



Sunrise

Monday, 05 December 2016

Rates: How long will risk-off last this time?

Risk aversion dominated Asian trading following as the Italian referendum outcome caused PM Renzi to resign. In line with the Brexit-referendum and US elections, we expect such global risk-off to be short-lived. Even the damage on peripheral bond markets could be contained with Thursday's ECB meeting and possible QE-extension looming.

Currencies: Euro in the defensive after Italian referendum

EUR/USD dropped temporary to the low 1.05 area after the resignation of Italian PM Renzi. The focus for global currency trading will remain on the consequences of the Italian referendum. A cautious risk-off modus might continue to weigh on EUR/USD and cap the topside of USD/JPY, at least temporary.

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** ended nearly unchanged as they failed to cling on to (small) gains on a decent, but near-consensus, payrolls report. **Overnight**, Asian stock markets lose moderate ground in a global risk-off move following the Italian referendum.
- **Matteo Renzi is set to resign** after suffering a heavy defeat in a referendum on his flagship constitutional reforms, a result that plunges Italy into political crisis and raises fears of turmoil in its banking system.
- **Austrians voted against an anti-immigrant populist as their next president** by a resounding margin, bucking a trend of nationalist electoral successes across the West. Center-left candidate Van der Bellen won with 53.3% of the vote
- **New Zealand PM Key**, who won praise for his economic stewardship after the global financial crisis, **unexpectedly announced his resignation** after eight years in power for personal reasons, backing his finance minister to take the helm.
- **President-elect Trump stepped up his rhetoric about Beijing's economic and military stances**, as senior members of his transition team sought to play down concerns that his phone call with Taiwan's president heralded a break from longstanding U.S. policy on China.
- The **Chinese Caixin/Markit services (PMI) rose to 53.1 in November** from 52.4 in October, a 16-month high though the increase in new orders dipped slightly and business expectations moderated.
- **Oil retreated from a 16-month high** overnight, as the Italian referendum led to a risk off move. Brent currently trades around \$54/barrel from 54.50 previously.
- **Today's** eco calendar contains EMU final services PMI, UK services PMI. Fed Dudley, Evans and Bullard are scheduled to speak and EMU FM's hope reach a compromise on Greek reforms at the Eurogroup meeting.

Rates

Short covering after plain vanilla US payrolls

On Friday, global core bonds corrected higher after the US payrolls turned out a mixed bag. The headline payroll number missed consensus by a whisker (178k vs 180k). The unemployment rate unexpectedly declined from 4.9% to 4.6%, the lowest level since 2007 and below the Fed's (current) NAIRU. Average hourly earnings disappointed though at -0.1% M/M and 2.5% Y/Y (from 2.8% Y/Y in October). Immediately after the US payrolls release some short-covering gains followed, but investors sold into the "rally" sending core bonds back to pre-payrolls levels. However, there was no follow through selling which brought a stronger bout of short covering and more substantial gains. **The upcoming referendum might have been of some additional help, but the Italian spread narrowing suggest that it wasn't the main factor. The change in the US curve, with the belly outperforming, suggests that markets scaled back their expectations for the (2017) Fed rate path, probably due to the disappointing decline of AHE (earnings). Equity markets initially gained some ground, but closed nearly unchanged. The oil price remained upwardly oriented, following some modest initial profit taking.**

In a daily perspective, changes on the US yield curve ranged between -4.7 bps (30-yr) and -7.7 bps (5-yr), the belly of the curve outperforming. **The German yield curve** bull flattened with yields down between 0.5 bps and 9.8 bps. **On intra-EMU bond markets**, the Italian 10-yr yield spreads versus Germany narrowed up to 6 bps, as optimism on the referendum was still high (see below for the cold shower that followed). Spanish, Portuguese and Greek spreads widened by 2 to 8 bps.

