

Wednesday, 29 January 2020

Rates: Balance sheet growth key at first Fed policy meeting

Core bonds fell prey to some profit taking yesterday on the coronavirus-driven rally since early last week. We expect no policy rate changes at tonight's first Fed policy meeting, with discussions probably centered around balance sheet growth. How long will the Fed keep its (term) repo facility and T-bill purchases in place?

Currencies: EUR/USD continues lackluster trading, with or without risk-off

Smaller, less liquid currency mostly reversed (a small) part of their recent losses yesterday. EUR/USD first dropped to test the 1.10 level and hardly profited from the subsequent risk rebound later. Today's Fed meeting will mostly address technical topics. A change on the IOER or on the balance sheet extension in theory might be mildly USD supportive.

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	→

- **WS** rebounded with gains up to 1.43% (Nasdaq) as investors were consoled by solid US data, upbeat earnings and attempts to contain the coronavirus. **Asian markets** are upwardly oriented with HK underperforming in a catch-up move.
- **US consumer confidence jumped to a 6-month high of 131.6 in January** from an upwardly revised December print of 128.2. Consumers take on a brighter view of both present and future business conditions amid easing headwinds.
- **Australian headline inflation ticked higher than expected in Q4/2019 to 0.7% (Q/Q)** while the annual pace rose to 1.8%. Core inflation, measured by the RBA's favorite trimmed mean gauge, stabilized at 1.6% Y/Y.
- **ECB's Jens Weidmann claimed the central bank's stimulus package in September went a bit too far**, in particular the additional bond purchases. Yet, interest rates won't rise again for a while given subdued inflation, he says.
- **Johnson's government is introducing a bill today to end automatic rights for EU vessels to fish in UK waters.** The proposal may have repercussions for the UK as the EU disclosed any trade deal must be underpinned by a fisheries pact.
- Minutes of the BoJ's last meeting show a growing concern over the effectiveness and consequences of prolonged low rates and the **BoJ's** ineffectiveness to meet its inflation target, with one member **indicating the need for a policy review.**
- **All eyes are on the Fed today** which is seen standing pat. Investors will attentively listen to Powell on hints on future balance sheet growth. In Europe, confidence indicators are due. Germany taps the bond market

Rates

Balance sheet growth key at first Fed policy meeting

	US yield	-1d
2	1.46	0.02
5	1.46	0.04
10	1.66	0.05
30	2.09	0.06

Core bonds fell prey to some profit taking yesterday on the coronavirus-driven rally since early last week. Hong Kong travel restrictions caused a final hiccup before investors decided to take some chips off the table. Stock markets recovered with the US outperforming Europe. Mixed-to-better US eco data and a weak US Treasury 7-yr Note sale contributed to a slight underperformance of US Treasuries vs German Bunds. The US yield curve bear steepened with yields ending 2.2 bps (2-yr) to 5.5 bps (30-yr) higher. The German curve shifted in similar fashion with yields rising 0.3 bps (2-yr) to 4.6 bps (30-yr). 10-yr yield spreads vs Germany narrowed slightly with Greece (-3 bps) and Italy (-5 bps) outperforming. **Greece successfully raised €2.5bn via a syndicated 15-yr (!) bond deal which drew nearly €19bn in bids.**

	DE yield	-1d
2	-0.63	0.00
5	-0.60	0.03
10	-0.34	0.04
30	0.17	0.05

Most Asian stock markets are upwardly oriented this morning even if the coronavirus death toll keeps rising. Hong Kong underperforms in a catch-up move after returning from a regional holiday. **Core bonds tread water near yesterday's correction lows.**

Today's eco calendar is all about the **Fed's first policy meeting of the year.** Last year's final dot plot showed near-consensus on keeping policy rates stable throughout 2020 while the Fed completes its internal policy review. Recent events, speeches by governors, eco data and inflation figures suggest **no alternation to this scenario** even if short term money markets discount a 25 bps rate cut by the end of the year. **Fed Chair Powell could be grilled on the central bank's balance sheet** though at the Q&A session. Since September 2019, the balance sheet **rose from \$3.8tn to \$4.1tn** as the Fed **first introduced (term) repo operations and later Treasury bill purchases (\$60bn/month)** to stem problems in the US repo markets originating from falling reserve levels. It's an open question on how the US central bank sees these emergency tools evolving. Will they become a permanent policy feature (e.g. standing repo facility) and/or will bill purchases be phased out during Q2? **Fed balance sheet growth in the past proved to be an important driver of risk sentiment.** Q4 earnings remain a wildcard for trading, while the debate around blocking impeachment witnesses in President Trump's trial could start grabbing some attention as well. A vote will probably be held on Friday.

