12 February 2018

Danske Daily

Market movers today

- There are no major global data releases today and focus remains on risk sentiment after the big drops in stock prices last week.
- In Denmark, we forecast CPI inflation was unchanged at 1.0% y/y in January (see next page).
- The most important event in Sweden this week is the Riksbank meeting on Wednesday.

Selected market news

US stock-index futures rose, while Asian equities are mostly higher this morning. Oil climbed above 63 USD/bbl along with gold and industrial metals, after a slump on Friday following another increase in the US oil rig count and deepening concerns about a new shale boom.

Japanese markets are closed for holiday today, delaying Treasury trading. On Friday the US 2y10y curve continued to steepen, while we saw significant underperformance of DKK callable bonds in particular driven by increasing interest rates and classic Danish investor behaviour. In the European **rates market** we now argue that the focal point on the curve will shift to the 10y segment. Like in the US, higher inflation expectations and volatility drives up the term premium in a situation where QE is coming to an end, while higher real rates will also particularly hurt the 10y segment (see also *Fixed Income Strategy: The 10Y segment most exposed if the FI sell-off continues*).

North Korea's leader Kim Jong Un has invited South Korean President Moon Jae-in for a meeting in Pyongyang. The invitation was verbally delivered by Kim's sister, on the occasion of the current Winter Olympics in South Korea. A Moon-Kim summit would mark the first time leaders of two countries have met in 11 years. While a summit in Pyongyang would signal easing tensions on the Korean Peninsula, it also risks driving a wedge in the alliance between the US and South Korea. The question now is whether the partners can stay united in keeping up the pressure on North Korea just as sanctions limiting export revenue and curbing fuel imports start to bite. So far South Korea has reacted cautiously to the opportunity, saying any summit would need the "right conditions". The Korean won rallied on the news.

The **Japanese** government is set to reappoint current Bank of Japan Governor Kuroda according to *Japanese media*, which would be in line with our expectation. The nomination will need approval by both houses of parliament, but since Shinzo Abe's LDP party has a majority of seats in both houses we do not expect this to be a hurdle. USD/JPY was little changed on the news and still trades around the 108.80 level this morning.

On Friday **Russia**'s central bank (CBR) cut its key rate by 25bp to 7.50%, as inflation has hit its post-Soviet low at 2.2% y/y. We think the recent slowdown in Russia s economic growth is likely to vanish, with stronger growth figures in H2 18. However, as the CBR sounded relatively dovish in its statement, we now expect CPR to cut the key rate further to 6.50% by end-2018, in the absence of geopolitical 'black swans' or a crude price crush (see also *Flash Comment - Bank of Russia: a cautious and consistent 25bp cut*).

Selected readings from Danske Bank

- *Bank of England review - Launching a hiking cycle*
- *FX Strategy: End of USD weakness? No - but new range for now*

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Scandi markets

Today we get **Danish** inflation numbers for January. Food surprised on the downside in December, with Christmas offers helping pull down prices. We expect this to reverse in January and, combined with rising power prices, push the CPI up again. In contrast, base effects from higher airfares in 2017 will fall out of the index. On balance, we forecast unchanged inflation of 1.0%.

Fixed income markets

The US curve 2y10y steepened more than 5bp on Friday. Yields in the short-end was pushed lower by the volatile risk markets that made the market pare bets on Fed hikes. The long-end on the other hand continues to be under pressure as higher inflation expectations, a higher term premium and a fear of a US bond supply glut in light of fiscal policy continued to rattle markets.

In the European rates market the 5y point has been the focus point as the ECB has been repriced. However, we now argue that the focal point on the curve will - like we saw in the US on Friday - move to the 10y segment of the curve, and that we will see a further steepening of the 5y10y curve. For more see our new research *Fixed Income Strategy: The 10Y segment most exposed if the FI sell-off continues*, 12 February 2018.

This week we have a string of core, semi-core and peripheral issuers coming to the market. Furthermore, Belgium could launch a new 15Y green bond. Gross issuance is expected to be EUR28bn. See *Government Bonds Weekly*, 11 February 2018.

