



Sunrise

Wednesday, 10 February 2016

Core bonds trade volatile in tango with equities

At the end of the session core bonds were again close to Monday's closing levels. Risk off sentiment still supportive, but markets may await Yellen's testimony this afternoon to become more active. Will she be able to quell uncertainty and pessimism?

Currencies: dollar remain on the defensive. Focus on Yellen

Yesterday, the dollar remained under pressure as global uncertainty weighed. This time, USD/EUR lost further ground while the decline in USD/JPY slowed. Today, Yellen's appearance before Congress will be the key driver for USD trading. Yellen leaving the door open for further interest rate hikes could be slightly supportive for the dollar?

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 ignored a new drop in the oil price and closed the session broadly unchanged.** This morning, **sentiment in Asia remains poor** with shares showing broad-based losses. Japanese stocks continue to underperform, losing more than 2%.
- **Crude oil prices dropped 8% yesterday** with the Brent nearing again the \$30/barrel level and the WTI closing below \$28/barrel as oversupply and demand worries continue to weigh. This morning, crude oil is trading slightly higher ahead of the weekly EIA inventory data.
- **Bernie Sanders won an impressive victory in the New Hampshire Democratic primaries yesterday**, defeating Hillary Clinton. On the Republican side, **Donald Trump won the New Hampshire primaries in a convincing way** with Ohio governor John Kasich coming in second.
- **According to new estimates by the IIF, China suffered another \$113 billion of capital outflows in January**, as the central bank likely spent another \$90 billion reserves in currency interventions, adding to recent concerns of surging capital outflows.
- **Rating agency Standard & Poor's cut the ratings of four US regional banks** by one notch yesterday, citing heavy exposure to energy loans whose credit quality has deteriorated over the past year due to depressed oil prices. S&P also lowered the rating of 45 junk-rated energy exploration and production companies.
- Today, the **eco calendar** contains then Italian and UK industrial production data and UK NIESR GDP estimate. The focus will however be on the **testimony of Fed Chairwoman Yellen before Congress**.

Rates

Volatile trading of bonds and equities ahead of Yellen

Markets are very nervous awaiting the views of Fed Yellen on current issues

Core bonds end mixed to higher

Portugal big victim in peripheral market

	US yield	-1d
2	0,698	0,0438
5	1,1463	0,0288
10	1,7173	0,0185
30	2,54	0,0106

	DE yield	-1d
2	-0,5110	0,0200
5	-0,2910	-0,0060
10	0,2350	0,0190
30	0,9086	0,0137

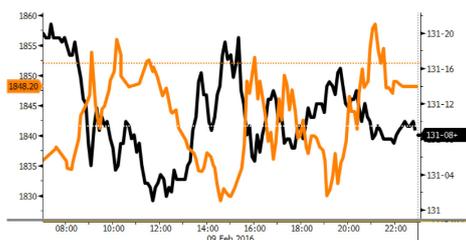
Eco calendar irrelevant

Yellen has difficult task to calm markets without giving up prospect of continuing tightening cycle at some point

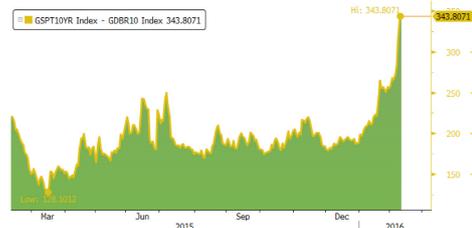
Yesterday, global core bonds had a very volatile session, mirroring the moves of riskier equities. The upcoming semi-annual testimony of Yellen might have been at play. At the end, equities were marginally lower, US Treasuries slightly higher and German bonds narrowly mixed. Core bonds were initially hit by some profit taking as overbought conditions had to be worked off and as European equities held up rather well following Monday's crash. However, during the afternoon session core bonds climbed higher again, as equities slid suffered and oil prices dropped significantly. However US equities erased most losses despite the renewed oil downleg. **On a daily basis**, German yields rose up to 1.6/1.4 bps (10-30-yr), while yields at the short end of the curve (2-5 yr) were fractionally lower. The US bond curve outperformed at the longer end (2.2 to 2.7 bps lower for the 10s and 30s), but was little changed at the short end.