US Non-manufacturing ISM, but Italian referendum key

In the euro area, the **final Markit business surveys for November** shouldn't stir markets while the **EMU retail sales** for October are outdated and not very reliable. The **UK services PMI** (54.3 from 54.5) may have a marginal effect if the outcome deviates from consensus. **In the US, the Non-manufacturing ISM** is more interesting. It is expected to have marginally increased in November to 55.5 from 54.8 previously. We have **no reasons to distance us from the consensus**. Speeches of **Fed Dudley, Evans and Bullard**, three doves, shouldn't bring fireworks either, as a rate hike next week is a near certainty.

Belly US curve outperforms

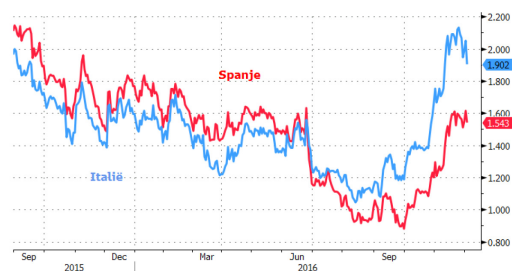
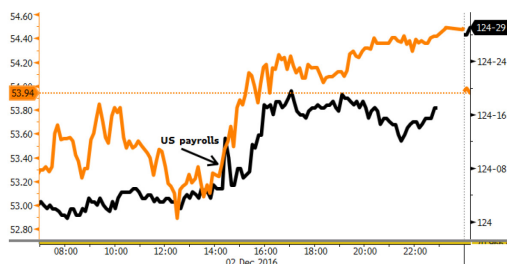
German curve bull flattens sharply after week of losses

Italian bonds outperformed ahead of referendum

	US yield	-1d
2	1,0998	-0,0438
5	1,8126	-0,0776
10	2,3688	-0,0705
30	3,0345	-0,0608

	DE yield	-1d
2	-0,7420	-0,0120
5	-0,4290	-0,0470
10	0,2650	-0,1050
30	0,9372	-0,0903

Strong US Non-manufacturing ISM



T-Note future (black) and oil (orange) (intraday): Initial tepid reaction on payrolls, but later on more sustained short covering.

Italian and Spanish 10-yr bond yields: How much will they rise today?

Italian PM Renzi resigns after referendum defeat

R2	163,19	-1d
R1	162,08	
BUND	161,13	1,1300
S1	159,14	
S2	158,67	

Italy rejected constitutional reforms proposed by PM Renzi in a referendum with a very clear 60% majority and a high turnout of about 70%. PM Renzi announced his resignation. The outcome is the worst possible for markets as it could be interpreted as rejecting Mr. Renzi's reform plans, but also as supporting opposition parties. According to a recent poll, outsider 5SM (Grillo's Five Star Party), would be first in eventual parliamentary elections. The outcome also raises uncertainty about the outcome of the Dutch and French elections in H1 2017 and about the tail risk of EMU disintegration (5 Star party promised EU referendum). **The Italian president will now launch a round of talks on the formation of a new government. Snap elections** aren't excluded given the clear outcome by high turnout, but are unlikely even if it would probably be the most democratic way of action. **The political instability could jeopardize BMPS's plans to raise up to €5B by the end of the year (eg if sentiment towards the Italian financial sector gets a new snap). The bank and its advisers are expected to meet this morning.** On markets, we expect last week Italian spread narrowing to be undo. Risk-off favors the Bund at the expense of swaps and other, especially peripheral, bonds. The euro pays the price with EUR/USD back towards 1.0550. **As Thursday's ECB meeting looms, we don't expect the risk-off moves to be extreme.**

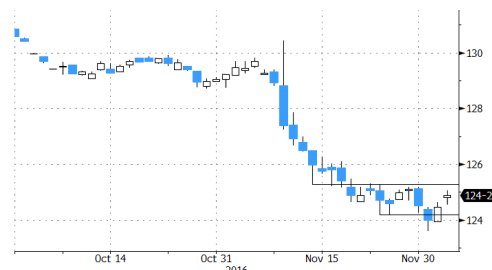
How long will risk-off last this time?

