

Danske Daily

Market movers today

- We expect an unchanged key rate at the MPC meeting at Norges Bank today. In June, Norges Bank indicated an almost 100% probability of a cut in September but the risk outlook has since changed significantly. For one thing, there are now clear signs that growth in the Norwegian economy is picking up and that the risk of a deeper and more protracted downturn has decreased greatly. Second, the housing market tightened considerably over the summer, with significant price increases, high turnover and limited supply. This means that a further rate reduction is no longer necessary when it comes to growth and is also less desirable when it comes to the housing market, given the risk to financial stability.

Selected market news

The outcome of the meeting in the Federal Reserve Open Market Committee (FOMC) yesterday was much in line with market expectations. The federal funds target was kept unchanged as expected by us, consensus and in line with the market only pricing in a 10% probability of a 25bp hike. Furthermore, the FOMC projects a 25bp hike later this year, which is also in accordance with market pricing of around a 50% probability of a rate hike in December. Consequently, the market reaction was relatively muted. EUR/USD rose slightly towards 1.12 and US treasury yields posted small declines, leading US stocks and the oil price marginally higher.

Regarding the oil market, the weekly inventory data from the US Energy Information Administration showed a large decline of 6.2mb last week. The numbers further indicated that US crude production rose for the second consecutive week, suggesting that oil demand is relatively strong in the US at the moment. The large draw, in conjunction with markets' slightly dovish interpretation of the outcome of the FOMC meeting and the news that Saudi Arabia will meet with Iran ahead of the producers meeting in Algiers next week, supported oil prices yesterday. The two are likely to seek to work out the disagreement, which hindered a production freeze agreement in April. The price on Brent crude recovered above USD47/bbl yesterday.

Selected readings from Danske Bank

- *Norges Bank Preview: 'Unchanged' but easing bias maintained*
- *FOMC review: Bird fight - we still expect the Fed to stay on hold as we think it may be too optimistic about the economic situation*

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Scandi markets

Norway. We expect an unchanged key rate at the MPC meeting at Norges Bank. In June, Norges Bank indicated an almost 100% probability of a cut in September but the risk outlook has since changed significantly. For one thing, there are now clear signs that growth in the Norwegian economy is picking up and that the risk of a deeper and more protracted downturn has decreased greatly. Second, the housing market tightened considerably over the summer, with big price increases, high turnover and limited supply. This means that a further rate reduction is no longer necessary when it comes to growth and is also less desirable when it comes to the housing market, given the risk to financial stability. Inflation has also been much higher than expected. This points to an upward revision of the central bank's interest rate path relative to June but it will still probably show an almost 50/50 chance of a cut before the end of the year. The reason is that, in isolation, high NIBOR premiums and a relatively strong krone are pulling the path down and so preventing a cut from being completely ruled out. We believe this is very much in line with current market pricing, so we do not expect any major reaction. However, the risk is also slightly asymmetrical, as Norges Bank is more likely to cut the key rate or soften its tone than to start signalling a rate increase.

Fixed income markets

The FOMC statement was quite hawkish but we think Fed chair Yellen was more dovish during her press conference. No less than 10 FOMC members expect one hike this year. However, the median 'dot' for next year was revised down from three hikes to two hikes, implying a shallower rate path. Importantly, the longer-run Fed funds rate was revised down once again to 2.875% from 3.00%.

The curve flattened the 2Y10Y and 2Y30Y after the announcement. The market prices in roughly a 60% chance of a December hike but longer-dated treasuries were supported by the fewer 'dots' in 2017 and the lower longer-run fed funds rate. The flattening of the US curve should be supportive for EGBs including the periphery – given the positive risk sentiment – and reverse some of the post-Bank of Japan losses from yesterday.

All in all, we stick to our view that the Fed will not hike this year, especially as we think the Fed may be too optimistic about the current economic situation given the weakness in ISM and retail sales but it is a close call. See *FOMC review: Bird fight - we still expect the Fed to stay on hold as we think it may be too optimistic about the economic situation*, 21 September 2016.

The Fed does not mind that the curve flattens, which is very different from the message from the BoJ yesterday. See more in our *Flash Comment: Bank of Japan review - new framework but no easing*.

There are no auctions in the EGB market today.

In Norway, it is time for the Norges Bank meeting and a new Monetary Policy Report. We expect an unchanged key rate, despite Norges Bank having indicated in June an almost 100% probability of a cut in September, given that the risk outlook has since changed significantly. The growth outlook has improved, inflation is higher and the housing market is booming. This points in isolation to an upward revision of the central bank's interest rate path relative to June, but will still probably show an almost 50/50 chance of a cut before the end of the year given the high Nibor premiums and a relatively strong krone. Little is priced in for a hike or alternatively measures to bring down the high Nibor premium. Hence, we recommend selling NOK 3M FRA DEC 2016 outright or against the NOK 3M FRA DEC 2017 (steeper FRA curve).

Alternatively, using FX forwards: buying the *NOK 3M forward versus USD*. We are also tempted to go long 10Y NGBs against bunds at a spread close to 120bp.

In Denmark, the recent surge in EUR/DKK up to around 7.4550 looks to be at odds with usual determinants, which suggests the move is due to temporary factors. However, before we see a stabilisation in EUR/DKK, we should expect the short end of the Danish curve to remain ‘nervous’.

FX markets

If we are right in our call on Norges Bank today and given current market pricing, an ‘unchanged’ announcement is unlikely to send EUR/NOK much lower. Our baseline case for EUR/NOK is that the cross will remain bound in the 9.15-9.35 range over the coming three months but we see near-term risks skewed towards a breach of the upper limit.

Following the Bank of Japan meeting yesterday, we continue to see USD/JPY in the range of 100-105, targeting 101 in 1M and 102 in 3M. On a 3-12M horizon, the prospect of a monetary policy surprise (either from the BoJ or the Fed) is low and while underlying support for JPY stemming from fundamental flows is likely to remain intact, we see the effects diminishing as the yen is no longer undervalued. Moreover, we note that speculative accounts, according to IMM, are very long JPY, suggesting an increased correction risk towards a weaker JPY. Finally, we expect the market to continue to price in a probability of a BoJ rate cut in the future, which will remain a supporting factor for the cross. We target USD/JPY at 104 in 6-12M.

Key figures and events

Thursday, September 22, 2016

				Period	Danske Bank	Consensus	Previous
8:45	FRF	Business confidence	Index	Sep			101.0
9:00	DKK	Retail sales	m/mly/y	Aug			-0.6% -2.0%
9:00	DKK	Consumer confidence	Net. bal.	Sep	5.0		4.8
10:00	NOK	Norges Banks monetary policy meeting	%		0.5%	0.5%	0.5%
10:00	EUR	ECB Publishes Economic Bulletin					
12:00	GBP	CBI survey					
13:00	TRY	Central Bank of Turkey rate decision	%		7.50%		7.50%
14:30	USD	Initial jobless claims	1000				260
15:00	EUR	ECB's Draghi speaks in Frankfurt					
15:00	USD	FHFA house price index	m/m	Jul		0.3%	0.2%
16:00	EUR	Consumer confidence, preliminary	Net bal.	Sep	-8.7	-8.1	-8.5
16:00	USD	Existing home sales	m (m/m)	Aug		5.45	5.39 -3.2%

Source: Bloomberg, Danske Bank Markets

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