KBC Market Research Desk - Havenlaan 12, 1080 Brussel

Sunrise

Thursday, 11 February 2016

Rates: Renewed equity weakness prevents bond correction

Core bonds are heavily overbought, but risk-off sentiment (equities, oil) keep benefiting core bonds. Yellen didn't give a helping hand to riskier assets, as she kept close to the remarks in the FOMC statement. Today, the calendar is uninspiring which means that risk sentiment will once again dominate.

Currencies: dollar fails to profit from Yellen comments

Yesterday, the dollar gained temporary ground against the euro as sentiment on risk improved and as Yellen kept the door open for further rate hikes. However, the gains couldn't be sustained. USD/JPY even extends its decline. Global market sentiment remains the key driver for USD trading. We look whether EUR/USD has started a topping out process.

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 reversed their gains in the final hour of trading** to end the session broadly unchanged. **Asian shares continue to suffer** this morning with Hong Kong stocks trading down by 5% following the Lunar New Year holidays.
- **Fed Chairwoman Yellen remained optimistic about the state of the US economy; although she added that uncertainty had increased, but did not back away from her policy gradual rate increases.** Overall, her tone was slightly more dovish, but she failed to give any clear guidance during the Q&A session.
- **EU President Tusk sounded alarm over populist politics bringing the bloc on the brink of suicide** as he said he was really afraid other EU leaders were ready to copy David Cameron's tactics for their own egoistic goals.
- **Gold prices rallied above $1200/ounce this morning** as sentiment in Asia remains risk-off with Hong-Kong shares opening sharply lower after the holidays.
- **Twitter failed to show any user growth in the fourth quarter** and the company said it even lost two million active users excluding those through messaging platforms. The company reported a loss of $90.2 million; excluding certain expenses, Twitter earnings were above expectation.
- The **eco calendar remains thin today** with only the US jobless claims. The **Swedish central bank will decide on rates** and **Fed Chairwoman Yellen will testify to the Senate Banking Committee**. Euro area Finance Ministers meet in Brussels and the supply agenda is well-filled.

Rates

	US yield	-1d
2	0,3663	-0,0002
5	1,426	0,0064
10	2,2111	0,0018
30	2,9849	0,0039

Core bonds end mixed, but sentiment remains positive

Italian and Spanish yield spreads narrowed, but Portugal and Greece continued to underperform.

US curve turns bear flattening into bull flattening, as equities slide lower.

	DE yield	-1d
2	-0,0420	-0,0090
5	0,1360	-0,0260
10	0,8530	-0,0140
30	1,7470	-0,0150

Yellen's testimony largely repeats last FOMC statement

Fed in wait-and-see, evaluating impact market turmoil.

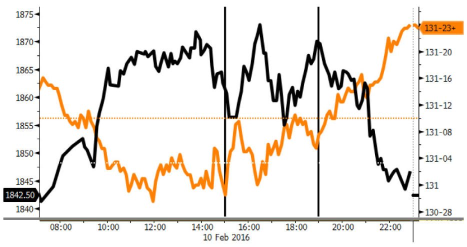
Eco calendar irrelevant

Renewed equity weakness prevent bond correction

Yesterday, global core initially fell prey to modest profit taking as risk sentiment on European stock markets improved, just like the day before. Yellen's comments for Congress were balanced, but the Fed chairwoman was slightly more dovish on the outlook. Maybe to the surprise of markets, she didn't explicitly exclude a March tightening. Therefore, the yield curve bear flattened slightly. However, US equities couldn't hold on to an early bid and slid again lower, erasing early gains. US Treasuries turned north and rallied to nice daily gains. The initial bear flattening turned to a robust bull flattening with yields 0.4 bps (2-yr) to 6.2 bps (30-yr) lower. The German yield curve ended nearly unchanged for tenors up to 10-yr with yields less than 1 bp higher. The 30-year yield added 2.6 bps. **On intra-EMU bond markets**, 10-yr yield spreads versus Germany narrowed 4 to 7 bps with Ireland outperforming. Greece and Portugal lagged with spread widening of 13 bps and 3 bps.

