



## Sunrise

Tuesday, 01 March 2016

### Rates: Bund sets new high on risk-off and negative EMU inflation

The Bund initially profited from risk-off sentiment, negative inflation and a weaker Chicago PMI, pushing it to new highs, while the German 10-yr yield approached all-time lows. Time to lighten long positions? Stronger US eco data or a disappointing ECB may spell troubles for overbought Bunds. Negative inflation protects the downside though.

### Currencies: Euro weakness prevails after negative EMU CPI

Yesterday, trading in the major cross rates was again mixed. USD/JPY failed to profit from a decline in the RRR by the PBOC as a poor Chicago PMI weighed on the dollar. The euro even underperformed the dollar after a negative EMU CPI. Will the euro or the dollar be hurt the most in case of poor data or negative risk sentiment?

### 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	↓

- After the close of European markets, sentiment in the US turned with **US equities reversing their gains to end the session lower. This morning, most Asian shares trade in positive territory.** Poor PMI's initially weighed on sentiment, but losses were reversed later on, supported by the PBOC's easing measures yesterday.
- **Fed's Dudley warned this morning that the balance of risks to the US economic outlook is starting to tilt slightly to the downside** and added that if the market turmoil persists, it would trigger a more significant downgrade to his outlook for the economy. Dudley also said the further fall in inflation expectations is worrisome.
- **Activity in China's manufacturing sector contracted sharper in February**, both the official and Caixin manufacturing PMI showed this morning, suggesting that recent easing measures had little effect for now. Also the non-manufacturing PMI disappointed, falling to its lowest level in more than 7 years.
- **OPEC oil output fell in February**, a Reuters survey showed yesterday, due to a halt in Iraq's northern exports and outages at other producers. In the US, data showed that some of America's biggest shale producers cut back oil and gas production for the first time in years. The Brent oil price nears this morning the \$37/barrel level.
- **The Reserve Bank of Australia decided to keep its cash rate steady at a record low level of 2%** as the board judged that there were reasonable prospects for continued growth with inflation close to target. The Aussie dollar strengthened slightly.
- Today, **the eco calendar heats up** with the euro zone (final) and UK manufacturing PMI, the US manufacturing ISM and euro zone unemployment rate.

# Rates

## Bund sets new high on risk-off and negative inflation

Global core bonds showed a mixed picture. The Bund profited initially from weaker equities and a mild risk-off sentiment. Maybe some late end of month buying added to the positive momentum. The EMU HICP surprised friend and foe by printing -0.2% Y/Y for the headline and 0.7% Y/Y for the core inflation, way below expectations. It added to expectations that the ECB may ease its policy stance in a bolder way than expected earlier. However, it didn't give the Bund immediately more momentum. The Bund topped out around noon. Equities were recovering in a reaction to a Chinese PBOC reduction of the bank reserve requirements. The correction of the bund was short-lived. Early in the afternoon, the Bund went up again, getting slight support from a weaker than expected Chicago PMI setting a new high at 166.63 after which sideways trading kicked in. The 10-year German yield trades current at 10.7 basis points (nearing the all-time low of 4.9 bps). In a daily perspective, German yields were up to 4 basis points lower at the 10-year tenor.

The US Treasury was higher too going into the European session, but failed to make headway giving way to some profit taking in the run-up to the US session. The tide turned when the Chicago PMI came out weaker, pushing Treasuries slightly higher. The US Treasuries underperformed the German bonds and yields fell slightly more than 2-bps at most tenors, the shape of the curve little changed. US equities lost 0.8%. Oil rose higher and closed near \$36.