On intra-EMU bond markets, peripherals couldn't recoup Monday's big losses, but, on a positive note, the rout paused at least for Italian and Spanish bonds. Spanish and Italian 10-yr yield spreads versus Germany fell 2-3 bps. Greek and Portuguese yield spreads on the contrary continued to widen by 60 and 27 bps respectively. Yields reached 15 month highs. **Portuguese FM Centeno defended the 2016 budget as balanced**, responsible, but Eurogroup will review the budget and give its opinion today. A statement may be released. Earlier this month, the EU Commission didn't reject the Portuguese draft budget, but called for further measures to ensure compliance with the Stability and Growth pact. So, **there is scope for a conflict with EU and Eurogroup finance ministers**. Under the new Socialist government, Portugal is considered a weak link inside the euro area.

The **eco calendar remains thin today** with only some national EMU production data. The focus will be on **Yellen's testimony** to Congress. **Yellen** should bolster optimism in markets after the renewed turmoil. Markets have now fully priced out rate hikes for 2016 and sharply lowered expectations for rate hikes further out. The first doom prophets are speaking about cutting rates and the debate of negative rates (if needed) has started, with former Fed governor Kocherlakota reiterating his call to cut rates into negative territory. The Fed's December dot plot of 4 hikes in 2016 and a lot more in 2017/18 looks outlandish. However, Yellen cannot completely capitulate. **She will recognize that the Fed should be more cautious on tightening and take its time to evaluate the impact of the turmoil on the US economy before deciding to continue its tightening cycle**. On the other hand, she will point to the robust national fundamentals and more specifically to the vibrant labour market. It is a delicate task and any wrong word may hit riskier markets hard.



US T-Note future (black) and S&P future (orange): volatile, directionless session



Portuguese-German 10-year yield spread sharply higher. General risk aversion but also specific Portuguese items (new government who reverses austerity measures) are putting yields at 15 month high.

Germany and US tap the market

R2	166	-1d
R1	165,23	
BUND	164,63	-0,2800
S1	160,38	
S2	156,4	

The German Finanzagentur launches a new 2-yr Schatz (€5B 0% Mar2018). On the grey market, the new Schatz trades with a 2.1 bps pick-up in ASW-spread terms against the previous benchmark (0% Dec2017). That corresponds with a 2 bps pick-up in yield terms. The record low absolute yield (-0.52%) is totally unattractive. Despite reigning negative risk sentiment, we fear that demand could be subdued. **The US Treasury started its mid-month refinancing operation with a terrible \$24B 3-yr Note auction.** The bid cover was the smallest since July 2009, and the auction stopped with a tail for the first time since June 2014. It was the largest tail since July 2010. Bidding details showed particularly small direct and indirect bids, while the dealer bid was good. Today, the US Treasury continues with a \$23B 10-yr Note auction. Currently, the WI trades around 1.71%.

Today: Risk sentiment and Yellen

Overnight, most Asian equity markets remain closed (including China). Other indices trade around 1% lower with Japan underperforming (-3%) on the back of JPY strength. The Nikkei loses more than 5%. The US Note future trades marginally higher suggesting a slightly stronger opening for the Bund.

Today's eco calendar contains only central bank speakers. Focus goes to Yellen's testimony. She will likely confirm the strong domestic economy, but highlight risks stemming from the "external" world. Such balanced message shouldn't really frighten markets. ECB Praet (talk down EUR?) and Fed Williams also speak **Risk sentiment and technical factors will continue drive trading ahead of Yellen.** European equity markets lost another important support level, suggesting more downside (risk off, positive core bonds). The S&P 500 is still testing crucial support. Oil prices are back in tail spin and support the Bund. So longer term sentiment remains positive for core bonds (also taking into account the technical picture), but both the Bund and the US Note future are heavily overbought, which make them vulnerable for **bouts of short term profit taking is risk sentiment improves.**

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 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%.**



German Bund: Technically overbought. Vulnerable to profit taking?



