16 December 2016

Danske Daily

Market movers today

- After a very busy week so far, we are in for a quieter day with few key data on the agenda.
- We have HICP data due out for the eurozone, but we already know much of the local data, so there will be little focus here.
- We also have US housing starts and building permits for November. The data might give us insight into whether the higher mortgage yields in the US after the US Presidential election have had any impact on housing activity after the very strong NAHB housing market index for December.

Selected market news

Yesterday was day one after Janet Yellen and the rest of the FOMC turned somewhat more hawkish and especially the FX market continued to price in the new Fed stance. Thus, the USD rally continued especially during the European session yesterday.

EUR/USD has now broken below the low at 1.0458 from March 2015 and is now trading at the lowest level since 2003. However, in our view, there is more dollar strength in store as 'the downside break' of the low in EUR/USD will open the door for further strengthening given rising US growth and rate expectations. As such, we continue to expect EUR/USD to edge lower short term. Medium term, however, we continue to expect EUR/USD to move higher due to valuation and the record-high eurozone-US current account differential.

In the FI market, the moves were more modest. After an initial sell-off in the European session, the market stabilised. Given the stronger US dollar, the market seems reluctant to price in further hikes in the curve. There are prices of around 2¼ hikes of 25bp in 2017, somewhat below the three hikes implied by the Fed 'dots'.

Yesterday, we got some of the first data collected after the US election and the jump in equity markets. The latest Philadelphia survey index rose almost 14 points to 21.5 in December from 7.6 in November. This exceeded the consensus estimate of 9.1 significantly, and it was the highest reading since November 2014. Importantly, the forward looking parts of the report were also very solid with new orders rising to 13.9 from -2.1. Hence, it seems that US manufacturers believe that Trump will 'make America great again'. We also had good news from the US housing market, where the NAHB index in December jumped to 70 from 56 the highest level since 2006. Hence, for now, no signs that the higher mortgage rates are hurting the US housing market.

But the manufacturing recovery does not seem to be only a US phenomenon. In the Eurozone, the flash PMI estimate for December rose to 54.9 from 53.7. It is now at the highest level since 2011.

Selected readings from Danske Bank

- *Bank of England review*
- *Norges Bank review*
- *Update on EUR/DKK*

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Scandi markets

No events today. In Denmark, we are keeping an eye on EUR/DKK, which has now dropped below DN's intervention target from earlier this year and close to the lower bound under present governor Lars Rohde. European political risk and a strong wealth effect of the recent rise in US stocks have been the main factors weighing on the pair. The latter spurs a hedging of US assets by Danish pension funds, thereby adding to DKK strength. Hence, the Danish central bank may need to sell DKK in FX intervention to cap the EUR/DKK lower bound around the 7.4340-50 level and thus increase the FX reserve from the present DKK450bn. For more, see our update *here*.

Fixed income markets

There is an increasing focus on the lack of high quality German collateral in the system – something ECB President Mario Draghi also addressed yesterday in an insightful letter to MEP lawmakers, see *here*. On the one hand, Draghi states that '*on the supply side, the ECB is aware that the imbalances in the market partly reflect the impact of its asset purchase programme (APP). At the same time, these imbalances are also a consequence of increasing demand. This increasing demand is caused by changes in the market structure and regulatory developments*'. However, Draghi also stated that '*there is no evidence that the increasing collateral specialness is a reflection of a shortage of collateral or repo market stress.'*

Once again, Draghi emphasises that the very low repo level on both GC and in particular bonds trading special on the German curve should not be a problem for a well-functioning market. It will be key to follow whether the new 'cash for bund facility' (started yesterday) and/or the fact that we will soon be over year-end, which should give some relief as we enter 2017 – or whether it will be outweighed by the ECB starting to buy below depo and thereby taking even more shorter-dated German collateral out of the market.

It is season for funding outlooks and yesterday the Dutch DMO announced that gross issuance will increase to EUR 30-35bn in 2017 up from 26.6bn in 2016 (see *here*).