Technically: core bond yields failed to take out resistance levels at **-0.18% (July high)/-0.15% (38% retracement of Feb '18 – Sep '19 decline) for the German 10-yr yield and 1.94% for the US 10-yr yield.** The Chinese coronavirus took markets hostage via risk aversion, pulling core bond yields below first support. We hold our view that this won't be a lasting market theme.



German 10-yr yield trades below intermediate support as Chinese coronavirus takes markets hostage.



US 10-yr yield: 1.94% proved to be tough resistance. No escaping global risk aversion in January.

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Currencies

EUR/USD continues lacklustre trading

R2	1.1265	-1d
R1	1.1199	
EUR/USD	1.1022	0.0003
S1	1.1000	
S2	1.0879	

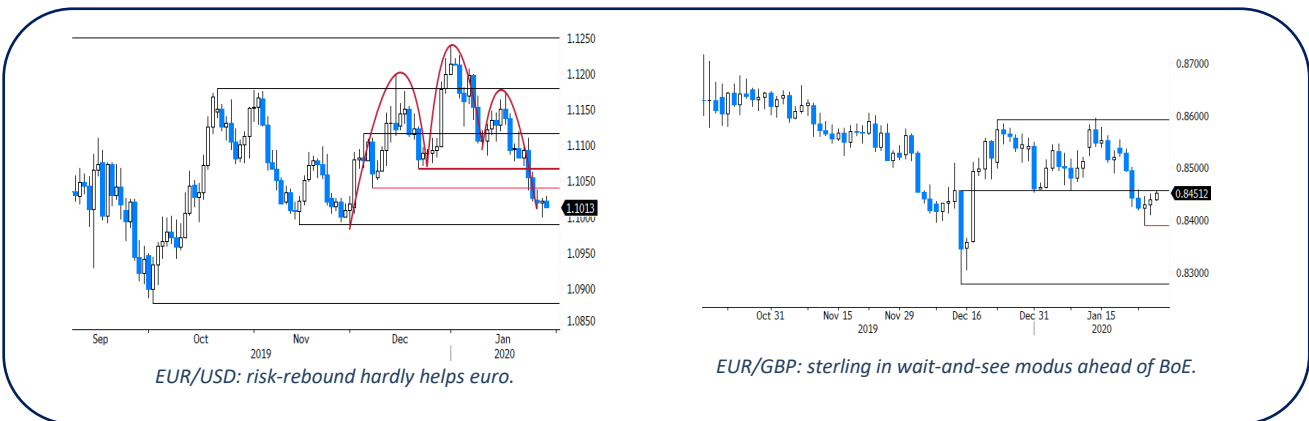
The risk-off first deepened yesterday as Hong Kong restricted travel due to corona, but sentiment improved in US trading. **Several smaller currencies** (AUD, SEK, NOK and to a lesser extent CZK, PLN) that were sold recently, rebounded. **USD/JPY returned north of 109**. The **Swiss franc came off a near 3-year top against the euro** (close 1.0725). **The (trade-weighted) dollar** also reversed its intraday gain. US data were mixed (poor durable orders, strong consumer confidence) but were largely ignored as driver for FX trading. **The performance of EUR/USD was again lacklustre**. The pair tested the 1.10 level, but the subsequent rebound was unconvincing. The pair closed little changed at 1.1022.

R2	0.8798	-1d
R1	0.8676	
EUR/GBP	0.8461	0.0023
S1	0.8275	
S2	0.8117	

Overnight, Asian equities also show signs of bottoming after yesterday's rebound on WS. Hong Kong reopens after the holidays (-2.5%). The **offshore yuan** (USD/CNH 6.96 area) rebounds after nearing the barrier of 7 earlier this week. **Australia Q4 inflation** rose slightly more than expected (1.8% Y/Y), supporting a guarded AUD comeback (AUD/USD 0.677 area). USD/JPY hovers in the lower part of the 109 figure. EUR/USD still struggles not to fall back to the 1.10 area.

