



Sunrise

Tuesday, 05 January 2016

Rates: Core bonds rally on equity carnage, but lack conviction

Yesterday, core bonds opened sharply higher on the Asian equity woes. US equities stabilized after the European closure, which was enough to halve the US Treasury gains. Also the Bund lost ground in after-trade. The Bund opened lower today. This makes us think that the bond rally yesterday missed conviction.

Currencies: Dollar trading mixed despite global risk-off sentiment

Yesterday, USD/JPY was hit hard as a China-inspired risk-off trade spooked global markets. Remarkably, the dollar gained ground against the euro despite negative sentiment on risk and a poor US manufacturing ISM. EUR/USD dropped to the 1.08 area. Today, a low EMU CPI might weight on the euro. The global risk-off trade remains a wildcard for USD trading

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	↓

- Following significant losses in Asia and Europe, also **US Equities** started the new year poorly as the plunge in Chinese stocks and poor manufacturing data weighed. **The S&P managed to reverse part of its losses**, but still ended 1.5% lower.
- **The Chinese government moved to support its sinking stock market today** as the regulator said in a statement it would announce guidelines later today that aim to regulate selling by major Chinese shareholders. State-controlled funds also bought equities. Chinese equities remain under pressure losing up to 4%.
- **The Swedish Riksbank took yesterday a step closer to intervening in the currency market** after it gave the governor the power to act immediately to weaken the crown and help push up inflation. The SEK weakened slightly yesterday.
- **Crude oil prices** continued to trade volatile yesterday. In the US session, the oil price was hit by a selling wave due to escalating tensions between Saudi Arabia and Iran and poor manufacturing data. The Brent oil price trades currently around \$37.30/barrel.
- **Japanese car sales rose at its fastest rate in six months in December**. Car sales jumped by 3.1% Y/Y up from 0.3% Y/Y in November, but the data are rather volatile.
- Today, the **eco calendar is rather thin** with only the first estimate of EMU inflation for December, the German unemployment data and US vehicle sales.
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Rates

Bonds rally as New year starts with risk-off session

	US yield	-1d
2	1,0519	0,0240
5	1,7434	0,0263
10	2,2534	0,0213
30	2,9983	0,0127

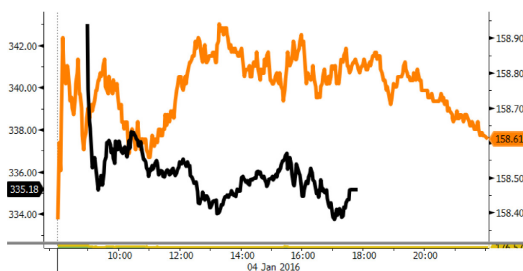
	DE yield	-1d
2	-0,3500	0,0030
5	-0,0495	0,0295
10	0,5900	0,0205
30	1,4390	0,0210

Yesterday, a sharp drop in Chinese equities and increased tensions in the Middle East pushed core bonds higher, yields lower and curves flatter. Most of the moves occurred at the start of the European/US sessions, as turmoil, especially in Chinese equity markets, roiled investors in Europe and later on in the US. **Three factors played a major role in the Chinese equity carnage.** First, a weaker than expected manufacturing PMI which showed that the deterioration in the industrial sector continued and suggested dangers for global growth. Second, **expectation that the prohibition of big equity holders to sell would be lifted** and third **increased tensions between the Middle East powerhouses Saudi Arabia and Iran.** Oil tried to move higher, but failed miserably. However, the news in the European and US session was bond friendly too with both lower than expected German inflation and a disappointing US manufacturing ISM. US Treasuries trimmed gains later in the session.

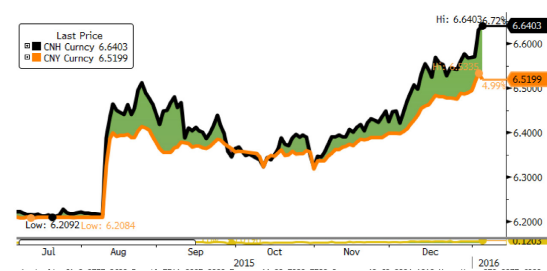
The data suggest that the ECB may not have reached the bottom of its easing cycle and the Fed might be obliged to go very soft on its tightening policy. Inflation expectations fell 1-1.3 bps, while real rates showed a bigger decline (on 10-yr tenors). Of course, we don't draw too much firm conclusions from this first trading session of the year, nor from the German inflation or the US ISM. In a daily perspective, German yields fell 0.6 bps (2-yr) to 7.2 bps (30-yr), while US yields fell 1.2 bps (2-yr) to 2.9 bps (30-yr). In the EMU bond markets, peripheral 10-yr yield spreads were marginally higher (1-2 bps) with the exception of Portugal (+9 bps) and Greece (-11 bps).

