KBC

Sunrise

Monday, 08 February 2016

Rates: core bonds erase initial post-payrolls dip

Core bonds ended the session little changed, as the initial dip on the payrolls was erased when equities continued to slide lower. Given the emptiness of the calendar, we expect technical inspired trading with oil and equities as the wild cards. Next key event is Yellen's testimony Wednesday. We look for a trigger that signals profit taking.

Currencies: dollar rebounds after decent US payrolls report

The reaction of global markets to the US payrolls was ambiguous. The dollar rebounded as the details of the report were strong. At the same time equities sold off. The dollar tries to build a bottom after last week's sell-off. Today, the calendar is thin. Yellen's appearance before Congress later this week might be the next reference 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	↘

- **US Equities dropped sharply on Friday** with the Nasdaq losing more than 3% due to a lacklustre outlook from LinkedIn. **In a holiday-thinned trading session, most Asian shares trade higher.** The Nikkei gained more than 1% supported by a weaker yen.
- **China's foreign reserves dropped for a third straight month in January,** by $99.5 billion to $3.23 trillion, reaching its lowest level since May 2012 as the central bank intensified its efforts to prop up the yuan after it devaluation.
- **Bank of Japan policymakers engaged in a heated debate last month in deciding to adopt negative interest rates.** The decision was made by a 5-4 vote with dissenters arguing that pushing down already low borrowing costs would have few benefits for the economy.
- **Fitch Ratings decided on Friday to raise Ireland's credit rating by one notch to A**, pointing to an improved economic performance and its securing of a primary surplus. The outlook was kept stable.
- **Both the Brent and WTI oil price dropped for a second straight session on Friday,** but are trading slightly higher this morning ($34.40/barrel for the Brent). Despite a rebound in the US dollar, **gold** ($1165/ounce) remains well-bid, nearing the highs reached in October last year.
- Today, **the eco calendar is empty**, both in the US and euro zone. **Chinese markets are closed in observance of the Lunar New Year holidays.**

Rates

Temporary profit taking after US payrolls

Initial post-payrolls bond decline reversed as US equities correct lower

Quite substantial Portuguese spread widening

	US yield	-1d
2	0,742	0,0358
5	1,2693	0,0404
10	1,8632	0,0223
30	2,691	0,0124

	DE yield	-1d
2	-0,4880	-0,0050
5	-0,3123	0,0037
10	0,2880	-0,0140
30	1,0000	-0,0224

Dovish positioned global core bonds initially fell prey to profit taking on the back of mixed payrolls. Headline payrolls disappointed, but the unemployment dropped to a cycle low of 4.9% (Fed's target), participation rate and workweek rose and average hourly earnings strongly exceeded expectations. **However, as equities sold off too, US Treasuries were able to turn the tide on a safety bid, recouped losses and ended mixed. The front end of the curve underperformed, maybe as the details kept the idea of Fed tightening at some point in the future alive.** In a daily perspective, the US yield changes ranged between + 2.4 bps (2-yr) and -0.7 bps (30-yr). The German yield curve dropped 0.6 bps (2-yr) to 2.1 bps (30-yr) lower. However, the US bond rally wasn't finished when EMU cash markets closed. **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany showed a lot of dispersion with Spain flat, Italy +3 bps, while Greece and Portugal traded 10/11 bps wider. The Portuguese government awaited the Commission's decision on its budget proposal.

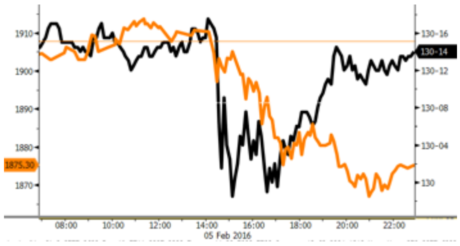
Fitch upgraded the Irish A- rating (positive outlook) to A (stable outlook). Fitch justifies the upgrade by an improvement in debt dynamics, reflecting the combination of strong growth and a return to a primary budget surplus. It forecasts debt/GDP at 96.6% from an earlier estimated 105% and a 120% high in 2012. Fitch expects the ratio to drop to 70% by 2024. **The rating agency also confirmed the Austrian AA+ rating (stable outlook).**

