

Danske Daily

Market movers today

- **Today, focus is on the US PCE inflation figures.** The Fed's preferred measure for core inflation – PCE core inflation – is due for release and we estimate the index rose 0.1% m/m in July, implying an unchanged core inflation rate of 1.6% y/y. The figure has been around this level in 2016 up from 1.3% y/y in mid-2015. It is thus closing in on the Fed's inflation target of 2% but so far it is not there yet. Core CPI inflation has been above 2% for nine months.
- Later this week, the US labour market report is due for release and based on the latest Fed communication it will be very important for the Fed's rate decision (see below). We expect job growth of 175,000 in August. This is below the prints of the past two months but still above the amount needed for labour market slack to come down. Last week, Janet Yellen specifically refereed to the 3M average for job growth. Hence, it seems to be the most appropriate measure to look at when judging how the Fed evaluated employment growth. Overall, the probability of a rate hike this year has clearly gone up and we will review our own forecast of a hike in June 2017 after the job report on Friday (see more in *Strategy: A checklist for the US economy*, 26 August).
- **This week, there will also be focus on the euro area inflation figure for August.** In Scandinavia, KI in Sweden is due to publish its forecast for the Swedish economy while the Norwegian GDP figures for Q2 should show growth of 0.3% q/q.

Selected market news

At the annual meeting of central bankers in Jackson Hole, Janet Yellen echoed other Fed members, saying that the case for an increase in the rate had strengthened recently. The key phrase from Yellen's speech was *'in light of the continued solid performance of the labour market and our outlook for economic activity and inflation, I believe the case for an increase in the federal funds rate has strengthened in recent months. Of course, our decisions always depend on the degree to which incoming data continues to confirm the Committee's outlook'*. Following Yellen's comment, Vice Chair Stanley Fischer said her remarks were consistent with a rate move already in September.

Over the weekend, the Fed's Loretta Mester repeated her hawkish stance and described the case for another rate increase as 'compelling'. She said the trends for employment and inflation are in the right direction while the US economy has *'proved itself resilient through a number of shocks'*. She declined to give an answer on the decision at the meeting on 21 September but in line with Yellen she said she wanted to review all economic data.

Otherwise, focus on Jackson Hole was on optimising the tools in the central bank arsenal. The Bank of Japan's Haruhiko Kuroda said *'we will act decisively'* and *'the bank will carefully consider how to make the best use of the policy scheme in order to achieve the price stability target'*.

The ECB's Benoît Cœuré repeated, *'we will fulfil the price stability mandate'* while also emphasising *'if other actors do not take the necessary measures in their policy domains we may need to dive deeper into our operational framework and strategy to do so'*.

Selected readings from Danske Bank

- *Strategy: A checklist for the US economy*
- *Weekly Focus: US jobs report may tell how close a Fed rate hike is*

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Scandi markets

There are no important data releases in Scandinavia today.

Fixed income markets

The main take away from Jackson Hole is that the Fed is still envisioning another rate hike this year. Yellen's remarks on Friday that the case for the next rate increase has 'strengthened' initially limited the market impact due to the lack of reference to timing. However, comments from other FOMC members gave the speech a hawkish tone such as Fischer saying that Yellen's speech was consistent with a possible September hike. Also, Lockhart (centrist) stated that we could see one more hike this year. Hence, despite Brexit unfolding, all meetings are now 'live' again and Friday's non-farm payrolls will be a very important input in the Fed's decision process. Given the general Fed focus on a lower neutral rate, we still look for a further flattening of the US curve 2Y10Y and 5Y10Y in case the Fed opts for a September hike.

The summer break in the primary market is finally over and we are actually in for a busy week with Italy tapping on Tuesday; Germany and Portugal on Wednesday; and Spain and France on Thursday. In addition, a syndicated deal is also possible with Finland being the traditional first mover after the summer break. The Finnish State Treasury communicated in its most recent Funding Outlook that a new 5Y would be the most likely candidate. However, we see risk clearly biased towards the DMO switching to the 7-8Y as the 5Y segment is trading below -40bp. We estimate that QE in Finland will be approaching the isin limit around year-end, and issuing longer could help extend this restriction a bit into the future.

