7 December 2016

Danske Daily

Market movers today

- **It is a quiet day in terms of data releases and market participants are likely to be in some state of wait-and-see mode ahead of the ECB meeting tomorrow** (see more on our expectation and view on the latest market moves below).
- **One of the few data releases is German industrial production.** Yesterday, the German factory orders surprised on the upside by rising 4.9% on the previous month. This indicates industrial production will be strong in coming months, which is in line with the economic survey indicators where both PMI manufacturing and ifo expectations have been robust in Q4. Overall, the latest figures suggest strong GDP growth following modest growth in Q3.
- **UK, Norwegian and Danish industrial production are also set to be released today.**
- **The UK NIESR GDP estimate for November will also be in focus** as it is quite a reliable indicator for actual GDP growth. In October, it pointed to an economic expansion of 0.4% q/q, close to the growth rate of 0.5% q/q in Q3.

Selected market news

Ahead of the ECB meeting tomorrow, a rate hike from the ECB in 2018 continues to be priced in with a high likelihood. Currently, the market is pricing in an 80% probability of the first 10bp ECB rate hike already in December next year. At the same time, the market is pricing in inflation at only 1.2% next year, which in our view is too low inflation for the ECB to have tapered its QE purchases and also hiked the policy rate. In other words, we see a market inconsistency reflected in a too high real rate in the short end of the curve.

Longer-dated inflation expectations have moved higher but remain too low for the ECB to tighten monetary policy. Medium-term, market-based inflation expectations (5Y5Y inflation swap) have gone from below 1.3% at the beginning of September to above 1.7%. The rising tendency should be very welcomed at the ECB, but looking back at when the 5Y5Y inflation swap first declined below 1.7%, the ECB announced its QE programme due partly to concerns about de-anchored inflation expectations.

Political uncertainty is another factor which, in our view, highlights that it is important for the ECB to stay off the tapering and hiking trigger. Although the financial market implications of the Italian ‘no’ in Sunday’s referendum have already been shaken off, there is still an elevated political risk that the ECB has no interest in boosting. If the ECB starts tapering its QE purchases across countries, yields will rise and particularly higher periphery yields could kill the fragile recovery in some of the periphery countries as higher yields would spill over to higher cost of borrowing.

We expect the ECB to extend its QE purchases by six months to September 2017 and maintain the purchases at EUR80bn at the meeting tomorrow. While this is close to consensus, we consider it most likely that the ECB will extend its QE purchases again next year as we expect the wage and underlying price pressure to remain too low for the ECB to conclude that inflation is on a sustainable path towards the 2% target.

Selected readings from Danske Bank

- *ECB preview: end-of-easing is premature*
- *Presentation: Five macro themes for 2017*

Follow us on *Twitter* :

@Danske_Research

Read more in Danske Bank’s recent forecasts and publications

- *The Big Picture*
- *Nordic Outlook*
- *Yield Forecast Update*
- *FX Forecast Update*
- *Weekly Focus*

Senior Analyst
Pernille Bomholdt Henneberg
+45 45 13 20 21
perni@danskebank.com

Scandi markets

The Swedish Debt Office is due to release November's budget data – a SEK43.2bn surplus for the month is expected. The Financial Stability Council (the Riksbank, Debt Office and FSA) is due to meet today to discuss various issues related to financial stability risks, with the housing market at the forefront.

Fixed income markets

Just one more session before we get the verdict from Mario Draghi and with very interesting price dynamics going into the pivotal decision. The boost to risky assets continues despite the 'no' from Italy. 10Y Italy tightened another 8bp versus the core yesterday and is now 35bp tighter than at the beginning of last week. The 'risk-on' move yesterday was fuelled by signals that Renzi could be in favour of a February general election (after the electoral law is changed). Italian equities ended Tuesday's session up 4.2%.

The yield on 10Y Germany has hit the highest level since January while euro area inflation expectations have surged rapidly with the 5Y5Y hitting 1.70%, having increased 40bp since early September. The sustained move higher in core yields heading into the ECB meeting appears out of sync with the majority of analysts that, according to Bloomberg, expect both an extension (64% expect an extension of QE at the current pace beyond March 2017) and an increase in the issue/issuer limit (72%). See also *ECB preview: end-of-easing is premature*, 2 December 2016.