Thin eco calendar

The **eco calendar is thin today.** In the **euro area, inflation** is expected to have picked up further in December, from 0.2% Y/Y to 0.4% Y/Y, despite a further decline in the oil price. Yesterday however, German inflation data showed an unexpected decline in December from 0.3% Y/Y to 0.2% Y/Y, not only based in energy, but also in prices of clothing & footwear and food & beverages We believe therefore that **EMU HICP and core HICP (pick up to 1% Y/Y expected) might surprise on the downside.** In **Germany, unemployment** is forecast to have dropped further in December, by 8 000 following a 13 000 decline in November. Here, we believe that the risks are for another bigger than expected decline in unemployment. In the US, strong car sales are expected.



Bund future (orange) and EuroStoxx (black): Bunds gain and equities lose on Chinese troubles and weak eco data. Price action mainly at start of session, but bonds lose later on, as US stocks stabilize



On-shore yuan fixed slightly lower, but difference with off-shore yuan still widens on bets for further depreciation. If depreciation deepens it's deflationary for US/EMU and thus bond friendly.

R2	160,66	-1d
R1	159,36	
BUND	158,61	-0,1400
S1	156,4	
S2	154,54	

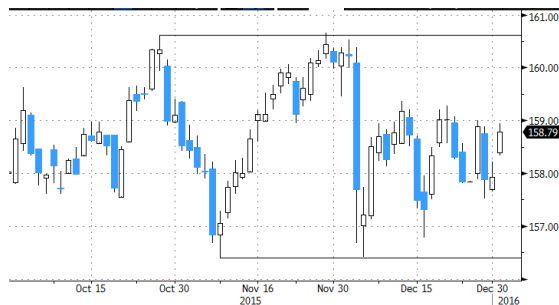
Only one regular scheduled auction this week

This week's scheduled EMU bond supply is thin with only a German Schatz auction (€5B 0% Dec2017) tomorrow. New syndicated deals are not excluded given the low-yield environment and the tendency of national debt agencies to frontload tentiment (slightly) supports bonds

Overnight, Chinese stock markets opened significantly weaker. Despite an intraday comeback (PBOC buying?), shares started sliding again though. Currently, they lose 1.5% to 3.5%. Most other Asian indices trade lower as well, suggesting that European risk sentiment will remain fragile. The US Note future is nevertheless marginally lower which could limit Bund gains at the start. SF Fed governor Williams said that he expected 3 to 5 rate hikes this year, but it didn't impact trading.

Today, the eco calendar contains **European inflation data**. Risks are on the downside of expectations which is a minor positive for the Bund. Overall, **risk sentiment on equity markets (bad?) and developments on commodity markets could be key for trading**. That could underpin core bonds via classic safe haven flows though yesterday's gains were lackluster given the extremely poor risk sentiment. The US eco calendar is empty and trading likely thin ahead of this week's key events including **Friday's payrolls report**.

Technically, both the Bund and the US Note future are in sideways trading ranges since November respectively between 156.40 & 160.66 and 125-01 & 127-10. We prefer a **sell-on-upticks approach with entry levels around those recent highs**, especially in the US. Longer term, we believe that December policy action by the ECB (failing to deliver on expected easing) and the Fed (start tightening cycle) puts a firm bottom below rate markets. In yield terms, we don't eye a return of the German 10-yr yield below 0.40% and of the US 10-yr yield below 2.1%.



German Bund: Sideways trading range



US Note future (March contract!!): Topside protected by start Fed tightening cycle. Sell-on-upticks near those highs (127-10)

Currencies

Dollar trading mixed despite global risk-off

Dollar trades mixed despite risk-off sentiment.

