Sunrise

Friday, 19 February 2016

Rates: Bonds rally despite only modest profit taking in equities and oil

Sentiment on bond markets remains very robust, suggesting that the recent rebound of riskier assets is still built on shaky foundations. We stay positive on bonds, but after yesterday's juicy gains, a pause might be needed, especially should equities return higher or if US inflation is sharply up.

Currencies: Dollar running into resistance as risk-on trade fades

Yesterday, the dollar initially gained of few ticks against the euro, but the gains evaporated later as equities and oil turned south. Today, a strong US CPI might be slightly USD supportive. Sterling traders look out for the outcome of the EU/UK negotiations.

Calendar

Headlines

- **US Equities failed to safeguard early gains as the oil price dropped lower again.** The S&P ended 0.47% down led by energy shares. This morning, **Asian shares trade mixed. Chinese stocks reversed their gains** after messages that the PBOC raised the RRR for several banks.

- **China's central bank will boost the amount of reserves that must be locked away by some banks that recently increased lending too quickly**, people familiar with the matter said. Regional banks are among the lenders affected by the increase.

- **Negotiations between the UK and fellow EU leaders will continue today** as UK PM Cameron encountered goodwill from his EU counterparts, but also ran into resistance from eastern European states over demands for more welfare curbs on non-British citizens.

- **Confidence at Japanese manufacturers remained subdued in February** and the mood was expected to deteriorate over the coming three months, the Reuters Tankan showed this morning, with also sentiment in the services sector weakening.

- **Crude oil reversed its gains yesterday** as data from the US Energy Information Administration showed a record increase in US crude stocks. The Brent oil price trades currently around $34/barrel, while the WTI hovers around $30.50/barrel.

- Today, the **eco calendar** contains the UK retail sales, US CPI inflation data and European Commission's consumer confidence. **EU Leaders will conclude the anti-Brexit Summit.**

Rates

Core bonds rallied nicely, despite profit taking equities

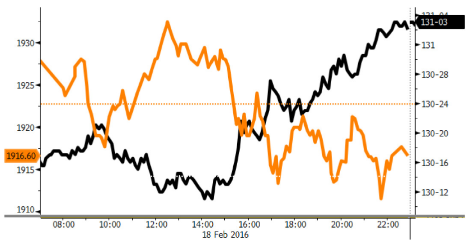
Core bond rally ebullient despite only modest losses equities and oil (profit taking)

Curves flatten sharply

Yesterday, global core bonds initially traded with a marginal downward bias, but held strong amid rising equities, a higher oil price and better US eco data. As the US equity session got going, risk sentiment soured affecting equities and oil negatively and allowing bonds to eke out juicy gains. Higher US oil inventories played some role, but the core bond rally was more vigorous than could have been expected given the modest losses for equities and oil. Also in previous days, when equities rallied sharply, bonds performed better than would normally have been expected. It suggests a very robust bond sentiment. The US eco data, claims and Philly Fed were okay, but without much impact. The **Minutes of the ECB meeting** were dovish: *"The point was made that, in a situation where risks were predominantly on the downside and new downside risks were emerging, it would be preferable to act pre-emptively, taking emerging risks into account, rather than to wait after risks had fully materialised".* The 30-yr TIPS went terrible (not a bond favourable factor), but couldn't stop the autonomous core bond rally. **In a daily perspective**, the German and US yield curves flattened. German yields fell between 0.9 bps (2-yr) and 5.8 bps (30-yr), while US yields dropped 4.9 bps (2-yr) to 7.9 bps (30-yr). The US eco data, claims and Philly Fed were okay, but without much impact. On intra-EMU bond markets, 10-yr yield spread changes versus Germany were very small except for Greece (-40 bps).

Fed Williams takes on a quite hawkish stance, as he put aside the turmoil and sees a strong US economy

San Francisco Fed Williams said that the US and global outlook hasn't changed despite the latest market upheaval and still expects a gradual normalization of Fed policy. The US economy is doing fine, the labour market is strong and inflation is a bit low due to global factors. While he advocated gradual tightening, he declined to comment on his specific rate forecast. He said negative rates could be in the toolbox, but emphasized they were not needed in the current context. **Williams is now clearly positioned on the more hawkish side of the FOMC aisle**.



