



## Sunrise

Tuesday, 17 January 2017

### Rates: Risk off sentiment to start the session

The eco calendar is uneventful, but the speech of UK PM May on Brexit may still affect sentiment on risk, while the return of US traders and their reaction on Trump's remarks during the weekend are also important. It might give core bonds some more upside, but we stick to the view that resistances (125-09 T-Note future) might cap the upside.

### Currencies: Dollar correction continues. May to decide on fate of sterling

Yesterday, the losses of the dollar were modest, despite unconventional, protectionist comments from president elect Trump. This morning, the US currency remains in the defensive as markets are counting down for a speech on the Brexit strategy of UK Prime Minister May. A deterioration of global risk sentiment might weigh further on the dollar and on sterling.

### 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      | ↔ |

- Asian **equities traded mixed, but a majority of key bourses lost ground** as local currencies fluctuated against the dollar and markets braced for the impact of a May's speech. Yen strength weighed heavily on Japanese stocks.
- **UK PM May** will test the nerves of currency markets today (11:40 GMT) when she declares that **Britain is making a clean break from the EU** and will not seek a deal that leaves the country "half in and half out" according to the FT.
- The **dollar correction** continued overnight with the trade weighted dollar near 101, close the month lows. There is no general correction in industrial commodities with oil trading near \$55.6/b, but copper overnight off cycle highs.
- **Gold on the contrary continue to erase more of the post-Trump losses** since the sell-off petered out by year end.
- **BoE Carney** reiterated that interest rates could respond in either direction to the economic outlook. He focused on the trade-off that central bankers face between supporting growth and curbing inflation.
- **Chinese equities** (Shanghai) try to avoid a 6<sup>th</sup> losing session, with tightening liquidity reported as the reason. However, **main support seems to hold for now**.
- **Northern Ireland will face its second assembly election** in less than a year on March 2, amid bitter disagreements between the two main political parties over the future of power-sharing. It may delay triggering art 50 in the Brexit process.
- **Today, attention will go to UK PM May's Brexit speech**. Regarding eco releases, the calendar is limited to US NY empire survey, German ZEW and UK inflation data. Supply is coming from Belgium (new 10-yr OLO) and Germany (Schatz).

# Rates

|    | US yield | -1d   |
|----|----------|-------|
| 2  | 1,16     | -0,03 |
| 5  | 1,85     | -0,05 |
| 10 | 2,35     | -0,05 |
| 30 | 2,94     | -0,05 |

German yields modestly lower

Greece and Italy underperform

|    | DE yield | -1d   |
|----|----------|-------|
| 2  | -0,74    | -0,03 |
| 5  | -0,50    | -0,03 |
| 10 | 0,32     | -0,02 |
| 30 | 1,07     | -0,02 |

Stronger German ZEW and strong NY Fed manufacturing survey expected

Did EMU bank lending conditions improve?

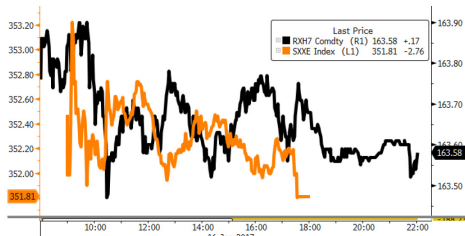
## Listless trading in face of empty calendar & US holiday

Yesterday, German bonds opened modestly higher as risk sentiment deteriorated in Asia on more acrimonious comments of Trump and speculation on today's Brexit-speech by UK PM May. However, the risk off sentiment didn't get traction in the European session. Equities opened moderately lower, but immediately moved sideways and didn't change tack anymore. As a result the Bund returned most of the opening gains.