US Note future: Also overbought. Too dovish ahead of Yellen speech?

Currencies

Currency stays crisis modus. The yen remains the preferred safe haven .

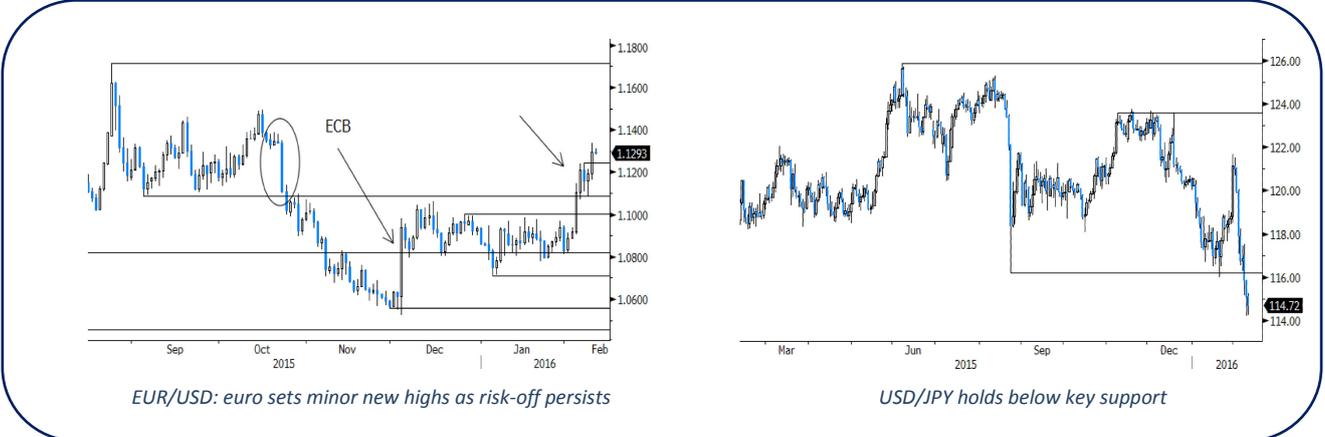
Contrary to what was the case on Monday, yesterday the euro outperformed even as sentiment remained risk-off

R2	1,1495	-1d
R1	1,1338	
EUR/USD	1,1285	0,0083
S1	1,106	
S2	1,081	

Dollar suffers as risk-off trade continues

On Tuesday, there were again few eco data with market moving potential. Early in Europe, it looked that the selling of risky assets could slow. However, the risk-off trading resumed around noon. USD/JPY was again an obvious victim. The pair returned to the 114.30 area, close to the Asian low but a new downleg didn't occur. Oil declined sharply during the US trading session, but the direct impact on other markets was limited. On Monday, the impact of the risk-off trade on the dollar and the euro was more or less balanced. Yesterday, the dollar underperformed. EUR/USD cleared the 1.1246 resistance and jumped temporary north of 1.13 to close the session at 1.1293 (from 1.1193 on Monday).

This morning, several Asian markets are still closed for the Lunar New Year holidays. Japanese equities remain under pressure, recording losses of 2%+. The yen hovers near a 15 month high against the dollar. USD/JPY trades in the 114.50 area, but no new downleg below yesterday's low occurred yet. Japanese PM Abe stated that the government is closely watching market moves. A new era of at least verbal interventions coming closer. Commodity currencies like the AUD and the CAD show a mixed picture, but in the end the losses on the oil price decline remained modest. EUR/USD is little changed, trading in the 1.1290 area.



EUR/USD: euro sets minor new highs as risk-off persists

USD/JPY holds below key support

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

The focus for global trading is on Yellen's testimony before Congress

Today, there are again only second tier eco data on the agenda in Europe and in the US. So, the focus for USD trading will remain on the swings in global markets and on a testimony of Fed's Yellen before Congress. Yellen will have to find a difficult balance. She will probably maintain a positive tone on the domestic economy, in particular on the labour market. At the same time, she cannot but acknowledge quite a long series of risks coming from outside the US and from global markets. In the end, we expect her to leave the door open for further rate hikes, conditional to developments in the near future. In theory, such a scenario shouldn't be that bad for the dollar as markets have priced out the chance for additional Fed rate hikes this year.

