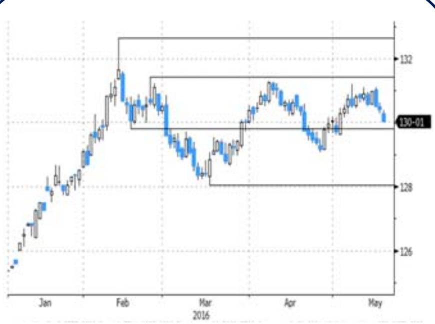
Sunset

Wednesday, 18 May 2016

Headlines

- **European shares opened lower this morning following the sell-off in the US yesterday**. Currently most European indices trade 0.5% down. **US equities opened slightly lower too.**
- **The European Commission deferred any disciplinary action against Spain and Portugal over their excessive budget deficits until after the Spanish elections**, but urged both countries to take further action to reduce their deficits this year and next and said they would review both countries' positions in early July.
- **According to the latest YouGov poll, the campaign to keep Britain in the EU has widened its lead over the "out" camp**. 44% wanted Britain to stay in the EU, compared with 40% who wanted the country to leave. **Another poll by Ipsos/MORI confirmed the campaign to keep Britain in the EU has taken a 18-point lead** over the out campaign.
- **The ECB should not discuss whether more policy action is needed until autumn**, **ECB's Vasiliauskas** said today, adding that they could buy more asset classes if needed.
- Later today, **the Fed will release the minutes of its April FOMC meeting.**

Rates



US Note future (YTD): topping off pattern. New downward correction as chances on a Summer rate hike increase again.

Front end US yield curve underperforms again

Today, global core bonds took a day off. Trading developed in very narrow ranges during European dealings amid an uneventful eco calendar. Final EMU CPI data were confirmed at -0.2% Y/Y for the headline reading and 0.7% for the core reading. **In the US session, global core bonds came under new downward pressure with the Note future underperforming the Bund. Oil and stock markets lost some ground but didn't impact trading.** At the time of writing, the German yield curve bear steepens with yield changes ranging between flat (2-yr) and +4.2 bps (30-yr). The US yield curve shifts 3.1 bps (5-yr) to 1.9 bps (30-yr) higher. The underperformance of the front end of the US curve continues following yesterday's hawkish Fed rhetoric and ahead of tonight's FOMC Minutes. Markets take into account a slightly higher chance of a Summer rate hike, triggering bear flattening of the US yield curve. The US 2-yr/10yr spread differential reached a new cycle low at 93 bps.

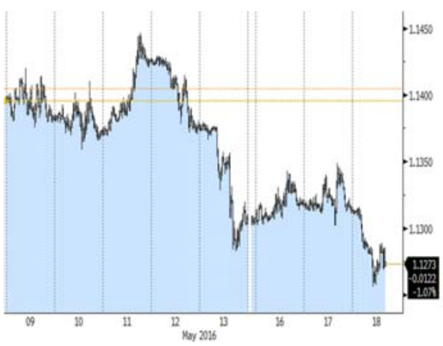
On intra-EMU bond markets, Spain, Portugal and Italy marginally outperformed. The 10-yr yield spread versus Germany narrowed 2 bps. The EC decided today not to fine these member states despite breaching budgetary rules. Instead they were given additional fiscal leeway. In a statement, the EC said: *"As regards Portugal and Spain, the Commission recommends to the Council to recommend a durable correction of the excessive deficit in 2016 and*

2017 respectively, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction." The EC warned Belgium, Italy and France that they didn't do enough to reduce their high debt levels, but it didn't start sanction procedures. Finally, Ireland, Cyprus and Slovenia left the excessive debt procedure.

Currencies

USD well bid ahead of the publication of the Fed Minutes

Today, the dollar still traded with a slightly positive bias as investors pondered the chance of a Fed Summer rate ahead of Fed Minutes (published later today). The downside of the dollar was well protected with slightly supportive interest rate differentials. EUR/USD trades currently in the 1.1270 area. USD/JPY holds relatively strong in the 109.40 area even as risk sentiment remains fragile.



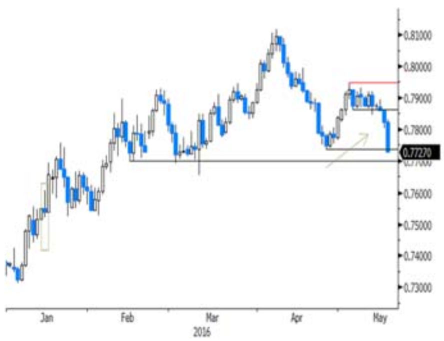
EUR/USD trends cautiously higher ahead of the Fed minutes

Overnight, Asian equities ex Japan traded in the red. Japanese Q1 GDP surprised on the upside of expectations with annualized growth of 1.7% Q/Q. Japanese equities outperformed the region early in the session, but gains evaporated later. USD/JPY found no clear direction and traded little changed in the low 109 area. Chinese equities showed substantial losses even as data suggested an acceleration in house prices (risk for a bubble?). EUR/USD dropped below the 1.13 barrier and tested the recent lows in the 1.1285 area at the start of European dealings.