During US dealings, **Fed chairwoman Yellen's testimony** before Congress took centre stage. In her written statement, she sounded cautious on the US' economic outlook. Risks stem from China while financial conditions became less supportive (sliding equity prices, higher credit spreads, stronger dollar): *"These developments, if they prove persistent, could weigh on the outlook for economic activity and the labour market".* She added that the Fed still expects to raise interest rates gradually, but the Fed would likely move slower *"if the economy were to disappoint or faster if economy would strengthen more than anticipated"*. **Overall, her tone was slightly more dovish (on the outlook) compared with the January policy statement, but markets were maybe disappointed that she kept the door open for near term tightening (without any hint to the timing). The Q&A didn't bring market relevant information**

In the week ending the 6th of February, **US initial jobless claims** are forecast to have edged slightly lower following an uptick in the week before. Initial claims are forecast to have dropped by 5 000, from 285 000 to 280 000. We have no reasons to distance ourselves from the consensus. Claims might remain somewhat higher than in the fourth quarter, when they were probably depressed by favourable weather conditions.



US T-Note future (black) and S&P future (orange): Early correction reversed, even before equities slid lower again towards the end of the session

S&P: technical picture still precarious. A drop below 1800 could determinate the MT fate equities.

R2	153	-1d
R1	152,49	
BUND	**150,77**	0,19
S1	150,53	
S2	149,91	

Italy, Ireland and US tap the market

The Italian debt agency taps the on the run 3-yr BTP (€1.5-2B 0.3% Oct2018), the on the run 7-yr BTP (€2-2.5B 1.45% Sep2022) and the off the run 15-yr BTP (€0.5-1B 3.5% Mar2030). In the run-up to the auction, the bonds cheapened slightly in ASW spread terms. On the Italian curve, the Mar2030 BTP is rich, while the Sep2022 BTP trades slightly cheap. Given current market sentiment, it could prove to be a tough auction, but investors should eventually manage to digest the relatively low amount on offer. **The Irish treasury auctions the on the run 10-yr IGB (€1B 1% May2026).** The bond cheapened in ASW spread terms since the successful launch in January and also trades rich on the Irish curve. Nevertheless, sentiment towards Ireland remains strong and we expect no difficulties. **The US Treasury continued its mid-month refinancing operation with a mixed $23B 10-yr Note auction.** The bid cover was the smallest since last August, but the auction stopped well below the 1:00PM bid side. Bidding details showed solid buy-side demand (both direct and indirect bids), but a disappointing dealer bid. **Today, the Treasury ends its refinancing operation with a $15B 30-yr Bond auction. Currently, the WI trades around 2.5%.**

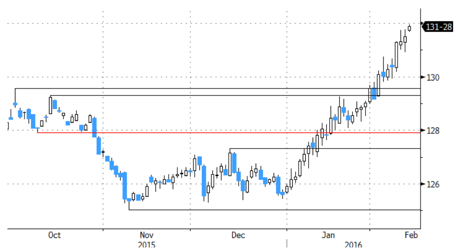
Today: Risk aversion still at play

Overnight, risk aversion is again name of the game with Asian stock markets lower (China and Japan are closed), a stronger yen and upwardly biased US Note future. This suggests a stronger opening for the Bund as well.

Today's eco calendar is empty apart from US weekly claims (irrelevant for trading) and Yellen's testimony (repeat of yesterday). **Risk sentiment and technical factors will continue to drive trading.** 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 (see graph above). 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 if risk sentiment improves**. This week, the latter was often the case during European dealings, while sentiment soured again in the US and Asia.

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, but risk aversion still dominates trading

Currencies

USD/JPY remains under pressure

Market sell-off stakes a pause, but it causes no sustained rebound of the dollar.

Yellen doesn't provide any clear guidance

On Wednesday, there were few eco data to guide currency trading. Risk sentiment improved temporary and provided some support for the dollar ahead of Fed Yellen's testimony before the House. Yellen kept a balanced approach. She acknowledged risks to the outlook. At the same time, the Fed still expects a path of gradual rate hikes. Initially, the dollar gained ground against the euro. However, the gains evaporated soon as US equities failed to extend gains. USD/JPY dropped below 114 to close the session at 113.35 (from 115.11). EUR/USD also reversed an earlier dip to close the session at 1.1292 almost unchanged from Tuesday (1.1293).