Of course, aside from Yellen's testimony, global market stress/volatility will remain a factor for USD trading.

Wednesday, 10 February 2016

Yesterday, signs of global financial stress and intra-day EMU spread widening didn't help the dollar, also not against the single currency. However, the reaction of EUR/USD to this kind of issues was not consistent of late. The drivers behind the price moves in EUR/USD weren't always clear but **with important pockets of rising financial stress coming to the surface, we don't see a big case for the euro to be a better safe haven than the dollar**. Ever deeper negative interest rates are also no help for the euro. We look out for signs of a topping out process in EUR/USD to reinstall shorts.

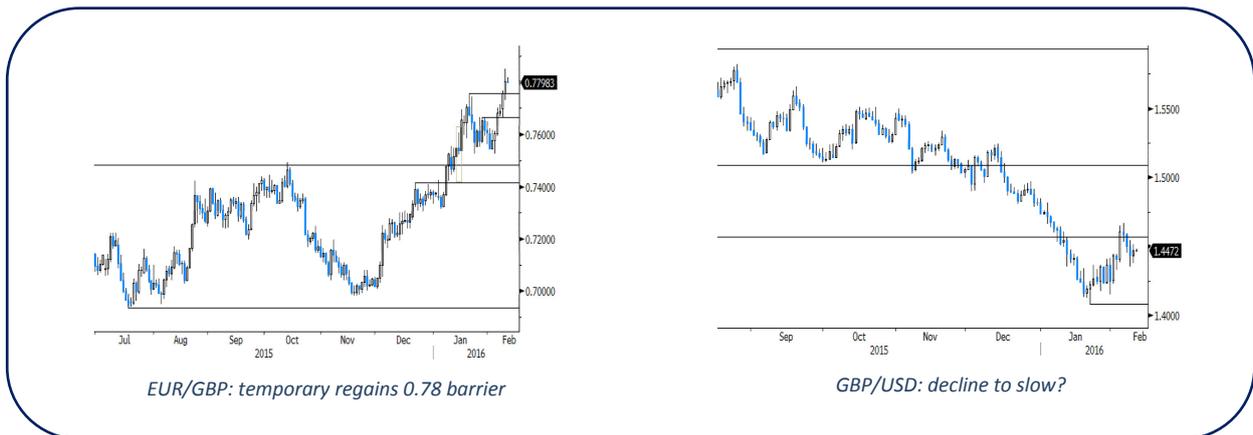
From a technical point of view, EUR/USD broke above the 1.1060/1.1124 resistance area (15 Dec top: 62% retracement). This is a dollar negative. The short-term correction high stands at 1.1338. Next important resistance kicks in at 1.1495. The jury is still out, but we have think that the EUR/USD rebound might be topping out. **The picture for USD/JPY improved temporarily as the pair rebounded above 120 after the BoJ easing two weeks ago. However, the gains evaporated very soon. The pair even dropped below the key 115.98 pre-BOJ correction low. This a high profile warning signal. We expect the BOJ to send warning signals. However, for now there is no good reason to fight current yen strength as long as global uncertainty persists.**

EUR/GBP regained another big figure (0.78)

R2	0,8066	-1d
R1	0,7854	
EUR/GBP	0,7796	0,0025
S1	0,7661	
S2	0,7526	

Yesterday, sterling trading was still mainly driven by global factors. Domestic data like the BRC retail sales and UK trade balance were largely ignored. Early in the European session sterling regained temporary ground against the euro and the dollar as sentiment on risk improved slightly/temporary. However, the gains could not be sustained. A return of the risk-off trade, a decline of oil prices and a rebound of EUR/USD pushed EUR/GBP to a new correction top well north of 0.78. The pair closed the session at 0.7803 (from 0.7756). Cable showed some intraday swings against broadly weaker dollar. The pair closed the session at 1.4472, compared to 1.4433 on Monday.