Unattractive eco calendar

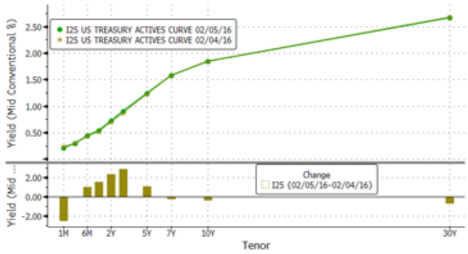
Chinese FX reserves continue to drop

Later on, Yellen faces difficult communication exercise at Congress

The **eco calendar is nearly empty today**, both in the US and euro zone. Eco data remain few throughout the week with German production on Tuesday and US retail sales, EMU production and US Michigan sentiment (all Friday) the only potential market movers. **Chinese markets are closed in observance of the Lunar New Year holidays. Chinese FX reserves fell $99.5B to $3.23T in January** according to the PBoC. That's less than the $108B in December and below the $120B consensus estimate. The PBoC has recently stabilized the yuan, but at the expense of FX interventions. The decline is likely due to the repayment of dollar debt by Chinese firms, but also to capital flight by firms, households and speculators. **The Chinese authorities took measures to stem the capital outflow, but it is unclear how much successful they are**. In the next months it should be become clear whether the haemorrhage of reserves stops or whether China should stop intervening, defend FX reserves and let the yuan depreciate, which would stoke more global markets unrest. The January decline in reserves is as such no reason to panic and doesn't weigh on Asian equities overnight.



T-Note future (black) and S&P future (orange):Initially both correct lower, but later on sliding equities turn core bonds around, easing losses



US Treasury curve: longer end little changed after payrolls, but shorter end up a few basis points, maybe due to the wage growth and drop unemployment rate in context of very soft positioning

Looking further ahead, **Fed vice chairwoman Yellen** gives her semi-annual Congressional testimony on Wednesday. **We expect her to comment on January turmoil in riskier markets and what it means for Fed policy.** Her response is complicated by last Friday's payrolls. On the one hand, slower job growth (and slower eco growth) is a reason to preach cautiousness on rates. On the other hand, the lower unemployment rate (full employment), higher participation rate, at last signs of stronger wage growth and the very dovish market positioning, point to keeping her message of gradual tightening in place. It would be odd to start the tightening cycle in December and call its "end" by February. It would lead to a loss of confidence in the Fed and create an image that the Fed has no good view on what's happening. This could be dangerous for riskier markets. So, she will have to give a finely balanced speech to avoid more turmoil.

Today: Technically-inspired trading

R2	165	-1d
R1	164,22	
BUND	**163,94**	0,0800
S1	160,38	
S2	156,4	

Overnight, Asian equities trade slightly higher, but several markets are closed (China, Hongkong, Indonesia, Malaysia, South Korea, Taiwan, Singapore). Chinese FX reserves dropped to the lowest level since 2012, but the decline was somewhat less than expected. The US Note future trades marginally lower suggesting a neutral to slightly weaker opening for the Bund.

Today's eco calendar is empty. Apart from Wednesday's Yellen testimony and Friday's retail sales, the calendar isn't that enticing later this week either. **This means that technical factors and risk sentiment will drive trading.** Both the Bund and the US Note future are still overbought, which make them vulnerable for **bouts of profit taking**. Equity markets remain at key support levels (eg Dax and S&P 500) while the recovery of oil prices is still tough going. It's hard to say which factor will take the upper hand today, so **we have a neutral view at the start of this week.**

Technically, the German 10-yr yield fell below final support (0.42%). Weakness in equity market/oil prices and the dovish turn of global central banks (ECB, BoE, BoJ and Fed) pulled yields lower since the start of the year. **The break lower opens theoretically the way for a complete retracement towards the all-time low at 0.05%. The US 10-yr yield dropped below 1.9%. From a technical point of view, this also suggests more downside towards 1.64%. Longer term sentiment remains positive for core bonds, but any lasting improvement in riskier markets may trigger profit taking.**

German Bund: Technically overbought. Vulnerable to profit taking?

US Note future: Also overbought, but markets numbed ahead of Yellen's speech?

Currencies

Dollar rebounds after decent US payrolls

Dollar rebounds after US payrolls report even as US equities declined

R2	1,1495	-1d
R1	1,1246	
EUR/USD	**1,11365**	-0,0059
S1	1,106	
S2	1,081	

On Friday, the US payrolls report dominated markets. Headline payrolls growth was lower than expected, but the details of the report were constructive. On the release equities declined, as did US bonds, but the bond decline evaporated as sentiment turned risk-off. The dollar spiked briefly lower upon the publication of the report, but after full lecture of the report soon returned into positive territory. Investors were apparently positioned for a negative surprise. The dollar maintained most of its intraday gains despite the equity sell-off. EUR/USD closed the session at 1.1158 (from 1.1209 on Thursday). USD/JPY closed the week at 116.89 (from 116.78). The trade-weighted dollar (DXY) rebounded north of 97.