Strong German bonds

EMU inflation negative again

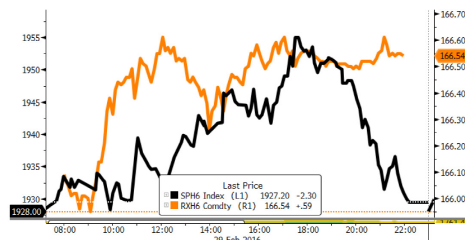
US Treasuries underperform Bunds

Strong performance Portugal continues

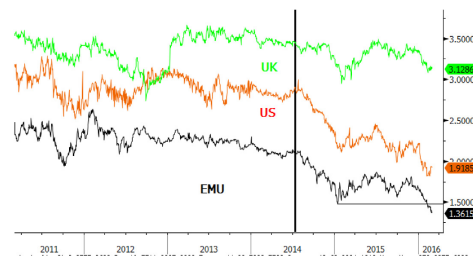
Little impact Irish elections

	DE yield	-1d
2	-0,5700	-0,0260
5	-0,4080	-0,0420
10	0,1070	-0,0360
30	0,8429	-0,0110

	US yield	-1d
2	0,7895	0,0000
5	1,2091	-0,0177
10	1,7244	-0,0172
30	2,6041	-0,0115



Bund future (orange) and S&P future (black) (intraday): Bund unstoppable, but test first resistance S&P fails



Inflation swap 5yr/5y forward: Decline in EMU (and to lesser extent US) continues. Well below ECB wishes.

## Today focus on US ISM and EMU unemployment

According to the first estimate, the euro zone manufacturing PMI dropped from 52.3 to 51.0, well below the market consensus. The final reading is forecast to confirm this outcome. Although other business confidence indicators weakened too, we believe that the risks are for a limited upward revision as the first estimate was maybe a little too pessimistic. Also in the euro area, the unemployment rate is expected to have stabilized at 10.4% in January after having dropped for two consecutive months. In the US, the manufacturing ISM will be closely watched after a disappointing Markit PMI. The consensus is looking for a limited further improvement, from 48.2 to 48.5. Besides a poor Markit PMI, also regional indicators were mixed, at best. We believe therefore that another disappointing figure is not excluded and our Nowcast model points to a 48.1 outcome. Finally, US vehicle sales are expected to have increased somewhat further in February.

Upward revision EMU PMI's

Disappointing US ISM?

ECB's Lautenschlaeger speaks

R2	167	-1d
R1	166,63	
<b>BUND</b>	<b>166,57</b>	0,5400
S1	165,63	
S2	163,79	

## Fed Dudley less confident on inflation

**NY Fed Dudley** said he is “somewhat less confident” on inflation outlook, but he marked its growth outlook for 2016 so far only very modestly down. The weaker Q4 GDP growth was due to transitory factors (warm weather and inventories), but likely won’t hold it down going forward. He called the balance of risks for growth and inflation maybe starting to tilt slightly to the downside. This may trigger revisions to the outlook. He mentioned in particular sliding market- and consumer-based inflation expectations as concerning. He denied to existence of a Fed put. Dudley’s statements give still more credence that the Fed will stay put at the March meeting, but is open-minded further out (data-dependent).

## Today: Time for some profit taking?

**Overnight**, Asian equity markets are positively oriented in the past hour. Lower Chinese reserve requirements for banks (easing measure) are supportive, overpowering weaker than expected Chinese PMI’s and a negative closure on WS (see headlines). The US T-Note is a bit higher, but sliding lower. Yen and euro are currently nearly flat versus dollar. Oil remains strong, again testing key resistance at \$36.25/37. We see sentiment as balanced and thus expect a neutral Bund opening.

