

Thursday, 18 July 2019

Rates: Risk aversion lifts core bonds

Disappointing earnings and negative headlines on the US-Sino trade talks weighed on risk sentiment. US Treasuries eventually followed Bunds higher. Risk sentiment will remain today's main driver for trading and could further underpin bonds in a daily perspective. Strong US eco data can provide some counterweight.

Currencies: dollar declines even as sentiment turns risk-off

The USD rebound ran into resistance yesterday. EUR/USD bottomed ahead of the key 1.1180/90 support area. A risk-off correction finally also pushed US yields lower, reducing interest rate support for the dollar. Risk sentiment will likely dominate USD trading today. The EUR/USD downside looks well protected. Sterling continues fighting an uphill battle.

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	→

- **US equities** lost further momentum yesterday with stocks declining up to -0.65% (S&P500). **Asian markets** slip in the wake of WS's performance, Japan (-2%) underperforms as the yen strengthens.
- **US/Sino trade talks have stalled.** The White House is figuring out how to address China's demand to ease restrictions on Huawei after president Trump promised to do so at the G20 summit end-of-June.
- **The central bank of South Korea unexpectedly cut rates from 1.75% to 1.50%** as it lowered its 2019 GDP growth forecasts to 2.2% (from 2.5%) and cut inflation projections to 0.7% (from 1.1% in April).
- **Australia's June job report** showed a meagre 500 new jobs (part time -20.6k, full time +21.1k) after two strong months. The unemployment rate stabilised at 5.2% while the participation rate increased to 66%.
- Regional Fed districts **suggested a modest eco expansion in the latest Beige Book.** The outlook was generally positive with continued labour market tightness. They noted "widespread concerns" about the impact of trade policy.
- **The House overwhelmingly blocked a Democratic member's bid to impeach president Donald Trump** over his comments about several liberal congresswomen which the House condemned as racist yesterday.
- **Today's eco calendar** contains the US Philly Fed business outlook for July and the weekly jobless claims. June retail sales are due in the UK. Fed's Bostic and Williams are scheduled to speak. Spain and France tap the bond market.

Rates

Risk aversion helps core bonds

	US yield	-1d
2	1.81	-0.04
5	1.81	-0.05
10	2.05	0.00
30	2.56	-0.06

	DE yield	-1d
2	-0.75	-0.02
5	-0.63	-0.04
10	-0.29	0.00
30	0.27	-0.05

Core bonds put in a strong performance yesterday even as a driver was (initially) missing. German Bunds outperformed US Treasuries in European dealings, but the latter made a catch-up on the US clock. **Disappointing earnings** (eg rail operator CSX) weighed on US stock markets which already showed signs of fatigue on Tuesday. Additionally, the WSJ released an article arguing that **progress toward a US-Sino trade deal stalled** on Chinese demands to ease restrictions on Huawei. US yields fell by 3.8 bps (2-yr) to 5.7 bps (10-yr) in a daily perspective. Comments by **voting FOMC member George** didn't affect trading. The Kansas City Fed President said that her outlook hasn't changed since June when she supported an unchanged monetary policy. **The Fed's Beige Book**, preparatory document for the July meeting, saw economic activity expanding modestly, but with widespread concerns about the possible negative impact of trade-related uncertainty. The German yield curve bull flattened with yields falling by 1.5 bps (2-yr) to 4.8 bps (30-yr). 10-yr yield spread changes vs Germany ended unchanged with Greece (+4 bps) and Italy (+3 bps) underperforming.

Risk aversion spreads to Asia this morning with regional bourses losing ground. Japan (-2%) underperforms on yen strength. The Bund and US Note future trade marginally higher. The Bank of Korea surprisingly cut its policy rate and slashed growth forecasts, mainly on weakness in exports and investments.

