



Sunrise

Tuesday, 08 December 2015

Rates: Weakness in commodity/equity markets positive for bonds

Core bonds surged higher on the back of crashing oil/commodity prices. Today's eco calendar remains thin which means that sentiment on commodity and equity markets remains the main driver for trading. More weakness on those markets further underpins the core bond rally.

Currencies: Dollar's attempt to come-back fails as risk-off dominates

The dollar still hasn't fully digested last week's sell-off. An attempt to regain ground is aborted by falling oil, gold and other commodities. Today, it seems that commodities, equities and the risk sentiment will guide currency trading. Can the euro end up as the surprise winner of the day?

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 | ↑ |

- Yesterday, **European equities** recovered some of last week's losses, with indices gaining up to 1.25%. **US equities** had a weak trading session due to the falling oil prices, S&P closed at -0.7%. Overnight, **Asian equities** are seeing red numbers all across the board with the sliding commodities, indices are losing up to -2.3%
- **Bad news from China**, with **Chinese exports in November falling -3.7% Y/Y** in Yuan, much more than the expected -2.9% Y/Y. **Imports declined -5.6% Y/Y**, which was better than the anticipated decline of -11.3% Y/Y.
- **Japanese GDP data suggested that the country is no longer in a technical recession**, as the GDP expanded at an annualised 1% for Q3.
- Atlanta Fed President **Dennis Lockhart said the economy is growing at a solid moderate rate** and that **conditions are very satisfactory for a rate hike**.
- **Commodities prices keep tumbling**, with Oil prices in freefall mode, new lows have been reached at **40.60 \$/barrel for Brent Crude** and **37.50\$/barrel for WTI crude**.
- Today the eco-calendar is rather empty, with only **the NIFD small business optimism indicator** and **the JOLTS job openings report in the US**.
-

Rates

Significant gains Bunds as oil prices hit new cycle low

| | US yield | -1d |
|----|----------|---------|
| 2 | 0,927 | -0,0318 |
| 5 | 1,6595 | -0,0641 |
| 10 | 2,2112 | -0,0794 |
| 30 | 2,9369 | -0,0822 |

Atlanta Fed Lockhart ready to vote for rate hike

| | DE yield | -1d |
|----|----------|---------|
| 2 | -0,3170 | -0,0180 |
| 5 | -0,0677 | -0,0813 |
| 10 | 0,5909 | -0,1018 |
| 30 | 1,4141 | -0,1089 |

Global core bonds started the week on a solid footing

Yesterday, global core bonds had a constructive session helped by lower oil prices. German bonds outperformed US Treasuries. That might have had something to do with the significant US/German spread narrowing the past trading sessions. Aftershocks of Friday's OPEC meeting pushed the WTI oil price below \$40/barrel (\$37.5 low) and Brent below \$42/barrel (\$40.60 low), both cycle lows. The Bloomberg commodity index declined further to the lowest level since 1999. European equity markets started strong, but returned part of the gains on lower oil. US stocks ended around 0.70% lower. **At the end of the session**, German yields dropped 1.8 bps (2-yr) to 9.7 bps (10-yr). The US yield curve bull flattened with yields 1.2 bps (2-yr) to 4.8 bps (30-yr) lower. On intra-EMU bond markets, 10-yr yield spread changes versus Germany ranged between -2 bps (Spain) and +4 bps (Portugal) with Greece underperforming (+50 bps).

Lockhart ready to vote in favour of rate hike

Atlanta Fed Lockhart (centrist, voter) said that he's ready for a decision to lift off. He believes that the criteria set by the Fed to determine when to raise rates "have been substantially met". Looking forward, he echoed other FOMC members, saying that every meeting is a live meeting and that the Fed won't mechanically raise rates like in previous cycles. On the inflation front, he sides with chairwoman Yellen: "As the economy evolves in 2016 and 2017, I am one who will be looking for **more direct evidence of converging to the inflation target**. I'm comfortable with making a first move; I would be less comfortable with making subsequent moves without supporting evidence our inflation objective, especially, is in the process of being achieved". **St. Louis Fed Bullard (hawk, voter in 2016)** made similar comments on the pace of the monetary tightening cycle, but he is confident that inflation will move to the 2% target as the energy shock fades. Lockhart and Bullard were the last public Fed speakers ahead of next week meeting as they so-called "black period" kicks in. Their comments reflected their known views and didn't impact trading.



