12 October 2016

Danske Daily

Market movers today

- **In the US today, the FOMC minutes from the September meeting are due out.** The committee looked very divided at the September meeting with three members voting for an instant hike and three members signalling no hikes in 2016 at all (ten members are signalling one hike). Hence, it will be important to see the discussion they had.
- **Industrial production for August for the euro area is due to be released today.** Industrial production saw a large monthly drop of 1.1% in July, led mainly by very weak German industrial production. We expect industrial production to rebound in line with the strong German figures. The recent manufacturing PMIs have also pointed towards an improving manufacturing sector, so we expect industrial production to remain solid in Q3.
- **There are no major data releases today in Scandinavia.**

Selected market news

Yesterday, the German ZEW expectations surprised on the upside at 6.2 in October from 0.5 in September. It was at 19.2 in June prior to the UK's vote to leave the EU. The current situation component, which is less forward looking, was also better than expected at 59.5 in October compared to 55.1 in September. This is the highest level since January this year. The figures confirm the signal from the PMI and Ifo expectations from September that the euro area is so far resilient to the UK's decision to leave the EU. It looks as if GDP growth could surprise on the upside in H2.

The new Bank of England (BoE) member Michael Saunders communicated yesterday, in line with the current BoE communication, that it is OK if inflation overshoots its target if it is due temporarily to FX movements. If wages pick up, the BoE dilemma is 'sharper'. Moreover, Saunders said that a weaker GBP is due to Brexit concerns but that the economy has not slowed as much as expected in the August report. In our view, the better-than-expected economic data means it is less likely that the BoE will cut rates in November. However, since the UK's Prime Minister, Theresa May, seems to be heading for a 'hard Brexit', which means that business optimism could take a hit again, it cannot be ruled out completely that the BoE will ease further.

In general, it was a fairly calm session in global financial markets yesterday, slightly skewed towards risk-off sentiment. Stock markets were fairly calm but did move mainly downwards. In fixed income markets, yields in Germany decreased after the recent period of yields climbing higher. The 10Y German government bond yield fell by approximately 3bp and thus remains some few basis points above negative territory. Moreover, Brent oil decreased, though modestly, to USD52.4/bbl.

Today, it has been a quiet morning. Regarding risk sentiment, so far it has been mainly risk-off with Asian stock markets in the red and with the 10Y government bond yield in Japan down by approximately 1bp. However, Brent oil has climbed slightly higher to USD52.6/bbl at the time of writing.

Selected readings from Danske Bank

- *US election monitor: Clinton regains a significant lead*

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Scandi markets

There are no major data releases today in Scandinavia.

Fixed income markets

The main event for the fixed income markets will be the minutes from the FOMC meeting in September, when the markets will look for indications on how close the Federal Reserve is to raising rates and how much pressure there is on Janet Yellen to raise rates. The US Treasury bond market is already affected by the expectations for a rate hike in December given the bearish steepening seen in October between 2Y and 10Y as well as 10Y and 30Y US Treasury yields. A hawkish report from the FOMC meeting would support the bearish steepening near term.

In the European fixed income markets there are no major key economic releases or government bond auctions. Portugal continued to perform on the back of the expectations that DBRS will maintain the IG rating and that the budget due to be released this week will show a solid improvement in the public finances, especially on the primary budget. There is still significant catch-up in the Portuguese government bonds if DBRS maintains the rating on Portugal. Sweden is also performing well on the back of the lower-than-expected CPI data released yesterday. Today, we have the Prospera inflation survey – this is expected to support the view that inflation is heading down.

Denmark and Sweden are tapping in the T-bill market. Denmark is tapping in Dec-16 and Mar-17 while Sweden is tapping into Jan-17 T-bills, but auctions look attractive swapped into USD.

FX markets

Yesterday, the disappointing inflation release out of Sweden marked the ‘complete’ week for disappointing Scandi inflation prints. The release saw EUR/SEK spike higher, breaching key support levels and reaching the highest level since 2010. EUR/SEK has been stuck in an uptrend since April – a trend driven mainly by negative momentum in Swedish macro data. It should be noted that while we see a growth slowdown, it is not a collapse but rather alignment with growth rates seen elsewhere, yet it does represent a change in the market perception of the Swedish ‘growth story’ that has dominated markets over the past years. The weak inflation print opens for an extension of the Riksbank QE programme already in October, or at the latest in December. We expect QE extension until mid-2017 with SEK20bn nominal government bonds and SEK10bn IL. At some point the Riksbank (RB) may open for covered bonds given the eventual lack of government bond supply. Ahead of these RB meetings, we expect markets to continue to ponder over more easing measures which may put further downward pressure on Swedish rates and as such the SEK. That said, after today’s rally EUR/SEK is trading more than three standard deviations above the rates-implied fair value. This is an unusually big gap, which suggests that EUR/SEK is already trading at expensive levels and thus that the upside potential is somewhat limited. The discrepancy between rates and FX also suggests that the FX market has been relatively more prepared for more QE. Meanwhile, the technical trend is no doubt pointing towards higher levels still (even though RSI, the relative strength index, is in overbought territory). Fundamentally and valuation wise, these levels seem stretched and are to a large extent the result of an overly SEK-obsessed/concerned RB. We do look for a rebound in the krona over the medium term but acknowledge near-term challenges, which suggest a weak SEK for longer.

EUR/USD has continued to grind lower in a move which in our view is driven by two factors: (1) rising political uncertainty in the euro zone following the signals from Theresa May that the UK will opt for a hard Brexit. The Brexit negotiations are going to test the EU's cohesion with different parts of the EU having diverging priorities. (2) The market is likely to remain focused on the Fed raising rates in December and with no major data this week, these expectations will drive USD strength. Technically, a downside break of 1.1050-1.11 will open for a test of 1.0950-1.1000. Short term, we expect EUR/USD to move lower still; medium term we continue to expect EUR/USD to move a lot higher towards 1.18 in 12M on valuation and C/A differentials.

Key figures and events

Wednesday, October 12, 2016				Period	Danske Bank	*Consensus*	Previous
-	EUR	ECB's Coeure speaks in Brussels					
1:30	AUD	Westpac Consumer Confidence	Index (% m/m)	Oct			101.4|0.3%
1:50	JPY	Machine orders	m/m|y/y	Aug		*-4.6%|7.9%*	4.9%|5.2%
8:00	SEK	Prospera inflation expectations					
8:45	FRF	HICP, final	m/m|y/y	Sep		*-0.2%|0.5%*	-0.2%|0.5%
11:00	EUR	Industrial production	m/m|y/y	Aug	**1.5%|...**	*1.2%|0.8%*	-1.1%|-0.5%
13:00	USD	MBA Mortgage Applications	%				2.9%
14:00	USD	Fed's Dudley (voter, dovish) speaks					
15:40	USD	Fed's George (voter, hawkish) speaks					
20:00	USD	Minutes from FOMC September meeting					
22:00	EUR	ECB's Mersch speaks in Cambrigde					

Source: Bloomberg, Danske Bank Markets

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