Today's eco calendar contains **US weekly jobless claims and Philly Fed Business Outlook**. The latter is expected to rebound from 0.3 to 5 in July, following a steep drop in June. That's a similar pattern than the one we've witnessed for the Empire Manufacturing Survey earlier this week. **Risk sentiment on stock markets might remain the main trading theme, underpinning core bonds in a daily perspective.** Morgan Stanley and Microsoft are amongst the firms reporting Q2 earnings. Speeches by Fed Bostic and Williams won't alter thinking on the outcome of the July Fed meeting. **A 25 bps rate cut is out preferred and the most likely outcome, but odds of a bigger slash in the policy rate (-50 bps) are again rising in recent days (currently 34.5% probability). We don't expect a July ECB rate cut (currently 40% probability).**

The **German 10-yr yield** last week's bounced higher after reaching a new all-time low around the ECB's deposit rate (-0.4%). First resistance appears around -0.03%/-0.13%. We expect range trading in this band. The **US 10-yr yield** managed to hold north of 2% after an intense test end of June/early July. First, small, resistance lures around 2.17%, with 2.33% being the more high profile test.



German 10-yr yield bounced off new all-time low around the ECB's deposit rate (-0.4%)

US 10-yr yield manages to retake 2.01% in last instance. Consolidation ahead?

Currencies

R2	1.1533	-1d
R1	1.1448	
EUR/USD	1.1224	0.0013
S1	1.1110	
S2	1.0864	

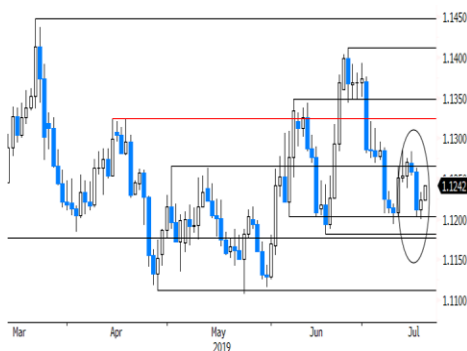
R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.9028	-0.0008
S1	0.8500	
S2	0.8314	

Dollar declines even as sentiment turns risk-off

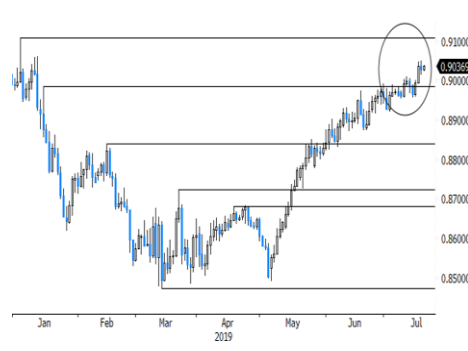
The dollar rebound ran into resistance yesterday. Trading was mostly technical in nature. Still, slightly higher than expected EMU headline inflation (1.3% Y/Y) maybe helped stopping the EUR/USD downside drift. The pair bottomed in the 1.12 area. Later in the session, a further decline in US yields finally also weighed on the dollar. EUR/USD finished at 1.1224 (from 1.1211). Deepening US equity losses pushed USD/JPY back below the 108 handle (close at 107.95).

Investor sentiment is deteriorating further in Asia. Investors fear disappointing corporate earnings. Trade talks between the US and China are said to be deadlocked on the US restrictions versus Huawei. Japan June trade data disappointed (both imports and exports declined). A surprise Bank of Korea rate cut fails to change investor sentiment for the better. The yen is also well bid. USD/JPY extends its decline (currently 107.70 area). The dollar is also ceding modest ground against the euro with EUR/USD trading in the 1.1240 area. **Later today**, there are no EMU data. The US Philly Fed business outlook is expected to improve (5.0 from 0.3) and jobless claims to stay low (216k). However, even a positive US data surprise probably won't change investors' mindset. **Earnings and equity sentiment will set the tone for trading. A risk-off correction** might incur further USD/JPY losses. **The impact on EUR/USD is less straightforward.** European assets often underperform in a risk-off context. At the same time, the low-yielding euro is an important funding currency for carry trades. Unwinding of those trades might cause euro buying. Lower US yields are a USD-negative too. The jury is still out, but the EUR/USD 1.1181 support looks solid short-term. **Global picture: EUR/USD drifted lower in the 1.11/1.14 range but rebounded (temporary?) after Powell paved the way for a July rate cut.** A rebound to the 1.13 would further ease the downside momentum. With the most important data before the July FOMC meeting printed, more trading near current levels is likely.