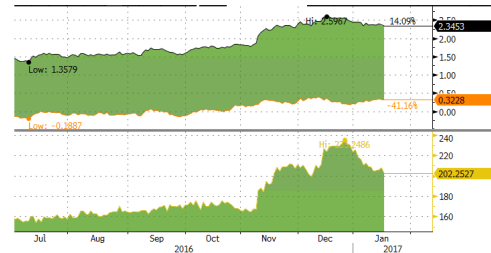
In a daily perspective, German yields declined (compared to Friday's close) by 1.5 bp (10-yr) to 2.7 bps (5-yr). There were rumours that the ECB/Bundesbank bought German 5-yr bonds below the depo-rate, a possibility that became available since Friday 13 January and may explain the slight outperformance of the 5-yr. On intra-EMU bond markets, 10-yr yield spread changes versus Germany were little changed for most sovereigns with the exception of Greece (+10 bps) and Italy (+3bps). Italy's rating downgrade by DBRS might have been behind the small underperformance of the countries' debt, but so was a downgrade of Italy's growth outlook. Portugal did well yesterday, despite signs that the ECB possesses about €36B of Portuguese bonds, limiting the Portuguese bond buying mainly to a part of the net newly issuance in 2017 (€14-16B). This may weigh on Portuguese bonds, but not yesterday.

## German ZEW sentiment and ECB bank lending survey

The EMU calendar remains thin, but the German ZEW economic sentiment survey gets sometimes attention. The expectations index got hit after the Brexit-vote and only fully recovered the lost ground in December. For December, an increase to 18.4 from 13.8 is expected, a level which is historically still modest. The current situation index is expected slightly stronger than in December at a high 65. The ECB bank lending survey will be scrutinized for improvement in lending conditions and demand. In the US, the calendar contains only the NY manufacturing survey. The headline index rose substantially in December to 9 from 1.5 in November and -6.8 in October. For December a stabilization is expected (8.5). So it will probably be a strong report, but we see little scope to surprise on the upside, even as it is a volatile indicator.



Bund future (black) and EuroStoxx (orange) (intraday): Bund starts higher. As equities stabilize after weak opening, the Bund gradually erases large part of opening gains.



US (black) and German (orange) 10-yr yield: Lower chart: spread differential narrows about 35 bps and erases the pre New year widening as US yields corrected lower and German somewhat higher.

## Scheduled supply from Germany; New 10-yr OLO?

|             |        |       |
|-------------|--------|-------|
| R2          | 165,48 | -1d   |
| R1          | 164,90 |       |
| <b>BUND</b> | 163,76 | -0,03 |
| S1          | 162,62 |       |
| S2          | 159,91 |       |

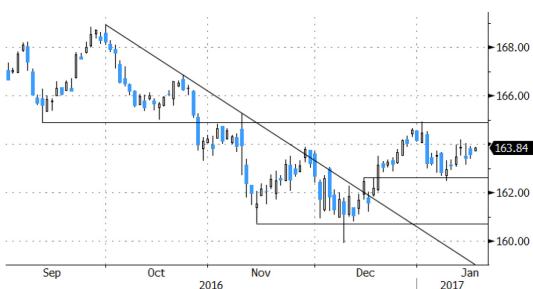
**Today**, the German Finanzagentur holds a 2-yr Schatz auction (€5B 0% Dec2018). In the run-up to the auction, the bond traded stable in ASW spread terms and it's a tad cheap on the German curve. Total bids at the previous 4 Schatz auctions averaged €5.7B. We expect a plain vanilla auction. **The Kingdom of Belgium announced the launch of a new 10-yr syndicated deal, OLO 81 (0.75% (?) Jun2027), which will likely take place today.** Concerning the pricing of the new OLO 81 on the Belgian yield curve, we interpolate asset swaps spreads between OLO 77 (1% Jun2026) and OLO 75 (1% Jun2031) as OLO 81 (0.75% (?) Jun2027) has a maturity date in between these two OLO's. We didn't use OLO 31 (5.5% Mar2028) because it trades outside the Belgian curve. **The interpolation (based on yesterday's closing levels) corresponds with an asset swap spread of 6 basis points, including a small new issue premium.**

## Sentiment-driven trading

**Overnight**, most Asian stock markets trade mixed, with many regional bourses profiting from dollar weakness, but Japanese equities suffering from yen strength. The risk assessment is modestly negative, as a weak yen and strong gold trump equity trading. US Treasuries are higher, suggesting a stronger Bund opening.

