



Sunrise

Monday, 17 October 2016

Rates: US 10-yr and 30-yr yields break above important levels

The US 10-yr and 30-yr yields broke above resistance levels on Friday evening as Fed chairwoman Yellen floated the idea of letting the US economy run hot. Today's eco calendar probably won't inspire trading suggesting sentiment-driven action. Currently, the core bond environment isn't exactly bond friendly.

Currencies: Trade-weighted dollar at multi-month top

On Friday, the dollar rally continued. A speech of Fed's Yellen didn't change the global picture. The dollar nears important resistance against the euro and the yen. The Jury is still out, but if these levels aren't broken soon, a pause in the USD rally might be on the cards.

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 closed the session** with minimal gains and well off the early highs, despite better than expected banking earnings (which remained weak though). Asian equities open mixed, giving little direction for Europe.
- **Fed chairwoman Yellen** laid out the case for keeping monetary policy easy, suggesting that running the U.S. economy hot could fix growth problems and boost labor force participation. Her comments Friday, which didn't preclude an interest rate increase this year, sent 30-yr Treasury yields higher
- **Deutsche Bank could pull back in the U.S. as its legal bills rise**, people familiar with the matter said. The lender is mulling the option as part of its broader strategy review, and the topic has come up in talks with American authorities.
- **Greece's creditors fly in today for their latest review of the economy**, 14 months after the country got its third bailout since 2010. Officials arrive as the Greek economy is projected to shrink by 0.7% in 2016.
- **BoE Broadbent said on BBC radio that a flexible FX rate is an important** help with shocks, as it helps cushion the UK economy. He sees inflation somewhat above target in the next couple of years.
- **Fed Rosengren, a dissenter in favour of a rate hike, said the Fed is already running the economy hot** to overshoot its NAIRU estimate and reach its 2% inflation target. **NY Fed Dudley** told WSJ that an interest-rate increase this year is pretty likely, while noting any actions that follow in 2017 will happen slowly as the Fed tests how far the job market can go without creating inflation problems.
- **Today, only the US NY manufacturing survey and the industrial production** may affect markets. The speech of Vice Fed Fischer on low rates is interesting.

Rates

Bear steepening core bond yield curves

On Friday, global core bonds lost some ground in the opening on the back of strong equity markets and higher Chinese CPI & PPI. Apart from positive risk sentiment, the UK Gilt market also fell prey to another selling wave, pulling Bunds and US Treasuries also slightly lower. All in all though it was mostly sideways trading. During US dealings, US retail sales printed in line with expectations though the control group, which is a proxy for goods consumption in US GDP, disappointed. US PPI data on the other hand, surprised on the upside of expectations. This mixed data picture caused some volatility on the US Treasury market, but ultimately T-Notes went higher to the openings levels, helped by a weak Michigan consumer sentiment. However, the tide turned and a sharp late session selling wave pushed core bonds lower again, sharply steepening the curve. Fed chairwoman Yellen played with the idea of allowing the US economy to run hot, suggesting that the Fed might tolerate somewhat higher inflation. Resistance levels at the 10-yr yield (1.75%) and 30-yr yield (2.5%) were broken.

In a daily perspective, the US yield bear steepened sharply with yields flat (2-yr) to 8.1 bps (30-yr) higher. The German yield curve shifted in similar but less outspoken way with yields flat (2-yr) to 3.1 bps (30-yr) higher. The US-German 10-yr yield spread (174 bps) nears the 2016 highs. On intra-EMU bond markets, 10-yr yield spread narrowed up to 2 bps with Portugal outperforming (-9 bps).

Focus on US manufacturing data

During the morning session, only the final Eurozone HICP inflation report for September will be released, but it won't move the markets. During the US session, the NY manufacturing survey index is expected to show a marginal improvement in October to 1 from -1.99 in September and -4.2 in August. We side with the consensus for an improvement, but being only marginal above zero it still suggests sluggish activity. The September US production is expected to show a modest 0.2% M/M rebound following a 0.4% M/M decline in August, while manufacturing production should be up 0.1% M/M following a 0.4% M/M drop. Aggregate hours worked in the manufacturing fell 0.4% M/M in September, which suggests a decline of manufacturing output. Offsetting this will be an increase in mining output (as number of operating rigs climbed) and a rise of utility output (warm September). Nevertheless, all in all we see downside risks to the consensus.