Overnight, Asian stock markets lose around 1% in the global risk-off move following the Italian referendum outcome. China underperforms despite an improving Caixin Services PMI, probably because of Trump's policy (see headlines). The US Note future gains ground, suggesting a stronger opening for the Bund.

Today, markets will have to digest the Italian referendum outcome. We think that the initial market reaction will be risk-off, but in line with the Brexit-vote and US elections, it shouldn't last long. Investors selling peripheral bonds risk being "countered" by a possible ECB decision to extend the current end date of the QE-programme when they meet on Thursday. The US non-manufacturing ISM is expected to remain strong, but risks being overshadowed by this weekend's events. Overall, we think that the current flight to safety could eventually be an opportunity to sell-the-upticks in core bonds as we expect Trump's reflation trade to remain markets' key theme.



German Bund: Downtrend remains intact. Temporary safe to quality on election outcome?



US Note future (March contract): sell-on-upticks

Currencies

Euro sets new correction low after Italian referendum

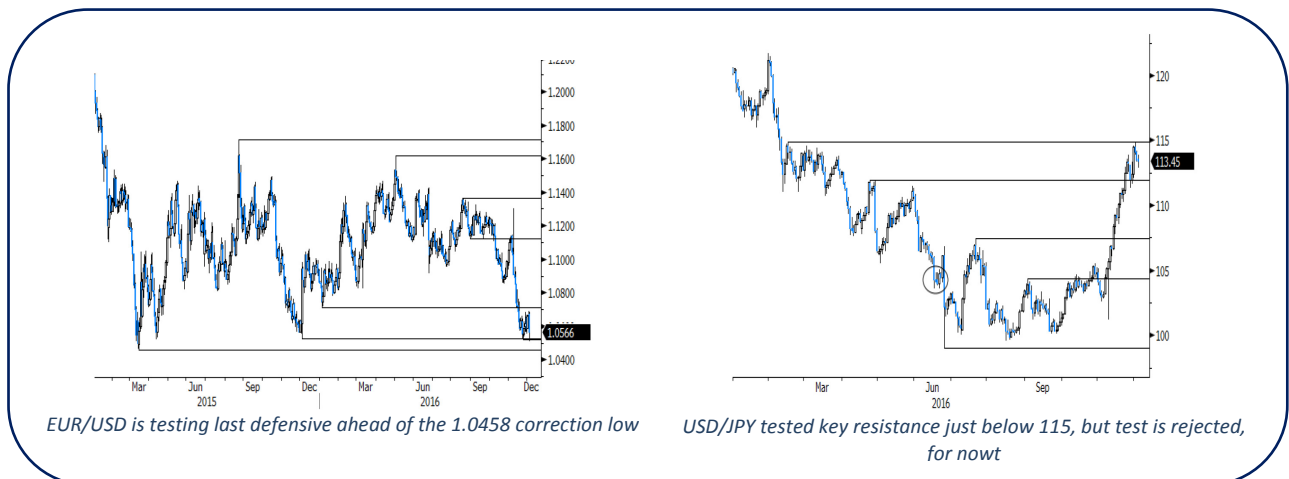
On Friday, the focus of global (currency) markets was on the US payrolls report. However, the payrolls were too close to expectations to inspire any directional USD move. It was a non-event for USD trading. EUR/USD closed the session at 1.0664 (from 1.0661 Thursday). USD/JPY lost gradually some ground off the reaction top and closed the session at 113.51 (from 114.10).

Overnight, Asian equities are losing up to 1.5% as the 'No vote' in the Italian referendum and the resignation of Italian PM Renzi put global markets in risk-off modus. The losses can be qualified as modest. The euro is the obvious victim of the Italian political uncertainty. EUR/USD set a new correction low in the low 1.05 area early in Asia, but reversed part of the initial losses (currently 1.0565). USD/JPY spiked temporary below 113, but also reversed the initial losses. The pair trades currently again in the mid 113 area. The kiwi dollar dropped to NZD/USD 0.7070 after Prime Minister Key announced to step down, but the pair trades currently again in the 0.71 area.

