey Expectations (Dec)	--	15.8
Germany			
08:00	Wholesale Price Index MoM / YoY (Nov)	--/--	0.4%/0.5%
08:00	CPI EU Harmonized MoM / YoY (Nov F)	0.0%/0.7%	0.0%/0.7%
11:00	ZEW Survey Current Situation (Dec)	59.0	58.8
11:00	ZEW Survey Expectations (Dec)	14.0	13.8
Italy			
10:00	Industrial Production MoM / WDA YoY (Oct)	0.2%/1.5%	-0.8%/1.8%
China			
03:00	**Industrial Production YoY / YTD YoY (Nov)**	**A6.2%/6.0%**	**6.1%/6.0%**
03:00	**Retail Sales YoY / YTD YoY (Nov)**	**A10.8%/10.4**	**10.0%/10.3**
03:00	Fixed Assets Ex Rural YTD YoY (Nov)	A 8.3%	8.3%
Spain			
09:00	CPI EU Harmonised MoM / YoY (Nov F)	0.2%/0.5%	0.2%/0.5%

Contacts

10-year	td	- 1d	2 -year	td	- 1d	STOCKS		- 1d	
US	2,48	0,05	US	1,15	0,02	DOW	19796	19796,43	
DE	0,40	0,02	DE	-0,74	-0,01	NASDAQ	or Exch - NQI	#VALUE!	
BE	0,74	0,03	BE	-0,63	-0,01	NIKKEI	19251	19250,52	
UK	1,47	0,08	UK	0,09	0,00	DAX	11190,21	11190,21	
JP	0,08	0,02	JP	-0,14	0,01	DJ euro-50	3199	3199,11	

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,35	-0,004
3y	-0,079	1,562	0,762	Euribor-1	-0,37	0,00	Libor-1 USD	0,26	0,26
5y	0,153	1,879	0,996	Euribor-3	-0,32	0,00	Libor-3 USD	0,38	0,38
10y	0,806	2,320	1,444	Euribor-6	-0,22	0,00	Libor-6 USD	0,54	0,54

Currencies		- 1d	Currencies		- 1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,06385	0,0026	EUR/JPY	122,55	1,14		193,3459	1160,95	55,66
USD/JPY	115,19	0,79	EUR/GBP	0,839	-0,0042	- 1d	1,93	-8,69	1,58
GBP/USD	1,2674	0,0090	EUR/CHF	1,0779	-0,0006				
AUD/USD	0,7482	0,0014	EUR/SEK	9,7418	0,05				
USD/CAD	1,3131	-0,0066	EUR/NOK	8,9662	0,01				

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