Today, the focus for (FX) trading turns the Fed policy decision and on the developing story of the corona virus. The Fed is likely to keep its policy and assessment unchanged. It might address technical issues (IOER, balance sheet). Any tweaks might be mildly USD supportive, but we don't expect a big impact. Yesterday's risk-rebound supported the higher-yielding/high risk currencies but failed to inspire EUR/USD. Both eco data and the fall-out of the virus didn't provide a clear guide for euro trading. EUR/USD was caught in a gradual, protracted downtrend. We look for technical signs of a bottoming. **The EUR/USD technical picture deteriorated after its break below 1.1066/40**. It paints a H&S pattern with targets near/below 1.09 and interim support at 1.0990/80. Regaining 1.1120 would be a first sign that downside bias is easing.

Sterling extended its 'corrective' decline against the euro yesterday. We consider the move as mainly technical in nature. The dispute on fishing rights between the EU and the UK might have been a tentative sterling negative too. Today, the UK eco calendar is thin. **Markets will keep a wait-and-see approach ahead of tomorrow's BoE policy meeting**. For now, **we seen no reason for further sterling losses**.



Calendar

Wednesday, 29 January		Consensus	Previous
US			
14:30	Advance Goods Trade Balance (Dec)	-\$65.0b	-\$63.2b
16:00	Pending Home Sales MoM / NSA YoY (Dec)	0.50%/10.30%	1.20%/5.6%
20:00	FOMC Rate Decision	1.50%/1.75%	1.50%/1.75%
20:00	Interest Rate on Excess Reserves	1.55%	1.55%
Japan			
06:00	Consumer Confidence Index (Jan)	39.1A	39.1
UK			
01:01	BRC Shop Price Index YoY (Jan)	-0.30%A	-0.40%
EMU			
10:00	M3 Money Supply YoY (Dec)	5.50%	5.60%
Germany			
08:00	Import Price Index MoM / YoY (Dec)	0.20%/-0.7%	0.50%/-2.1%
08:00	GfK Consumer Confidence (Feb)	9.6	9.6
France			
08:45	Consumer Confidence (Jan)	102	102
Italy			
10:00	Consumer Confidence Index (Jan)	110.5	110.8
Events			
Q4 earnings	McDonalds (bef-mkt), Boeing (bef-mkt), Mastercard (bef-mkt), Facebook (aft-mkt), Microsoft (aft-mkt) ...		
11:30	Germany to Sell €4bn of 2025 Bonds		
20:30	Powell Holds Post-FOMC meeting Press Conference		

10-year	Close	-1d		2-year	Close	-1d	Stocks	Close	-1d
US	1.66	0.05		US	1.46	0.02	DOW	28722.85	187.05
DE	-0.34	0.04		DE	-0.63	0.00	NASDAQ	9269.681	130.37
BE	-0.10	0.04		BE	-0.58	0.01	NIKKEI	23379.4	163.69
UK	0.55	0.04		UK	0.45	0.04	DAX	13323.69	118.92
JP	-0.04	0.00		JP	-0.13	0.00	DJ euro-50	3719.22	41.38
IRS	EUR	USD	GBP	EUR	-1d	-2d	USD	-1d	-2d
3y	-0.31	1.48	0.63	Eonia	-0.4530	0.0000	Libor-1	1.6493	0.0000
5y	-0.24	1.48	0.66	Euribor-1	-0.4570	-0.0040	Libor-3	1.7745	0.0000
10y	0.02	1.60	0.75	Euribor-3	-0.4010	-0.0030	Libor-6	1.7835	0.0000
				Euribor-6	-0.3370	-0.0040			
Currencies	Close	-1d		Currencies	Close	-1d	Commodities	Close	-1d
EUR/USD	1.1022	0.0003		EUR/JPY	120.3	0.30	CRB	173.80	0.62
USD/JPY	109.15	0.25		EUR/GBP	0.8461	0.0023	Gold	1575.80	-7.90
GBP/USD	1.3028	-0.0029		EUR/CHF	1.0725	0.0042	Brent	59.51	0.19
AUD/USD	0.6762	0.0001		EUR/SEK	10.5912	-0.0130			
USD/CAD	1.3155	-0.0039		EUR/NOK	10.045	-0.0302			

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