Sunset

Tuesday, 03 May 2016

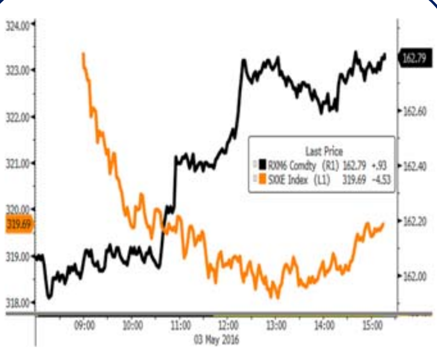
Headlines

- **European shares opened sharply lower this morning and remained close to their lows during the remainder of the session** in the absence of eco data or other important news items. **US Equities opened lower too** but losses are more contained (-0.7%).
- **France, Italy and Spain are set to miss the EU budget targets both this year and next without urgent government action, the European Commission forecasts showed.**Portugal will likely to be in breach of the EU budget rules too.
- **The UK manufacturing sector shrank for the first time in three years in April,** the manufacturing PMI showed, falling from 50.7 to 49.2, while a limited increase was expected. Companies attributed the deterioration in operating conditions to a softer domestic demand and a reduction in new business from overseas.
- **Spain's King Felipe dissolved parliament and called elections for June 26**, the second in six months after four months of fruitless coalition talks between Spain's four main parties.
- **Fed's Mester and Williams** are still scheduled to speak and both **Republican and Democratic primaries are held in Indiana.**

Rates

Core bonds profit from equity/oil weakness

Global core bonds had a better day, which wasn't always the case in the past days. They gained moderate ground as equities and the oil price dropped. The eco calendar was empty. The EU Commission Spring forecasts were interesting and slightly supportive for core bonds (see lower) as was a weak UK manufacturing PMI. Volumes traded remained thin though making it dangerous to draw longer term conclusions from today's price action. At the time of writing, the US yields were 4 bps (2-yr) to 7.4 bps lower, the belly outperforming (curve is virtually unchanged). The German yield curve bull flattened with yields down by 1.7 bp (2-yr) to 4.9 bps (30-yr). **On intra-EMU bond markets**, 10-yr yield spread changes versus Germany remained nearly unchanged with underperformance of Italy/Spain (+3 bps) and Greece (+15 bps). The spread widening occurred largely ahead of the publication of the EC Spring forecasts.



German Bund future (black) & EuroStoxx (orange) intra-day. Bund gains on equity (and oil) weakness.

Atlanta Fed Lockhart said a June rate hike is a real option, but he is still undecided on his voting intentions. He wants to see more eco data as the picture for Q2 is still very unknown. He added though that markets may be underestimating the odds for June action (currently 10% chance is discounted).

We consider his remarks as broadly neutral, but when he spoke, the T-note future added slight gains.

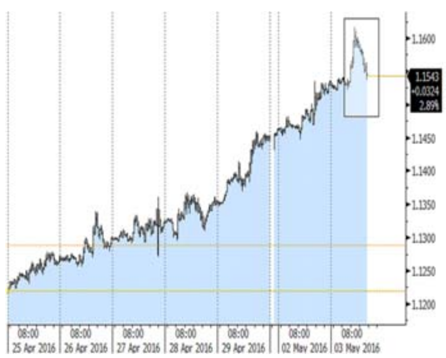
The EC Spring forecasts downgraded both the growth and inflation outlook compared to the Winter report, published in February. Inflation is now expected 0.2% in 2016 (versus 0.5% previously) and 1.4% in 2017 and growth was revised 0.1%-point lower to 1.6% and 1.8% in 2016/17. **The report was critical for Spain, Italy and France on the subject of deficits/debts.** Spain will miss its target for the 9th consecutive year in 2016, as it might come out at 3.9% and 3.1% in 2016/17, up from 3.6% and 2.6% predicted in February. This may open the way for further measures from the EC towards Spain later this month, including imposing a fine. Italy was under scrutiny too, as its public debt is expected to stabilize at 132.7% of GDP in 2016 and its structural deficit increases. Italy's growth was revised lower to 1.1% in 2016 from 1.4% previously. France is also not off the hook as its debt continues to rise amid slow economic growth.

Currencies

USD stop-loss selling intially persisted, but finally slowed

This morning, the repositioning out of the dollar initially continued. USD/JPY dropped to the mid 105 area. EUR/USD jumped temporary north of 1.16. The move was in the first place technically in nature as investors had to defend the break of key technical levels in USD/JPY and EUR/USD. Later in the session, the dollar reversed part of the early losses, but sentiment on the US currency remains fragile.