German Bund (black) and Brent oil price (orange): lower oil prices supported core bonds



Brent oil price hits new cycle low (\$40.6/barrel) in the aftermath of Friday's OPEC meeting

Today's eco calendar contains US NFIB Small Business Optimism (96.4 expected from 96.1) and JOLTS job openings (5500 expected from 5500). In EMU, the first revision to the Q3 GDP is expected to confirm the initial 0.3% Q/Q outcome.

We do get a detailed breakdown of growth for the first time. The US Treasury starts its mid-month refinancing operation with \$24B 3-yr Note auction. Currently, the WI trades around 1.235%.

Today: More positive momentum on weak oil/equities?

| | | |
|-------------|---------------|--------|
| R2 | 161,77 | -1d |
| R1 | 160,66 | |
| BUND | 158,44 | 1,3100 |
| S1 | 156,4 | |
| S2 | 154,54 | |

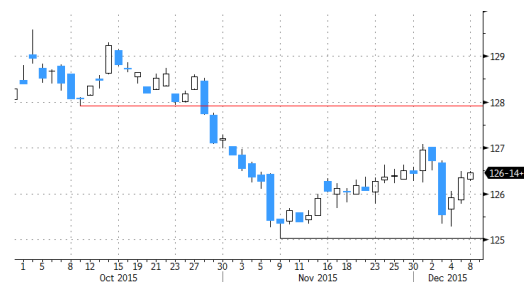
Overnight, Asian stock markets lose up to 1% with China underperforming (losses of up to 2%). Weakness in commodities is the main reason. Chinese exports fell for a fifth month and the Chinese yuan is headed for its weakest close in four years. The latter is likely still due to yesterday's reserves data which showed a big decline in China's FX stockpile. **The US Note future remains upwardly oriented, suggesting a solid opening for the Bund as well.**

Today, the eco calendar remains thin with only EMU Q3 GDP revision and US NFIB Small Business Optimism & JOLTS. We don't expect the data to influence trading. That leaves technical factors, commodity prices and risk sentiment on equity markets as main trading drivers. **A further decline in commodities/equities gives core bonds more positive intraday momentum.**

In Europe, the December ECB meeting took the angle out of the threat that the ECB will ease policy forever. In retrospect, it might turn out to be the end of the global rat race to have the easiest monetary policy. That puts a huge bottom below European rate markets (ceiling for the Bund). After last week's Bund sell-off, we believe that in first instance a new equilibrium needs to be found around first support (March 2016 contract: 156.40). Weak commodity prices currently underpin the Bund. In the US, the market implied probability of a December lift off, our base scenario, increased further to 78%. **We hold our sell-on-upticks approach for return action to the 125-01 recent low in the US Note future (2.37% resistance in US 10-yr yield).**



German Bund: Bounced off lower bound sideways range as oil price faced another setback



US Note future (March contract!!): more neutral as commodity complex falls off a cliff. Fed lift-off may still push contract to support

Currencies

Dollar bulls still groggy from Thursday's sell-off

Temporary dollar upturn misses momentum

Free-fall oil weighs on equities and aborts dollar comeback

| | | |
|----------------|---------------|----------------|
| R2 | 1,1087 | -1d |
| R1 | 1,0981 | |
| EUR/USD | 1,0854 | -0,0013 |
| S1 | 1,0524 | |
| S2 | 1,0458 | |

Poor risk sentiment in Asia on weak commodities

Dollar losses remain moderate

Today, second tier data.

Sentiment on risk and commodities will be the key drivers

USD rebound aborted as risk-on rally changed course

On Monday, currency markets initially retuned to the divergence trade with the dollar regaining further ground and the euro returning part of the post-ECB gains. The move was corrective in nature, as there was no high profile news to guide the price action. The decline in oil and other commodities weighed on the likes of the CAD,NZD,AUD and the NOK and supported the US dollar. During the US trading session, the dollar lost part of the earlier gains as the decline of oil triggered substantial losses on the US equity markets. Later on oil continued to decline but the euro stabilized. EUR/USD closed the session at 1.0837 (from 1.0981 on Friday). USD/JPY held up remarkably well and closed the day at 123.37 (from 123.11).

Overnight, Asian equities turned also in risk off modus. Chinese trade data were again weak (especially exports). It keeps several commodities (including oil) near the recent lows. **The Japan Q3 GDP was revised higher than expected from -0.8% Q/Q annualised to (+1.0%), avoiding a technical recession.** USD/JPY is declining moderately, but most likely on regional risk-off sentiment rather a positive reaction on the Q3 revision. **The rout in commodities is weighing on the likes of the kiwi dollar and the Aussie dollar.** However, the decline of the AUD (currently 0.7240 area) stays moderate. The global risk-off trade supports the euro slightly more than the dollar. EUR/USD trades in the 1.0850/60 area.

