9 December 2016

Danske Daily

Market movers today

- Very little on the agenda today, despite the University of Michigan's consumer confidence.
- The market will use today to scrutinize yesterday's message from the ECB.
- In Scandinavia, focus turns to CPI data in Norway. See more on the next page.

Selected market news

All eyes were of course on the ECB meeting yesterday. The ECB decided to extend its QE purchases by nine months to December 2017, but reduced the monthly purchases to EUR60bn from EUR80bn. The lower pace of purchases followed, according to the ECB, as the risk of deflation has now largely disappeared (the reason why the pace of purchases was temporarily lifted). President Draghi said the nine-month extension followed as the ECB wants to signal a sustained presence and no near-term tapering.

In our view, Draghi expressed a dovish tone during the Q&A and continued to repeat that tapering had not been discussed. According to Draghi, none of the ECB members want to taper QE, but the main message was a sustained ECB presence in the markets without distortions. Related to this, the ECB communicated additional flexibility in case of a less favourable inflation outlook or a worsening in financial conditions.

In terms of QE restriction changes, the ECB now permits buying bonds with a yield below the deposit rate while the maturity range includes the 1-2Y. The ECB has thus not lifted the 33% issue/issuer limit and will continue to follow the capital key distribution.

The decision to buy below the deposit rate at -0.4% and to include bonds with a 1-2Y maturity led to a strong rally in the front end of especially the German government bond curve, where 2Y yields dropped to -0.76%. The reaction was very different in the long end of the curve, where both 10Y and 30Y German bonds came under pressure due to the lower QE amount, though the yield level at the end of the day was not that much higher. All in all, it resulted in a significant steepening of the yield curves for 2Y10Y, 5Y10Y and 10Y30Y. It is our view that the steepening of the German curve and the EUR swap curve will continue in 2017, but at a more moderate pace compared to what we have seen over the past couple of months. Despite the ECB's assurance that yesterday's decision had nothing to do with 'tapering', this will eventually become the 'talk of the town' in 2017. Furthermore, the global 'reflation' theme and the impact of the US bond market will tend to steepen European curves in 2017. Working in the other direction is the fact that the yield curves are already very steep and that the ECB core inflation forecasts remain optimistic. For more on the meeting, see yesterday's *ECB review: less 'punch in the bowl' from Draghi.*

The ECB's QE for at least another nine months boosted risk appetite further and especially European equities marched higher and the euro dropped. The SEK gained against the euro yesterday. However, we firmly believe that the Riksbank will have to stay relatively dovish after the ECB's message. The Riksbank will definitely have to do more QE and, in our view, a 10bp repo rate cut in Sweden at the policy meeting on 21 December is still a possibility.

Selected readings from Danske Bank

ECB review: less 'punch in the bowl' from Draghi

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Scandi markets

In Norway, attention turns to CPI data for November. Core inflation, CPI-ATE, has moved higher over the past four years and peaked at 3.7% in July, boosted by the weaker NOK, but then dropped to 2.9% in October. In November, core inflation is estimated to be unchanged at 2.9%. The impact of the weaker NOK in 2016 will eventually peter out and we continue to see Norwegian core inflation edging lower in 2017.

Fixed income markets

It is time to digest yesterday's verdict from Mario Draghi. The EUR60bn for nine months was less than the market had expected, triggering a sell-off, while Schatz rallied to a new low in yield terms after Draghi opened the door for the possibility of 'buying below depo'.

The fact that the issue/issuer limit was kept unchanged means purchases in Ireland and Portugal are set to decrease further (deviate more) from what the capital key would have suggested. Portugal widened 20bp to core while the market reaction in Ireland was more muted. Ireland has tightened substantially to France recently but with QE purchases set to decrease further due to the issue limit ('old' promissory notes holdings), we expect Ireland to underperform again relative to France.