T-Note (black) and S&P future (orange) (intraday): Strong bond rally amid modest profit taking equities

US 10-yr yield (LT): Back lower and not too far from key 1.60% level. Drop below would be surprising but not impossible

Upside risks US CPI and EMU consumer confidence

Fed Mester & ECB Constancio speak

EU Summit on UK concludes

Focus on US CPI and EU Summit

Negative base effects stemming from last year's drop in the oil price will have a major impact on **January US inflation data**. While CPI inflation is expected to have dropped by 0.1% M/M, the annual reading is forecast to increase from 0.7% Y/Y to 1.3% Y/Y. Core inflation, on the contrary, is expected stable at 2.1% Y/Y, despite a limited increase in the month-on-month data (0.2% M/M). Following significantly higher PPI inflation data, we believe that **also CPI might surprise on the upside.** In the euro area, **consumer confidence** is expected to have weakened further in February, with the consensus looking for a drop from -6.3 to -6.6. We believe that the **risks are for an upward surprise** following the dip at the start of the year.

Today: Underlying sentiment remains positive

Overnight, Asian markets trade mixed with Japan underperforming on the back of a stronger yen and a weak All Industrial Activity Index. The PBOC said to raise the reserve requirement ratio for banks that boosted lending too fast which is pulling Chinese bourses lower as we head into the end of Asian dealings. The US Note future trades higher, suggesting a somewhat stronger opening for the Bund as well.

Today's eco calendar contains US CPI data and EMU consumer confidence. Risks are on the upside of expectations, but it remains doubtful whether higher US inflation will weigh on US Treasuries. **Over the past trading sessions, it became clear that core bond market sentiment remains very favourable.** Losses on the back of higher stocks, higher oil prices and better data remained very limited. (Hawkish) Cleveland Fed Mester speaks and is expected to confirm her hawkish views. That shouldn't surprise or influence markets. **Risk sentiment, oil prices and technical factors will continue to be the main trading factors in an environment of positive underlying sentiment.**

Technically, the US Note future's first test to drop below the steep uptrend line failed, suggesting still some momentum. Nevertheless, we expect sideway trading ahead, roughly between 129 and 133. The picture for the Bund is more or less similar.

German Bund: Range trading ahead?

US Note future: First failed test to break below steep uptrendline suggests ongoing positive momentum

Currencies

Dollar rebound stalls as oil declines

Dollar rebound running into resistance as oil returns gains

On Thursday, the dollar initially gained ground further against the euro as sentiment on risk remained constructive and as oil extended gains. The gains of USD/JPY were negligible as were the moves in the bond market. US data (Philly Fed, claims) were marginally better than expected, but had only a marginal impact on USD trading. Later in the session, oil even declined after high US inventory data. This decline of oil weighed on overall market sentiment and also broke the positive USD momentum. EUR/USD closed the session off the intraday lows at 1.1107 (from 1.1128). USD/JPY ended the session in the red at 113.24 (from 114.10).

Asian equities join modest correction in the US.

USD/JPY is hit the hardest

Losses of dollar against the euro remain modest.

Overnight, Asian equities trade mostly lower, reacting to the price action in the US yesterday evening and to the correction in the oil price. Japanese equities underperform with losses of about 1.5%. USD/JPY dropped temporarily below 113 this morning, but currently trades again in the 113.15 area. The japan all industry index declined more than expected, it was no big issue for trading on Japanese markets. The PBOC put the fixing of the yuan against the dollar slightly weaker at 6.5186. Both the CNY (currently 6.5203) and the CNY (6.5250) trade slightly weaker on a daily basis. Still yuan overnight lending rates in Hong Kong jumped sharply higher today. This might be the result of tighter liquidity due to PBOC interventions in the off-shore market. The PBOC also announced that it will raise the Reserve Requirement Ratio for banks that boosted lending too fast. In the end, the Chinese currency still trades substantially stronger in a weekly perspective. The easing in the risk-off sentiment is also a slightly negative for the dollar against the euro. EUR/USD trades currently in the 1.1115 area.

