



Sunrise

Thursday, 10 March 2016

Rates: Can Draghi meet expectations? Bund vulnerable?

The ECB is expected to ease its monetary policy further. Will Draghi avoid a repeat of the December-scenario where the central bank overpromised and underdelivered, triggering a sell-off on core bond markets. Our best guesstimate for today is a 10 bps deposit rate cut, while the QE-programme might be expanded (by €10B/month) and extended (by 3/6 months).

Currencies: Substantial ECB easing might be a negative for the euro

Today's ECB meeting will also be key for the next directional move in EUR/USD. We expect a further substantial ECB easing. Contrary to what was the case in December we see chances for a decline of the euro as the market is positioned less euro short than was the case at that time.

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 yesterday's session moderately higher** led by gains in energy shares. This morning, **most Asian shares trade in positive territory**. Chinese stocks trade mixed.
- **China's CPI inflation picked up sharply in February**, from 1.8% Y/Y to 2.3% Y/Y, reaching its highest level since mid-2014. Food prices surged 7.3% Y/Y boosted by the Lunar New Year holidays, suggesting that the uptick might be only temporary.
- **The Reserve Bank of New Zealand surprised markets overnight by cutting its main interest rate by 25 basis points to 2.25%** saying most of the risks to the economy were on the downside and a further depreciation of the kiwi dollar was desirable. The kiwi dollar weakened significantly overnight.
- **Crude oil prices rose almost 5% yesterday** with the Brent closing above \$41/barrel as weekly data showed US gasoline demand rose further to the highest level since September, reducing inventories for a third straight week. The WTI oil price closed above \$38/barrel.
- **Rating agency Moody's is withdrawing from the Russian domestic market** as legislative changes and other potential restrictions affect the business of providing national scale ratings, the FT reports.
- Today, **the focus is on the ECB meeting and press conference of President Draghi**. The eco calendar is thin with only US jobless claims, French production data and some national inflation figures.

Rates

	US yield	-1d
2	0,8903	0,0122
5	1,3795	0,0198
10	1,8796	0,0316
30	2,6643	0,0093

German and US bonds correct lower

Japanese 30-yr yield rises as much as it declined Tuesday

	DE yield	-1d
2	-0,5320	0,0250
5	-0,3350	0,0330
10	0,2440	0,0600
30	1,0199	0,0312

ECB to cut depo-rate by 10-20 bps and to raise and extend asset buying

Will it be enough to avoid an adverse reaction as after December decision?

Downside risks US claims

Stronger French production?

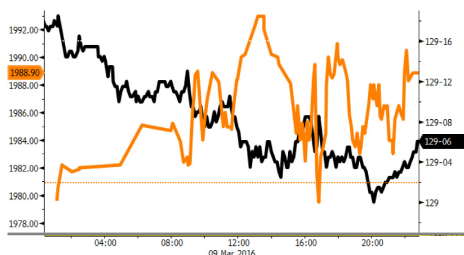
Bonds correct lower on internal market considerations

Global core bonds lost ground, reversing most of Tuesday's gains amid an empty eco calendar. The decline of US Treasuries and Bunds occurred from start to finish without any strong particular trigger. Risk sentiment improved a bit on equity markets, while oil recouped most of the previous day's sharp losses. **More neutral positioning into the ECB meeting was also at play. The US 10-year Note auction was weak, keeping pressure on bonds late in the session. The extreme wild swings in the Japanese bond markets over the previous days might have also been a wake-up call for European and US bond investors to become more cautious following the breathtaking rally in the first two months of 2016.** In a daily perspective, the Germany yield curve ended 2.4 bps (2-yr) to 5.4 bps (10-yr) higher. Changes on the US yield curve varied between +2.4 bps (2-yr) and +4.7 bps (10-yr). **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany narrowed up to 7 bps. Portuguese supply was well digested and Portugal outperformed together with Greece and Italy.

