



Sunrise

Wednesday, 14 December 2016

Rates: Rate hike and unchanged dot plot?

Tonight's FOMC meeting will probably determine trading conditions for the remainder of the year. A 25 bps rate hike in combination with an unchanged dot plot is discounted and could trigger consolidation/correction higher of US bonds. A hawkish surprise, higher dots, could mark the start of a new selling wave and possibly a break of key US yield resistance levels.

Currencies: FOMC decision to offer a pretext for ST USD profit taking?

We expect the Fed to raise rates by 25 basis point, but they won't anticipate on the future Trump policy. In this relatively soft Fed scenario, some ST profit taking on the dollar might kick in going into the year end. However, even such a move shouldn't go too far. The USD trend remains up.

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** raced to all-time highs, but ended off the intraday highs, safeguarding nice gains though. **Asian equities** cannot profit from WS's performance and trade mixed on Chinese concerns and weak Japanese data.
- The **Q4 Japanese Tankan** printed marginally below expectations, but up versus Q3, at least for the manufacturing survey (yen weakness). Non-manufacturing sentiment stabilized, but the **capex outlook deteriorated**.
- The **HIBOR (CNH) rose another 2.7%-points to 7.3%**. It suggests the PBoC remains concerned about expectations of further renminbi depreciation, as traders short the Chinese currency at the less-regulated CNH market in HK.
- The **FOMC** will increase rates by 25 basis points. The focus is on eventual hints about policy next year and in 2018 following Trump's election. We think the FOMC will wait on specific fiscal action before adapting its "gradual" mantra.
- It isn't a good sign for **Australian retailers** ahead of Christmas, but consumer confidence fell to its lowest level since April. The Westpac index dropped to 97.3 in Dec. from 101.3 in Nov. Pessimists outnumbered optimists.
- **Demand for oil will outstrip supply** in the next six months as long as Opec and countries outside the cartel can implement a deal signed at the weekend to lower output, according to the IEA. The cuts could reduce the stockpiles.
- **Spain has won praise from the IMF for its "impressive" economic recovery**, in a report that offered strong backing for the political measures taken by PM Rajoy at the height of the recent crisis.
- **Today, the FOMC meeting** takes centre stage, but **US retail sales and PPI** are worth watching too together with the **UK labour market data**

calm and this might remain the case till the end of the year with some profit taking. **If the Fed drops hints that its policy will become more aggressive, the curve will (bear) steepen.**

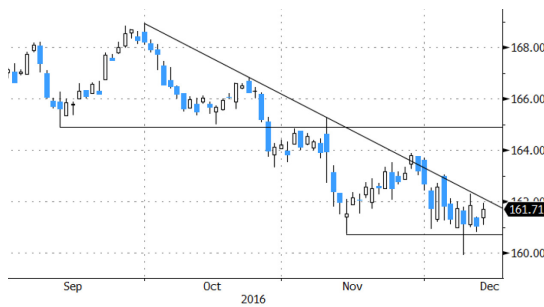
Rate hike, but unchanged dot plot?

R2	163,36	-1d
R1	162,08	
BUND	161,87	0,6000
S1	159,91	
S2	158,67	

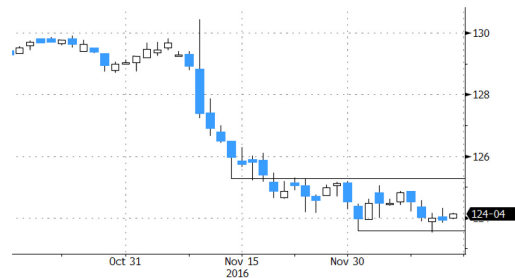
Overnight, Asian stockmarkets trade mixed. Brent crude and the US Note future are nearly unchanged, but, if any, point to a slightly stronger opening for the Bund.