Asian equities take slow start to the week

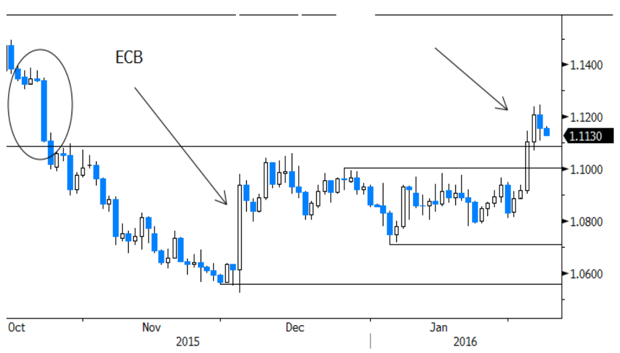
USD maintains post-payrolls gains.

This morning, Asian trading started on a slow footing, as several markets are closed for the Lunar New Year. **On Sunday, the PBOC reported that foreign reserves declined $99.5 bln in January**. It indicates that the PBOC was again very active to support the yuan. However, the decline in reserves was slightly less than expected. Japanese equity markets trade stronger (+1 to 1.5%) despite Friday's sell-off in the US. USD/JPY is off last week's low and trades again north of 117, currently around 117.35. The dollar remains also well bid against the euro. EUR/USD trades in the 1.1130 area. Commodity currencies like the Canadian and the Aussie dollar stabilize after Friday's setback. **Brent oil moves higher and trades** around $34.5 p/b as investors ponder the potential impact of a meeting between the Saudi oil minister and its Venezuelan counterpart on Sunday.

There are few eco data with market moving potential on the agenda today

Will the dollar start a bottoming out process after last week's setback

Today, the calendar is devoid of market moving items. The guidance for Asia is also diffuse. So, USD trading will most probably be order-driven and technical in nature. **Friday's US payrolls didn't removed market uncertainty on the health of the global and the US economy and on the pace of the Fed policy normalisation.** The dollar rebounded, but US equities turned in risk-off modus. Friday's rebound of the dollar was due to the pre-payrolls bearish positioning. It was reversed on Friday, but there are few clues for USD trading at the start of the new week. Will Friday's correction top at 1.1246 hold as a new strong support for the dollar. Later this week, Fed chair Yellen might clarify the position of the Fed as she appears before Congress on Wednesday (see rates section). Regarding the US data, only the US retail sales (Friday) bring new info. We start with a cautiously USD positive bias.



EUR/USD: USD correction running into resistance

USD/JPY: looking for a bottom

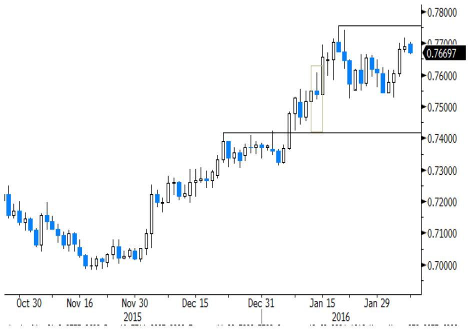
From a technical point of view, EUR/USD broke above the 1.1060/1.1124 resistance area (15 Dec top: 62% retracement). This is a dollar negative. The short-term correction high stands at 1.1246. Next important resistance kicks in at 1.1495.The jury is still out, but we have think that the EUR/USD rebound might be topping out. **The picture for USD/JPY improved temporarily as the pair rebounded above 120 after the BoJ easing two weeks ago, but the gains evaporated very soon. The 115.98 pre-BOJ correction low remains an important point of reference. We expect the BOJ to send warning signals in case of a break below this level. A technical rebound is possible after the recent sharp setback, but we stay very cautious on USD/JPY long exposure as global uncertainty persists.**

EUR/GBP rally slows, at least for now

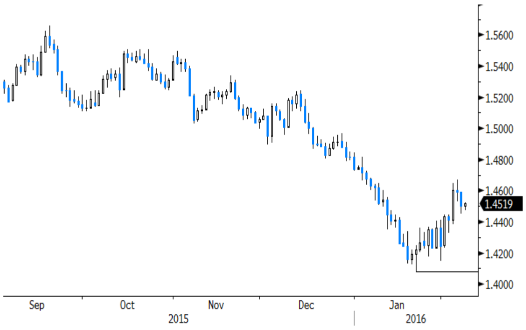
R2	0,7755	-1d
R1	0,7716	
EUR/GBP	**0,7675**	-0,0012
S1	0,7525	
S2	0,7313	