**Today’s eco calendar is uneventful in EMU** with final PMI figures and the unemployment rate. The speech of NY Dudley overnight is slightly bond positive, but markets view on the March FOMC meeting has been made. Inflation expectations warrant close scrutiny, as they decline despite the stabilization of oil prices. **The US ISM may disappoint which would be bond positive. Markets may also be attracted to the all-time low for the German 10-year yield (4.9 bps), but overall we would take today a somewhat more defensive attitude versus bonds. The rally has been breathtaking (Bund) and a lot of bond positive news including the ECB easing is discounted. Bund is again overbought. So the market may be ripe for some profit taking, especially if US eco data in the next days would positively surprise and investors position themselves a bit more neutral ahead of the ECB meeting. Anyway, a run to the lows is worth a sell.**

**Technically**, the US Note future lost its uptrendline, but remains in a tight range near the highs. We expect sideways trading ahead, roughly between 129 and 133. The technical picture for the Bund is still better with the uptrendline intact and new highs in past sessions. Medium term, the German 10-yr yield is only 5 bps away from the all-time low (0.049%). A test in the run-up to the March ECB-meeting is possible, but worth a sell.



German Bund: First test contract high failed, but still above trendline



US Note future: uptrendline broken, but now in sideways range near the highs

# Currencies

*Dollar struggled against the yen as global sentiment on risk remains fragile*

*At the same time, the euro underperforms on poor EMU inflation*

R2	1,1376	-1d
R1	1,1068	
<b>EUR/USD</b>	<b>1,0881</b>	<b>-0,0073</b>
S1	1,081	
S2	1,0711	

*Asian equities slightly higher on RRR cut, but sentiment remains fragile*

*RBA keeps policy unchanged as expected*

*Today the focus will be on the US manufacturing ISM*

*Will poor US data halt the outperformance of the dollar against the euro?*

## Euro weakness prevails

On Monday, USD trading showed a mixed picture. USD/JPY declined in Asia but stabilised in Europe as markets' disappointment on the G20 was counter-balanced by a PBOC cut of the Reserve Requirement Ratio. Later on USD/JPY drifted again south after a poor Chicago PMI and as US equities turned again south. USD/JPY closed the day at 112.66 (114.00 on Friday). Still, the euro underperformed the dollar. The euro was sold from the start in Europe and came under further pressure as EMU inflation came out negative. EUR/USD finished the day at 1.0873 (from 1.0934)

**This morning**, the official Chinese PMI's and Caixin PMI declined further (see headlines). Still, most Asian equity indices show limited gains as they react to yesterday's PBOC RRR cut. The PBOC fixed the yuan stronger against the dollar at USD/CNY 6.5385. **The PBOC apparently wants to reaffirm yuan stability despite yesterday's RRR cut.** The Reserve bank of Australia as expected kept its policy rate unchanged at 2%. The statement was little changed from the previous one. The Aussie dollar trades slightly softer at 0.7135. USD/JPY was under pressure early in the session, but selling eased in the low 112.20 area. The pair trades in the 112.65 area. EUR/USD is little changed in the 1.0880 area.

**Today**, according to the first estimate, the EMU **manufacturing PMI** dropped sharply from 52.3 to 51.0. Other business confidence indicators weakened too, but we see risks for a **limited upward revision** as the first estimate was maybe a little too pessimistic. The EMU **unemployment rate** is expected to have stabilized after two consecutive declines. In the US, the **manufacturing ISM** will be closely watched after a disappointing Markit PMI. The consensus is looking for a limited improvement, from 48.2 to 48.5. **Another disappointing figure is not excluded.**



EUR/USD negative structure remains in place. Euro weakness rather than USD strength became the driver.



USD/JPY nearing the correction low area

So, the data might be slightly negative for the dollar, while equity sentiment will remain fragile. This context is negative for USD/JPY. However, the rebound of the yen might slow as investors become vigilant for BOJ action when the pair nears the 110.98 correction low. **In past days, short-term US-German rate differential widened in favour of the dollar.**

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It is unlikely this will continue if US data are weak. The day-to-day price pattern of EUR/USD remains negative. However, the pair declined without interruption off the 1.1376 top and is nearing support in the 1.0810/1.0711 area. We don't row against the EUR/USD negative tide, but a slowdown might be on the cards if US eco data disappoint.