Today's eco calendar contains US retail sales, PPI and industrial production data but these will be overshadowed by the Fed meeting. **We expect a 25 bps rate hike and an unchanged dot plot. That's discounted on rate markets and could trigger consolidation/correction higher into the year-end. A hawkish surprise (higher dots) could cause a new sell-off on the US Treasury market and force a break of key technical levels.** The US 2-yr yield broke is already 1.1% resistance, but key resistance levels in the US 5-yr yield (1.85-1.9%), 10-yr yield (2.5%) and 30-yr yield (3.25%) managed to hold. 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 doubt 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. Short term, the outcome of the Fed meeting, will also influence European rates.**



German Bund: no change to technical picture after ECB meeting



US Note future (March contract): Unchanged Fed and consolidation/correction into year-end or hawkish Fed and break lower?

Currencies

Dollar drifting sideways going into the FOMC policy decision.

R2	1,0851	-1d
R1	1,0809	
EUR/USD	1,06445	0,0006
S1	1,0506	
S2	1,0458	

No clear trends on Asian markets this morning.

EUR/USD trades with a slightly positive bias overnight

US calendar is well filled, but focus is on the FOMC decision.

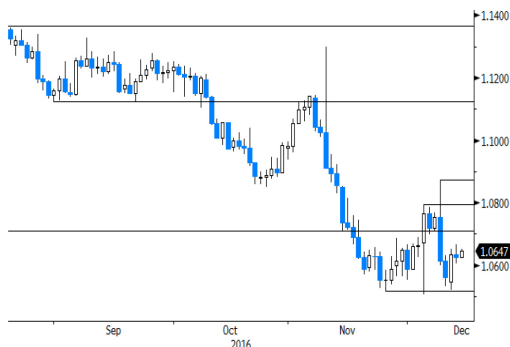
If the Fed stays muted on 'more aggressive' normalization post Trump, USD profit taking might kick in.

FOMC decision to trigger more USD profit taking?

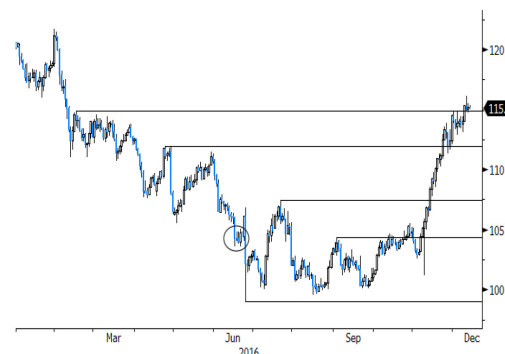
On Tuesday, the countdown to the Fed decision continued. Equities extended their march north as investors expect the Fed to remain mild for markets. Initially, US bonds were also well bid, but returned gains later. However, the moves in bonds and equities had only a limited impact on the dollar. EUR/USD finished at 1.0626 (from 1.0635 on Monday). USD/JPY closed the session at 115.19 (from 115.02).

Overnight, Asian equities don't join the rally in the US. Regional indices swing between profit and loss. China slightly outperforms. The headline Tankan large manufacturing index rose from 6 to 10 as the weaker yen supports activity. Most other sub-indicators were mostly slightly softer than expected. There was no obvious impact on the yen. USD/JPY is hovering in the 115.00/115.35 area. EUR/USD is trading with a slightly positive bid, changing hands in the 1.0645 area.

Today, there are plenty of interesting US data including the November retail sales, PPI and industrial production. However any market reaction will probably be limited just hours before the FOMC decision. **The FOMC will increase its official rate corridor to 0.50-0.75%.** It promised to increase rates very gradual, but the election of Donald Trump with a programme of tax cuts, extra spending, protectionism and anti-immigration has changed the environment for next years. **Markets didn't wait and priced in a reflationary policy. Markets are now looking for hints the FOMC will become more aggressive in 2017/18.** However, we think the FOMC won't anticipate on a change in fiscal policy, but wait for more concrete plans. **They may proceed cautiously and confirm 2 rate hikes in 2017 and 3 hikes in both 2018 and 2019 (dot plot).** In this scenario markets, including the dollar, should react calm. Some ST profit taking on the recent USD rally might occur. In thinning marked conditions any repositioning might become a bit disorderly, but we don't expect the move to go really far. For EUR/USD the 1.0796/1.0874 recent highs are the first point of reference. A sustained break beyond that level is unlikely. **If we are wrong and the Fed drops hints that its policy will become more aggressive, the curve will (bear) steepen and the dollar might receive additional support.**