**Today's eco calendar remains thin and second tier. The general risk sentiment will be the main market driver, but technicals should be taken into account too.** The current negative risk sentiment might still be influenced by the speech of May, but many details are already released. However, **US traders didn't get the chance to react to it and neither to this weekend's acrimonious comments of Donald Trump. So, the reaction during the US trading session may prime developments this morning.** Technically, the US Note future tested 125-09 resistance several times last week, but a break didn't occur. **We think that the US Note future might remain in the sideways trading range between 122-14+ and 125-09. Thus we expect that risk off sentiment won't be able to push the Note future beyond 125-09.** In yield terms, the US 10-yr yield has support at 2.28% and 2.15% (gap), levels which should come into play if we are wrong.

**Longer term, we expect US markets to further align with the Fed's scenario of 3 rate hikes this year. In EMU, the German Bund bounced into 164.9 resistance. The short-term trading range is 162.62-164.90.** As the underlying economic picture in EMU improves further, we also expect more downside in the Bund despite the ECB's bond buying programme.



German Bund: Trading band between 160.72 and 164.90



US Note future: Sideways trading between 122-14+ and 125-09

# Currencies

*Dollar shows mixed picture as European markets react calm to UK and US political comments*

## USD correction continues

On Monday, the dollar traded with a negative bias in Asia as sentiment on risk turned negative on harsh Brexit comments and negative comments from US president-elect Trump on Europa/Germany. However, European markets reacted calm tempering the negative impact on the dollar. USD/JPY finished the session at 114.20 (from 114.49). EUR/USD closed the session at 1.0601 (from 1.0643).

**Overnight**, Asian equities are trading mixed, mostly with a positive bias, outside Japanese equities which suffer from a stronger yen. The dollar remains in the defensive with USD/JPY taking the lead in the decline, as global political uncertainty (Brexit, recent Trump comments) are yen supportive. USD/JPY is changing hands in the mid 113 area, firmly extending its recent decline. The dollar is also losing ground against the euro (EUR/USD trades in the mid 1.0650 area). For now, the 1.0670/86 area remains intact.

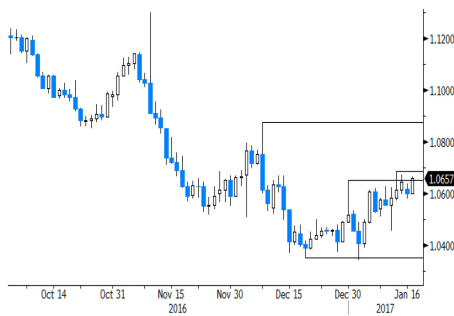
**Today**, the German **ZEW economic sentiment** and the ECB lending survey will be published. The ZEW expectations were hit after Brexit, but fully recovered by December. For January, an increase to 18.4 from 13.8 is expected. The current situation index is expected slightly stronger at a high 65. The **ECB bank lending survey** will be scrutinized for improvement in lending conditions and demand. The US calendar contains only **the NY manufacturing survey**. The headline index rose substantially in November and December. For January a stabilization at a high level is expected (8.5). **Of course, The Brexit speech of UK PM Theresa May and the fall-out from the recent comments from US president-elect Donald Trump will also have a big impact on global/USD trading.**

*Dollar correction continues*

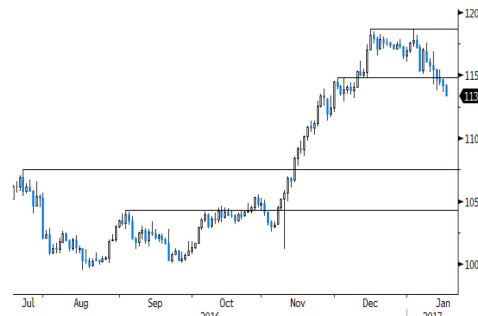
|                |               |               |
|----------------|---------------|---------------|
| R2             | 1,0874        | -1d           |
| R1             | 1,0685        |               |
| <b>EUR/USD</b> | <b>1,0657</b> | <b>0,0037</b> |
| S1             | 1,0341        |               |
| S2             | 1,0000        |               |

*Eco calendar not so important*

*UK May's Brexit speech and global political uncertainty might further weigh on the USD*



EUR/USD holding near the recent correction high



USD/JPY extending decline as sentiment turns risk-off

Asian markets are trading mixed, but **price action in China and Japan suggests a risk-off sentiment in Europe and maybe also in the US**. Until now, US and European equities held to post-Trump highs, but the Trump reflation trade is clearly losing momentum (dollar, bonds corrected). **Negative political headlines (in the first place on Brexit) might cause profit taking the global reflation trade, weighting on the dollar**. USD/JPY remains in the defensive as sentiment is turning risk-off. The reaction of EUR/USD is less evident. Brexit-uncertainty is also a potential euro negative. So, USD/JPY taking the lead in the USD decline. For EUR/USD, the picture remains fairly neutral.

