

Danske Daily

Market movers today

- **While the majors calendar is very thin, today marks another Scandi inflation day with the monthly inflation release in Sweden due.** We expect both CPI and CPIF to print 0.2pp below the Riksbank's forecast, marking the beginning of our inflation forecast divergence. For more details see the Scandi Markets section.
- In the **US**, weekly jobless claims data are due. While a volatile series, markets will look for a reversal following last week's highest print in five weeks, albeit the four-week moving average still points to a strong US labour market.

Selected market news

In **Norway**, the **NOK** has rallied significantly following yesterday's much higher-than-expected inflation release (core measure jumping from 3.1% y/y to 3.7% in July). Overall, the print see inflation return as a key factor in the Norges Bank's rate setting calculations amid a prolonged shift of focus towards domestic growth and employment. Indeed, yesterday's print alone should (from a historical perspective) lift Norges Bank's rate path in September by close to a full hike (25bps) which is why a substantial amount of rate cut expectations has been priced out in NOK rates. On the other hand, the Nibor-policy rate spread widening (see *Strategy: The US Money Market Reform - The Scandi angle*, 10 August) alone would counter this effect. Moreover, the move in NOK, which is now also marginally stronger than-expected, should also have a marginal negative effect on the rate path. This leaves a very tight housing market (especially in Oslo) on the one hand, but also a lower oil price and the uncertainties related to the spill-over effects from Brexit. Finally, it is key to remember that in June Norges Bank signalled a '100% probability' of a cut under a Breman scenario. All in all, yesterday's inflation print makes the coming month's data highly decisive but at this stage we still think it is too early to rule out a September cut.

Overnight, the **UK's RICS housing market survey** for July showed a rebound in the expectations index for the next three months. Yet the survey – usually quite a good indicator – still points to a sharp decline in both housing market activity and prices (see *tweet* for illustration).

In the August *Bank of England agents' summary*, **UK** company respondents turned more negative on the business outlook than in the July survey that covered only a small post-Brexit period. Specifically, the respondents stated that “*the result of the EU referendum would have a negative effect, overall, on capital spending, hiring and turnover over the coming year*”. The manufacturing sector notably reported that the exports decline had been halted by the GBP depreciation.

After Tuesday's gilt purchase shortfall, the **Bank of England (BoE)** yesterday reported that the bank intends to cover the relatively small gap-to-target at a later stage as it made no changes to its revived government bond purchase programme of GBP60bn. The failed reverse auction had led to speculation that the bank could run into trouble finding sufficient bonds to buy, albeit thin summer liquidity was arguably a factor. Meanwhile, yesterday's gilt operation was fully covered.

As expected, the **Reserve Bank of New Zealand** cut the cash rate by 25bp to a record low of 2.00% while signalling more easing to come. As rates markets had priced a 20% probability of a 50bp cut at yesterday's meeting, the NZD rose on the release with NZD/USD up c. 0.75% at the time of writing.

Selected readings from Danske Bank

- *The MM reform - the Scandi angle*
- *Flash Comment: China holiday wrap-up: sentiment improving*
- *Flash Comment US: Another strong job report makes it more likely Fed will hike in H2 16*
- *Strategy: Central bank fatigue gives way to fiscal stimulus*
- *IMM Positioning Update*
- *Strategy - What US investors think and how we differ*

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- *Weekly Focus*

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Scandi Markets

In **Sweden**, July inflation will be released. We expect both CPIF and CPIF excluding energy to be 0.2pp below the Riksbank's forecasts. Indeed, from today's print onwards we see a quite different path than the Riksbank's, with a gradual divergence of our forecasts. In our view the inflation trend has turned down after peaking in H1. Our long-standing view is that 1) domestic price pressure is contained by low wage costs – only rising due to repeated tax hikes (alcohol, tobacco and energy taxes, congestion charges and reduced ROT renovation subsidy) over the past years and 2) import prices are falling again as the SEK is no longer depreciating on a trend basis. There is also a downside risk related to oil: it appears as if the pattern of the past two years is being repeated, implying lower prices in autumn.

Fixed income markets

The main focus today is on the **Swedish inflation data** especially after the upward surprise in the Norwegian inflation data yesterday. We expect underlying inflation to decline by 0.2% m/m – this is well below the Riksbank's projected path. If we are right, it is supportive for SGBs even though we have seen a solid performance against EU peers – but, as seen yesterday, there was decent demand at the auction for the old 10Y and 30Y benchmarks. This also coincides with a solid rise in the foreign investor share of the SGB markets, which is to some extent driven by Japanese investors as shown by the BoJ data. Japanese investors have bought some SEK15-16bn in SGB since the start of 2016.