Purchases of longer-dated German bonds are also set to be reduced significantly as we enter 2017, as the QE holdings in +8Y Germany approach the 33% issue limit. It remains an open question whether the ECB will be willing to buy significant amounts below the depo rate and/or whether it could also eventually deviate from the capital key. For a full overview, see *ECB review: less 'punch in the bowl' from Draghi.*

FX markets

EUR/USD initially bounced on the ECB announcement but fell thereafter when the market realized that the policy change was in a more dovish direction than it initially appeared. At the press conference, Draghi clearly struck a dovish tone, stressing that sustained ECB presence in the markets is the main message. Near term, we see EUR/USD in a 1.05-1.10 range with the balance of risks skewed towards a break to the downside. As such, EUR/USD is a sell on rallies within the 1.05-1.10 range. We forecast EUR/USD at 1.05 in 1M and 1.04 in 3M before a sustained move higher to 1.08 in 6M and 1.12 in 12M.

For the SEK, we think that the Riksbank will have to stay relatively dovish given the ECB's dovish line. It will definitely have to do more QE and, in our view, also a 10bp repo rate cut, although the latter is admittedly a close call. We see near-term upside risk for the EUR/SEK, as the market is not priced for a rate-cut scenario. However, in 2017, we expect the EUR/SEK to move lower on valuation, global reflation and relatively strong growth in the Swedish economy. For the NOK, the combination of a rebound in oil prices and a relatively dovish ECB sent the EUR/NOK lower. However, we see upside risk for the cross given that the NOK traditionally performs weakly in the latter half of December.

Emerging market currencies generally strengthened against the EUR yesterday on the back of the ECB meeting. Among the exceptions was the Turkish lira, where the stabilisation and economic growth measures presented by the government were seen as underwhelming. We sent out a new FX strategy yesterday (*FX Strategy: TRY - Hit by a perfect storm*) where we see the USD/TRY to be overbought and see the pair moving to 3.40 in 1M. Our short-term model is pointing to a fair value of 3.13 but we remain cautious on the political risk, including central bank independence in Turkey. The forint and zloty also weakened against the euro. Without any significant economic news out of Hungary and Poland, we think the rising long-term yields in the eurozone and new slight widening of the periphery spread to Germany may explain the underperformance of the two currencies.

Key figures and events

Friday, December 9, 2016				Period	Danske Bank	*Consensus*	Previous
-	EUR	Fitch may publish ESM's debt rating					
-	EUR	Fitch may publish EFSF's debt rating					
-	EUR	Fitch may publish France's debt rating					
-	EUR	S&P may publish Estonia's debt rating					
2:30	CNY	PPI	y/y	Nov		*2.2%*	1.2%
2:30	CNY	CPI	y/y	Nov		*2.2%*	2.1%
7:45	CHF	Unemployment	%	Nov		*3.3%*	3.3%
8:00	DEM	Trade balance	EUR bn	Oct		*22*	24.2
8:00	DEM	Labour costs	q/q|y/y	3rd quarter			0.2%|1.8%
8:00	NOK	Core inflation(CPI-ATE)	m/m|y/y	Nov	**0.1%|2.9%**	*0.1%|2.9%*	0.2%|2.9%
8:00	NOK	CPI	m/m|y/y	Nov		*0.2%|3.5%*	0.5%|3.7%
8:00	NOK	PPI	m/m|y/y	Nov			2.3%|-4.5%
8:45	FRF	Industrial production	m/m|y/y	Oct		*0.6%%|-0.7%*	-1.1%|-1.1%
9:00	DKK	Current account (nsa|sa)	DKK bn	Oct			...|11.9
9:00	DKK	Trade balance ex ships	DKK bn	Oct			5.6
9:00	DKK	Exports	m/m	Oct			
10:30	GBP	Construction output	m/m|y/y	Oct		*0.2%|-0.2%*	0.3%|0.2%
10:30	GBP	Trade balance	GBP mio.	Oct		*-4363*	-5221
16:00	USD	University of Michigan Confidence, preliminary	Index	Dec	**95.0**	*94.1*	93.8

Source: Bloomberg, Danske Bank Markets

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