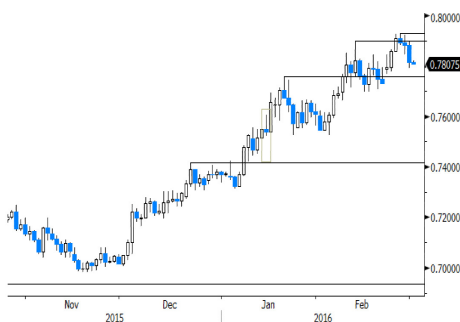
**From a technical point of view**, the correction high stands at 1.1376, next important resistance at 1.1495. The dollar gradually fought back. The decline below 1.1060 was a ST negative for EUR/USD and finally opened the way to the 1.0810/1.0711 support area. **USD/JPY dropped below the 115.98 pre-BOJ low**. Japanese officials warned on potential action, putting a short-term floor under the pair. Even so, it remains vulnerable. **Any rally might run fast into resistance (113.77/114.87 with 115.98 January low the next resistance)**.

### EUR/GBP: euro weakness prevails

**On Monday**, UK lending data were stronger than expected, but it didn't left traces on the sterling graphs. **The price action in cable and in EUR/GBP was primarily driven by the price swings in the euro and the dollar**. Cable initially declined and set a new correction low in the 1.3936 area. However, the pair rebounded later, as the dollar lost ground after a poor Chicago PMI. Cable closed the day at 1.3917 (from 1.3871 on Friday). EUR/GBP was under pressure during the whole European session on global euro weakness (cf. EUR/USD part of this report). The pair dropped even temporary below the 0.78 level and closed the session at 0.7813 (from 0.7882 on Friday).

**Today**, the **UK manufacturing PMI** is expected to decline again from 52.9 to 52.3. **We see slight downside risks**. Of late, weak eco data or a risk-off sentiment were negatives for sterling, as was uncertainty on Brexit. Over the previous days, euro weakness prevailed as a driver for currency trading. **At the same time, the news on Brexit moved somewhat to the background as a ST driver for sterling trading**. Some consolidation or even a limited rebound might be on the cards after the recent decline. However, for now, it is too early to call a sterling trend reversal. We are interested to see the reaction of sterling in case of a weak UK PMI (in combination with similar poor data in the US/Europe). Will sterling still be the weakness link or is some improvement in sentiment on the cards? **The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top. The pair cleared the 0.7898 resistance earlier this week. 0.8066 is the next important resistance**.

R2	0,8066	-1d
R1	0,7929	
<b>EUR/GBP</b>	<b>0,7802</b>	<b>-0,0089</b>
S1	0,7696	
S2	0,7526	