In the **European fixed income** market the rally continues and spreads are grinding lower. Yesterday's Bund auction produced a new record low yield for the Bund auction while the bid-to-cover was higher than the previous auctions. Therefore there is 'demand' as the ECB continues to 'vacuum' the EGB market for bonds, combined with modest supply in August. The market has also been supported by the bullish UK treasury market since the Brexit vote, even though there has been some uncertainty over the BoE's QE programme in the past couple of days after the reverse auction on Tuesday at which the BoE did not manage to buy what it needed. It was back to normal yesterday at the reverse auction of 7Y to 15Y gilts which was oversubscribed 4.7 times.

We have been fairly "quiet" regarding **Danish government bonds** and T-bills – but they remain attractive swapped into USD. The Danish central bank has been a solid buyer of the bonds for the government funds, such as the Social Pension fund as well as the government's own portfolio, and has bought DKK36bn since the start of the year. Even so, the government's account is still well above the target of DKK100bn set out by the Ministry of Finance. The purchases by the Danish central bank are not really a QE programme, as it is not expanding liquidity in the manner of the ECB as it spends money on the government account. But the Danish central bank is to some extent vacuuming the front end as well as the DGB 4% '19 and DGB 1.5% '23.

In terms of **Danish mortgage bonds**, prepayments for the October mortgage payment date total DKK49.75bn. The DKK49.75bn total includes DKK46.28bn in the fixed-rate callable segment, which is at the high end of our prepayment forecast range of DKK35-50bn. In the fixed-rate callable mortgage bond segment, prepayments in the 3% and 3.5% segments represent the bulk of the total. Looking at average prepayment rates (average for RD, Nykredit and Nordea Kredit) for the individual bond series, the 3%, 3.5% and 4% tenors have generally witnessed the highest prepayment rates. The high level of prepayment activity in July was accompanied by generally increased issuance of callable mortgage bonds. July issuance of callables totalled DKK33bn, broadly matching our expectation of DKK34bn. As such, callable issuance in July seems consistent with prepayment volume. Hence, there are no indications so far of any huge refinancing out of terminated ARM loans and into fixed-rate loans (via rate-hedging

agreements). For more details see *Danish Mortgage Bonds – Fewer callables and focus on forthcoming ARM and floater auctions.*

FX markets

EUR/SEK was also dragged lower by the rally in the NOK yesterday (see Selected Market News for NOK comment) and EUR/SEK fell to its lowest level since mid-July despite the release of weak Swedish industrial production data. Today, Swedish CPI figures will be in the spotlight. Given our call that both the CPIF and the CPIF excluding energy will print 0.2pp below the Riksbank's forecasts, this could in isolation be bullish for EUR/SEK. However, we still expect the SEK to perform in the near term driven by pent-up demand from natural SEK buyers which should help it to claw back most of its summer losses in the weeks to come.

In the majors, **EUR/GBP** once again inched higher as the BoE continued its asset purchase operations. Yesterday, it reached its buying target after supply fell short on Tuesday. We still expect GBP to remain under pressure in the coming months, targeting EUR/GBP at 0.90 in 6M. However, following the past six days of consecutive gains, EUR/GBP now looks increasingly overbought according to short-term technical indicators, such as RSI. The BoE has completed its asset purchase operations this week and the bank will resume buying government bonds on Monday. This could ease some of the downward pressure on UK interest rates and GBP in the coming days. Our bearish view on GBP is not just a story of monetary policy easing in the UK, but more importantly, a macroeconomic story about the adjustment of a large current account imbalance. Hence, we would look for opportunities to buy EUR/GBP on corrections lower.

EUR/USD broke above 1.1150 yesterday for the first time since last week's strong US labour market report. In recent months there have been many reasons for EUR/USD to fall including strong US NFP data and a repricing of the Fed, but the price action is telling. The Europe-US current account differential is back at 2004-2006 levels and the EUR is fundamentally cheap. This implies that the 'natural flow' in EUR/USD is buying of EURs and selling of USD. Political risk in Europe may not matter much as slowing European growth and bank de-leveraging may just be EUR supportive. We thus expect EUR/USD to trade in a 1.10-1.14 range near-term, breaking higher medium-term.

Key figures and events

Thursday, August 11, 2016

				Period	Danske Bank	Consensus	Previous
1:01	GBP	RICS house price balance	Index	Jul		0.1	0.2
8:00	SEK	PES unemployment	%	Jul			3.8%
8:45	FRF	HICP, final	m/m/y/y	Jul		-0.4% 0.4%	-0.4% 0.4%
9:30	SEK	Underlying inflation CPIF	m/m/y/y	Jul	-0.2% 1.1%	-0.1% 1.2%	0.1% 1.5%
9:30	SEK	CPI	m/m/y/y	Jul	-0.2% 0.8%	-0.2% 0.8%	0.1% 1.0%
10:00	ITL	HICP, final	m/m/y/y	Jul	... -0.1%		... -0.1%
14:30	USD	Initial jobless claims	1000			265	269
14:30	USD	Import prices	m/m/y/y	Jul		-0.3% -4.3%	0.2% -4.8%

Source: Bloomberg, Danske Bank Markets

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