In Denmark, the Debt Office will conduct the last auction this year with a tap in the 2Y and 10Y segments (as usual). We expect the DMO to sell between DKK2.5-3bn. We are still in wait-and-see mode regarding buying DGBs and look for better levels in January, where spreads to EU peers usually widen – especially in the long end, where we await a new 10Y bond given a funding requirement of DKK65bn, see *Strategy: Last Danish government bond auction in 2016 and a glimpse into 2017*, 6 December 2016.

FX markets

All eyes are turning to the ECB meeting tomorrow. The EUR/USD is trading on a fairly stable note after the rebound in the wake of the Italian referendum. It may be the calm before the storm, as we think that the ECB may come out on the dovish side versus market expectations, which are more mixed about the stance of the ECB. If we are right, we may see a downward move in the EUR/USD, but we should note that the selling pressure may be more limited due to the EUR short-long USD positions in the markets.

The GBP fell somewhat yesterday after Prime Minister Theresa May agreed to reveal her Brexit plans to Parliament before Article 50. We think that this a sign of what is to come, as we see GBP weakening further as we approach the deadline for the UK government to trigger Article 50 before the end of Q1 next year.

The NOK strengthened a bit yesterday after it was revealed that Norges Bank's regional network survey dropped marginally to 0.73 (expected: 0.7) from 0.75 in August. Although this indicates growth in mainland GDP of around 0.4% q/q for the next two quarters, a bit weaker than expected by Norges Bank in MPR 3/16 (roughly 0.45% q/q), the deterioration of the growth outlook was not, in our view, sufficient to trigger another rate cut expectation, as the housing market represents an increasing risk to the stability of the economy and the economy after all seems to have avoided a recession. However, the EUR/NOK came under pressure as oil prices dropped on stories that OPEC production increased in November on the back of production increases in Angola, Libya, and Nigeria. The lower oil prices may also reflect the market's lingering doubt about compliance to the OPEC deal and we may see further buying of EUR/NOK if oil prices drop further going into this weekend's meeting between OPEC and non-OPEC countries on sharing the cut in oil production.

The PLN has experienced a rebound over the past two days. This is in line with our expectation, as the zloty should get support from S&P's upgrade to the outlook for the rating to stable for Poland on Friday and the quiet market reaction to the Italian referendum result. We think the cross may move further down with our short-term financial model suggesting a fair value for EUR/PLN of around 4.43. However, one key feature to watch is the US 10-year yield, which can be taken as a proxy for a global bond sell-off, hitting a large fixed income market such as Poland quite significantly, and the zloty in particular given the sizeable foreign ownership.

Key figures and events

Wednesday, December 7, 2016				Period	Danske Bank	*Consensus*	Previous
-	CNY	Foreign exchange reserves	USD bn	Nov		*3065.7*	3120.7
-	PLN	Polish central bank rate decision	%		**1.50%**	*1.50%*	1.50%
1:30	AUD	GDP	q/q|y/y	3rd quarter		*0.5%|2.5%*	0.5%|3.3%
6:00	JPY	Leading economic index, preliminary	Index	Oct		*101.5*	100.3
8:00	NOK	Manufacturing production	m/m|y/y	Oct			2.2%|-5.6%
8:00	NOK	Industrial production	m/m|y/y	Oct			-5.6%|-12.4%
8:00	DEM	Industrial production	m/m|y/y	Oct	**1.5%|...**	*0.8%|1.5%*	-1.8%|1.2%
9:00	DKK	Industrial production	m/m	Oct			-8.1%
9:00	CHF	SNB balance sheet, intervention	CHF bn	Nov			630.3
9:30	SEK	Budget balance	SEK bn	Nov			-15.8
10:30	DKK	Danish Central Bank publishes Q4 outlook		4th quarter			
10:30	GBP	Industrial production	m/m|y/y	Oct		*0.2%|0.4%*	-0.4%|0.3%
10:30	GBP	Manufacturing production	m/m|y/y	Oct		*0.2%|0.8%*	0.6%|0.2%
16:00	GBP	NIESR GDP estimate	q/q	Nov		*0.4%*	0.4%
16:00	CAD	Bank of Canada rate decision	%		**0.50%**	*0.50%*	0.50%
16:30	USD	DOE U.S. crude oil inventories	K				-884
21:00	USD	Consumer credit	USD bn	Oct		*17.5*	19.3

Source: Bloomberg, Danske Bank Markets

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank').

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

The research reports of Danske Bank are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from and do not report to other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

This report is updated on a daily basis.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change, and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.