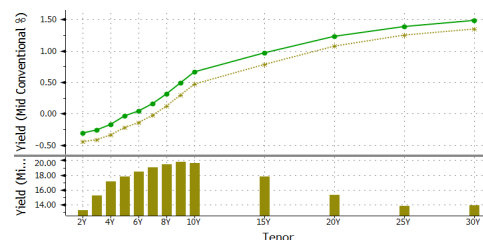
Today, Will Draghi deliver?

Analysts and markets are 100% sure that the ECB will cut its deposit rate. Loss of economic momentum, awful February inflation readings, market turmoil during the first weeks of the New year, a strong pre-announcement at the January meeting and some tough talk by Draghi and his colleagues are the basis for this expectation. The OIS forward curve shows that eonia should be at -0.367% in one month and -0.43% in 6 months. Currently eonia stands at -0.236%. This means that at 13 bps rate cut is discounted for today and an additional 5 bps in the next months which would bring the depo to about -50 bps for a cycle low. **That seems enough for us and we don't expect much "over deliverance"**. The ECB might go for 20 bps today (we favour 10 bps), but than it would be in a tiered system. We also look for **more monthly purchases** and a change in a number of other policy features. **See our flash for a complete overview** and see below for our market positioning.

After having picked up in the previous two weeks, **US initial jobless claims** are forecast to have edged slightly lower this week from 278 000 to 275 000, but we believe that **even a lower outcome is not excluded**. The effects of the President's Day holiday should have been worked out, which might push the claims again somewhat lower. In the euro area, the **French production** data will be interesting. After strong German data, it will be interesting to see whether we will see a similar rebound in France.



T-Note future (black) & S&P future (orange): Decline bonds independent from volatile gyrations equities-



German yield curve before (yellow-green) and after (dark green) previous ECB meeting: sharp shift higher when Draghi overpromised, but underdelivered. Repeat possible today?

R2	166,63	-1d
R1	164	
BUND	162,1	-1,0700
S1	161,94	
S2	161,23	

More weakness in US auctions

Following Tuesday’s weak 3-yr Note auction, **the US Treasury \$20B 10-yr Note auction didn’t go well either**. The auction stopped with a tail and the bid cover (2.49) was well below average despite the smaller auction size. Bidding details showed low demand across the three categories (direct, indirect and dealer bid). **Today, the US Treasury concludes its mid-month refinancing operation with \$12B 30-yr Bond auction**. Currently, the WI trades around 2.67%.

Bund vulnerable despite additional ECB easing?

Overnight, Asian equity markets trade mixed to higher with Japan outperforming on the back of a weaker yen. The RBNZ unexpectedly cut its policy rate to 2.25% while also warning that policy might be eased further. Chinese inflation picked up to 2.3% Y/Y while a stabilization at 1.8% Y/Y was expected. The oil price and US Note future trade stable, suggesting a neutral opening for the Bund.

Today’s trading might be numble ahead of the ECB meeting. We expect the ECB to cut its deposit rate by 10 bps (or 20 bps and introduce a tiered system) while expanding (by €10B/month) and extending (by 3/6 months) its QE-programme. For an extended preview, see our FLASH. Anything short of this would trigger a repeat of the December policy meeting, when Draghi overpromised and underdelivered. The German yield curve shifted 13 bps (2-yr) to 20 bps (10-yr) higher following that meeting. Even in case Draghi delivers this time, we aren’t convinced that the Bund would still benefit in a substantial, prolonged, way. Markets are developing the idea that the ECB’s armoury is running low on ammunition and that today’s easing will be nothing but mere eyewash.

Last week, three important markets more or less simultaneously broke key technical levels. The Brent oil price (\$37.55/barrel), S&P 500 (1950) and US 10-yr yield (1.85%) all moved above resistance levels, painting double bottoms on the charts. The US 10-year yield struggles to stay above though. This suggests that risk sentiment changed compared to the beginning of the year (more positive) and gives more downside for core bonds (especially US Treasuries). The Bund also fell below a steep uptrend line since the start of the year, but the German 10-yr yield remains below 0.3% resistance (neckline double bottom).