Sterling remained in the defensive yesterday as investors see a growing chance that the political turmoil might finally lead to a no deal Brexit. This sentiment was reinforced by comments of Brexit Secretary Barclay as he said that the risk of a no-deal Brexit is 'underpriced'. EUR/GBP retained recent gains and hovered lower half of the 0.90 big figure. Today, UK June retail sales are expected to show a third consecutive monthly decline. Even in case of a positive surprise, we expect any GBP-rebound to stay limited as Brexit uncertainty continues to dominate.



EUR/USD rebounds even as sentiment turns risk-off



EUR/GBP: holding north of 0.90 as Brexit uncertainty persists

Calendar

Thursday, 18 July		Consensus	Previous
US			
14:30	Philadelphia Fed Business Outlook (Jul)	5	0.3
14:30	Initial Jobless Claims	216k	209k
14:30	Continuing Claims	1700k	1723k
Japan			
01:50	Trade Balance (Jun)	¥589.5bA	-¥968.3bR
01:50	Trade Balance Adjusted (Jun)	-¥14.4bA	-¥609.1b
01:50	Imports/Exports YoY (Jun)	-5.2%A/-6.7%A	-1.5%/-7.8%
UK			
10:30	Retail Sales Ex Auto Fuel MoM/YoY (Jun)	-0.2%/2.6%	-0.3%/2.2%
10:30	Retail Sales Inc Auto Fuel MoM/YoY (Jun)	-0.3%/2.6%	-0.5%/2.3%
Events			
2019Q2 earnings	Morgan Stanley (13:30), Microsoft (aft-mkt) ...		
18-20JUL	Central Bank Research Association holds annual meeting in NY		
10:45	Spain to Sell Bonds		
10:50	France to Sell Bonds		
12:30	G-7 Finance Officials Meet in Chantilly, France		
15:30	Fed's Bostic Speaks to Clarksville Chamber in Tennessee (non-voter)		
19:00	US to Sell 10-Year TIPS		
20:15	Fed's Williams Speaks on Monetary Policy (voter)		

	<u>Close</u>	<u>-1d</u>		<u>2-year</u>	<u>Close</u>	<u>-1d</u>	Stocks	<u>Close</u>	<u>-1d</u>
US	2.05	0.00		US	1.81	-0.04	DOW	27219.85	-115.78
DE	-0.29	0.00		DE	-0.75	-0.02	NASDAQ	8185.206	-37.59
BE	0.03	-0.01		BE	-0.66	-0.02	NIKKEI	21046.24	-422.94
UK	0.76	0.00		UK	0.54	-0.05	DAX	12341.03	-89.94
JP	-0.14	-0.02		JP	-0.20	-0.01	DJ euro-50	3501.58	-19.78
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	-0.40	1.79	0.75	Eonia	-0.3700	0.0000	Libor-1	2.3004	0.0000
5y	-0.27	1.80	0.81	Euribor-1	-0.3970	-0.0020	Libor-3	2.2996	0.0000
10y	0.14	1.98	0.97	Euribor-3	-0.3690	-0.0020	Libor-6	2.2070	0.0000
				Euribor-6	-0.3570	-0.0070			
Currencies	<u>Close</u>	<u>-1d</u>		Currencies	<u>Close</u>	<u>-1d</u>	Commodities	<u>Close</u>	<u>-1d</u>
EUR/USD	1.1224	0.0013		EUR/JPY	121.16	-0.19	CRB	179.42	-0.66
USD/JPY	107.95	-0.29		EUR/GBP	0.9028	-0.0008	Gold	1423.30	12.10
GBP/USD	1.2433	0.0026		EUR/CHF	1.1084	0.0009	Brent	63.66	-0.69
AUD/USD	0.701	-0.0002		EUR/SEK	10.5139	-0.0129			
USD/CAD	1.3054	-0.0034		EUR/NOK	9.639	0.0270			

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