Sharp bear steepening US yield curve

US-German 10-yr yield spread near 2016 highs

Portugal continues to outperform

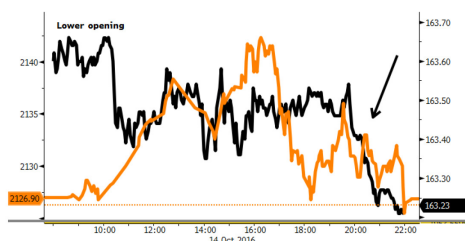
	US yield	-1d
2	0,7107	0,0080
5	1,1737	0,0227
10	1,7429	0,0279
30	2,5745	0,0228

	DE yield	-1d
2	-0,5130	-0,0050
5	-0,3830	0,0040
10	0,1220	0,0230
30	0,8074	0,0536

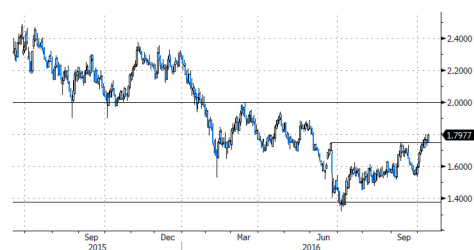
NY manufacturing remains weak

Downside risks US production

Vice chair Fischer speaks but we don't expect new insights



Bund future (black) and EuroStoxx (orange) intraday Bund opened lower on mild risk off. Sideways trading followed with sharp sell-off at the end of the session.



US 10yr T-Note yield: Is 1.75% yield resistance now really broken? This would mean 1.75-2% is the new range.

German, Spain and France tap market

R2	165	-1d
R1	163,74	
BUND	164,04	-0,1600
S1	160,81	
S2	160,11	

This week's EMU bond supply is rather low, coming from Germany, Spain and France. On Wednesday, the German Finanzagentur taps the off the run 30-yr Bund (€1B 2.5% Aug2046). On Thursday, the French Treasury taps the on the run 5-yr OAT (0% May2021) and off the run OAT (3% Apr2022) for a combined €5-6B. The Spanish debt agency auctions the on the run 3-yr Bono (0.25% Jan2019), off the run Obligation (5.9% Jul2026) and on the run 50-yr Obligation (3.45% Jul2066). The amount on offer still needs to be determined. This week's supply will be supported by a €18B Italian redemption.

US 10-yr and 30-yr yields advance further

Overnight, Asian stock markets trade mixed near opening levels. The US Note future and Brent crude trade stable, suggesting a neutral opening for the Bund.

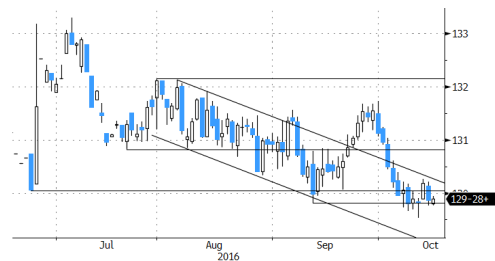
Today's eco calendar contains the final EMU inflation figure for September, US empire manufacturing and US industrial production. Risks for the latter are on the downside of expectations, but we don't expect the data to influence trading. A speech by Fed vice-chair Fischer is a wildcard for trading.

Overall we expect sentiment-driven trading on core bond markets. The current environment is not exactly bond friendly. US 10-yr and 30-yr yields broke above key resistance levels last week. The US Note future is still testing a key support area (see graph).

The Bund lost ground since the start of the month and now also approaches first support (lower bound trading range 163-162.56; 10yr yield 0.08%-0.10%). We expect more QE tapering rumours/fear in the run-up to this week's ECB meeting, which should cap the potential of any upward corrections while we don't expect technical breaks lower yet.



German Bund: in the run up to Thursday's ECB meeting, the key support may remain a focal point



US Note future: Extensively testing downside. Break more likely with US 10-yr yield above 1.75%?

