



**Friday, 04 January 2019**

## Rates: Room for profit taking on stretched core bond rally?

US Treasuries significantly outperform Bunds in US dealings yesterday following a huge negative surprise of the manufacturing ISM and as stock markets lost up to 3%. Risk sentiment improved overnight on trade developments. Together with an expected strong payrolls report, it could provide the setting for some profit taking on the stretched core bond rally.

## Currencies: Dollar to ease on 'softer' Powell?

FX markets were looking for a new equilibrium yesterday after the early morning 'flash crash'/yen rally. Later in the session, the dollar declined further as a poor ISM reinforced investor concerns on US growth. Today, the focus for USD trading will be on the US payrolls and on an interview of Fed's Powell. The combination of an easing in the risk-off trade and a 'softer' Powell might weigh on the dollar.

## Calendar

# Headlines

- **US equities** dropped heavily yesterday with losses up to 3% after Apple's revenue warning and a disappointing ISM. **Asian equities** are trading mixed, with China outperforming on new trade hopes.
- **The US and China confirmed to hold trade talks on Monday.** A US delegation, led by Deputy Trade Representative Jeffrey Gerrish, will visit Beijing for a first face-to-face negotiation since both countries agreed to a 90-day truce.
- **The US House of Representatives**, now lead by Democrats, **passed funding bills yesterday aimed to end the partial shutdown of the government.** US President Trump already signalled to veto the bills as it doesn't include wall funding.
- **Italy is weighing its options to rescue the latest endangered lender, Banca Carige, to shield small savers and taxpayers from losses.** A larger bank to take over Carige or a capital increase are the options currently under consideration.
- **China's Caixin PMI Services increased modestly in December to 53.9**, up from 53.8. **The Composite PMI rose to 52.2**, up from 51.9 in November. Meanwhile, the Chinese government continues to support small business financing.
- **Ireland booked its first surplus in 2018 since the economic crisis in 2008.** PM Varadkar said they are now well-prepared for a no-deal Brexit. However, the surplus mainly depends on corporate tax receipts from multinationals.
- **Today's economic calendar** contains US Payrolls, Average Hourly Earnings and the Unemployment Rate, while for the EMU we receive inflation data. Ex-Fed giants Yellen, Bernanke and current chair Powell speak.

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	↗

# Rates

## Bad ISM gives huge push in US T's back

	US yield	-1d
2	2,38	-0,09
5	2,40	-0,10
10	2,55	-0,07
30	2,91	-0,05

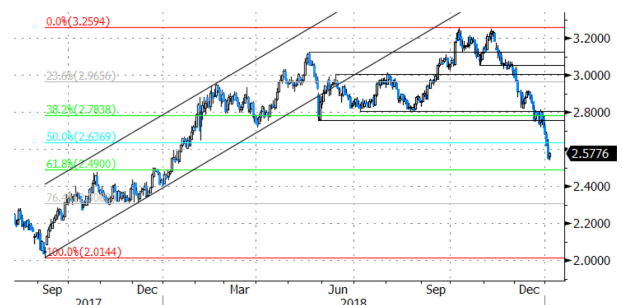
	DE yield	-1d
2	-0,61	0,00
5	-0,38	-0,01
10	0,15	-0,01
30	0,82	0,00

**US tech giant Apple' revenue warning**, blaming cooling Chinese demand, determined Asian dealings and the start of European trading. **Risk aversion was name of the game with JPY, gold and (to a lesser extent) core bonds rallying.** Tensions eased during European trading hours, suggesting that the breathtaking core bond rally, which started early November and lasted through the end of 2018, might finally lose some steam. The uptick in the oil price (Brent > \$56/barrel) in this respect played a role as well, given the strong correlation between the collapse of oil, declining inflation expectations and lower (long term) yields we have witnessed. Technically, the German 10-yr yield bounced off final support (0.15%; 2017 low) before returning to (sub)-zero levels. **Any hopes of peace on global markets were nipped in the bud by a dismal December US manufacturing ISM**, dropping from 59.3 to 54.1 (vs 57.5 forecast). It put all risk-off trades back on and caused a significant outperformance of US Treasuries vs German Bunds. US yield declined by 10 bps (5-yr) to 4.9 bps (30-yr). **The outperformance of the front end (2-yr yield -9 bps) indicates that investors' start discounting that the Fed's next move will be a rate cut.** Changes on the German yield curve varied between +0.3 bps (wings) and -1.5 bps (belly). Peripheral yield spread changes vs Germany widened by 2 bps (Ireland) to 7 bps (Portugal) **with Italy underperforming (+18 bps)**. There was no political news, but investors probably get nervous ahead of first Italian supply operations. The Italian debt agency might soon want to prove its access to long-term funding (10-yr+?) via (syndicated?) deals.