EUR/USD: decline halts ahead of 1.1060/70 support

USD/JPY declines on oil/equity setback

Eco calendar is modestly interesting

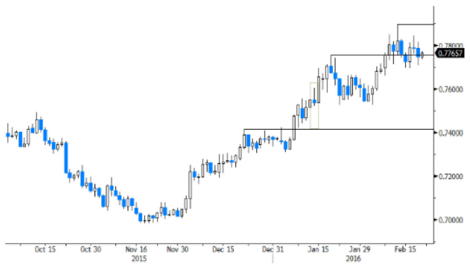
US CPI data in focus today

Today, the EU consumer confidence and the US CPI will be published. EU consumer confidence is expected marginally softer at -6.6 from -6.3, but we see a slight upward risk. US headline CPI is expected at -0.1% M/M and 1.3% Y/Y. Core CPI is expected at 0.2% M/M and 2.1% Y/Y. **We see upside risks for both measures. If so, it could be positive for the dollar.** It's not yet a big issue for (currency) markets, but higher inflation data might cause some unease with the very 'flat' FF strip curve discounting the path of future Fed rate hikes. The global context will also play its role for USD trading. The decline in oil and the slight setback on the equity markets is a slightly negative for the dollar. This applies in the first place to USD/JPY. This cross rate recently struggled to profit from an improved sentiment on risk and is vulnerable even in case of a limited setback. **Of late, EUR/USD was far less affected by this dynamics. So, we assume some consolidation in EUR/USD after the recent modest gains.** Apparently, there is a real/substantial trigger needed to push this pair below the 1.1060/70 support. The EU/UK negotiations are outside risk, also for EUR/USD trading. A failure could also weigh on the euro. But this is not our preferred scenario.

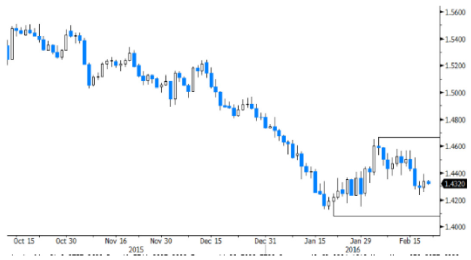
From a technical point of view, EUR/USD broke above the 1.1060/1.1124 area (15 Dec top/62% retracement). This was USD negative. The correction high stands at 1.1376. Next important resistance kicks in at 1.1495.We see some short-term topping out process in EUR/USD with room for a correction lower in the range. **USD/JPY dropped below the key 115.98 pre-BOJ low.** Japanese officials warned on potential action, putting a short-term floor under the pair. Even so, it remains vulnerable if global tensions resurface**. Any rally might soon run into resistance . The 115.98 previous low is a first technical resistance.**

Sterling awaiting the outcome of EU/UK negotiations

On Thursday, the downside in the UK currency was protected as oil extended its gains. Mid-morning., **BoE deputy Governor Cunliffe said he couldn't see anything in the past three or four weeks to warrant the shift in UK interest rate expectations, pushing BoE rate hike expectations back to 2019**. Sterling gained a few ticks after the Cunliffe headlines. Around noon, sterling extended gains as EU's Juncker said he was confident that an anti-Brexit deal would be reached at the EU Summit. There were still headlines on pending issues around financial supervision and safeguards for London's financial sector. However, this time, sterling traders were apparently more convinced by the positive headlines. Still, the sterling rally eased later in the session. EUR/GBP closed at 0.7747 (from 0.7786). Cable closed session at 1.4337 (from 1.4294).