Today, the EMU Q3 GDP revision will be published. The composition of the GDP is interesting, but it won't affect trading anymore. **In the US, the NFIB small business confidence and the JOLTS job openings will provide some valuable information on the US economy, but also here are no strong market movers.** **The dollar is probably more sensitive to negative than to positive surprises.** Global sentiment on risk (negative) and the developments in the commodity markets will be the key drivers for global (currency) trading. This context is more negative for the dollar than for the euro. The unwinding of carry trades (euro positive) will probably outweigh the theoretically positive effect of declining commodities on the dollar. Even so, as short-term US interest rates hold up well, we expect the upside in EUR/USD to be limited and the post-ECB ranges to hold.



EUR/USD: Dollar comeback misses legs as previous sell-off needs to be digested as risk off now favours euro at the margin



USD/JPY: still paralyzed in the tight range with yen overnight marginally stronger on risk off.

With the ECB deposit rate at -0.3%, the euro will continue to face an impressive interest disadvantage. Interest rate differentials at 2-year between Germany and the US have declined from the 140 area to around 125 currently. This is a substantial adjustment. After last week's ECB decision, the debate has shifted to the pace of further Fed tightening after next week's Fed meeting. It might still take some time (and some good US eco data) for the dollar to regain further ground. However, even after last week's 'ECB failure' to meet market expectations, policy divergence has probably still a role to play. Admittedly, it will have to come from USD strength, rather than from euro weakness.

EUR/GBP stabilizes near correction top

| | | |
|---------|---------------|--------|
| R2 | 0,7298 | -1d |
| R1 | 0,7251 | |
| EUR/GBP | 0,7212 | 0,0020 |
| S1 | 0,6983 | |
| S2 | 0,6936 | |

On Monday, the UK, US and EMU calendars were devoid of market moving data releases. The ECB decision (on Thursday) propelled the euro higher across the board, but caused a rebound of cable and a rise in EUR/GBP as cable underperformed EUR/USD. Yesterday, sterling tried to regain ground on the euro, but didn't succeed. Early gains evaporated and the pair closed little changed at 0.7198. Weaker commodities weighted more on the heavily commodity influenced UK equities. So the risk off keeps sterling near the post-ECB lows. Overnight, EUR/GBP went even a bit higher and trades again just north of 0.72. within striking distance of first EUR/GBP resistance at 0.7250.

Yesterday, cable initially dropped lower as EUR/GBP followed EUR/USD down. When the euro rebounded on weak commodities and a decline of equities, sterling still underperformed, pushing cable lower to a close near 1.5050, a decline of Friday's close at 1.5112. The short term trend in cable remains down, but the pair is still some way of the recent lows at 1.4895. So, sterling sentiment remains fragile. The commodity rout and risk off hit sterling more than dollar or euro.

Today, the UK BRC sales largely underperformed expectations and dropped 0.4% Y/Y in November, following a 0.2% M/M decline in October. Markets expected a 0.5% M/M increase. That's an additional slightly sterling negative factor. Later today, the Halifax house prices will show buoyancy in the sector (concern for BoE and government), but also weak industrial production is on the agenda (0.1% M/M expected). As the BoE wants to ignore the housing bubble (macro-prudential measures are advised), we are afraid that sterling won't find support in the data. Only a turnaround of commodities and equities may avoid a retest of recent lows. At this stage it is too early to bet on a scenario of the BoE becoming more hawkish, limiting the comeback room for sterling. Today, we expect technically inspired trading near the 0.7250 resistance area.