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 will keep the lead in the policy normalization.** This is putting a strong floor for 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 1.0795/1.0874 area suggests that the upside 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 of USD/JPY has improved. The pair took out key resistance at 111.45/91 and now tries to sustain north of the 115 pivot. 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. A ST correction might be on the cards if the Fed doesn't change its rate outlook for 2017 yet. However, the LT trend remains up. A drop below 112.88 would suggest a loss of upside momentum short-term.**

Sterling stabilizes at a high level

On Tuesday, EUR/GBP traded in the 0.84 area early in Europe, but soon drifted south again. Sterling probably still profited from Monday's comments from UK FM Hammond as he advocated a Brexit transition period. Investors also didn't want to be positioned sterling short going into the **UK inflation data**. UK headline inflation rose from 0.9% Y/Y to 1.2% Y/Y. Core inflation accelerated to 1.4% Y/Y, **both marginally higher than expected.** At the same time, UK PPI data were slightly softer than expected. Sterling already anticipated a rather strong UK CPI early in the session. The pair **stabilized in the mid 0.83 area after the CPI data.** However, some late session swings finally reversed most of the intraday GBP gains. EUR/GBP close the session at 0.8395 (from 0.8388).

Today, the UK labour market data will be published. In line with last month's data, employment growth is expected to have shifted into a lower gear. On the other hand wage growth might accelerate slightly. We have the impression that labour market data have become a bit less important for markets compared to e.g. price data. We don't expect the labour market data to be a big help for sterling. Over the previous days sterling stabilized, but continued to trade within reach of the recent highs against the euro and the dollar. 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 lower. Despite recent sterling strength, we look for confirmation that a bottoming out process is in place. A correction of EUR/USD (if it occurs) might also help EUR/GBP.