**Risk sentiment improved again overnight.** News that China and the US will meet early next week in Beijing **to discuss a trade truce** lifted stock markets and weighed on core bonds. China outperforms, additionally helped by a stronger services PMI and hints on monetary and fiscal support by the Chinese PM. Japanese markets are notable underperformers, but still had some catching up to do, returning from NY holidays. **Today's eco calendar heats up with EMU inflation (core: 0.9% Y/Y and headline 1.7% Y/Y; downside risks) and US payrolls (+184k; upside risks).** Markets are currently most concerned about the shape of the US economy with activity data probably taking over from inflation numbers as main market driver. EMU CPI readings might therefore be ignored even in case of weakness. On top, European markets are already positioned extremely dovish as well, only discounting positive 3M Euribor rates by mid-2021! **A positive payroll surprise, the overnight improvement in risk sentiment and upward pressure on oil prices might therefore determine today's global trading, providing some space for profit taking on the stretched core bond rally.** Speeches by Fed members (Powell, Bostic and Barkin) are wildcards.



German 10-yr yield tests 2017 low. Final technical hurdle before returning to (sub) zero levels.



US 10-yr yield lost 38% retracement level suggesting room for a further technical decline towards 2.5%

# Currencies

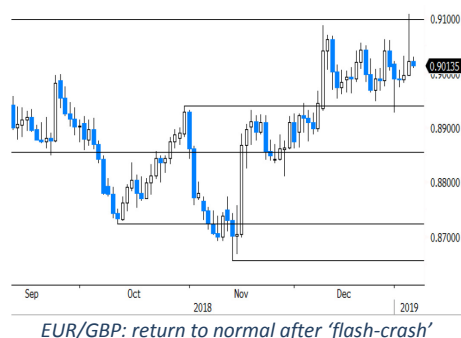
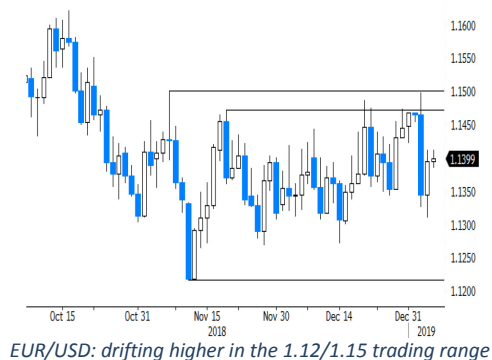
R2	1,1815	-1d
R1	1,1621	
EUR/USD	1,1394	0,0050
S1	1,1187	
S2	1,1119	

R2	0,93067	-1d
R1	0,91	
EUR/GBP	0,9021	0,0025
S1	0,8700	
S2	0,862	

## Dollar the ease on more dovish tone from Powell?

FX markets were looking for a new equilibrium in the wake of the sharp rally of the yen early in Asia yesterday. The yen gradually reversed part of the gain acquired during the FX flash crash. Risk sentiment remained fragile but initially core/US yields stabilized after the recent decline. USD showed no clear direction. US data were mixed with strong ADP private job growth, but the **manufacturing ISM tumbled sharply from 59.3 to 54.1** and rekindled investor fears on US/global growth. **US yields, equities and the USD started a new downleg.** EUR/USD rebounded to the 1.14 area. Remarkably, USD/JPY held rather 'strong' despite a further decline in US interest rates and equities. EUR/USD finished the day at 1.1394. USD/JPY rebounded after the flash-crash to close the day at 107.68 (from 108.88). **Overnight**, Asian equities show a mixed picture. Japan shows losses of 1.50%/2.25% as they return from the New Year holidays, but the Japan manufacturing PMI (52.6) wasn't too bad. The Chinese Caixan services/composite PMI's also surprise on the upside, easing growth fears. Chinese equities are rebounding. EUR/USD stabilizes just below 1.14. USD/JPY (108.15 area) gains a few ticks as the risk-off trade is losing some traction. **Later today**, the final EMU PMI's, EMU inflation and German labour data will be published. **Inflation will probably be soft, but the impact on the euro might be modest.** In the US, the payrolls take centre stage. Solid job growth (184K) is expected. However, labour data are a lagging indicator. So, the impact might be less than e.g. of the ISM's. There is probably also **an asymmetrical risk** with the dollar more sensitive to a negative rather than to a positive surprise. Last but not least, markets will keenly monitor a scheduled interview of Fed's Powell together with his predecessors Yellen and Bernanke. Some dovish concessions (data dependence and taking into account financial conditions) might weigh on the dollar. EUR/USD recently held in the 1.12/15 consolidation pattern. EMU and US data might be mixed, but we continue to see modest downside risk for the dollar in case of an easing of the risk-off trade or in case of some 'soft' concessions of Fed's Powell. EUR/USD might drift a bit further north.

**Sterling** was mainly driven by technical considerations yesterday. EUR/GBP returned back to the low 0.90 area after an initial spike higher due to the flash crash. We expect more wait-and-see trading. The UK services PMI probably will only be of intraday significance. A less negative risk context might be slightly GBP-supportive.