German Bund (June contract): Technical picture becomes less bullish. Bund vulnerable despite additional easing?



US Note future (June contract): break below double top suggests more downside

Currencies

Dollar captured in directionless trading ahead of the ECB

R2	1,1376	-1d
R1	1,1193	
EUR/USD	1,0981	0,0005
S1	1,081	
S2	1,0711	

Asian equities trade mostly in positive territory

Yen weakness

Kiwi dollar hammered after surprise RBNZ rate cut

The eco calendar is again thin

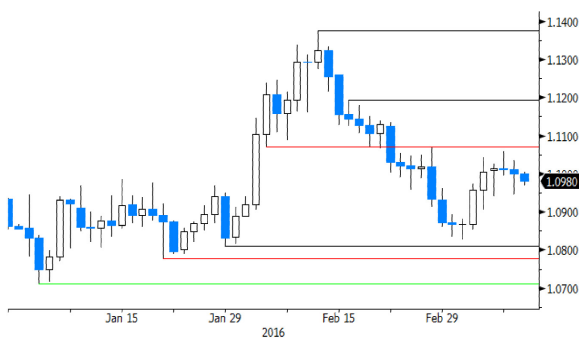
ECB to decide on next directional move in the euro and the dollar

ECB to decide on next directional move

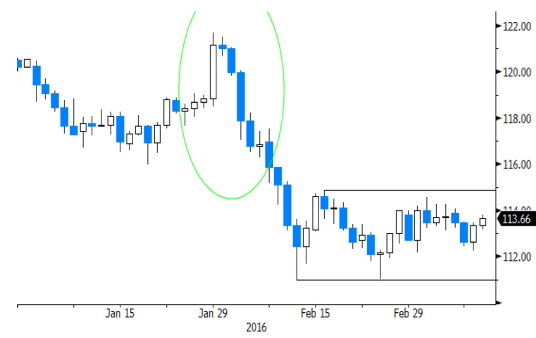
On Wednesday, USD trading was again driven by global factors as key eco data were missing. Equities and commodities rebounded and so did core bond yields. This was a positive context for the dollar, but USD gains were modest at best. (Currency) markets are in a wait-and-see modus ahead of the ECB policy meeting. USD/JPY gained further ground later in US dealings and closed the session at 113.35 (from 112.62). Via EUR/JPY, EUR/USD moved also temporary higher in lockstep. The pair finished the session at 1.0999 (from 1.1011).

This morning, Asian equity markets trade mixed to positive. Japanese markets outperform, profiting from a weaker yen. USD/JPY trades currently in the 113.75 area, again up one yen in a daily perspective. Chinese equities underperform. Chinese CPI rebounded from 1.8% to 2.3%, but the rise was primarily driven by higher food prices. Commodities stay near the recent highs with Brent oil holding north of \$40 p/b. The **Reserve bank of New-Zealand unexpectedly cut its policy rate to a record low of 2.25%**. The RBNZ kept an easing bias. The bank also wants a weaker kiwi dollar as it would be appropriate given weakness in export prices. NZD/USD dropped more than one big figure and trades in the 0.6640 area. EUR/USD returned to the 1.0975 area after yesterday's rebound.

Today, **only the ECB policy decision matters trading on all markets. For an in debt analysis of the decision see our KBC Flash report.** Our basis scenario is for the ECB to cut the deposit rate by at least 10 bp. More is possible in a tiered system. We also expect an extension of the asset buying program (in amount and probably also in time). **The reaction of the market to the BOJ easing late January illustrated that the markets can still go the other way, even in case of a more aggressive easing than expected. In a first reaction however, we see room for a decline of the euro.** The absolute low level of (negative) interest rates should make the single currency very unattractive for non-EMU residents. At the same time, markets are not extremely positioned short euro as was the case ahead of the ECB December meeting. So, the risks for a euro short-squeeze in case of a disappointment should also be less than in December.



