

Danske Daily

Market sell-off takes a breath

Market movers today

- The US-China trade war might be entering a quiet phase after the recent round of escalation. The next thing to look for is any news on more Chinese stimulus and more specific information on when the next round of talks in Beijing could take place. While things may calm down for now, we still see a risk of another flare-up later as the two sides seem far from each other on the final critical bits of the deal. More financial stress is needed, in our view, to get enough pressure to reach a deal. For more on this see also *China Weekly Letter – China strikes defiant tone, recovery postponed*, 16 May 2019.
- On the data front it is a very light day. We have the final euro area HICP for April out, where we see scope for an upward revision in both core and headline inflation by 0.1pp. In the afternoon the US releases preliminary consumer confidence for May from the University of Michigan. We also have the Fed's Williams (voter, neutral) speaking tonight.

Selected market news

After a dreadful start to the week, risk sentiment recovered some ground on Thursday, despite President Trump's decision to add more fuel to the fire with his executive order that effectively bans Chinese telecom firms Huawei and ZTE doing business in the US. We still struggle to see a trade deal coming until there has been another round of escalation and sell-off in the markets that creates the needed pressure for both sides to meet each other halfway.

European equities shrugged off the trade 'angst' and advanced for a third day in a row, while Bunds sold off slightly and peripherals performed, with the 10Y Italian government bond yield tightening some 7bp vs Germany. However, considering the recovery in European equities, the change in 10Y Bund yields was still limited, underlining that yields are not just depressed due to weak risk appetite but also due to a general pessimism in the market about the outlook for growth and inflation. Market inflation expectations headed further South with 2y2y inflation swaps dropping below 1% for the first time since 2016, see [here](#). Hence, even if the positive risk appetite continues next week, we do not expect any significant fixed income sell-off in core markets.

In the US, the market also reversed some of the pricing of Fed cuts seen earlier in the week, after Fed speakers Brainard and Kashkari did little to support the market's expectation of the Fed cutting rates before year-end. Treasuries gave back some of this week's gains, lifting 10Y yields back above 2.40%. An outlier to the risk-on move was emerging markets equities, with the MSCI Emerging Markets Index falling to its lowest level against developed markets stocks since November.

In the UK, pressure on PM Theresa May to resign over her failure to deliver Brexit is mounting. After a meeting with the Conservatives Party leadership, the embattled premier agreed to set out a timetable for a Tory leadership race after the Withdrawal Agreement Bill is put to a vote in the House of Commons in the first week of June.

Selected reading from Danske Bank

- *China Weekly Letter - China strikes defiant tone, recovery postponed*
- *US-China Trade: Back in the tit-for-tat spiral*
- *Euro Area Research - Inflation under the microscope: simmering, not boiling*

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Senior Analyst

Aila Mihr
+45 45 12 85 35
amih@danskebank.dk

Scandi markets

No releases in the Scandi countries today.

Fixed income markets

We think that pricing of cuts from the ECB is premature as the possibility of, for example, tiering is very low. Hence, in *Government Bonds Weekly* we recommend to pay 9m3m EONIA. We also take a closer look at the Italian bond curve and, despite the recent spread-widening, we stay side-lined in respect of BTPs given the political risks. But we do repeat our cautious recommendation from last week to buy the 1Y BOT. We also take a closer look at the new 20Y Dutch green bond that is due next week.

Note the Danish FI market is closed today (Bank holiday).

FX markets

The main driver of FX markets yesterday was the recovery in risk sentiment, which also helped send equities and commodity prices up. USD/JPY rose back towards the 110 level, Scandies were bid and EUR/USD fell below 1.12 as the market also reversed some of the pricing of Fed cuts. In the big picture, we do not expect yesterday's 'risk-on' move to extend much further in the short term. For that we need substantial good news either on the trade war front, data front or from more dovish central bankers.

Key figures and events

Friday, May 17, 2019					Period	Danske Bank	Consensus	Previous
11:00	EUR	HICP inflation	m/mly/y	Apr		1.7%	1.7%	
11:00	EUR	HICP - core inflation, final	y/y	Apr		1.2%	1.2%	
16:00	USD	University of Michigan Confidence, preliminary	Index	May		97.9	97.2	
17:15	USD	Fed's Williams (voter, neutral) speaks						
20:00	USD	Fed's Williams (voter, neutral) speaks						

Source: Bloomberg, Danske Bank

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