# Calendar

Friday, 4 January		Consensus	Previous
<b>US</b>			
14:30	Change in Nonfarm Payrolls (Dec)	184k	155k
14:30	Change in Private Payrolls (Dec)	185k	161k
14:30	Change in Manufact. Payrolls (Dec)	20k	27k
14:30	Unemployment Rate (Dec)	3.7%	3.7%
14:30	Average Hourly Earnings MoM / YoY (Dec)	0.3%/3.0%	0.2%/3.1%
14:30	Average Weekly Hours All Employees (Dec)	34.5	34.4
14:30	Labor Force Participation Rate (Dec)	--	62.9%
<b>Canada</b>			
14:30	Net Change in Employment (Dec)	10.0k	94.1k
14:30	Unemployment Rate (Dec)	5.7%	5.6%
<b>China</b>			
02:45	Caixin China PMI Composite (Dec)	52.2A	51.9
02:45	Caixin China PMI Services (Dec)	53.9A	53.8
<b>Japan</b>			
01:30	Nikkei Japan PMI Mfg (Dec F)	52.6	52.4
<b>UK</b>			
01:01	BRC Shop Price Index YoY (Dec)	0.3%A	0.1%
08:00	Nationwide House PX MoM / NSA YoY (Dec)	0.1%/1.5%	0.3%/1.9%
10:30	Money Supply M4 MoM / YoY (Nov)	--/--	0.7%/1.0%
10:30	Markit/CIPS UK Services PMI (Dec)	50.7	50.4
10:30	Markit/CIPS UK Composite PMI (Dec)	50.8	50.7
<b>EMU</b>			
10:00	Markit Eurozone Services PMI (Dec F)	51.4	51.4
10:00	Markit Eurozone Composite PMI (Dec F)	51.3	51.3
11:00	PPI MoM / YoY (Nov)	-0.2%/4.2%	0.8%/4.9%
11:00	CPI Core YoY (Dec A)	1.0%	1.0%
11:00	CPI Estimate YoY (Dec)	1.7%	2.0%
<b>Germany</b>			
09:55	Unemployment Change (000's) (Dec)	-13k	-16k
09:55	Unemployment Claims Rate SA (Dec)	5.0%	5.0%
09:55	Markit Germany Services PMI (Dec F)	52.5	52.5
09:55	Markit/BME Germany Composite PMI (Dec F)	52.2	52.2
<b>France</b>			
08:45	CPI EU Harmonized MoM / YoY (Dec P)	0.1%/2.0%	-0.2%/2.2%
09:50	Markit France Services PMI (Dec F)	49.7	49.6
09:50	Markit France Composite PMI (Dec F)	49.4	49.3
<b>Italy</b>			
09:45	Markit/ADACI Italy Services PMI (Dec)	50.1	50.3
09:45	Markit/ADACI Italy Composite PMI (Dec)	49.3	49.3
11:00	CPI EU Harmonized MoM / YoY (Dec P)	0.1%/1.4%	-0.3%/1.6%
<b>Spain</b>			
09:15	Markit Spain Services PMI (Dec)	53.7	54.0
09:15	Markit Spain Composite PMI (Dec)	53.7	53.9
<b>Sweden</b>			
08:30	Swedbank/Silf PMI Services (Dec)	--	62.2
<b>Events</b>			
16:15	Fed Chair Powell plus Bernanke and Yellen interviewed at AEA		
16:15	Fed's Bostic Speaks at AEA in Atlanta		
19:30	Fed's Barkin Speaks on Outlook for Growth		

10-year	<u>Close</u>	<u>-1d</u>		2-year	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	2,55	-0,07		US	2,38	-0,09	DOW	22686,22	-660,02
DE	0,15	-0,01		DE	-0,61	0,00	NASDAQ	6463,504	-202,43
BE	0,71	0,00		BE	-0,54	-0,02	NIKKEI	19561,96	-452,81
UK	1,19	-0,02		UK	0,70	-0,01	DAX	10416,66	-163,53
JP	-0,03	-0,03		JP	-0,18	-0,04	DJ euro-50	2954,66	-38,52
IRS	<u>EUR</u>	<u>USD</u>	<u>GBP</u>	EUR	<u>-1d</u>	<u>-2d</u>	USD	<u>-1d</u>	<u>-2d</u>
3y	-0,10	2,45	1,14	Eonia	-0,3660	0,0020			
5y	0,14	2,42	1,22	Euribor-1	-0,3630	-0,0010	Libor-1	2,5071	0,0000
10y	0,75	2,57	1,37	Euribor-3	-0,3090	0,0010	Libor-3	2,7939	0,0000
				Euribor-6	-0,2370	0,0010	Libor-6	2,8739	0,0000
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>	Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1,1394	0,0050		EUR/JPY	122,67	-0,88	CRB	171,55	1,16
USD/JPY	107,68	-1,20		EUR/GBP	0,9021	0,0025	Gold	1294,80	10,70
GBP/USD	1,2628	0,0021		EUR/CHF	1,1243	0,0012	Brent	55,95	1,04
AUD/USD	0,7006	0,0021		EUR/SEK	10,255	0,0261			
USD/CAD	1,3488	-0,0091		EUR/NOK	9,9004	0,0123			

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