

Friday, 13 September 2019

Rates: ECB out of ammunition; over to fiscal policy

ECB President Draghi presented markets with an early goodbye present and passed the torch on to fiscal policy. The bear flattening of EMU yield curve suggests that markets take into account that the ECB is out of ammunition and that we've had a final rate cut. Focus turns to the US (consumer) today with retail sales and University of Michigan consumer confidence.

Currencies: ECB 'end-game' and the call for fiscal stimulus support euro bottoming

EUR/USD rebounded off the 1.0926 support as markets realized that the ECB has shot its last bullet. The call for more fiscal stimulus is a euro positive, too. Today, soft US retail sales might inspire some USD caution ahead of next week's Fed meeting. EUR/USD regaining the 1.11 barrier would call off the short-term alert in EUR/USD.

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	↗

- **Wall Street** edged higher yesterday. Most indices are close to their all-time highs. The Nasdaq and S&P outperformed (+0.3%). **Asian markets** are buoyed by fresh ECB stimulus and trade optimism. Korea (+1.2%) outperforms.
- Bloomberg reported that **US president Trump would consider an interim limited trade deal** in which some tariffs would be delayed/scaled back in return for commitment from China on intellectual property and farm goods purchases.
- EU negotiator Barnier said he has yet to receive a proposal from the UK to base talks upon. Meanwhile, the **DUP said it would allow North Ireland to abide by some EU rules after Brexit** to replace the current backstop, the Times reported.
- The **US budget deficit widened to more than \$1 trillion**, or 4.4% of GDP, during the first 11 months of the fiscal year as military spending and interest expenses increased while revenues weakened.
- **CDU leader Kramp-Karrenbauer warned that Germany's fiscal scope is narrow** given the debt brake embedded in its constitution, adding that the country's "black zero policy" remains the benchmark.
- **Acting PM Sanchez rejected the latest proposal by Podemos to form a coalition on a one-year trial period.** Podemos' suggestion was to review the coalition after a budget had been approved.
- **Today's economic calendar** puts the focus on the US with August retail sales and September University of Michigan consumer confidence. EU finance ministers meet in Helsinki.

Rates

Draghi passes the torch on to fiscal policy

	US yield	-1d
2	1.72	0.04
5	1.64	0.04
10	1.77	0.01
30	2.26	0.03

	DE yield	-1d
2	-0.72	0.12
5	-0.74	0.09
10	-0.52	0.05
30	0.04	0.02

ECB President Draghi threatened markets with an early goodbye present. **The central bank cut the deposit rate by 10 bps to -0.50%, introduced a tiered-system to mitigate some of the negative side-effects for the financial sector, extended its forward guidance which now is data instead of time dependent, raised the attractiveness of TLTRO's and restarted its Asset Purchase Program (€20bn/month). The magnitude of the package slightly exceeded expectations, explaining the initial decline in bond yields. However, ECB President Draghi stressed that it's time to pass the torch on to fiscal policy to revive EMU growth (and as a consequence inflation). We interpret it as a strong hint that the ECB might be out of ammunition and that we're on the eve of a regime change under next president Lagarde. The market reaction following the Q&A session was a textbook case of investors interpreting the current rate cut as the final one in the cycle.** The German yield curve bear flattened with yields rising by 11.8 bps (2-yr) to 1.5 bps (30-yr). Peripheral yield spreads vs Germany narrowed by 8 bps (Portugal/Spain) to 15 bps (Italy) on Draghi's open-ended promise to continue buying bonds. US yields added 3.2 bps (10-yr) to 4.5 bps (2-yr). The US Treasury's \$30-yr Bond auction was soft with a 1.6 bps tail and a slightly below average bid cover.

Positive risk sentiment on Asian stock markets remains in place as the US and China prepare for trade talks. **Sources suggest that US officials have discussed offering an interim trade deal to China to delay tariffs.** Main indices gain up to 1%. The Bund and US Note future trade near yesterday's closing levels.

Today's eco calendar contains US retail sales (August) and University of Michigan consumer confidence (September). Both indicators have market moving potential as they offer insight on developments in the stronghold of US growth: consumption. Hints of weakness might be taken as a sign that weakness in the globally oriented production sector infected the domestic services sector. **We see downside risks for US retail sales, suggesting a better bid for US Treasuries in this week's final trading session. US investors eye next week's FOMC meeting as well. German Bunds can further underperform US Treasuries.**

Technically, the German 10-yr yield and US 10-yr yield both broke first minor support levels, respectively at -0.61% and 1.6%, calling of the downside alert. Our interpretation of yesterday's ECB meeting (see above) suggest more room for profit taking on Bund positions. The next resistance for the German 10-yr yield stands at -0.40%. Next resistance for the US 10-yr yield is 1.94%



German 10-yr yield: break above -0.61% paves the way for further return action towards -0.4% area



US 10-yr yield: move above 1.6% suggests that downward trend channel could be replaced by a sideways one going forward.

Currencies

R2	1.1533	-1d
R1	1.1448	
EUR/USD	1.1065	0.0055
S1	1.0864	
S2	1.0778	

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8971	0.0041
S1	0.8500	
S2	0.8314	

EUR/USD bottoms despite ECB easing

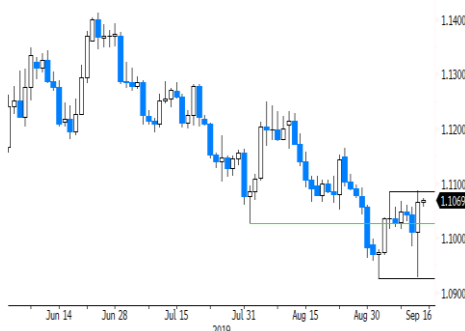
Yesterday's EUR/USD moves followed the **swings in sentiment around the ECB decision**. EUR/USD dropped to test the low near 1.0926 after the policy announcement. The combination of a deposit rate cut and, even more, the restart of QE, initially highlighted the ECB commitment to an ultra-easy approach. However, during the press conference, Draghi stressed that **fiscal stimulus** now has a much bigger role to play. As did Lagarde earlier this month, he acknowledged **the side-effects** (and thus the limits) of policy. **European yields more than reversed the initial decline and so did EUR/USD**. The pair closed at 1.1065 (from 1.1010). USD/JPY extended its 'reflation' rally to close north of 108.