Finally, we are approaching the month end where index flows are traditionally in focus although the index boost amounts to just 0.02 in August. This month, Italy is in for the largest country-specific duration increase amounting to 0.10, see [details](#).

It is a Bank Holiday in the UK today; therefore, there will not be any Bank of England QE operations before tomorrow when it is the +15Y that will be conducted, see [calendar](#).

The Danish national budget for 2017 is widely expected to be published on Tuesday. It means that the Danish Ministry of Finance should publish borrowing requirements tonight. If anything, the risk is tilted towards a lower borrowing requirement for 2016 and 2017. We stay positive on 5Y and 10Y DGBs. See our analysis on the DGB Q4 effect [here](#).

FX markets

The US dollar gained significantly on Friday on the back of Janet Yellen's hawkish speech at the Jackson Hole conference, indicating that a Fed hike this year still is very much in play. The tone in her speech was in line with the series of other FOMC members, which over the past weeks have voiced similar views about a rate hike, and thus the next move from the Fed now very much seems to depend on the incoming data. Hence, Friday's US jobs report will be pivotal for the short term outlook for USD. In relation to EUR/USD, we maintain our long-held view that the undervaluation of the EUR and the wide eurozone-US current account differential are longer-term EUR positives. Hence, while an early Fed hike is likely to create more downside for EUR/USD in the short term and potentially support a break below the lower bound of the current range as we see it of 1.09-1.13, we expect any USD rally to be relatively short lived. Hence, it is still our view that EUR/USD will reach 1.20 before it reaches 1.00. We target 1.18 in 12M.

Both EUR/SEK and EUR/NOK were pushed higher on Friday by weak risk appetite following Yellen's speech. We have a lot of important data releases in Scandinavia this week including Norwegian GDP and the NIER outlook for the Swedish economy. However, given the market's focus on timing, the Fed is also likely to have significant spillovers to the SEK and NOK. In the

case of the SEK, higher US money market rates is likely to add downward pressure on Swedish Stibor fixings (see *Strategy: US money market reform - implications for the Scandi markets*, 9 August, for details), which along with a possible sell-off on equity markets points to a weaker SEK. For the NOK, however, it is not clear whether a Fed hike (or market's pricing of a hike in 2016) will lead to a stronger or weaker NOK. In isolation, higher US money market rates support higher Norwegian money market fixings (see *Strategy: US money market reform - implications for the Scandi markets*, 9 August, for details). This should send EUR/NOK lower while weak risk sentiment and a possible decline in oil prices will support EUR/NOK. As such, we think the risk channel will dominate, which points to upside risks in EUR/NOK in the event of an early Fed hike – especially as we expect Norges Bank to address tight NOK liquidity and high Nibor fixings at its next monetary policy meeting on 20 September. See *Norges Bank Dilemma - Too early to rule out monetary policy easing* (12 August) for details.

Key figures and events

Monday, August 29, 2016

				Period	Danske Bank	Consensus	Previous
-	DEM	Retail sales	m/m/y/y	Jul		0.5% 0.7%	-0.1% 2.7%
9:30	SEK	Retail sales s.a.	m/m/y/y	Jul		0.2% 2.2%	-0.6% 3.2%
9:30	SEK	Trade balance	SEK bn	Jul			1.8
10:00	ITL	Business confidence	Index	Aug		102.4	103.1
14:30	USD	PCE core	m/m/y/y	Jul	0.1% 1.6%	0.1% 1.5%	0.1% 1.6%
14:30	USD	PCE deflator	m/m/y/y	Jul	0.0% 0.8%	0.0% 0.8%	0.1% 0.9%
14:30	USD	Personal income	m/m	Jul	0.5%	0.4%	0.2%
14:30	USD	Personal spending	m/m	Jul	0.4%	0.3%	0.4%

Source: Bloomberg, Danske Bank Markets

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Expected updates

None.

Date of first publication

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