R2	0,8708	-1d
R1	0,8578	
EUR/GBP	0,8404	0,0014
S1	0,83	
S2	0,8117	



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



GBP/USD: consolidation continues

Calendar

Wed., 14 December		Consensus	Previous
US			
14:30	Retail Sales Advance MoM (Nov)	0.3%	0.8%
14:30	Retail Sales Ex Auto MoM (Nov)	0.4%	0.8%
14:30	Retail Sales Ex Auto and Gas (Nov)	0.4%	0.6%
14:30	Retail Sales Control Group (Nov)	0.3%	0.8%
14:30	PPI Final Demand MoM / YoY (Nov)	0.1%/0.9%	0.0%/0.8%
14:30	PPI Ex Food and Energy MoM / YoY (Nov)	0.2%/1.3%	-0.2%/1.2%
15:15	Industrial Production MoM (Nov)	-0.3%	0.0%
15:15	Manufacturing (SIC) Production (Nov)	-0.2%	0.2%
15:15	Capacity Utilization (Nov)	75.1%	75.3%
16:00	Business Inventories (Oct)	-0.1%	0.1%
20:00	FOMC Rate Decision (Upper Bound)	0.75%	0.50%
20:00	FOMC Rate Decision (Lower Bound)	0.50%	0.25%
Japan			
00:50	Tankan Large Mfg Index (4Q)	A: 10	6
00:50	Tankan Large Mfg Outlook (4Q)	A: 8	6
00:50	Tankan Large Non-Mfg Index (4Q)	A: 18	18
00:50	Tankan Large Non-Mfg Outlook (4Q)	A: 16	16
00:50	Tankan Large All Industry Capex (4Q)	A: 5.5%	6.3%
05:00	Tokyo Condominium Sales YoY (Nov)	A: -22.7%	-0.6%
05:30	Industrial Production MoM / YoY (Oct F)	A: 0%/-1.4%	0.1%/-1.3%
05:30	Capacity Utilization MoM (Oct)	A: 1.4%	-2.0%
UK			
10:30	Claimant Count Rate (Nov)	2.3%	2.3%
10:30	Jobless Claims Change (Nov)	6.5K	9.8k
10:30	Average Weekly Earnings 3M/YoY (Oct)	2.3%	2.3%
10:30	Weekly Earnings ex Bonus 3M/YoY (Oct)	2.6%	2.4%
10:30	ILO Unemployment Rate 3Mths (Oct)	4.8%	4.8%
10:30	Employment Change 3M/3M (Oct)	50k	49k
EMU			
11:00	Industrial Production SA MoM / WDA YoY (Oct)	0.1%/0.8%	-0.8%/1.2%
France			
08:45	CPI EU Harmonized MoM / YoY (Nov F)	0.0%/0.7%	0.0%/0.7%
Italy			
10:00	CPI EU Harmonized YoY (Nov F)	0.1%	0.1%
Events			
	EU's Moscovici meets ECB's Draghi in Frankfurt		
20:00	Fed Summary of Economic Projections		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	2,45	-0,02	US	1,16	0,02	DOW	19911 19911,21
DE	0,35	-0,05	DE	-0,75	0,00	NASDAQ	for Exch - NQI #VALUE!
BE	0,65	-0,09	BE	-0,63	0,00	NIKKEI	19254 19253,61
UK	1,44	-0,02	UK	0,10	0,01	DAX	11284,65 11284,65
JP	0,06	-0,02	JP	-0,15	-0,01	DJ euro-50	3237 3236,71

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,352 -0,002
3y	-0,097	1,574	0,749	Euribor-1	-0,37	0,00	Libor-1 USD	0,26 0,26
5y	0,124	1,875	0,961	Euribor-3	-0,32	0,00	Libor-3 USD	0,38 0,38
10y	0,763	2,287	1,390	Euribor-6	-0,22	0,00	Libor-6 USD	0,54 0,54

Currencies		-1d	Currencies		-1d	Commodity	CRB	GOLD	BRENT
EUR/USD	1,06445	0,0006	EUR/JPY	122,51	-0,04		193,3459	1161,35	55,15
USD/JPY	115,12	-0,07	EUR/GBP	0,8404	0,0014	-1d	0,00	0,40	-0,51
GBP/USD	1,2658	-0,0016	EUR/CHF	1,0765	-0,0014				
AUD/USD	0,7487	0,0005	EUR/SEK	9,7426	0,00				
USD/CAD	1,3124	-0,0007	EUR/NOK	8,9582	-0,01				

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Mathias van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research		France	+32 2 417 32 65
Austin Hughes	+353 1 664 6889	London	+44 207 256 4848
Shawn Britton	+353 1 664 6892	Singapore	+65 533 34 10
Prague Research (CSOB)		Prague	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Bratislava	+421 2 5966 8820
Marek Gabris	+421 2 5966 8809		
Budapest Research		Budapest	+36 1 328 99 85
David Nemeth	+36 1 328 9989		

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBCCORPORATES.COM/RESEARCH

This non-exhaustive information is based on short-term forecasts for expected developments on the financial markets. KBC Bank cannot guarantee that these forecasts will materialize and cannot be held liable in any way for direct or consequential loss arising from any use of this document or its content. The document is not intended as personalized investment advice and does not constitute a recommendation to buy, sell or hold investments described herein. Although information has been obtained from and is based upon sources KBC believes to be reliable, KBC does not guarantee the accuracy of this information, which may be incomplete or condensed. All opinions and estimates constitute a KBC judgment as of the data of the report and are subject to change without notice.