Overnight, the risk rally continued as headlines continue to suggest that the US and China are aiming for some kind of partial trade agreement. The yuan (USD/CNY 7.0785) maintains this week's gains. USD/JPY is holding north of 108. EUR/USD stabilizes in the 1.1070 area.

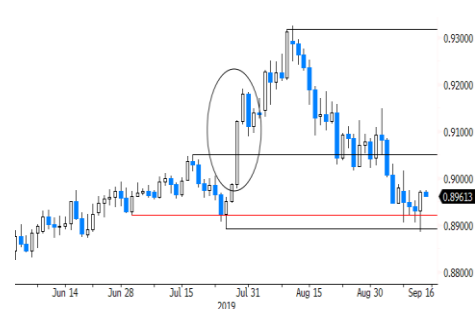
Markets will still ponder the meaning of yesterday's ECB policy decision. Headlines on the trade war suggest **an ongoing constructive risk sentiment**. Regarding the data, the focus turns to the **US retail sales** and the Michigan consumer confidence. **Retails sales growth is expected slow** after five strong months. A slight setback/negative surprise wouldn't change the broader picture but might be cause some USD caution ahead of next week's Fed policy decision. Yesterday's market reaction (both in yields and the euro) suggest that **markets assume the ECB is running out of ammunition**. The focus on **fiscal policy** in theory is a euro positive, too. Investors also might turn a bit more cautions on the dollar ahead of next week Fed meeting. From a technical point of view, yesterday's intraday price action solidifies the 1.0925 support area. So, we take a cautious positive bias on EUR/USD.

A return north of 1.11 would call off the ST negative alert for EUR/USD.

Yesterday, there was little high profile 'new news' on Brexit. Trading in EUR/GBP mostly followed the ECB-driven price pattern of EUR/USD. Sterling lost some ground against a broadly stronger euro (EUR/GBP 0.8971 close) but closed little changed against the dollar. Today, there are no important data in the UK. With the news flow on Brexit gradually becoming thinner, we expect **more technical trading in sterling, following the global trends the dollar and/or the euro**.



EUR/USD: test of 1.0926 support rejected as Draghi pleads for fiscal stimulus



EUR/GBP: more technical trading expected as back stage talks continue.

Calendar

Friday, 13 September		Consensus	Previous
US			
14:30	Import Price Index MoM/YoY (Aug)	-0.50%/-2.00%	0.20%/-1.80%
14:30	Import Price Index ex Petroleum MoM (Aug)	-0.10%	0.00%
14:30	Export Price Index MoM/YoY (Aug)	-0.30%/--	0.20%/-0.90%
14:30	Retail Sales Advance MoM (Aug)	0.20%	0.70%
14:30	Retail Sales Ex Auto MoM (Aug)	0.10%	1.00%
14:30	Retail Sales Ex Auto and Gas (Aug)	0.20%	0.90%
14:30	Retail Sales Control Group (Aug)	0.30%	1.00%
16:00	U. of Mich. Sentiment (Sep P)	90.8	89.8
16:00	U. of Mich. Current Conditions (Sep P)	107.8	105.3
16:00	U. of Mich. Expectations (Sep P)	85.2	79.9
16:00	U. of Mich. 1 Yr Inflation (Sep P)	--	2.70%
16:00	U. of Mich. 5-10 Yr Inflation (Sep P)	--	2.60%
16:00	Business Inventories (Jul)	0.30%	0.00%
Japan			
06:30	Capacity Utilization MoM (Jul)	--	-2.60%
06:30	Industrial Production MoM/YoY (Jul F)	--/--	1..30%/0.70%
EMU			
11:00	Trade Balance SA (Jul)	17.5b	17.9b
Events			
13SEP	Euro area finance ministers hold a meeting in Helsinki		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	1.77	0.01		US	1.72	0.04	DOW	27182.45	45.41
DE	-0.52	0.05		DE	-0.72	0.12	NASDAQ	8194.468	24.79
BE	-0.18	0.03		BE	-0.63	0.10	NIKKEI	21988.29	228.68
UK	0.67	0.04		UK	0.55	0.06	DAX	12410.25	51.18
JP	-0.16	0.06		JP	-0.24	0.03	DJ euro-50	3538.86	22.04
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0.45	1.62	0.80	Eonia	-0.3660	0.0000			
5y	-0.38	1.57	0.78	Euribor-1	-0.4550	-0.0020	Libor-1	2.0359	0.0000
10y	-0.08	1.66	0.80	Euribor-3	-0.4330	-0.0030	Libor-3	2.1273	0.0000
				Euribor-6	-0.4080	0.0000	Libor-6	2.0529	0.0000
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.1065	0.0055		EUR/JPY	119.61	0.89	CRB	174.46	0.73
USD/JPY	108.1	0.28		EUR/GBP	0.8971	0.0041	Gold	1507.40	4.20
GBP/USD	1.2335	0.0009		EUR/CHF	1.0956	0.0024	Brent	60.38	-0.43
AUD/USD	0.6866	0.0004		EUR/SEK	10.6473	-0.0037			
USD/CAD	1.321	0.0016		EUR/NOK	9.9263	0.0655			

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