6 December 2016

Danske Daily

Market movers today

- Today, there will be an Ecofin meeting in Brussels and any comments on the political situation in Italy will be scrutinised

  Today, the third estimate for euro area GDP is due to be released. In this release, we gain information on how each GDP component has developed and we expect domestic demand to have served as the main growth driver in Q3 (see *The Big Picture: Recovery, reflation and political uncertainties*, 30 November).

- October German factory orders are also due to be released today.

- In Sweden, the Riksbank's Martin Flodén will give a speech (10:45) on the effects of the negative repo rate and how long they will last. In Norway, the most important release of the week is Norges Bank's regional network survey. We suggest tentatively that the aggregate output index edged down to 0.7 in November. See Scandi markets section on page 2.

Selected market news

Italy took the limelight yesterday, but any fears that the 'no' in the referendum would derail the relative positive global sentiment turned out to be wrong, despite it being bigger than most polls had indicated. Hence, for the third time this year, after Brexit and the US presidential election, the market was able to shake off a political event very quickly.

We initially saw a widening of the Italian 10Y bond spread against Germany of some 12bp but relatively quickly the spread tightened again and as the day was over, Italy had only widened 3bp against Germany and the spread is still some 20bp tighter than seen a week ago.

Today, we could see more support for the Italian bond market after, Prime Minister Matteo Renzi was asked by President Sergio Mattarella in the evening to stay in office until the budget has been approved by parliament, which could come as early as Friday. The acceptance by Renzi to stay in office gives the president better time to form a new temporary government. This should minimise further the political instability after the referendum. The relatively calm market reaction to the 'no' does not imply that all problems have vanished in Italy, as the political situation remains very uncertain. Attention will also remain focused on the troubled banking sector with Monti dei Paschi, which is in the middle of raising EUR5bn in new capital, in focus. However, from a market perspective, Italy is now less in the spotlight and attention now turns to the ECB meeting on Thursday.

The global FI sell-off continued yesterday after the calm reaction to the Italian referendum and as the US non-manufacturing PMI rose to 57.2, which is the fastest pace in more than a year. IN addition, Fed President Dudley said he favours a somewhat tighter monetary policy. The market is fully priced for a Fed hike next week and attention is now more on the guidance for 2017, and how the Fed is going to take account of the new US fiscal policy stance.

The better sentiment was also visible in the FX market, where over the past 24 hours, EUR/USD is up close to big figures, currently trading at 107.57. Overnight, the Reserve Bank of Australia kept the policy rate unchanged at 1.5% as expected, saying that a slower growth at year end is still expected, but noting that higher commodity prices are boosting national income.

Selected readings from Danske Bank

- *Scandi markets ahead*

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Scandi markets

In Sweden, the Riksbank's Martin Flodén is due to give a speech on the effects of the negative repo rate and how long they will last. Most likely he will touch not only on the real and inflationary effects but also on unintended consequences on household indebtedness. It will also provide an opportunity for him to respond to the FSA's Thedéen's veiled critique recently of the Riksbank's ultra-easy monetary policies. It is also possible that he will leave that for tomorrow's discussion in the Financial Stability Council where the FSA, the Riksbank, The Swedish National Debt Office and the MoF all due to take part.

In Norway, the most important release of the week is Norges Bank's regional network survey, due at 10.00 CET. Since the aggregated output index bottomed in November 2015, it has risen steadily to a two-year high of 0.75 in August. There have been improvements in most of the sector indices and it was mainly the construction and export sectors that contributed to the upturn in August. We believe that the key drivers behind growth in the Norwegian economy – government demand and homebuilding – will keep the fires burning well into next year, which should lend further support to the construction sector. We also expect the retail, export and service sectors to signal further solid growth but we are worried that the outlook for oil-related industries, which painted a slightly less negative picture in August, may have taken another turn for the worse. The oil investment survey suggests that 2017 will be weaker than we previously thought and both Statistics Norway's business tendency survey and the PMI have recently shown signs of weakness. They seem to be being pulled down by a decline in firms' order books, which suggest inflows of new orders, although increasing, are not strong enough to compensate for completed projects. We tentatively suggest that the aggregate output index edged down to 0.7 in November

Fixed income markets

The Italian 'no' barely echoed in yesterday's market with 10Y BTPS underperforming Bunds by just 5bp yesterday. The spread is still 20bp tighter than just a week ago. Interestingly, the move in the core followed the pattern in equities, with positive sentiment triggering a 5bp sell-off in 10Y and we are now just a few bps from the post-Trump high in yield terms.