Currencies

Trade-weighted dollar at multi-month top

Dollar extends gains

Yellen speech no decisive factor

R2	1,1714	-1d
R1	1,1495	
EUR/USD	1,1414	0,0007
S1	1,1327	
S2	1,1144	

Asian markets show no clear trend

Trade-weighted dollar at multi-month highs

Eco data probably won't be important enough to guide USD trading

Fed speakers are a wildcard

Some USD consolidation might be on the cards after recent rally

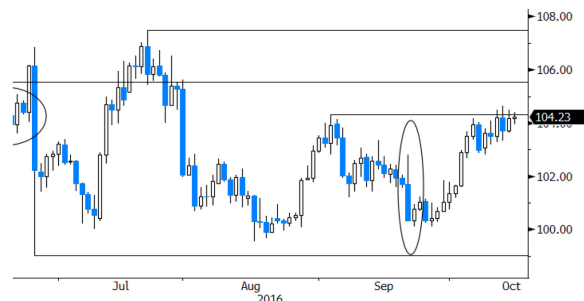
On Friday morning, the dollar profited from higher interest rates (versus euro) and strong equities (versus yen). The US PPI beat expectations and the retail sales were strong, but apparently not strong enough, as the control group disappointed. The USD rally even slowed temporary after the data. A speech of Fed's Yellen caused some intraday USD volatility as she suggested inflation could temporary overshoot the target. However, the dollar finally resumed its intraday uptrend and closed the session near the intraday highs against the euro. EUR/USD finished the session at 1.0972 (from 1.1056). USD/JPY closed the session at 104.18 (from 103.71 on Thursday evening).

Overnight, there is no obvious driver from trading on global markets. Asian markets mostly trade with marginal gains. Japan outperforms slightly, probably as USD/JPY holds north of 104. The dollar remains well bid across the board. The trade-weighted dollar (DXY) trades near 98, reaching the highest level since early March. EUR/USD came within reach of the 1.0952 support this morning, but a real test didn't occur. The pair trades currently again in the 1.0985 area.

Today in Europe only the final EMU HICP inflation for September will be released. It probably won't move the markets. **In the US**, the NY manufacturing index is expected to show a marginal improvement from -1.99 in September and -4.2 in August. **We side with the consensus for an improvement**, but being only marginally above zero it still suggests sluggish activity. The **September US production** is expected to show a modest 0.2% M/M rebound following a 0.4% M/M decline in August, while manufacturing production should be up 0.1% M/M following a 0.4% M/M drop. Aggregate hours worked in the manufacturing fell 0.4% M/M in September, which suggests a decline of manufacturing output. An increase in mining output (number of operating rigs climbed) and a rise of utility output (warm September) will be offsetting this. **Nevertheless, all in all we see downside risks to the consensus.**



EUR/USD nears next support area



USD/JPY holds near the recent highs

Last week, the dollar had a good run. The move was mostly driven by a general market feeling that the Fed will likely raise rates in December. However, there was no obvious one-to-one link with the US data or with interest rate differentials, especially not with spreads at the short end of the curve. Fed speakers will probably reaffirm the likelihood of a December hike before the

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black-out period ahead of the November FOMC meeting starts. However, this should already be discounted in the dollar. Global factors as the Chinese Q3 GDP or the ECB policy meeting are a wild card for USD trading later this week. However, we don't expect Draghi and Co to give already clear hints on the post March-2017 period. We don't row against the USD positive momentum yet. That said, the dollar nears significant resistance against the euro (1.0952/13) and the yen (104.35/104.64). The jury is still out, but if those levels won't be broken soon, the dollar rally might take a breather.

From a technical point of view, we keep a close eye how the test of the 1.0952/13 support turns out. A break below that level would be a USD positive and open the way for the next intermediate support at 1.0822/1.0711. A similar pattern is developing for USD/JPY. A sustained break north of 104.32 would paint a double top formation on the charts with targets in the 108/109 area. However, we stay cautious on sustained USD/JPY gains beyond the 104.32/65 resistance especially as global volatility/uncertainty might intensify.

Does the BoE really care about sterling?

R2	0,8153	-1d
R1	0,8117	
EUR/GBP	0,8009	-0,0063
S1	0,7947	
S2	0,7774	

On Friday, the Sterling benign neglect since the Brexit referendum by the BoE and the UK government got a first crack. **BoE governor Carney** said the bank was not indifferent to the level of the pound, now down almost 20 percent since Britain voted to leave the EU in June. The Fx rate matters for monetary policy. It is an indication of the **boundaries to the maximal inflation the BoE may tolerate**. Of course, it may be that Carney only wanted the sterling decline to go more gradual and feared that without minimal official support at some point a run on the pound may occur. His support for sterling didn't look wholehearted and the markets reacted accordingly. The sterling gains against the euro were modest. EUR/GBP closed the session at 0.9004 (from 0.9022). Cable even close the session in negative territory (1.2191 from 1.2254) as USD strength prevailed.