EUR/USD: holding near 1.10 ahead of the ECB meeting.



USD/JPY drifting higher in the range

Of late we advocated sideways EUR/USD trading within the 1.1193/1.0810 trading range. In case the ECB delivers a substantial easing package, EUR/USD might return to the lower bound of this range. A break above 1.1193 would suggest a similar scenario as in December and open the way for a full retracement to the 1.1376 correction top. However, this is not our preferred scenario. The impact on USD/JPY from the ECB decision is less easy to foresee. We assume that a sustained break beyond the 114.87 level will be difficult without further positive news/interest rate support from the US.

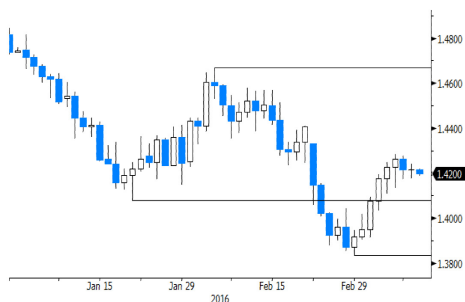
EUR/GBP: Focus shifts from sterling to the euro

R2	0,8066	-1d
R1	0,7929	
EUR/GBP	0,7729	-0,0008
S1	0,7691	
S2	0,7526	

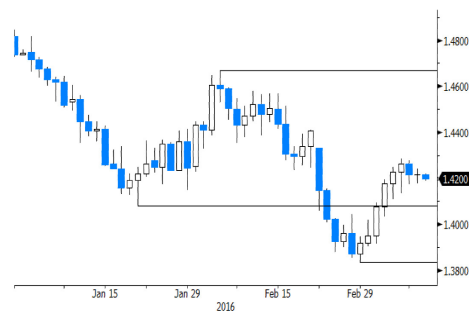
On Wednesday, the correction of commodities halted and Brexit went off the radar. From the start in Europe, EUR/GBP drifted lower in line with a similar move in EUR/USD. At the same time, cable rebounded too. This combination pushed EUR/GBP to the low 0.77 area. The UK production data were stronger than expected. In particular the cyclical manufacturing sector performed better than expected in January (0.7% M/M rise). However, this positive eco report didn't help sterling much. The 0.7691 support was left intact. Later in the session EUR/GBP joined the technical rebound in EUR/USD. The pair closed the session at 0.7737 (from 0.7746 on Tuesday). Cable finished at 1.4217, almost unchanged from Tuesday.

Overnight, the RICS house price balance was reported in line with expectations at 50%. Later today, there are no important eco data on the agenda in the UK. Sterling traders will also keep a close eye on the ECB policy decision and on the market reaction of EUR/USD. Different scenarios are possible. As we see risks for a negative reaction of EUR/USD, EUR/GBP and cable might feel some pressure too. Over the previous days, trading in cable and EUR/GBP was often driven by the GBP-side of the story (post-Brexit sterling rebound). Today, the focus is on the euro.

Last week, sterling rebounded as the Brexit-fears moved to the background, but the rebound slowed at the end of last week. We assume that the short-term bottoming out process can continue, unless there would again be negative news from Brexit. The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top. Short-term, EUR/GBP tested a first support at 0.7696 on Wednesday last week. A sustained break below this level would be a first indication that sterling sentiment improves.



