

Monday, 06 May 2019

Rates: US President Trump jeopardizes US-Sino trade talks

US President Trump unexpectedly upped the ante in US-Sino trade talks by threatening to raise existing tariffs and introduce new levies on Chinese imports. China considers to walk away from this week's scheduled talks. A risk-off wave sends core bonds higher this morning. Trade will dominate today's second tier agenda. Volumes will be lower with UK markets closed.

Currencies: Dollar doesn't profit from strong US payrolls nor from rising trade tensions

The dollar didn't profit from strong US payrolls on Friday. Modest wage growth and a poor non-manufacturing ISM capped any potential USD progress. This morning, sentiment turns outright risk-off as president Trump warned on new tariffs on Chinese goods. The dollar again doesn't profit. The US currency might lose interest rate support if tensions escalate further.

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 equity markets** matched record highs on Friday with tech shares outperforming. **Asian shares** are trading in red as US-Sino trade talks are struggling. Chinese indices underperform heavily (-6%). UK markets are closed.
- **US President Trump increased pressure on China by threatening amongst others to raise existing tariffs from 10% to 25%** because trade negotiations are going too slowly. China considers to cancel this week's discussions.
- **UK PM May is drafting a new law** that would create a custom union-style arrangement, **guaranteeing no checks on goods crossing the UK-EU border**, a key demand from opposition party Labour. Cross-party talks continue this week.
- **China will cut the required reserve ratio by 3% for small commercial lenders** that serve small firms. The cut will release 280 billion yuan of liquidity and seems to be aimed at lifting sentiment following Trump's new threat.
- US National Security adviser John Bolton said **the US will send an aircraft carrier and bomber force to the Middle East** to send **"a clear message to the Iranian regime"**. The US is attempting to reduce Iran's oil exports to zero.
- **Portuguese Socialist PM Costa threatened to quit** if a coalition of left-wing allies and centre-right opponents continued with **a controversial pay deal for teachers**. The coalition backed down, making it unlikely for the deal to pass.
- **Today's US economic calendar** is empty. The EMU prints retail sales results for March. Italy, Spain and Sweden publish Composite/Services PMI's. Fed's Harker speaks today, as does outgoing ECB chief economist Peter Praet.

Rates

President Trump jeopardizes trade talks

	US yield	-1d
2	2.33	-0.01
5	2.32	-0.02
10	2.53	-0.02
30	2.92	-0.01

	DE yield	-1d
2	-0.59	0.00
5	-0.41	0.00
10	0.03	-0.01
30	0.67	-0.01

Core bonds booked some profits last Friday. US Treasuries attempted to carve out losses on a strong US payrolls report, but the move failed as **the increase in net job growth was countered by disappointing earnings. A more pronounced than expected setback in the non-manufacturing ISM** settled the argument with investors preferring **some safety going into the weekend. Plenty of Fed governors spoke**, with St-Louis Fed Bullard and Chicago Fed Evans sounding **in favour of a rate cut should inflation drift further away from the Fed's 2% target.** Vice-chair Clarida said that current conditions warrant stability in policy rates. US yields declined by 1.1 bp (30-yr) to 2.2 bps (5-yr) in a daily perspective. Changes on the German yield curve ranged between -0.1 bp and -0.5 bps. 10-yr yield spread changes vs Germany were virtually unchanged.

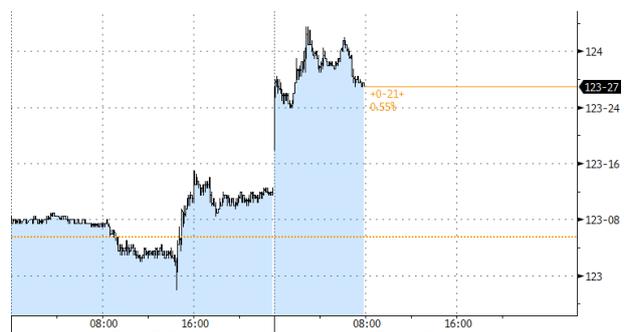
Asian stock markets (ex. Japan; still closed) lose ground this morning (-1%) with **China hugely underperforming (-6%)** after **US President Trump** unexpectedly launched a series of tweets, **threatening to impose more and higher tariffs on Chinese imports by Friday because trade negotiations are moving to slow. China is now considering to delay this week's scheduled talks** in Washington according to officials. **Core bonds surge higher this morning while Brent crude falls back below \$70/barrel. The reaction on the FX markets is more muted** with small gains for USD and JPY. The US decision to deploy an aircraft carrier to the Middle East and North Korea's first ballistic missile launch since 2017 add to geopolitical risk. A better-than-expected Chinese Caixin services PMI (54.5) and a cut in small banks' reserve requirement ratio can't balance the scales.