This morning, the **Rightmove House Prices** were reasonably strong at 0.9% M/M and 4.2 Y/Y. BoE Broadbent said that the recent decline of sterling will help the UK economy to overcome shocks from Brexit. He also admitted that inflation could move somewhat above target in the next few years. **These comments only confirm that the BoE might give priority to growth, rather than to inflation or sterling**, when setting policy in the post-Brexit era. The comments won't help sterling. **The sterling decline slowed last week**. However, we don't expect a real, sustained change for the better. It is much too early to call a bottom for sterling. We continue to avoid sterling long exposure as long as the debate on a hard Brexit persists. **Especially the downside in cable looks vulnerable. A retest of the 1.20 barrier might be on the cards**



EUR/GBP: sterling decline slows, at least temporary



GBP/USD: off the multi-year low, but picture remains fragile

Calendar

Monday, 17 October		Consensus	Previous
US			
14:30	Empire Manufacturing (Oct)	1.00	-1.99
15:15	Industrial Production MoM (Sep)	0.2%	-0.4%
15:15	Capacity Utilization (Sep)	75.6%	75.5%
15:15	Manufacturing (SIC) Production (Sep)	0.2%	-0.4%
Japan			
06:00	Tokyo Condominium Sales YoY (Sep)	A 40.9%-	-24.7%
06:30	Industrial Production MoM / YoY (Aug F)	A 1.3%/4.5%-	1.5%/4.6%
06:30	Capacity Utilization MoM (Aug)	A2.6%	0.6%
UK			
01:01	Rightmove House Prices MoM / YoY (Oct)	A0.9%/4.2%	0.7%/4.0%
EMU			
11:00	CPI MoM / YoY (Sep)	0.4%/0.4%	0.1%/0.4%
11:00	CPI Core YoY (Sep F)	0.8%	0.8%
China			
17OCT-18OCT	New Yuan Loans CNY (Sep)	1000.0b	948.7b
17OCT-18OCT	Aggregate Financing CNY (Sep)	1390.0b	1470.0b
17OCT-18OCT	Money Supply M0 YoY (Sep)	7.3%	7.4%
Events			
18:15	Fed Vice Chair Fischer Speaks in New York		
11:45	ECB Mersch speaks in Luxembourg		
15:45	ECB published weekly QE data and BoE publish buying operation results		
16:45	BoE vice governor Broadbent speaks in London		
18:15	Fed Vice chair Fischer speaks in NY		
19:35	ECB president Draghi and ECB Weidmann speak in Frankfurt		
23:10	RBA Governor Lowe Speech in Sydney		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,74	0,03	US	0,71	0,01	DOW	17556,17556,41
DE	0,12	0,03	DE	-0,52	0,00	NASDAQ	for Exch - NQI #VALUE!
BE	0,52	0,03	BE	-0,45	0,02	NIKKEI	15929,15928,79
UK	1,40	0,03	UK	0,39	0,03	DAX	9682,99,9682,99
JP	-0,09	-0,01	JP	-0,26	-0,01	DJ euro-50	2924,2924,23

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,333,0,001
3y	-0,143	0,943	0,824	Euribor-1	-0,34	0,00	Libor-1 USD	0,51,0,51
5y	-0,008	1,146	0,964	Euribor-3	-0,25	0,00	Libor-3 USD	0,59,0,59
10y	0,519	1,599	1,382	Euribor-6	-0,13	0,00	Libor-6 USD	0,74,0,74

Currencies		-1d	Currencies		-1d	Commodity	CRB	GOLD	BRENT
EUR/USD	1,14075	0,0002	EUR/JPY	123,56	0,54		171,8246	1254,57	42,6
USD/JPY	108,335	0,45	EUR/GBP	0,8009	-0,0067	-1d	0,78	5,56	0,62
GBP/USD	1,4238	0,0119	EUR/CHF	1,0881	0,0009				
AUD/USD	0,7617	0,0062	EUR/SEK	9,2538	-0,04				
USD/CAD	1,2910	-0,0078	EUR/NOK	9,3579	-0,03				

Contacts

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
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias van der Jeugt	+32 2 417 51 94	France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Singapore	+65 533 34 10
Shawn Britton	+353 1 664 6892		
Prague Research (CSOB)			
Jan Cermak	+420 2 6135 3578	Prague	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	Budapest	+36 1 328 99 85

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