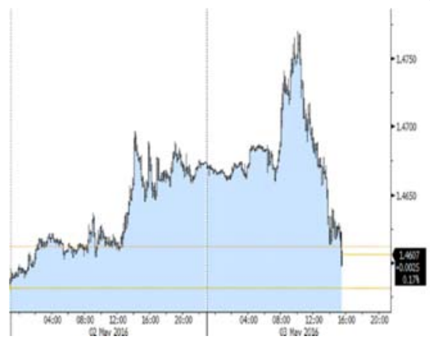
Overnight, the China **Caixa manufacturing PMI** declined from 49.7 to 49.4, but there was no lasting negative reaction of Asian/even Chinese equities. Asian equities traded mixed. Chinese indices even recorded modest gains. The **RBA cut its policy rate by 25 basis points** to 1.75%. The rate cut was executed as inflation remained lower than forecast and as the appreciation of the Aussie dollar complicated the economic adjustment. AUD/USD dropped from the 0.7720 area to set an intraday low around 0.7755. Later in the session, the Aussie dollar traded more in line with the global USD moves. Japanese markets were closed today but it didn't prevent further USD/JPY losses. The pair already traded in the high 105 area before the open of the European markets. EUR/USD was initially little changed in Asia trading near yesterday's close around 1.1535.



EUR/USD: (10 d). Dollar moving in oversold territory?

Contrary to what was the case in Asia, European equities opened in outright risk-off modus. **In this context a weakening dollar and declining European equities reinforced each other**. EUR/USD was squeezed sharply higher. A lot of investors apparently weren't positioned for the break beyond 1.15 and had further short-covering to do. EUR/USD set a new correction low in the 1.1615 area. Finally, the decline in equities and the dollar slowed. The EC reduced the EMU growth and inflation forecasts for 2016 and 2017. However, we doubt that this was the reason for the gradual intraday correction of EUR/USD. Technical considerations prevailed. USD/JPY set a correction low at 105.55 more or less at the same time of the intraday top in EUR/USD and rebounded gradually later on.

There were no important eco data in the US. Fed's Lockhart said that markets underestimate the chance of a June rate hike, but at the same time admitted that there were several factors of uncertainty including Brexit. At the margin the quotes might have helped the dollar to find a new short-term equilibrium, off the intraday lows. **EUR/USD trades currently in the 1.1555 area. USD/JPY rebounded to the 106 area. So, given the USD sell-off this morning, the intraday losses are now relatively modest.**



GBP/USD: sharp intraday reversal as PMI drops below 50

Sterling sold as manufacturing PMI drops below 50

Sterling was initially driven by the sharp swings in the dollar. In this move cable was also squeezed sharply higher. The pair set a multi-month top around 1.4770. EUR/GBP initially traded relatively stable in the mid 0.78 area. However, **the UK manufacturing PMI unexpectedly dropped in contraction territory (49.2).** A marginal improvement to 51.2 was expected. The report triggered a protracted intraday sterling downtrend, both against the dollar and the euro . Cable trades currently in the 1.4600 area. EUR/GBP filled offers above 0.79 ad trades currently around the 0.7900 big figure. The rebound of sterling is probably over, not only against the euro, but also against the dollar.

News

EU Commission lowers growth and inflation forecasts

In its Spring Economic Forecasts, the European Commission lowered its euro zone growth forecasts for both this year and next by 0.1% to 1.6% and 1.8% respectively. Growth will remain dependant on domestic demand, but its composition might shift somewhat from private consumption to investments. While private consumption should continue to benefit from improving labour market conditions and moderate wage growth, the expected gradual rebound in inflation will shave off a large part of nominal income growth. Investments should pick up as borrowing conditions have eased, capacity utilisation is above its long-term average, corporate deleveraging pressure is fading, and global demand is expected to gradually strengthen. Net trade was already a drag on growth last year and will remain so in 2016, the Commission expects, due to slow growth in export markets and the recent euro appreciation. Next year however, exports should turn neutral. Government consumption is also set to lose some momentum next year as the refugee crisis should ease. The **Commission also lowered its inflation forecasts from 0.5% to 0.2% for this year and from 1.5% to 1.4% for 2017.** This is mainly the result of the new drop in oil prices, but also core inflation failed to show a real upward trend. Underpinned by economic growth, the general government deficit is expected to decline further this year and next, but at a slower pace than previously expected due to costs related to the inflow of asylum seekers. **The commission warned that there remains substantial uncertainty and the economy is exposed to considerable downside risks** as slowing growth in emerging markets, abrupt moves in oil prices, turmoil on financial markets and uncertainty ahead of the UK referendum.

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,33%			0,21%			0,92%		
Greece	#VALUE!	#VALUE!	#VALUE!	8,60%	839	5,7	#VALUE!	#VALUE!	#VALUE!
Portugal	1,83%	216	2,4	3,09%	288	4,4	4,03%	311	5,3
Italy	0,36%	69	2,5	1,46%	126	5,2	2,58%	167	4,1
Spain	0,54%	87	2,1	1,57%	136	5,2	2,78%	187	4,4
Ireland	-0,03%	30	-0,5	0,89%	69	-0,1	1,84%	92	-0,1
Belgium	-0,27%	6	0,4	0,60%	40	1,4	1,67%	75	-0,8
France	-0,14%	19	-0,1	0,56%	36	1,0	1,52%	61	0,2
Austria	-0,31%	2	0,4	0,43%	22	0,8	1,40%	48	0,1
Netherlands	-0,35%	-3	0,1	0,44%	24	0,7	1,06%	14	-0,4
Finland	-0,19%	14	-0,2	0,51%	30	0,9	1,09%	17	-0,2
US	1,24%	157	-3,7	1,79%	159	-1,6	2,66%	174	-0,6
UK	0,93%	126	-0,5	1,54%	133	0,1	2,33%	141	-0,6

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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