European equities joined the downtrend from the US and Asia, but the losses were moderate. There was again no obvious logical link between equities on the one hand and bonds or the dollar on the other hand. Core yields grinded marginally higher, probably on recent Fed speak. The USD also ignored the negative risk sentiment and gradually extended gains against the euro and even against the yen. EUR/USD filled bids just below 1.1260. USD/JPY settled in the mid 109 area. The EMU inflation was confirmed at -0.2% Y/Y, but as usual had no impact on euro trading.

There were no data with market moving potential in the US. European equities/US equity futures struggled to avoid further losses. **At the same time, the dollar maintained most of its recent gains, supported by slightly higher US bond yields/interest rate differentials.** The 2-yr spread between the US and Germany rose further to 135/6 bp. EUR/USD trades currently in the low 1.1270 area. USD/JPY hovers in the 109.40/50 area. The focus for USD trading is now on the Fed Minutes that will be published later today. Markets will look for hints on the probability of a Fed Summer rate hike.

Markets, including sterling, signal lower Brexit risk



EUR/GBP tests 0.7735 support

Early in the session, sterling basically followed the trades in the euro and the dollar. Cable lost a few ticks on global dollar strength. EUR/GBP tested the 0.78 area driven by the decline of EUR/USD. A yougov poll in favour of the remain camp (44%/40%) was slightly supportive for sterling. Midmorning, the UK labour data were not too bad. Employment growth was stronger than expected. The wage data were mixed and the unemployment rate stabilized a multi-year low of 5.1%. In our view, the report was reasonably OK compared to the consensus. Even so, sterling lost temporary a few ticks but the setback was soon reversed. **A new poll indicating a lead for 'remain' and gave sterling a shot in the arm. EUR/GBP dropped sharply lower. The pair currently even tests first important support in the 0.7735 area.** Cable changes hands around 1.4585. The market is clearly repositioning for a reduced Brexit risk!

News

UK labour market data show a mixed picture

UK unemployment rate stayed unchanged at 5.1%.

In April, **UK jobless claims dropped unexpectedly**, falling by 2 400, while a further increase by 5 000 was expected. The downward surprise was however overshadowed by a significant upward revision to the previous month's data, which rose by 14 700 from an earlier reported 6 700. The unemployment rate stayed unchanged at 5.1% in the three months to March, in line with expectations. Looking at the details, unemployment dropped by 2 000, while employment increased by 44 000. Slightly disappointing were the vacancies, which dropped for the first time since the middle of last year. Wage data showed a mixed picture too. Average weekly earnings picked up from 1.9% Y/Y to 2.0% Y/Y in the three months to March, while earnings ex-bonus slowed from 2.2% Y/Y to 2.1% Y/Y in the same period. **The UK labour market data showed a mixed picture, but were overall quite close to the consensus. Although growth has slowed somewhat recently and taken into account the uncertainty ahead of the EU referendum, the British labour market remains in relatively good shape.**

16:00 CET

Daily EMU spread changes (bps)

	5-yr			10-yr			30-yr		
	Yield	Spread	Change	Yield	Spread	Change	Yield	Spread	Change
Germany	-0,36%			0,17%			0,88%		
Greece	#VALUE!	#VALUE!	#VALUE!	7,42%	725	2,0	#VALUE!	#VALUE!	#VALUE!
Portugal	1,87%	223	-0,6	3,09%	293	-1,3	4,08%	319	-4,0
Italy	0,36%	72	-0,4	1,47%	131	-1,4	2,63%	175	-5,0
Spain	0,54%	90	1,1	1,58%	142	-1,8	2,80%	192	-3,6
Ireland	-0,01%	35	0,9	0,85%	68	1,2	1,83%	95	0,4
Belgium	-0,30%	6	0,0	0,56%	39	0,2	1,62%	74	-0,6
France	-0,16%	20	-0,1	0,51%	34	0,2	1,48%	60	-0,5
Austria	-0,34%	3	-0,5	0,37%	20	0,1	1,38%	50	0,1
Netherlands	-0,38%	-2	-0,2	0,39%	22	0,1	1,02%	14	-0,3
Finland	-0,22%	14	0,2	0,44%	28	0,8	1,06%	17	-0,1
US	1,33%	169	1,6	1,80%	164	-0,2	2,63%	174	-2,0
UK	0,86%	122	4,6	1,44%	127	3,4	2,31%	143	2,3

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

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBCCORPORATES.COM/RESEARCH