USD/JPY is hit hard by the risk-off trade

EUR/USD shows a surprise decline

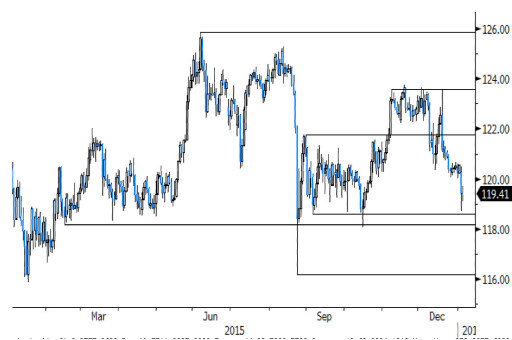
On Monday, risky assets nosedived. Investors questioned the outlook for Chinese growth after mixed Chinese PMI's. Tensions between Iran and Saudi Arabia were an additional source of uncertainty, as is the prospect of a lifting of the equity selling ban (in China). The reaction of the dollar to risk-off sentiment was not straightforward. USD/JPY dropped from the mid 120 area to touch an intraday low in the 118.70 area. EUR/USD rebounded temporary north of 1.09, but the rally stalled soon. Soft German CPI data capped the EUR/USD topside. The US manufacturing ISM declined further below 50. The USD reaction was remarkable. EUR/USD had already reversed a big part of the intra-day gains in early US dealings and the decline continued even after the poor US ISM. USD/JPY also stayed off the intraday lows. Low volumes may have played a role. Or is the dollar taken up a safe haven role? EUR/USD closed the session at 1.0831, as a test of the 1.08 failed. USD/JPY ended the day at 119.44

R2	1,1087	-1d
R1	1,1004	
EUR/USD	1,083	-0,0095
S1	1,0781	
S2	1,0524	

Overnight, the sell-off of Chinese equities eased as the PBOC injected liquidity to the system via reverse repurchases operations. At the same time, the Chinese regulator indicated to be prepared to amend the circuit breakers on the equity markets which came into force yesterday. The government apparently bought equities following a weak start, but Chinese equities are sliding again lower. e also rumours of interventions to support Chinese equities. Asian equities struggle to prevent further losses, but there is no indication of a genuine rebound. The yuan was fixed somewhat higher. USD/CNY trades near 6.52, but the off shore CNH losing some further ground. The dollar stabilizes against the euro and the yen respectively at USD/JPY 119.45 and EUR/USD 1.0823.



EUR/USD: Will EUR/USD drop below 1.08 support?



USD/JPY: Breaks below 120 support area

EMU data will probably be only of secondary importance for USD trading

Will risk-off sentiment continue to support USD/EUR?

Later today, the EMU CPI and the German labour data might affect EUR/USD trading. Yesterday's low German CPI puts the risk to the downside for the EMU CPI. **A soft EMU CPI might keep the debate on further ECB easing alive and hamper a potential rebound in EUR/USD.** There are only car sales in the US, but with little market moving potential. Risk off sentiment in Asia is less aggressive than yesterday, but remains fragile. **This might slow the decline of USD/JPY, but it is much too early to row against the tide.** As was the case yesterday, the dollar is still fairly well bid against the euro this morning.

Tuesday, 05 January 2016

The real driver for EUR/USD trading is still far from clear. Interest rate differentials between the US and Europe hardly narrowed despite the risk-off sentiment. Question is whether this will remain the case if the global risk-off trade persists or if US eco data signal more economic weakness. So, despite yesterday's surprise EUR/USD decline we are cautious to install/add EUR/USD shorts at current levels. We look to sell the pair closer to the 1.10/1.11 area

At the end of last year, EUR/USD settled in a sideways 1.08/1.10 range. The Fed confirmed that policy normalisation will be gradual, but the dots (4 hikes in 2016) were less dovish than expected and left US dollar well protected. It is still early days, but a binary market focus might continue to set the tone for USD trading.

Sentiment on risk remains a first driver as investors are pondering the health of the Chinese (and global) economy. Global uncertainty might be moderately negative for the dollar, especially for USD/JPY. The negative impact on USD/EUR might be much more contained as the theme shouldn't change the relative policy approach between the ECB and the FED. **At same time, markets look out whether the US data support the Fed-guidance for 4 rate hikes in 2016.** Friday's US payrolls will be an important yardstick. In case of more disappointing US eco data and/or a deepening of the global risk-off trade, the dollar might prepare for less Fed rate hikes. Yesterday's USD reaction was a bit strange, but for now we assume that the dollar will be in the defensive if sentiment on risk remains negative.

From a technical point of view, EUR/USD rebounded after the December ECB policy meeting, but failed to regain important resistance (previous range bottom/break down at 1.1087 and the 62% retracement from the October high at 1.1124). This area will be tough to break. Yesterday, EUR/USD dropped temporary below 1.0796 (07 Dec low) but closed slightly above 1.08. A sustained break below 1.0796 would improve the ST technical picture for the dollar. For now, we don't preposition for such a move and maintain a neutral bias for EUR/USD. However yesterday's price action indicates that the scenario of a downside break is more realistic than recently anticipated. The picture for USD/JPY turned negative as the pair dropped below 120 support. 118.07 (15 Oct low) and 116.18 (August spike) are next supports.