Tuesday, 17 January 2017

**Global context:** EUR/USD touched a multi-year low (1.0341) two weeks ago. **After the Trump rally, plenty of good USD news is discounted. For now, interest rate differentials between the dollar and the euro are narrowing (correction), causing a dollar correction. Longer-term,** the absolute interest rate support should provide a USD floor if US data remain good and as there are no profound doubts on the ability of the US government to execute its pro-growth agenda. **A buy the dollar on dips strategy remains preferred. EUR/USD 1.0670/85 resistance was tested last week, but no sustained break occurred. A return north of 1.0874 would question the USD positive momentum.** On the downside, **EUR/USD 1.0341 is the first key support. A test of parity remains possible MT.** USD/JPY is trading well off post-Trump highs (118.60/66). A first support (114.74/115.07) is broken, giving a short-term negative signal. We stay USD/JPY positive long-term, but are in no hurry to rush in. An equity correction or a further decline in core bond yields might be short-term negatives for USD/JPY. 111.16 marks the 38% retracement of the 99.02/118.66 rally .

**Will speech of PM May cause further damage for sterling?**

|                |               |                |
|----------------|---------------|----------------|
| R2             | 0,9047        | -1d            |
| R1             | 0,8881        |                |
| <b>EUR/GBP</b> | <b>0,8794</b> | <b>-0,0041</b> |
| S1             | 0,8450        |                |
| S2             | 0,8304        |                |

**On Monday, sterling trading was** dominated by today’s Brexit speech of UK PM May. Sterling tumbled in thin Asian markets. Cable filled bids below 1.20. EUR/GBP set a new short-term top in the 0.8854 area. **A calm reaction on the European markets to the Brexit-headlines eased sterling selling.** EUR/GBP closed the session at 0.8799 (from 0.8694). Cable drifted sideways in the 1.21 big figure and finished the day at 1.2047.

**Today,** all eyes will be on the speech of UK PM and her Brexit strategy. If the press reports are right, the UK will give priority to regain control on immigration and UK law-making. Theresa May will probably repeat that the UK will take a constructive approach to the negotiations. **However, markets probably conclude that a clean Brexit might turn out to be a “hard” Brexit. The UK inflation data are also interesting. Headline inflation is expected to rise to a still modest 0.3% M/M and 1.4% Y/Y. An upward surprise is possible.** In a speech yesterday, BoE’s Carney still kept a balanced/rather soft tone.

**After the recent sell-off, quite some sterling negative news is discounted. Even so, we don’t preposition for a buy-the-rumour sell-the-fact reaction. A global negative risk sentiment might be an additional negative for sterling.** For now, we maintain our sterling negative bias. From a technical point of view, sterling regained a next ST-term resistance and is near the 0.8860 previous breakdown area.