The trade story will continue to dominate trading today. The sharp reaction on Asian stock markets suggests that markets were positioned for a positive outcome. **UK markets are closed for May Day, suggesting that low volumes in Europe can amplify (risk-off) moves.** We hold our positive bias towards core bonds. The eco calendar only contains final EMU services PMI's and outdated (March) EMU retail sales. Speeches by ECB Lautenschlager, ECB Praet and Fed Harker are wildcards.

Long term view: markets concluded that the ECB missed out on this cycle. They even start pondering the possibility of an additional deposit rate cut. The downtrend in the German 10-yr remains in place so far. **Regarding Fed policy, markets now discount a >50% probability of a Fed rate cut by December.** The US 10-yr yield earlier this month returned above the lower bound of the previous 2.5%-2.79%. This turned the picture more neutral again, but the move lacks conviction.



Shanghai Composite loses more than 6% this morning after President Trump ups the ante once more in trade talks



US Note future extends gains this morning as US-Sino trade talks at risk of setback

Currencies

USD hardly profits from rising trade tensions

R2	1.1815	-1d
R1	1.1621	
EUR/USD	1.1198	0.0026
S1	1.1110	
S2	1.0864	

R2	0.93067	-1d
R1	0.91	
EUR/GBP	0.8502	-0.0073
S1	0.8500	
S2	0.8314	

The euro outperformed on Friday, but the market reaction to the data was a bit remarkable. EUR/USD didn't profit from a jump in EMU inflation (1.7% headline, 1.2% core), which was considered temporary. Later, US payrolls showed strong job growth, but the dollar also failed to profit as wage growth disappointed again. The US currency even lost further ground as the US non-manufacturing ISM unexpectedly dropped. (FX) markets keep the view that the dollar is at risk to lose interest rate support if US inflation stays as tame as it was of late. EUR/USD closed at 1.1198. USD/JPY finished at 111.10.

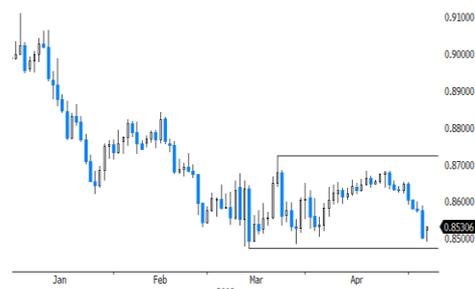
This morning, the positive (goldilocks-like) sentiment in the US on Friday is abruptly overthrown as president Trump said he might raise tariffs on Chinese good as soon as Friday. The tweets are causing doubts on a positive outcome of the US-China trade talks. Asian equities and the yuan (USD/CNY 6.78) are suffering heavy losses. AUD/USD dropped below 0.70. The yen strengthened to the USD/JPY 110.30 area, but gains eased later. The euro is holding up well. EUR/USD is still changing hands in the high 1.11 area.

Today, there few important data in the US and EMU. The focus will turn to the US-China trade war. The yen will probably outperform. **The impact on EUR/USD is not that evident**. The EMU economy proved very sensitive to global trade tensions. So, an escalation in the trade war might be a euro negative. At the same time, a risk off correction might lead to lower US yields (less interest rate support for the dollar). If trade tension escalate further, US president Trump might also threat to use US the dollar as weapon. As always, we keep a close eye at the EUR/JPY price action in a risk-off context. However, we have the impression that the negative impact on EUR/USD might be limited for now. The price action on Friday also suggested that the bar for sustained USD gains might be quite high. We maintain the view that the EUR/USD 1.1110 support area won't be that easy to break.

On Friday, sterling gained further ground on headlines/rumours that the negotiations between UK government and labour might lead to an agreement on a rather soft Brexit (customs union). EUR/GBP dropped to the 0.85 area. However, comments during the weekend suggested there is still quite some distrust between the two parties. **UK markets are closed today**. For now, we don't expect sterling to get additional support from investors anticipating a political agreement on Brexit.