EUR/GBP: still close to the 0.7250 resistance area



Cable: digests recent gains, but looks weak

Calendar

| Tuesday, 8 December | | Consensus | Previous |
|---------------------|--|----------------|---------------|
| US | | | |
| 12:00 | NFIB Small Business Optimism (Nov) | 96.4 | 96.1 |
| 16:00 | JOLTS Job Openings (Oct) | 5500 | 5526 |
| 16:00 | IBD/TIPP Economic Optimism (Dec) | 45.1 | 45.5 |
| Canada | | | |
| 14:15 | Housing Starts (Nov) | 200.0k | 198.1k |
| 14:30 | Building Permits MoM (Oct) | 2.9% | -6.7% |
| Japan | | | |
| 00:50 | GDP SA QoQ (3Q F) | A: 0.3% | -0.2% |
| 00:50 | GDP Annualized SA QoQ (3Q F) | A: 1.0% | -0.8% |
| 00:50 | GDP Deflator YoY (3Q F) | A: 1.8% | 2.0% |
| 00:50 | BoP Current Account Adjusted (Oct) | A: ¥1493.7b | ¥776.2b |
| 00:50 | Trade Balance BoP Basis (Oct) | A: ¥200.2b | ¥82.3b |
| 06:00 | Eco Watchers Survey Current (Nov) | A: 46.1 | 48.2 |
| 06:00 | Eco Watchers Survey Outlook (Nov) | A: 48.2 | 49.1 |
| China | | | |
| | Exports YoY/ YoY CNY (Nov) | A: -6.8%/-3.7% | -6.9%/-3.6% |
| | Imports YoY/YoY CNY (Nov) | A: -8.7%/-5.6% | -18.8%/-16.0% |
| | Trade Balance (Nov) | A: \$54.10b | \$61.64b |
| EMU | | | |
| 11:00 | GPD SA QoQ/YoY (3Q P) | 0.3%/1.6% | 0.3%/1.6% |
| 11:00 | Household consumption QoQ | 0.5% | 0.4% |
| UK | | | |
| 01:01 | BRC Sales Like-For-Like YoY (Nov) | A: -0.4% | -0.2% |
| 09:00 | Halifax House Prices MoM / 3Mths/Year | 0.2%/9.5% | 1.1%/9.7% |
| 10:30 | Industrial Production MoM/YoY (Oct) | 0.1%/1.2% | -0.2%/1.1% |
| 10:30 | Manufacturing Production MoM/YoY (Oct) | -0.2%/0.0% | 0.8%/-0.6% |
| 16:00 | NIESR GDP Estimate (Nov) | -- | 0.6% |
| Events | | | |
| 11:30 | UK - Gbp 2bn 3.5% Jan 2045 Gilt | | |
| 19:00 | US - Usd 24bn 3-year note auction | | |

| 10-year | td | -1d | 2-year | td | -1d | STOCKS | -1d |
|---------|------|-------|--------|-------|-------|------------|------------------------|
| US | 2,21 | -0,08 | US | 0,93 | -0,03 | DOW | 17731 17730,51 |
| DE | 0,59 | -0,10 | DE | -0,32 | -0,02 | NASDAQ | for Exch - NQI #VALUE! |
| BE | 0,88 | -0,12 | BE | -0,25 | -0,03 | NIKKEI | 19493 19492,60 |
| UK | 1,81 | -0,12 | UK | 0,56 | -0,07 | DAX | 10886,09 10886,09 |
| JP | 0,32 | -0,01 | JP | -0,01 | 0,00 | DJ euro-50 | 3360 3360,21 |

| | | | | | | USD | td | -1d |
|-----|-------|----------|-------|-----------|-------|-------------|--------|--------|
| IRS | EUR | USD (3M) | GBP | EUR | -1d | Eonia EUR | -0,142 | -0,004 |
| 3y | 0,021 | 1,266 | 1,152 | Euribor-1 | -0,17 | Libor-1 USD | 0,50 | 0,50 |
| 5y | 0,247 | 1,583 | 1,418 | Euribor-3 | -0,11 | Libor-3 USD | 0,58 | 0,58 |
| 10y | 0,915 | 2,081 | 1,834 | Euribor-6 | -0,03 | Libor-6 USD | 0,74 | 0,74 |

| Currencies | -1d | Currencies | -1d | Commoditie | CRB | GOLD | BRENT |
|------------|----------------|------------|---------------|------------|---------|--------|-------|
| EUR/USD | 1,0854 -0,0013 | EUR/JPY | 133,57 -0,36 | | 183,242 | 1073,3 | 40,94 |
| USD/JPY | 123,11 -0,17 | EUR/GBP | 0,7211 0,0019 | -1d | -0,06 | -11,90 | -1,84 |
| GBP/USD | 1,5045 -0,0059 | EUR/CHF | 1,0849 0,0002 | | | | |
| AUD/USD | 0,7237 -0,0096 | EUR/SEK | 9,262 0,03 | | | | |
| USD/CAD | 1,3508 0,0113 | EUR/NOK | 9,3850 0,10 | | | | |

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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