R2	0,7493	-1d
R1	0,7424	
EUR/GBP	0,7354	-0,0043
S1	0,7307	
S2	0,7197	

Sterling set new short-term lows

On Monday, sterling trading was guided by conflicting factors. Sterling started the new year on a weak footing due to global risk off sentiment. Cable dropped to the lowest level since April last year. EUR/GBP touched a 2-month high at 0.7424. The UK currency found its composure during the European session. The UK data were mixed. The manufacturing PMI dropped more than expected to 51.9, but UK lending data were strong, especially mortgage lending. **Sterling rebounded against the dollar and the euro after the lending data. Technical factors were probably also in play.** Later in the session, cable set another multi-month low on (selective) USD strength. The pair closed the session at 1.4716. EUR/GBP stabilised after the intraday reversal. The pair ended the day 0.7346, well off the intraday top.

Today, only the **UK construction PMI will be published.** A slight rebound from 55.3 to 56.0 is expected. We don't expect the report to be a big help for sterling even in case of a positive surprise. **The focus for sterling trading is on global factors and on the Brexit debate.** A sustained rebound of sterling will be difficult unless there is a real improvement/signs of progress in one of those to factors.

The technical picture of sterling against the dollar and the euro looks fragile. Yesterday's intraday price pattern suggests that the rebound of EUR/GBP might become a bit exhausted, but we want further confirmation. EUR/GBP 0.7424 is a first short-term resistance. Next resistance is seen at 0.7493 (Oct top).

Calendar

Tuesday, 5 January		Consensus	Previous
US			
	Wards Domestic Vehicle Sales (Dec)	14.15m	13.99m
	Wards Total Vehicle Sales (Dec)	18.00m	18.05m
15:45	ISM New York (Dec)	--	60.7
Japan			
00:50	Monetary Base End of period (Dec)	A: ¥356.1t	¥343.7t
00:50	Monetary Base YoY (Dec)	A: 29.5%	32.5%
06:00	Vehicle Sales YoY (Dec)	A: 3.1%	0.3%
UK			
10:30	Markit/CIPS UK Construction PMI (Dec)	56.0	55.3
EMU			
11:00	CPI Estimate YoY (Dec)	0.3%	0.2%
11:00	CPI Core YoY (Dec A)	1.0%	0.9%
Germany			
09:55	Unemployment Change (000's) (Dec)	-8k	-13k
09:55	Unemployment Claims Rate SA (Dec)	6.3%	6.3%
Italy			
11:00	CPI EU Harmonized MoM/YoY (Dec P)	0.2%/0.4%	-0.5%/0.2%
Norway			
09:00	Manufacturing PMI (Dec)	--	47.6
Spain			
09:00	Unemployment MoM Net ('000s) (Dec)	-50.0	-27.1
Events			
11:30	UK Gilt Auction (£3B 2% Sep 2025)		

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	2,25	0,02	US	1,05	0,02	DOW	17149 17148,94
DE	0,59	0,02	DE	-0,35	0,00	NASDAQ	for Exch - NQI #VALUE!
BE	0,95	0,03	BE	-0,31	0,02	NIKKEI	18374 18374,00
UK	1,89	-0,01	UK	0,58	-0,02	DAX	10283,44 10283,44
JP	0,26	0,00	JP	-0,01	0,00	DJ euro-50	3165 3164,76

IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	USD	td	-1d
3y	0,043	1,374	1,241	Euribor-1	-0,21	0,00	Eonia EUR	-0,241	-0,114
5y	0,300	1,701	1,517	Euribor-3	-0,13	0,00	Libor-1 USD	0,51	0,51
10y	0,945	2,160	1,926	Euribor-6	-0,04	0,00	Libor-3 USD	0,59	0,59
							Libor-6 USD	0,75	0,75

Currencies	-1d	Currencies	-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,083 -0,0095	EUR/JPY	129,37 -0,74		176,1439	1077,8	37,3
USD/JPY	119,45 0,34	EUR/GBP	0,7354 -0,0043	-1d	0,00	5,14	-0,01
GBP/USD	1,4721 -0,0042	EUR/CHF	1,0849 -0,0016				
AUD/USD	0,7202 -0,0021	EUR/SEK	9,2086 0,02				
USD/CAD	1,3916 -0,0013	EUR/NOK	9,6079 -0,05				

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