EUR/USD: dollar doesn't profit from strong US payrolls. Rising trade tensions this morning also provide little support for the US currency.



EUR/GBP: sterling gained as markets hoped that labour and conservatives made progress on Brexit, but distrust remains.

Calendar

Monday, 6 May		Consensus	Previous
UK markets closed (early May bank holiday)			
Japan			
29APR-10MAY	Construction Orders YoY (Mar)	--	-3.4%
EMU			
10:00	Markit Eurozone Services PMI (Apr F)	52.5	52.5
10:00	Markit Eurozone Composite PMI (Apr F)	51.3	51.3
10:30	Sentix Investor Confidence (May)	1.2	-0.3
11:00	Retail Sales MoM/YoY (Mar)	-0.1%/1.8%	0.4%/2.8%
Italy			
09:45	Markit/ADACI Italy Services PMI (Apr)	--	53.1
09:45	Markit/ADACI Italy Composite PMI (Apr)	--	51.5
Belgium			
06MAY-20MAY	Budget Balance YTD (Apr)	--	-11.246b
China			
03:45	Caixin China PMI Composite (Apr)	52.7A	52.9
03:45	Caixin China PMI Services (Apr)	54.5A	54.4
Spain			
09:00	Unemployment MoM Net ('000s) (Apr)	--	-34
09:15	Markit Spain Services PMI (Apr)	55.1	56.8
09:15	Markit Spain Composite PMI (Apr)	54.5	55.4
Sweden			
08:30	Swedbank/Silf PMI Services (Apr)	--	55.3
08:30	Swedbank/Silf PMI Composite (Apr)	--	54.6
Events			
09:30	ECB's Lautenschlaeger Speaks in Frankfurt		
15:30	Fed's Harker Speaks on the Economic Outlook (non-voter)		
17:00	ECB Chief Economist Praet Speaks in Frankfurt		

10-year	Close	-1d		2-year	Close	-1d		Stocks	Close	-1d
US	2.53	-0.02		US	2.33	-0.01		DOW	26504.95	197.16
DE	0.03	-0.01		DE	-0.59	0.00		NASDAQ	8163.996	127.22
BE	0.46	-0.01		BE	-0.50	0.01		NIKKEI	22258.73	0.00
UK	1.22	0.03		UK	0.80	0.03		DAX	12412.75	67.33
JP	-0.04	0.00		JP	-0.15	0.00		DJ euro-50	3502.48	13.55
IRS	EUR	USD	GBP	EUR	-1d	-2d		USD	-1d	-2d
3y	-0.13	2.38	1.14	Eonia	-0.3560	0.0060		Libor-1	2.4666	-0.0005
5y	0.04	2.37	1.24	Euribor-1	-0.3650	0.0010		Libor-3	2.5599	-0.0052
10y	0.52	2.51	1.40	Euribor-3	-0.3090	0.0000		Libor-6	2.6174	-0.0211
				Euribor-6	-0.2300	0.0020				
Currencies	Close	-1d		Currencies	Close	-1d		Commodities	Close	-1d
EUR/USD	1.1198	0.0026		EUR/JPY	124.45	-0.16		CRB	181.77	-0.13
USD/JPY	111.1	-0.41		EUR/GBP	0.8502	-0.0073		Gold	1281.30	9.30
GBP/USD	1.3173	0.0141		EUR/CHF	1.1388	-0.0002		Brent	70.85	0.10
AUD/USD	0.7018	0.0018		EUR/SEK	10.6866	-0.0134				
USD/CAD	1.342	-0.0055		EUR/NOK	9.7467	-0.0364				

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Contacts

Brussels Research (KBC)		Global Sales Force	
Mathias Van der Jeugt	+32 2 417 51 94	Corporate Desk(Brussels)	+32 2 417 45 82
Peter Wuyts	+32 2 417 32 35	Institutional Desk(Brussels)	+32 2 417 46 25
Mathias Janssens	+32 2 417 51 95	CBC Desk (Brussels)	+32 2 547 19 19
Dieter Lapeire	+32 2 417 25 47	France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Singapore	+65 533 34 10
Shawn Britton	+353 1 664 6892		
Prague Research (CSOB)		Prague	+420 2 6135 3535
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574		
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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