EUR/GBP: sterling awaiting the outcome of the EU/UK negotiations



GBP/USD: holding in the lower part of the established range

Today, the UK retail sales are expected to rebound (0.7% M/M and 3.5% Y/Y) after a setback in December. We don't have strong arguments to take a different view from the consensus. Usually, this is an important figure for sterling trading. A good figure might still be slightly positive for sterling**, but the focus will be on the outcome of the EU/UK Summit.** The negotiations will resume this morning. Markets are apparently positioned for a scenario that an agreement will be reached anyway. Of course, the question is whether the deal will be good enough for Cameron to go to a referendum. No deal will cause losses for sterling, but may also be a negative the euro against the likes of the yen and the dollar. **We stay cautious on sterling until there is more clarity on the EU/UK negotiations as there is too much binary risk, not only on the fact of reaching an agreement but also on the content of the deal. The medium term technical picture of sterling against the euro remains negative as EUR/GBP broke above the 0.7493 Oct top. First resistance stands at EUR/GBP 0.7898.** A return below EUR/GBP 0.74 would be a first indication that sterling enters calmer waters.

Calendar

Friday, 19 February		Consensus	Previous
US			
14:30	**CPI MoM/YoY (Jan)**	**-0.1%/1.3%**	**-0.1%/0.7%**
14:30	**CPI Ex Food and Energy MoM/YoY (Jan)**	**0.2%/2.1%**	**0.1%/2.1%**
14:30	Real Avg Weekly Earnings YoY (Jan)	--	1.6%
Canada			
14:30	Retail Sales MoM (Dec)	-0.9%	1.7%
14:30	CPI MoM/YoY (Jan)	-0.1%/1.8%	0.1%/1.6%
14:30	CPI Core MoM/YoY (Jan)	0.2%/1.9%	-0.4%/1.9%
Japan			
05:30	All Industry Activity Index MoM (Dec)	A: -0.9%	-1.0%
06:30	Tokyo Dept Store Sales YoY (Jan)	A: 0.2%	2.2%
06:30	Nationwide Dept Sales YoY (Jan)	A: -1.9%	0.1%
UK			
10:30	**Retail Sales Ex Auto Fuel MoM/YoY (Jan)**	**0.7%/3.4%**	**-0.9%/2.1%**
10:30	**Retail Sales Inc Auto Fuel MoM/YoY (Jan)**	**0.8%/3.6%**	**-1.0%/2.6%**
10:30	Public Finances (PSNCR) (Jan)	--	8.1b
10:30	Public Sector Net Borrowing (Jan)	-13.9b	6.9b
10:30	PSNB ex Banking Groups (Jan)	-12.3b	7.5b
EMU			
16:00	**Consumer Confidence (Feb A)**	**-6.6**	**-6.3**
Germany			
08:00	PPI MoM/YoY (Jan)	-0.3%/-2.0%	-0.5%/-2.3%
Belgium			
15:00	Consumer Confidence Index (Feb)	--	-4
Sweden			
09:30	Unemployment Rate SA (Jan)	7.1%	7.2%
Events			
10:00	**EU Leaders Conclude Summit in Brussels**		
14:00	**Fed's Mester to Speak at Global Interdependence Center**		
14:30	**ECB's Constancio Speaks in New York**		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	1,73	-0,07	US	0,70	-0,03	DOW	16413	16413,43
DE	0,20	-0,07	DE	-0,52	-0,02	NASDAQ	'or Exch - NQI	#VALUE!
BE	0,55	-0,07	BE	-0,41	0,00	NIKKEI	15967	15967,17
UK	1,43	-0,04	UK	0,36	0,00	DAX	9463,64	9463,64
JP	0,01	-0,01	JP	-0,22	-0,03	DJ euro-50	2895	2895,15

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	-0,244	0
3y	-0,125	0,861	0,850	Euribor-1	-0,25	0,00	Libor-1 USD	0,51	0,51
5y	0,035	1,097	1,010	Euribor-3	-0,19	0,00	Libor-3 USD	0,59	0,59
10y	0,566	1,573	1,441	Euribor-6	-0,12	0,00	Libor-6 USD	0,74	0,74

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,11195	-0,0030	EUR/JPY	125,73	-1,12		161,8898	1225,6	34,07
USD/JPY	113,09	-0,74	EUR/GBP	0,7766	-0,0036	-1d	3,02	17,00	-0,80
GBP/USD	1,4315	0,0033	EUR/CHF	1,1028	-0,0012				
AUD/USD	0,7112	-0,0034	EUR/SEK	9,3849	-0,08				
USD/CAD	1,3751	0,0089	EUR/NOK	9,5525	0,03				

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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