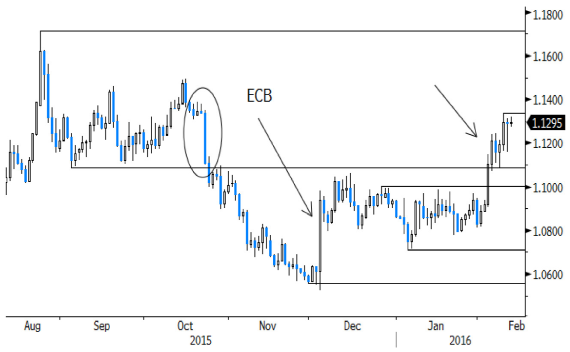
R2	1,2886	-1d
R1	1,2840	
EUR/USD	**1,2645**	-0,0082
S1	1,2606	
S2	1,2501	

This morning, several Asian markets return from the Lunar new year holidays. Mainland Chinese markets remain closed. Markets in Hong Kong and South Korea have some catching up to do on the recent decline in other markets. Japanese markets are closed but the yen remains under upward pressure. USD/JPY set an new correction low in the 112.54 area. EUR/USD is little changed hovering near the 1.13 pivot.

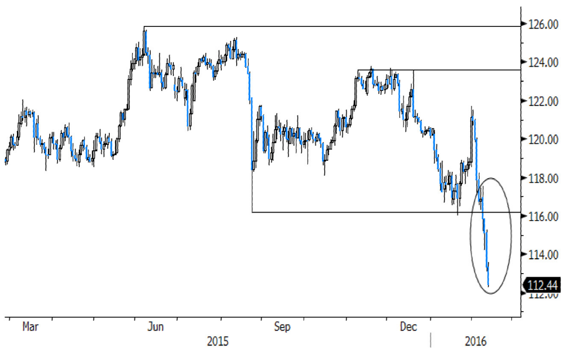
There are again few eco data to guide currency trading

The dollar remains at the mercy of global market swings.

Today, there are again very few eco data with market moving potential in Europe and in the US. The US jobless claims are expected to decline slightly from 285 000 to 280 000. The report might have some intraday impact on currency trading, but it is no trend-setter. Fed's Yellen will attended the second part of her hearing before Congress. Yesterday's hearing before the house didn't bring a high profile guidance for USD trading. So, currency traders will again have to look for clues from global markets trading.



EUR/USD: hovers up and down in the 1.13 area



USD/JPY: sell-off continues

Tion

Over the previous days, **global markets showed diffuse, instable trading dynamics.** Some markets (like oil) showed a temporary pause in the downtrend, but sentiment remains very fragile. The same applies for the developments in the credit markets and stress in the financial universe. It will probably take quite some time for all this markets to find a new equilibrium. At the same time, US bond yields remain on a downward trajectory. **A sustained directional rebound of the dollar remains difficult in this context even as Fed's Yellen kept the door open for further rate hikes.** USD/JPY obviously is most vulnerable in this process. EUR/USD is holding within reach of the recent highs, but for now the losses of the dollar against the euro remain limited. Of course, Europe/the euro has its own issues that make it difficult for the single currency to play its role as preferred safe haven (stress in the financial sector, gradually rising tensions/spread widening in the periphery, deeply negative interest rates). Admittedly, the drivers behind the price moves in EUR/USD weren't always clear of late. However, **we don't see a big case for the euro to be a better safe haven than the dollar**. 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 looking for a topping out process in EUR/USD. **The picture for USD/JPY improved temporarily 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.**

Sterling decline takes a breather

R2	0,8153	-1d
R1	0,8066	
EUR/GBP	**0,7877**	-0,0016
S1	0,7850	
S2	0,7755	

Yesterday's easing of global tensions also calmed selling pressure on sterling. This rebound was again driven by global market sentiment. The UK production data disappointed. **Sterling temporary lost a few ticks upon the publication of the report, but soon extended its intraday comeback as global sentiment improved.** EUR/GBP touched an intraday low in the 0.7713 area but rebounded as the risk-on correction ran into resistance later in the session. The pair closed the session at 0.7775 (from 0.7803). Cable also returned north of 1.45 to set an intraday top in the 1.4578 area. However, cable lost some ground later in the session. The pair closed the session at 1.4522 (from 1.4472).

