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Danske Daily

Market movers today

- We have a fairly thin data calendar ahead of us today. Markets will continue to focus on the resolution of the Deutsche Bank issue and political developments in the US, UK, Italy and Spain.
- In the **UK,** PMI construction data is due out, which is estimated to remain around 49. This suggests that the construction sector is still being undermined by the uncertainty created by Brexit.
- In the **US,** ISM New York data is due to be released. Following yesterday's increase in the ISM manufacturing index, the market will now look for indications of whether the non-manufacturing sector is also picking up speed ahead of tomorrow's ISM non-manufacturing number.

Selected market news

Risk sentiment continues to be in positive territory. Most Asian stock indices are up this morning, helped by surprisingly strong US ISM manufacturing numbers released yesterday. The index increased to 51.5 in September from 49.4 in August. Especially, new orders looked strong, with the index surging to 55.1 from 49.1, although employment intentions remain weak. The release gave way to a stronger USD overnight while the probability of a Fed rate hike by December as implied by the Fed fund futures was raised slightly to 61% from 58%, nearing the top of the recent probability range. US treasury yields were higher across the board, crude oil gained for the fourth consecutive day. Meanwhile, the Japanese yen retreated for the sixth day on increased expectations of a US rate hike.

Furthermore, **Australia's central bank kept its cash rate unchanged this morning** amid a positive impact on the Australian economy of the recent rise in commodity prices. The unchanged rate decision was as expected. The new central bank governor, Philip Lowe, welcomed in his first policy meeting the recent gains in commodity prices but also noted 'that inflation remains quite low, given very subdued growth in labour costs and very low cost pressures elsewhere in the world, this (eq. low inflation) is expected to remain the case for some time'. The surge in the Australian dollar, which has increased by about 10% against the US dollar since the lows in January, is also complicating the RBA's efforts to increase inflation.

Meanwhile, focus continues to be on the new signals from the UK government on its Brexit strategy. British Prime Minister Theresa May stressed at the conservative party conference that British financial services companies will not get special treatment in the upcoming Brexit negotiations with the EU. This marks a departure from her predecessor David Cameron, who put the risk to financial services at the heart of his failed referendum campaign to keep the UK in the EU. For more on the British EU exit strategy, see *Flash Comment UK: PM May set to trigger Article 50 before March 2017 - EUR/GBP set to move higher*, 3 October 2016.

Selected readings from Danske Bank

- *UK: PM May set to trigger Article 50 before March 2017 - EUR/GBP set to move higher*

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Scandi markets

In Denmark, the Nationalbank is due to publish FX reserves numbers for September today. The reserves have been relatively flat since June and although the krone has weakened against the euro in September, it is still trading below the central parity rate.

Fixed income markets

The Italian bond market were under pressure during the session yesterday, as the Italian constitutional referendum due to take place on 4 December 4 is still too close to call, according to the polls, and as the market did not take any comfort in Renzi saying that he would not step down in case of a defeat.

Just before the BTP closing bell yet another big blow came to the market, as the Italian Tesoro announced that it will issue the long-discussed 50Y BTP (01/03/2067) through syndication. It will happen 'in the near future subject to market conditions' (read: today). According to the Tesoro, the announcement came because of 'the positive market environment' and 'the positive experience with the introduction of the 20-year BTP'. The new 50Y BTP will not affect the issuance policy on traditional long-term bonds, which will continue to be regularly offered at mid-month auctions.

The Tesoro announcement came after SPGB 2066 traded with a record low yield of 2.48% earlier in the day. Hence, demand for these ultra-long bonds seems to be very strong at the moment. Even though the announcement came just before close yesterday, we would expect to see further BTP concessions this morning. But that said, we are now approaching a yield-level, for example against Spain, which is starting to look quite interesting.

It is also worth keeping an eye on the ECB's monthly QE data, due to be released this afternoon (one day later the normal). The figures are again set to show that purchases in Portugal/Ireland remain below the capital key share, as the issue/issuer restrictions are denting purchases. Around year-end, Finland could be next and then Germany, if no PSPP tweaks are implemented.

Yesterday, we saw a jump higher in the extremely low bund repo rates, as we have now passed the quarterly turn. However, the trend is still down for bund repo rates. Hence, the squeezed bunds continue to be well supported against other core/semi-core and Scandi government bonds.

The market continues to discuss whether the Fed will hike at the December meeting or not. The stronger-than-expected ISM gave support to the December hike camp. The market prices in slightly above 60% for a December hike.

FX markets

EUR/NOK has moved sharply lower over the past couple of weeks, breaching important levels, which consequently has left the cross in technically unchartered territory. The drivers behind the move have been (1) Norges Bank surprising markets by implementing a neutral bias on 22 September and (2) the oil price moving USD5/bbl higher on speculation that OPEC could reach an agreement to cut output before year-end.

Admittedly, despite our long-held strategic bullish view on the NOK, we did not forecast this short-term appreciation tempo. As a result, yesterday we were stopped out of our tactically long EUR/NOK trade put on after OPEC agreed to implement an output ceiling of 32.5mb/d-33mb/d (i.e. a slight production cut). The details behind this supply cut have yet to be worked out ahead of the official 30 November OPEC meeting. We still think achieving this objective will be easier said than done and we could well see the oil price erase the past week's gains later in Q4 – see *Commodities Strategy: OPEC's good intentions may prove difficult to carry out*, 28 September

2016. Hence, we see the latest OPEC speculations as having added increased volatility into the NOK currency at a time where 'technicals' struggle to keep the currency in check.

In terms of Norges Bank (NB), it is noteworthy that the significant easing bias in the September rate path (implied 40% probability of a 25bp rate cut) was likely left to counter some of the NOK pressure stemming from the official shift to a neutral stance in the statement. While the oil price has moved higher since the September meeting, Norwegian growth is, in our view, less sensitive to oil price changes around current levels. The big question, therefore, is if NB can tolerate the monetary tightening stemming from currency appreciation as the NOK is now 3% stronger than NB assumed in its policy projections. Economic data will react with a lag to a stronger currency and it will be the next quarter of data that will determine whether NB will re-implement an easing bias/cut rates further. At this stage, we would not be surprised to see EUR/NOK ending the year at unchanged or higher levels relative to the current spot, but catching the falling knife short term has proven very difficult. Yet, NB only pencilled in a 0.6% appreciation of the NOK over the next full year and our short-term financial models suggest the latest move lower in EUR/NOK is much overdone given the coinciding moves in relative rates, the oil price and risk sentiment. Our short-term financial model for EUR/NOK – which has historically been one of our best FX models – has 9.17 as a 'fair value'.

Key figures and events

Tuesday, October 4, 2016				Period	Danske Bank	Consensus	Previous
5:30	AUD	Reserve Bank of Australia rate decision	%		**1.50%**	*1.50%*	1.50%
7:00	JPY	Consumer confidence	Index	Sep		*41.8*	42.0
10:30	GBP	PMI construction	Index	Sep		*49.0*	49.2
11:00	EUR	PPI	m/m|y/y	Aug		*-2.1%|0.0%*	-2.8%|0.1%
12:50	EUR	ECB's Praet Speaks in Madrid					
14:05	USD	Fed's Lacker (non-voter, hawkish) speaks					
16:00	DKK	Currency reserves	DKK bn	Sep			449,8

Source: Bloomberg, Danske Bank Markets

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