Dollar directionless after payrolls.

R2	1,0851	-1d
R1	1,069	
EUR/USD	1,0583	-0,0096
S1	1,0506	
S2	1,0458	

EUR/USD sets new correction low



The EUR/USD 1.0458 cycle low is again on the radar

Later today, the final EMU Markit business surveys for November shouldn't stir markets. The EMU retail sales for October are outdated and not very reliable. In the US, the Non-manufacturing ISM is more interesting. It is expected to have marginally increased in November to 55.5 from 54.8 previously. We have no reasons to distance us from the consensus. However, the focus for global trading will be on consequences of the Italian referendum. The outcome for markets is the worst possible as it might be seen not only as a big "no" to Mr. Renzi and his reform plans, but also as a "yes" for the opposition, especially the outsider Five Star Party. The narrowing of the Italian spread of last week might be undone. The spread between German yields and US yields might also widen further. This is a euro negative. So, the euro might stay in the defensive. Markets will also keep a close eye at Italian bank stocks. A sell-off might cause nervousness in other markets, including the currency market. At the end of last week, the euro basically traded sideways as investors didn't put additional shorts in place going into the Italian referendum. At the same time; the dollar rally also lost slightly momentum. This morning euro weakness is again the name of the game. There is no reason to expect a trend reversal anytime soon.

For now, USD/JPY is holding up fairly well, but we don't see much upside short-term if global sentiment turns risk-off and if the rise in core bond yields takes a breather.

From a technical point of view, EUR/USD cleared intermediate support at 1.0851 and 1.0711 (2016 low). The pair set a minor new low below the 1.0524/18 support this morning. So, the cycle low at 1.0458 is again on the radar. We maintain a sell-on-upticks bias for EUR/USD. The 38% retracement from the Trump decline comes in at 1.0817. We don't expect EUR/USD to regain that level. The technical picture for USD/JPY improved too. The pair took out the key resistance at 111.45/91. Next key resistance at 114.50/115 was tested last week but the test was rejected. **The pair is moved well into overbought territory. The rally might be ripe for a modest correction.**

EUR/GBP testing next support at 0.8333

On Friday, **sterling trading was driven by technical considerations.** The UK construction PMI was marginally stronger than expected. BoE's chief economist Haldane maintained a neutral policy stance, but warned that the BoE shouldn't tighten policy too hastily. Both factors were no big issue for sterling trading. During the afternoon session, sterling found again a better bid. Some positive comments from UK policy makers on a further cooperation with the EU post Brexit might have played a role. EUR/GBP drifted gradually south reversing Thursday's late session rebound. The pair closed the session at 0.8389 (from 0.8467). Cable also rebounded sharply as the dollar rally slowed. The pair closed the session at 1.2729.

Today, the UK services PMI is expected slightly softer at 54.00 from 54.5. The report brings important info on the UK economy in the post-Brexit era. However, a big surprise is to have a big impact on sterling trading. **The negative euro sentiment after the Italian referendum also weighs on the EUR/GBP cross rate.** EUR/GBP is currently testing the 0.8333 support. Last week, EUR/GBP showed tentative signs of a bottoming out process. However, sterling strength is now replaced by euro weakness. So for now there is still no good reason to try to catch the falling knife of EUR/GBP.

R2	0,8708	-1d
R1	0,8578	
EUR/GBP	0,8336	-0,0118
S1	0,83	
S2	0,8117	



EUR/GBP: 0.8333 under heavy pressure.



