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# Danske Daily

## Market movers today

- A very quiet day on the data front. The **US initial jobless claims** and Philadelphia Fed survey are the only data of interest. It will be interesting to see if the Philadelphia Fed mirrors the Empire index earlier this week and stays at solid levels.
- Geopolitics continue to be in focus as **US-China negotiations** continue and some uncertainty has arisen over the meeting between **North Korean leader Kim Jong-un and US President Donald Trump**.
- **Norway** is out for Constitution Day today.

## Selected market news

**Italy**'s 10Y government bond yields have been on the rise as markets see new political risk is rising in the country and the probability of a populist government is increasing. A flight to quality boosted demand for bunds, causing the biggest intraday widening in 10Y bond spread in a year and weighing further on the **EUR**.

The sentiment has dented both European and US assets on news that EUR250bn of Italian debt could be written off. However, the speculations were denied by one of the parties, which is in process to establish a coalition. **US Treasuries** saw a sell-off as the 10Y yield climbed some 2bp.

**North Korea** threatened to cancel the upcoming summit between President Trump and Kim Jong-un planned for 12 June in Singapore. **North Korea** suspended talks with **South Korea** because of a joint military drill by South Korea and the **US**. Trump's reaction has been muted so far.

The **EM FX** two-day plunge stopped on the **USD** retreating from its highest levels YTD. The **USD/TRY** retreated from its record high yesterday after the Turkish central bank announced it could take necessary steps. Markets started expecting an emergency rate hike.

## Scandi markets

In **Sweden**, Q1 housing starts and permits data are due to be published. We expect another negative quarter. Incorporated in our GDP estimate for Q1 (released on 30 May) is a 5% drop in residential investments between Q4 and Q1.

### Selected readings from Danske Bank

- *Fixed Income Strategy*
- *FX Essentials*
- *Reading the Markets Norway*

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- *Yield Outlook*
- *FX Forecast Update*
- *Weekly Focus*

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## Fixed income markets

Key focus in the European fixed income markets will be the political developments in **Italy**. The political concerns regarding a government between the League and the Five Star Movement (5SM) sent Italian government bond yields dramatically higher and the spread to Bunds widened some 20bp yesterday. The main driver was that the League and the 5SM were still discussing the possibility of asking the ECB for a write-down of EUR250bn of Italian government debt. Furthermore, Head of the League Matteo Salvini had been asked about the 'market pressure' on **Italy**. He was very dismissive and indicated strongly that he would not bow to 'market pressure'.

We think that the proposal regarding **a debt write-down by the ECB** is too farfetched as this has also been confirmed by the League. However, the comments from Salvini, that the new government will not 'bow' to market pressure is more disturbing as this indicates that Italy will follow its own rules and increase public spending significantly. This could potentially be a deal breaker, if it cannot find the relevant funding sources.

**France** and **Spain** are tapping today. **France** is selling up to EUR7.5bn in the 3Y and 5Y nominal bonds and up to EUR1.75bn in the 4Y, 9Y and 29Y linkers.

## FX markets

**EUR** crosses were in deep dives yesterday after speculation that **Italy**'s possible new coalition government would be looking to write off a sizeable chunk of Italian public debt sparked market worries; this was later denied by the parties though and helped to ease selling pressure somewhat. New cycle highs in the US 10Y yield, however, kept **EUR/USD** under pressure and while rate momentum is currently strong, we do not think **US** rates are in for another level shift just yet. This should limit the potential for **USD** strength from a factor that has been the dominating force in FX markets in recent weeks.

Our Short-Term Financial Model for **EUR/USD** suggests the cross is very oversold, and we stress that from a technical point of view, good support should still be seen at 1.1718 (Dec-17 low). The cross is likely to settle in a new range around current levels near term but remains a buy on dips in a 6-12M perspective.

**GBP** gained overnight following a report by The Telegraph that Theresa May's **Brexit war** Cabinet has agreed on a new 'backstop' as a last resort to avoid a hard Irish border, meaning that the **UK** will tell the **EU** that it is prepared to stay in the customs union beyond 2021. The **Irish border issue** remains one of the key problems for the Brexit negotiations and it is still unsure whether this new agreement within the UK government is enough to push Brexit negotiations forward. FX price actions underscore that Brexit remains a key driver for **GBP**. Hence, while we still expect **GBP** to gain support from relative rates as a Bank of England rate hike moves closer, the trigger for **EUR/GBP** eventually breaking significantly lower towards our 12M forecast of 0.83 remains Brexit clarification.

The **USD/TRY** hit another all-time high yesterday, posting 4.50 as Recep Tayyip Erdoğan was meeting Turkish central bank's (the TCMB) governor. Markets became even more confused following Erdoğan's interview to Bloomberg on Tuesday, as he stated that he plans to take more responsibility for monetary policy after the election next month.

Yet, the **TRY** rate is one of the key factors for voters during the snap election on 24 June. Thus, Erdoğan is facing a clear dilemma. To stop **TRY**'s devaluation, the central bank needs a significant, credible hike of more than 150bp. That could mean an emergency hike before the June decision. While we have stayed **TRY** bearish on weak Turkish macro, the current **TRY** levels show the lira has been oversold.

## Key figures and events

| Thursday, May 17, 2018 | | | | Period | Danske Bank | *Consensus* | Previous |
|---|---|---|---|---|---|---|---|
| - | NOK | Constitution Day | | | | | |
| 11:00 | EUR | Trade balance | EUR bn | Mar | | | 21 |
| 14:30 | USD | Initial jobless claims | 1000 | | | | |
| 14:30 | USD | Philly Fed index | Index | May | | | 23.2% |

*Source: Bloomberg, Danske Bank*

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