Overnight, the RICS house price balance was weaker than expected at 49%. Later today, there are no important eco data. Sterling trading will again be driven by global factors. There are no really high profile signals this morning, but sentiment remains fragile. So, a sustained further rebound of sterling is far from evident in a daily perspective. The most recent headlines on the Brexit-negotiations also suggests some obstacles in the process. **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 EUR/GBP 0.7854/75.** A return below EUR/GBP 0.74 would be a first indication that sterling enters calmer waters.

EUR/GBP holds near the recent top

GBP/USD: decline to slow?

Calendar

Thursday, 11 February		Consensus	Previous
US			
14:30	**Initial Jobless Claims**	**280k**	**285k**
14:30	**Continuing Claims**	**2245k**	**2255k**
Canada			
14:30	New Housing Price Index MoM/YoY (Dec)	0.2%/--	0.2%/1.6%
UK			
01:01	RICS House Price Balance (Jan)	A: 49%	R: 49%
Sweden			
08:00	PES Unemployment Rate (Jan)	4.3%	4.2%
09:30	**Riksbank Interest Rate**	**-0.45%**	**-0.35%**
09:30	Average House Prices (Jan)	--	2.677m
Events			
11:00	Swedish Riksbank Monetary Policy Press Conference		
12:30	BoE's Cunliffe, Bailey Speak in London		
15:00	**Euro Area Finance Ministers Meet in Brussels**		
16:00	**Fed's Yellen to Appear Before Senate Banking Committee**		
Ireland	**Bond Auction (€1B 1% Jun2026)**		
Italy	**BTP Auctions (€1.5-2B 0.3% Oct2018, €2-2.5B 1.45% Sep2022, €0.5-1B 3.5% Mar2030)**		
Sweden	I/L Bond Auction (SEK1B 0.125% Jun2026)(11:03)		
UK	Gilt Auction (£1.5B 3.5% 2045) (11:30)		
US	**30Yr bond auction ($15B)(19:00)**		
	Quarterly earnings release from PepsiCo Inc (12:30), Societe Generale (06:46), Nokia (07:00), Total , Rio Tinto,		

10-year	td	-1d	2 -year	td	-1d	STOCKS		-1d
US	2,21	0,00	US	0,37	0,00	DOW	16461	16461,32
DE	0,86	-0,01	DE	-0,04	-0,01	NASDAQ	ermissioned	#VALUE!
BE	1,22	-0,02	BE	0,03	-0,01	NIKKEI	15139	15138,96
UK	2,20	0,03	UK	0,65	-0,01	DAX	8940,14	8940,14
JP	0,48	-0,01	JP	0,04	-0,01	DJ euro-50	3009	3008,53

							USD	td	-1d
IRS	EUR	USD (3M)	GBP	EUR	-1d	-2d	Eonia EUR	0,017	0,005
3y	0,288	0,990	1,353	Euribor-1	0,01	0,00	Libor-1 USD	0,50	0,50
5y	0,461	1,587	1,745	Euribor-3	0,08	0,00	Libor-3 USD	0,55	0,55
10y	1,102	2,326	2,290	Euribor-6	0,19	0,00	Libor-6 USD	0,68	0,68

Currencies		-1d	Currencies		-1d	Commoditie	CRB	GOLD	BRENT
EUR/USD	1,2645	-0,0082	EUR/JPY	135,6	-0,43		270,3511	1243,8	84,8
USD/JPY	107,23	0,31	EUR/GBP	0,7875	-0,0017	-1d	-2,65	-4,40	-1,51
GBP/USD	1,6053	-0,0066	EUR/CHF	1,2064	-0,0004				
AUD/USD	0,8761	-0,0026	EUR/SEK	9,199	0,00				
USD/CAD	1,1251	0,0035	EUR/NOK	8,3642	0,01				

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