GBP/USD: trending gradually higher

Calendar

Monday, 5 December		Consensus	Previous
US			
16:00	Labor Market Conditions Index Change (Nov)	-0.2	0.7
16:00	ISM Non-Manf. Composite (Nov)	55.5	54.8
Japan			
01:30	Nikkei Japan PMI Services (Nov)	A 51.8	50.5
01:30	Nikkei Japan PMI Composite (Nov)	A 52	51.3
06:00	Consumer Confidence Index (Nov)	A 40.9	42.3
UK			
10:00	New Car Registrations YoY (Nov)	--	1.4%
10:30	Markit/CIPS UK Services PMI (Nov)	54.3	54.5
10:30	Markit/CIPS UK Composite PMI (Nov)	--	54.8
EMU			
10:00	Markit Eurozone Services PMI (Nov F)	54.1	54.1
10:00	Markit Eurozone Composite PMI (Nov F)	54.1	54.1
10:30	Sentix Investor Confidence (Dec)	14.3	13.1
11:00	Retail Sales MoM / YoY (Oct)	0.8%/1.7%	-0.2%/1.1%
Germany			
09:55	Markit Germany Services PMI (Nov F)	55.0	55.0
09:55	Markit/BME Germany Composite PMI (Nov F)	54.9	54.9
France			
09:50	Markit France Services PMI (Nov F)	52.6	52.6
09:50	Markit France Composite PMI (Nov F)	52.3	52.3
Italy			
09:45	Markit/ADACI Italy Services PMI (Nov)	51.6	51.0
09:45	Markit/ADACI Italy Composite PMI (Nov)	51.6	51.1
Spain			
09:00	Industrial Production MoM (Oct)	0.8%/1.4%	-1.4%/0.8%
09:15	Markit Spain Services PMI (Nov)	55.0	54.6
09:15	Markit Spain Composite PMI (Nov)	54.9	54.4
China			
02:45	Caixin China PMI Services (Nov)	A 53.1	52.4
02:45	Caixin China PMI Composite (Nov)	A 52.9-	52.9
Sweden			
08:30	Swedbank/Silf PMI Services (Nov)	--	57.6
09:30	Industrial Production MoM / NSA YoY (Oct)	0.2%/1.3%--	6.8%/1.5%
Events			
14:30	Fed's Dudley Speaks on Economy and Policy in New York		
15:00	ECB Weidmann speaks in Munich (purdah period)		
15:25	Fed's Evans Speaks on Economy and Policy in Chicago		
20:05	Fed's Bullard to Speak on U.S. Economic Outlook In Arizona		

Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS		-1d
US	2,37	-0,07	US	1,10	-0,04	DOW	19170	19170,42
DE	0,27	-0,11	DE	-0,74	-0,01	NASDAQ	for Exch - NQI	#VALUE!
BE	0,65	-0,05	BE	-0,66	0,00	NIKKEI	18275	18274,99
UK	1,38	-0,12	UK	0,10	-0,05	DAX	10513,35	10513,35
JP	0,03	-0,01	JP	-0,16	0,00	DJ euro-50	3015	3015,13

						USD	td	-1d	
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,347	-0,003
3y	-0,093	1,488	0,734	Euribor-1	-0,37	0,00	Libor-1 USD	0,26	0,26
5y	0,095	1,784	0,926	Euribor-3	-0,31	0,00	Libor-3 USD	0,38	0,38
10y	0,680	2,189	1,326	Euribor-6	-0,22	0,00	Libor-6 USD	0,55	0,55

Currencies		-1d	Currencies		-1d	Commodity	CRB	GOLD	BRENT
EUR/USD	1,0583	-0,0096	EUR/JPY	120,36	-1,42		191,694	1172,83	54,06
USD/JPY	113,78	-0,29	EUR/GBP	0,8336	-0,0118	-1d	0,29	-1,04	0,39
GBP/USD	1,269	0,0065	EUR/CHF	1,0734	-0,0054				
AUD/USD	0,7435	0,0024	EUR/SEK	9,7799	-0,04				
USD/CAD	1,3320	0,0014	EUR/NOK	8,9596	-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		

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