Last week we saw significant underperformance of DKK callable bonds in particular recently driven by increasing interest rates and classic Danish investor behaviour. It seems fair to have a higher premium in callables as the market generally expects higher volatility (swaption volatility has increased). For more see *Danish Mortgage Bonds - Pronounced repricing of Danish mortgage bonds - particularly callables*, 9 February 2018.

FX markets

Friday was an unusually volatile session for the NOK as the cocktail of souring risk appetite alongside a disappointing Norwegian inflation print sent EUR/NOK to an intraday high of 9.8785. As risk (alongside the oil price) rebounded in late US trading amid the S&P500 200D-MA constituting support, we saw EUR/NOK drop sharply again almost erasing most of the initial gains. To us that confirms, that global risk appetite remains the key driver for the NOK at present and that we need to see a stabilisation for EUR/NOK to move lower on a more sustainable basis. In terms of the domestic story, we still see a fundamental case for a stronger NOK and emphasize that plane-tickets, alongside clothes prices, was a key factor for Friday's disappointment. Indeed, "plane tickets" has become an unpredictably volatile inflation component over the last couple of years, cf. this *chart*, which has created NOK FX moves which more often than not should be faded.

An important week for the SEK with several important events piling up on Wednesday in particular and of which the most important of them all is the Riksbank's rate decision. We expect the Riksbank to maintain its stance from December which means signalling a first hike in Q3. In addition, we get Valueguard housing data and Prospera that same morning. EUR/SEK is opening the week close to our 9.90 near-term target, and we see two-sided risks to the cross in relation to Wednesday's events - see Reading the Markets Sweden (pls INSERT LINK) for more details.

Last week's meeting of the UK's so-called 'Brexit war cabinet' did not reveal anything about the UK's negotiating position. Any indication that a transition agreement could be drawn out will be negative for GBP. Besides Brexit, focus will be on the CPI release tomorrow, not least now the Bank of England may hike in May. Market is already pricing in around 70% probability of a rate hike in May, and we would need to see a significant upside surprise in the CPI figures to lift UK interest rates higher this week. We expect the BoE to hike twice in 2018. This is more hawkish than consensus and market's pricing and we expect EUR/GBP to decline to 0.84 in 12M. See *Bank of England Review – Launching a hiking cycle*, 8 February.

On Friday, Japanese medias (Kyodo News and Nikkei Newspaper) reported that Prime minister Shinzo Abe plans to nominate Koruda for another term as Bank of Japan Governor. We expect the parliament to vote on the BoJ leadership before the end of February. While it is widely anticipated by the market that Koruda would get another term as governor, clarification about the future BoJ leadership would reduce uncertainty and to some extend underpin USD/JPY in the current volatile and less risk friendly markets. However, in the short term, USD/JPY remains caught between the sell-offs in the US fixed income and global equities, and we expect the cross trade within the range of 108.00-110.84 in the near term. We target USD/JPY at 113 in 3M supported by Fed-BoJ divergence.

Russia's central bank (CBR) cut its key rate by 25bp to 7.50% on 9 February, as inflation has hit its post -Soviet low at 2.2% y/y. At the same time, the CBR sounded dovish in its statement announcing completion of 'the transition from moderately tight to neutral monetary policy in 2018'. From now, we expect the CBR to cut to 6.50% (previously 6.75%) by the end of 2018 and to 6.00% by the end-2019, given no geopolitical 'black swans' or crude price crush. Traditionally and as we expected, the RUB reacted positively to the CBR's decision immediately following the announcement. Yet, on Friday afternoon, the USD/RUB bounced back to its opening levels. The Russia-friendly assessment by the US Treasury this week and an unwillingness to sanction Russia's government debt or other financial instruments has cheered up RUB sentiment. See Bank of Russia: a cautious and consistent 25bp cut, published on 9 February.

Key figures and events

Monday, February 12, 2018				Period	Danske Bank	Consensus	Previous
8:00	DKK	CPI	m/m|y/y	Jan	**0.0%|1.0%**	*0.0%|1.0%*	-0.3%|1.0%
9:15	CHF	CPI	m/m|y/y	Jan		*-0.2%|0.7%*	0.0%|0.8%
20:00	USD	Budget statement	USD bn	Jan		*50.0*	51.3

Source: Bloomberg, Danske Bank

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