Denmark also released the 2017 funding outlook yesterday. The target for the sale of government bonds and T-bills in 2017 is DKK65bn and DKK30bn, respectively – unchanged from 2016. The issuance target is a bit higher than what we had anticipated owing partly to the fact that USD loans amounting to slightly more than DKK8bn will be redeemed next year and the DMO is not planning a new USD issuance. Issuance will also be focused predominantly on the 2Y and 10Y with two new benchmarks planned for 2017. See our review *here*.

FX markets

The USD rally continued during the European session yesterday after the hawkish FOMC rate hike on Wednesday evening. EUR/USD broke below the decade low at 1.0458 from March 2015, and in our view, the downside break of the low in EUR/USD will open the door for further losses given rising US growth and rate expectations. As such, we continue to see EUR/USD as a short-term 'sell on rallies'. Medium term, we continue to expect EUR/USD to move higher due to valuation and the record-high eurozone-US current account differential.

USD/JPY broke above 118 for the first time since February 2016. We expect the JPY to continue to suffer in an environment of rising global bond yields and a higher oil price as portfolio flows out of Japan are likely to counter the underlying appreciation pressure in the JPY stemming from fundamentals. However, we expect upside momentum to ease as short-term technical indicators suggest that the cross is very overbought.

As expected, Norges Bank kept rates unchanged yesterday while maintaining a neutral bias in the statement. We think the bar for more monetary easing has become high in Norway, especially given the housing market situation in Oslo. A hike, however, also seems far away given the outlook of still only moderately higher output growth, falling inflation and lower-than-expected wage growth outlook. We still expect EUR/NOK to move lower next year targeting 8.80 in 12M as normalising growth and real interest rates, higher oil prices and valuation forces all point to a lower cross in 2017. Near term, however, we see a risk of markets overreacting to OPEC headlines, which together with markets digesting a more hawkish Fed and year-end seasonality could prove to be near-term headwinds. See *Norges Bank Review: Unchanged rates and neutral bias maintained* (15 December) for details.

Yesterday, EUR/DKK dropped below 7.4350 and thus below the FX intervention target of DN from earlier this year. We see two factors weighing on EUR/DKK at present: (1) continued focus on using DKK to hedge risk to the EUR from political uncertainty in Europe. This is not likely to be a significant factor at present but several events are looming in 2017; (2) USD/DKK selling on the back of the recent rally in the USD and US stocks (in Q2, Denmark had DKK540bn worth of US stocks amounting to 20% of Denmark's foreign portfolio investments). We have lowered our EUR/DKK forecast and now expect it to trade at 7.4375 on 1-3M (revised down from 7.4425). On 6-12M, we look for the downward pressure to ease and EUR/DKK to trade at 7.4425 (unchanged from last time). See *FX Strategy: EUR/DKK falls close to lower bound under Rohde* (15 December) for details.

Key figures and events

Friday, December 16, 2016				Period	Danske Bank	*Consensus*	Previous
-	EUR	S&P may publish Germany's debt rating					
8:45	FRF	Business confidence	Index	Dec		*102.0*	102.0
9:00	DKK	House prices (Association of Danish Mortgage Banks)	q/q|y/y	3rd quarter			
11:00	EUR	HICP inflation	m/m|y/y	Nov	**...|0.6%**	*-0.1%|0.6%*	...|0.5%
11:00	EUR	HICP - core inflation, final	y/y	Nov	**0.8%**	*0.8%*	0.8%
11:00	EUR	Trade balance	EUR bn	Oct		*25.0*	24.9
11:00	EUR	Labour costs	y/y	3rd quarter			1.0%
11:30	RUB	Central Bank of Russia rate decision	%		**10.0%**	*10.0%*	10.0%
14:30	USD	Building permits	1000 (m/m)	Nov		*1243*	1260.0 (2.9%)
14:30	USD	Housing starts	1000 (m/m)	Nov		*1230*	1323.0 (25.5%)
18:30	USD	Fed's Lacker (non-voter, hawkish) speaks					

Source: Bloomberg, Danske Bank Markets

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