EUR/GBP: Nearing a first important support



GBP/USD: sterling rebound slows

Calendar

Thursday, 10 March		Consensus	Previous
US			
14:30	Initial Jobless Claims (Mar 5)	275K	278k
14:30	Continuing Claims	2250K	2257k
15:45	Bloomberg Consumer Comfort (Mar 6)	--	43.6
18:00	Household Change in Net Worth (4Q)	--	-\$1232b
20:00	Monthly Budget Statement (Feb)	-\$196.5b	-\$192.4b
Canada			
14:30	Capacity Utilization Rate (4Q)	--	82.0%
14:30	New Housing Price Index MoM YoY (Jan)	0.2% / 1.8%	0.1% / 1.6%
Japan			
00:50	PPI MoM YoY (Feb)	A -0.2%/-3.4%	-0.9% / -3.1%
03:00	Tokyo Avg Office Vacancies (Feb)	A 4.04	4.01
China			
02:30	CPI YoY (Feb)	A 2.3%	1.8%
02:30	PPI YoY (Feb)	A -4.9%	-5.3%
UK			
01:01	RICS House Price Balance (Feb)	50%	49%
EMU			
13:45	ECB Main Refinancing Rate (Mar 10)	0.05%	0.05%
13:45	ECB Deposit Facility Rate (Mar 10)	-0.40%	-0.30%
Germany			
08:00	Trade Balance (Jan)	A 13.6b	18.8b
08:00	Current Account Balance (Jan)	A 13.2b	25.6b
08:00	Exports SA MoM (Jan)	A -0.5%	-1.6%
08:00	Imports SA MoM (Jan)	A 1.2%	-1.6%
08:00	Labor Costs SA QoQ YoY (4Q)	--	0.0% / 2.4%
France			
07:30	Non-Farm Payrolls QoQ (4Q F)	A 0.2%	0.2%
08:45	Industrial Production MoM YoY (Jan)	0.8%/0.1%	-1.6% / -0.7%
08:45	Manufacturing Production MoM (Jan)	0.5%/1.3%	-0.8% / 0.5%
Norway			
10:00	CPI MoM YoY (Feb)	0.4% / 3.0%	0.6% / 3.0%
10:00	CPI Underlying MoM YoY (Feb)	0.7%/3.1%	-0.1% / 3.0%
Spain			
09:00	Retail Sales SA YoY (Jan)	3.1%	2.2%
Greece			
11:00	Unemployment Rate (Dec)	--	24.6%
11:00	CPI – EU harmonized YoY (Feb)	--	-0.1%
Portugal			
12:00	CPI-EU Harmonized MoM YoY (Feb)	--	-1.1%/0.7%
Sweden			
08:00	PES Unemployment Rate (Feb)	A 4.1%	4.3%
Events			
14:30	ECB President Draghi Holds Press Conference		
Sweden	IL Bond Auction (SEK0.5B 1% Jun2025, SEK0.5B 4% Dec2020) (11:03)		
US	30Yr Bond Auction (\$12B) (19:00)		

Contacts

10-year	td	-1d	2 -year	td	-1d	STOCKS	-1d
US	1,88	0,03	US	0,89	0,01	DOW	17000,36
DE	0,24	0,06	DE	-0,53	0,03	NASDAQ	for Exch - NQI #VALUE!
BE	0,54	0,03	BE	-0,43	0,02	NIKKEI	16852,35
UK	1,48	0,08	UK	0,34	0,00	DAX	9723,09
JP	-0,01	0,00	JP	-0,19	0,01	DJ euro-50	3016,18

IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	USD	td	-1d
3y	-0,146	1,053	0,858	Euribor-1	-0,29	0,00	Eonia EUR	-0,236	-0,002
5y	0,031	1,272	1,031	Euribor-3	-0,22	0,00	Libor-1 USD	0,51	0,51
10y	0,614	1,696	1,467	Euribor-6	-0,14	0,00	Libor-3 USD	0,59	0,59
							Libor-6 USD	0,74	0,74

Currencies	-1d	Currencies	-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0981	0,0005	EUR/JPY	124,82	1,27	169,4693	1248
USD/JPY	113,675	1,12	EUR/GBP	0,7729	-0,0008	-1d	-2,23
GBP/USD	1,4203	0,0020	EUR/CHF	1,095	-0,0004		-7,81
AUD/USD	0,7487	0,0061	EUR/SEK	9,2879	-0,04		1,02
USD/CAD	1,3257	-0,0167	EUR/NOK	9,3718	-0,04		

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