EUR/GBP correction on global euro weakness



GBP/USD sets minor new correction low, but decline slows

# Calendar

Tuesday, 1 March		Consensus	Previous
<b>US</b>			
	Wards Domestic Vehicle Sales (Feb)	13.80m	13.79m
	Wards Total Vehicle Sales (Feb)	17.60m	17.46m
15:45	Markit US Manufacturing PMI (Feb F)	51.2	51.0
<b>16:00</b>	<b>ISM Manufacturing (Feb)</b>	<b>48.5</b>	<b>48.2</b>
16:00	Construction Spending MoM (Jan)	0.5%	0.1%
<b>Canada</b>			
14:30	Quarterly GDP Annualized (4Q)	0.1%	2.3%
15:30	RBC Manufacturing PMI (Feb)	--	49.3
<b>Japan</b>			
00:30	Jobless Rate (Jan)	A 3.2%	3.3%
00:30	Job-To-Applicant Ratio (Jan)	A 1.28	1.27
00:30	Overall Household Spending YoY (Jan)	A -3.1%	-4.4%
00:50	Capital Spending YoY (4Q)	A 8.9%	11.2%
00:50	Company Profits (4Q)	A -1.7%	9.0%
03:00	Nikkei Japan PMI Mfg (Feb F)	A 50.1	50.2
06:00	Vehicle Sales YoY (Feb)	A -4.6%	0.2%
<b>Australia</b>			
<b>04:30</b>	<b>RBA Cash Rate Target</b>	<b>A 2.00%</b>	<b>2.00%</b>
<b>China</b>			
<b>02:00</b>	<b>Manufacturing PMI (Feb)</b>	<b>A 49.0</b>	<b>49.4</b>
<b>02:00</b>	<b>Non-manufacturing PMI (Feb)</b>	<b>A 52.7</b>	<b>53.5</b>
<b>02:45</b>	<b>Caixin China PMI Mfg (Feb)</b>	<b>A 48.0</b>	<b>48.4</b>
<b>UK</b>			
<b>10:30</b>	<b>Markit PMI Manufacturing SA (Feb)</b>	<b>52.3</b>	<b>52.9</b>
<b>EMU</b>			
<b>10:00</b>	<b>Markit Manufacturing PMI (Feb F)</b>	<b>51.0</b>	<b>51.0</b>
<b>11:00</b>	<b>Unemployment Rate (Jan)</b>	<b>10.4%</b>	<b>10.4%</b>
<b>Germany</b>			
09:55	Unemployment Change (000's) (Feb)	-10k	-20k
09:55	Unemployment Claims Rate SA (Feb)	6.2%	6.2%
09:55	Markit/BME Manufacturing PMI (Feb F)	50.2	50.2
<b>France</b>			
09:50	Markit Manufacturing PMI (Feb F)	--	50.3
<b>Italy</b>			
09:45	Markit/ADACI Manufacturing PMI (Feb)	52.2	53.2
10:00	Unemployment Rate (Jan P)	--	11.4%
11:00	GDP Annual YoY (2015)	--	-0.4%
11:00	Deficit to GDP (2015)	--	3.0%
<b>Spain</b>			
09:15	Markit Manufacturing PMI (Feb)	54.5	55.4
<b>Belgium</b>			
11:00	Unemployment Rate (Jan)	--	7.9%
<b>Norway</b>			
09:00	Manufacturing PMI (Feb)	48.0	49.2
<b>Sweden</b>			
08:30	Swedbank/Silf PMI Manufacturing (Feb)	55.0	55.5
<b>Events</b>			
<b>US</b>			
<b>Super Tuesday with 13 States Holding Primary Elections</b>			
05:30	Fed's Dudley Speaks on Economy and Policy in Hangzhou		
15:05	ECB's Lautenschlaeger Speaks in New York		



# Contacts

10-year	td	-1d	2-year	td	-1d	STOCKS		-1d
US	1,73	-0,01	US	0,79	0,00	DOW	16517	16516,50
DE	0,11	-0,03	DE	-0,57	-0,02	NASDAQ	for Exch - NQI	#VALUE!
BE	0,46	-0,01	BE	-0,45	-0,03	NIKKEI	16086	16085,51
UK	1,34	-0,07	UK	0,35	-0,01	DAX	9495,4	9495,40
JP	-0,06	0,00	JP	-0,26	0,01	DJ euro-50	2946	2945,75

						USD	td	-1d	
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,227	0,016
3y	-0,186	0,922	0,743	Euribor-1	-0,26	0,00	Libor-1 USD	0,51	0,51
5y	-0,032	1,122	0,855	Euribor-3	-0,20	0,00	Libor-3 USD	0,59	0,59
10y	0,500	1,556	1,274	Euribor-6	-0,13	0,00	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,0883	-0,0068	EUR/JPY	122,7	-0,98		163,4499	1245	36,83
USD/JPY	112,76	-0,18	EUR/GBP	0,7805	-0,0087	-1d	1,78	16,22	1,54
GBP/USD	1,3941	0,0065	EUR/CHF	1,0858	-0,0046				
AUD/USD	0,7160	0,0030	EUR/SEK	9,3144	-0,05				
USD/CAD	1,3509	-0,0014	EUR/NOK	9,4464	-0,06				

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