In absence of important UK data. EUR/GBP held Friday close to, mostly slightly above the 0.77 barrier. Cable drifted cautiously lower in the 1.46 big figure as the recent decline of the dollar took a breather going into the US payrolls report. The picture for sterling trading didn't change after the payrolls. EUR/GBP dropped temporary a few ticks in line with EUR/USD, but soon returned to the 0.77 area. The pair closed the session at 0.7690, little changed from the 0.7683 on Thursday as EUR/USD and cable moved lockstep after the payrolls. Cable dropped temporary below the 1.45 on post-payrolls USD strength, but closed the session at 1.4503 (from 1.4589 on Thursday).

Today, there are again no important eco data in the UK. We expect again a lot of headlines this week on Brexit, as the EU summit on 18/19 February comes closer. Even as the uncertainty on Brexit persists, the decline of the sterling slowed last week. The rebound of cable was mostly an USD decline, but EUR/GBP is also running into resistance. A stabilisation/correction on the recent rally in EUR/USD might cap the topside in EUR/GBP too. EUR/GBP 0.7715 is the first resistance ahead of the 0.7656 (correction top). We think that a sustained comeback off sterling will be difficult as long as there is no clear sign how the Brexit debate will turn out. **The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top. Next big resistance stands at 0.7875.** A return below EUR/GBP 0.74 would be a first indication that sterling enters calmer waters.



EUR/GBP: rally running into resistance, at least short-term



GBP/USD: rally slows

Calendar

Monday, 8 February		Consensus	Previous
US			
16:00	Labor Market Conditions Index Change (Jan)	2.5	2.9
Canada			
14:15	Housing Starts (Jan)	185.0k	173.0k
14:30	Building Permits MoM (Dec)	6.2%	-19.6%
Japan			
00:50	BoP Current Account Balance (Dec)	A: ¥960.7b	¥1143.5b
00:50	BoP Current Account Adjusted (Dec)	A: ¥1635.4b	¥1423.5b
00:50	Trade Balance BoP Basis (Dec)	A: ¥188.7b	-¥271.5b
00:50	Bank Lending Incl Trusts YoY (Jan)	A: 2.3%	2.2%
00:50	Bank Lending Ex-Trusts YoY (Jan)	A:2.4%	2.2%
01:00	Labor Cash Earnings YoY (Dec)	A: 0.1%	0.0%
01:00	Real Cash Earnings YoY (Dec)	A: -0.1%	-0.4%
EMU			
10:30	Sentix Investor Confidence (Feb)	7.4	9.6
France			
08:30	Bank of France Bus. Sentiment (Jan)	99	99
Spain			
09:00	Industrial Output NSA YoY/SA YoY (Dec)	--/4.1%	5.7%/4.2%
09:00	Industrial Production MoM (Dec)	--	-0.0%
Events			
12:00	ECB's Walter, Dutch CB's Sijbrand, Dijsselbloem speak in Adam		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	1,86	0,02	US	0,74	0,04	DOW	16205	16204,83
DE	0,29	-0,01	DE	-0,49	-0,01	NASDAQ	for Exch - NQI	#VALUE!
BE	0,61	0,01	BE	-0,39	-0,01	NIKKEI	17004	17004,30
UK	1,56	-0,01	UK	0,35	-0,01	DAX	9286,23	9286,23
JP	0,04	0,02	JP	-0,21	0,00	DJ euro-50	2879	2879,39

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,236	-0,005
3y	-0,134	0,950	0,879	Euribor-1	-0,23	0,00	Libor-1 USD	0,51	0,51
5y	0,056	1,227	1,093	Euribor-3	-0,17	0,00	Libor-3 USD	0,59	0,59
10y	0,638	1,755	1,549	Euribor-6	-0,10	-0,01	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,11365	-0,0059	EUR/JPY	130,71	-0,01		163,4528	1164,6	34,35
USD/JPY	117,4	0,61	EUR/GBP	0,7675	-0,0012	-1d	-0,73	10,40	0,09
GBP/USD	1,4505	-0,0052	EUR/CHF	1,1068	-0,0057				
AUD/USD	0,7093	-0,0101	EUR/SEK	9,4283	0,02				
USD/CAD	1,3876	0,0161	EUR/NOK	9,5425	0,02				

Contacts

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
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias van der Jeugt	+32 2 417 51 94	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)			
Jan Cermak	+420 2 6135 3578	**Prague**	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	**Bratislava**	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	**Budapest**	+36 1 328 99 85

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