EUR/GBP: sterling sell-off accelerates as Brexit-fears dominate trading

GBP/USD decline slows as sterling decline meets USD weakness

# Calendar

| Tuesday, 17 January |  | Consensus        | Previous         |
|---------------------|--|------------------|------------------|
| <b>US</b>           |  |                  |                  |
| 14:30               | <b>Empire Manufacturing (Jan)</b>                    | 8.5              | 9.0              |
| <b>Japan</b>        |  |                  |                  |
| 05:30               | Industrial Production MoM / YoY (Nov F)              | A1.5%/4.6%-      | 1.5%/4.6%        |
| 05:30               | Capacity Utilization MoM (Nov)                       | A 3%             | 1.4%             |
| <b>UK</b>           |  |                  |                  |
| 10:30               | <b>CPI MoM / YoY (Dec)</b>                           | <b>0.3%/1.4%</b> | <b>0.2%/1.2%</b> |
| 10:30               | <b>CPI Core YoY (Dec)</b>                            | <b>1.4%</b>      | <b>1.4%</b>      |
| 10:30               | RPI MoM / YoY (Dec)                                  | 0.4%/2.3%        | 0.3%/2.2%        |
| 10:30               | RPI Ex Mort Int. Payments (YoY) (Dec)                | 2.5%             | 2.5%             |
| 10:30               | PPI Input NSA MoM / YoY (Dec)                        | 2.4%/15.5%       | -1.1%/12.9%      |
| 10:30               | PPI Output NSA MoM / YoY (Dec)                       | 0.4%/2.9%        | 0.0%/2.3%        |
| 10:30               | PPI Output Core NSA MoM / YoY (Dec)                  | 0.2%/2.2%        | 0.0%/2.2%        |
| 10:30               | House Price Index YoY (Nov)                          | 6.1%             | 6.9%             |
| <b>EMU</b>          |  |                  |                  |
| 08:00               | EU27 New Car Registrations (Dec)                     | --               | 5.8%             |
| 11:00               | ZEW Survey Expectations (Jan)                        | --               | 18.1             |
| <b>Germany</b>      |  |                  |                  |
| 11:00               | <b>ZEW Survey Expectations (Jan)</b>                 | <b>18.4</b>      | <b>13.8</b>      |
| 11:00               | ZEW Survey Current Situation (Jan)                   | 65.0             | 63.5             |
| <b>Events</b>       |  |                  |                  |
|                     | Morgan Stanley (13:00) announces Q4 earnings         |                  |                  |
| 10:00               | <b>ECB Bank Lending Survey</b>                       |                  |                  |
| 11:35               | Germany to sell EUR 5B 0% 2018 bonds                 |                  |                  |
| 14:45               | Fed's Dudley Speaks on Consumer Behavior in New York |                  |                  |

| 10-year    | td     | -1d     |      | 2-year     | td      | -1d     | Stocks      | td       | -1d     |
|------------|--------|---------|------|------------|---------|---------|-------------|----------|---------|
| US         | 2,35   | -0,05   |      | US         | 1,16    | -0,03   | DOW         | 19885,73 | 0,00    |
| DE         | 0,32   | -0,02   |      | DE         | -0,74   | -0,03   | NASDAQ      | 5574,116 | 0,00    |
| BE         | 0,67   | -0,01   |      | BE         | -0,57   | 0,01    | NIKKEI      | 18813,53 | -281,71 |
| UK         | 1,31   | -0,05   |      | UK         | 0,15    | -0,04   | DAX         | 11554,71 | -74,47  |
| JP         | 0,05   | -0,01   |      | JP         | -0,23   | -0,01   | DJ euro-50  | 3294,53  | -29,81  |
|            |        |         |      |            |         |         |             |          |         |
| IRS        | EUR    | USD     | GBP  | EUR        | -1d     | -2d     | USD         | td       | -1d     |
| 3y         | -0,11  | 1,66    | 0,70 | Eonia      | -0,3530 | -0,0010 | Libor-1     | 0,7683   | 0,0000  |
| 5y         | 0,08   | 1,90    | 0,90 | Euribor-1  | -0,3720 | 0,0000  | Libor-3     | 1,0232   | 0,0000  |
| 10y        | 0,69   | 2,23    | 1,30 | Euribor-3  | -0,3280 | -0,0010 | Libor-6     | 1,3316   | 0,0000  |
|            |        |         |      | Euribor-6  | -0,2380 | -0,0020 |             |          |         |
|            |        |         |      |            |         |         |             |          |         |
| Currencies | td     | -1d     |      | Currencies | td      | -1d     | Commodities | td       | -1d     |
| EUR/USD    | 1,0657 | 0,0037  |      | EUR/JPY    | 120,75  | -0,13   | CRB         | 194,54   | 0,00    |
| USD/JPY    | 113,3  | -0,51   |      | EUR/GBP    | 0,8794  | -0,0041 | Gold        | 1210,80  | 4,60    |
| GBP/USD    | 1,2119 | 0,0097  |      | EUR/CHF    | 1,0732  | 0,0008  | Brent       | 55,59    | 0,12    |
| AUD/USD    | 0,7519 | 0,0036  |      | EUR/SEK    | 9,5052  | 0,0292  |             |          |         |
| USD/CAD    | 1,3105 | -0,0027 |      | EUR/NOK    | 9,054   | 0,0186  |             |          |         |

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