Focus is now shifting to Thursday's the ECB meeting. An array of possible policy moves is on the table with focus on QE extension, PSPP tweaks and efforts to alleviate the collateral scarcity/repo squeeze. We expect a six-month EUR80bn extension with a 50% probability of a further extension in 2017. See *ECB preview: end-of-easing is premature*, 2 December 2016.

The November QE details showed total purchases amounting to an expected EUR85.4bn due to front loading going into the December slowdown. Both Ireland and Portugal keep running below what the capital key would suggest but not at a decreasing pace. PSPP purchases in Germany have moved slightly lower on the curve, due to the recent increase in eligible bonds in the belly, with a weighted average maturity in November of 10.3 years (10.9 in October)

In Scandinavia, focus is on the speech due to be given by Riksbank member Martin Floden in Sweden and the Regional Survey in Norway. For more, see *Scandi Markets Ahead: Swedish industrial data, Norwegian regional survey and DGB and NGB auctions*, 4 December 2016. Yesterday, we published an auction preview ahead of the bond auction in Norway in the NGB May 2023. For more see *Fixed Income Strategy: Norges Bank set to sell NOK3bn in NGB NST 475, 2.00%, May 24, 2023*.

FX markets

The FX market impact of the political upheaval in Italy following the 'no' vote on Sunday was very short-lived. After a brief decline, the EUR quickly recovered ground and ended up almost 1% higher against the USD. This underscores two things: (1) political uncertainty only matters for the EUR if the future of the common currency is at risk, and we are by no way there yet in Italy (this would entail a scenario of a snap election where the electoral law is not changed and therefore provides a relatively high risk of the Five Star Movement winning the majority) and (2) the EUR was close to stretched short territory ahead of the referendum and hence supported the upward move in the EUR/USD. While markets will continue to monitor the situation in Italy, attention will shift to the ECB meeting on Thursday where we expect a fairly dovish stance (six months extension of the QE programme and EUR80bn buying per month), we recommend selling EUR/USD on rallies with a 3M target of 1.04 (although there may be a slight upside risk to this target).

In Norway, the Norges Bank's regional network survey is due out today at 10:00 CET. We expect the aggregate output index in the survey to edge down to 0.7 in November as the PMI and the business tendency survey have recently shown weakness. We think that if the regional survey disappoints, Norges Bank may well re-implement an explicit easing bias in its upcoming statements. This, together with probably downward pressure on oil prices after the strong rally over the past week and negative year-end seasonality for NOK, may send the EUR/NOK higher over the coming weeks.

In Sweden, as stated, Flodén is due to give a speech on the effects of the negative repo rate and how long they will last. Most likely he will touch not only on the real and inflationary effects but also on unintended consequences on household indebtedness. However, we think that he may reiterate the bank's dependence on the ECB and thus its readiness to do more on 21 December, which would create upside risk for the EUR/SEK. However, within the Board, he is currently seen as a relative hawk and hence he may express doubts about further rate cuts, which would be a downside risk for EURSEK.

Key figures and events

Tuesday, December 6, 2016				Period	Danske Bank	*Consensus*	Previous
1:00	JPY	Labor cash earnings	y/y	Oct		*0.2%*	0.0%
4:30	AUD	Reserve Bank of Australia rate decision	%		**1.50%**	*1.50%*	1.50%
8:00	DEM	Factory orders	m/m|y/y	Oct	**1.0%|...**	*0.6%|1.6%*	-0.6%|2.6%
9:00	EUR	ECOFIN meeting in Brussels					
9:15	CHF	CPI	m/m|y/y	Nov		*-0.1%|-0.1%*	0.1%|-0.2%
10:00	NOK	Norges Bank Regional Network Report: Output next 6M	Index	Oct	**0.7**	*0.7*	0.8
11:00	EUR	GDP, final	q/q|y/y	3rd quarter		*0.3%|1.6%*	0.3%|1.6%
11:00	EUR	Gross fixed investments	q/q	3rd quarter		*0.4%*	1.1%
11:00	EUR	Government consumption	q/q	3rd quarter		*0.4%*	0.2%
11:00	EUR	Private consumption	q/q	3rd quarter		*0.3%*	0.2%
14:30	USD	Unit labour cost, final	q/q	3rd quarter		*0.3%*	0.3%
14:30	USD	Trade balance	USD bn	Oct		*-41.6*	-36.4
16:00	USD	Core capital goods orders, final	%	Oct			0.4%

Source: Bloomberg, Danske Bank Markets

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