Today, the UK industrial/manufacturing production data will be published. Both series are expected to signal an almost standstill (or even a decline) in production. So, the report probably won't be a big help for sterling. Later in the session the NIESR January UK GDP growth estimate will be published. Global factors will remain the key driver for sterling trading. It is difficult to call the end of the current rout, but in case of some easing of tensions, the decline of sterling might slow. **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 0.7854/75.** A return below EUR/GBP 0.74 would be a first indication that sterling enters calmer waters.



EUR/GBP: temporary regains 0.78 barrier

GBP/USD: decline to slow?

Calendar

Wednesday, 10 February		Consensus	Previous
US			
13:00	MBA Mortgage Applications	--	-2.6%
20:00	Monthly Budget Statement (Jan)	\$22.8b	--
Japan			
00:50	Housing Loans YoY (4Q)	A: 2.2%	2.4%
00:50	PPI MoM/YoY (Jan)	A: -0.9%/-3.1%	-0.3%/-3.4%
03:00	Tokyo Avg Office Vacancies (Jan)	A: 4.01	4.03
UK			
10:30	Industrial Production MoM/YoY (Dec)	-0.1%/1.0%	-0.7%/0.9%
10:30	Manufacturing Production MoM/YoY (Dec)	0.1%/-1.4%	-0.4%/-1.2%
16:00	NIESR GDP Estimate (Jan)	--	0.6%
France			
08:45	Industrial Production MoM/YoY (Dec)	0.3%/1.7%	-0.9%/2.8%
08:45	Manufacturing Production MoM/YoY (Dec)	0.3%/1.7%	0.4%/2.8%
Italy			
10:00	Industrial Production MoM YoY (Dec)	0.3% / 1.4%	-0.5% / 0.9%
Norway			
10:00	CPI Underlying MoM/YoY (Jan)	0.0%/3.0%	-0.2%/3.0%
10:00	CPI (Jan)	0.0% / 2.4%	-0.4% / 2.3%
Events			
14:30	Fed's Yellen to Appear Before House Financial Services Committee		
15:00	ECB's Praet Speaks on the Lender of Last Resort in Washington		
19:30	Fed's Williams Speaks on Health and the Economy in LA		
Germany			
Schatz Auction (€5B Mar 2018) (11:30)			
US			
10Yr Notes Auction (\$23B)			
Quarterly earnings release from Tesla Motors (Aft-mkt), Cisco (Aft-mkt), Heineken (07:00), Telenet (07:00)			

10-year	td	-1d	2-year	td	-1d	STOCKS	-1d
US	1,72	0,02	US	0,70	0,04	DOW	16014 16014,38
DE	0,24	0,02	DE	-0,51	0,02	NASDAQ	for Exch - NQI #VALUE!
BE	0,61	0,04	BE	-0,43	-0,02	NIKKEI	15713 15713,39
UK	1,42	0,00	UK	0,31	0,05	DAX	8879,4 8879,40
JP	0,01	0,03	JP	-0,24	0,03	DJ euro-50	2737 2736,50

						USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	Eonia EUR	-0,237	0,005
3y	-0,125	0,850	0,791	Euribor-1	-0,24	Libor-1 USD	0,51	0,51
5y	0,063	1,101	0,968	Euribor-3	-0,17	Libor-3 USD	0,59	0,59
10y	0,609	1,592	1,429	Euribor-6	-0,11	Libor-6 USD	0,74	0,74

Currencies	-1d		Currencies	-1d		Commoditie	CRB	GOLD	BRENT
EUR/USD	1,1285	0,0083	EUR/JPY	129,52	0,90		156,5784	1189,61	30,88
USD/JPY	114,795	-0,03	EUR/GBP	0,7796	0,0025	-1d	-5,35	-1,49	-1,93
GBP/USD	1,447	0,0060	EUR/CHF	1,0973	-0,0058				
AUD/USD	0,7077	0,0038	EUR/SEK	9,4863	0,02				
USD/CAD	1,3901	-0,0039	EUR/NOK	9,6739	0,06				

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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