18 December 2017

Danske Daily

Market movers today

- The main events this week will be the Riksbank meeting this Wednesday and the Bank of Japan meeting on Thursday.
- On the data front, we start the week with a very light day.
- In the euro area, note that the revised inflation figures for November are also due to be released today.
- Furthermore, in South Africa, the election of the new leader of the ANC may take place, which is already having a great bearing on the South African financial assets and the ZAR.

Selected market news

The final details of the US tax overhaul were revealed on Friday. The Republican tax plan cuts the corporate tax rate to 21% on a permanent basis, while offering temporary cuts to individuals. The tax plan is expected to be voted through Senate by Tuesday and signed by President Donald Trump by the end of the week, before entering into force by February. According to the Joint Committee on Taxation (JCT), the reform will raise economic growth of about 0.8% over the next ten years. However, according to the JCT's estimate (*link*), this will only cover about a third of the cost, which means that the reform will add at least USD1trn to the USD20trn national debt over next decade. The plan could also boost US corporate earnings by some 10% on average, with oil refiners, airlines and banks among the main beneficiaries, according to *Financial Times*.

Expected passage of tax plan lifts equity markets. On Thursday, concerns about the tax plan passing this year weighed on stocks as not all Republican senators had committed to supporting it. However, on Friday there seemed to be full backing for the deal with all 52 Senate Republicans in support. This lifted US stocks, with S&P rising 0.9% and the gains have carried over to Asian trading this morning.

Fitch upgrades Ireland and Portugal on Friday. Ireland was upgraded by one notch to 'A+', while Portugal's sovereign rating was raised two notches to 'BBB'. Please see the Fixed Income section for details.

Russia's central bank (CBR) delivered surprise cut of 50bps to 7.75% on Friday. Together with the market and Bloomberg consensus, we unanimously expected a 25bp cut. Yet, prior to the decision we pointed out that a 50bp cut would likely mean increasing hidden pressure on the CBR ahead of the presidential election as the central bank has stayed conventionally overcautious and hawkish despite falling inflation. We expect the CBR to cut its key rate gradually to 6.75% by end-2018 (previously 7.00%). As an initial reaction the USD/RUB spot jumped slightly higher and rates dropped a bit. After a while, RUB was stronger against the USD and rates were almost at the same level as they were before the surprise cut. We expect high real rates to prevail in Russia in 2018, being one of the supporting factors for the RUB.

Selected readings from Danske Bank

- *Strategy - Strong economy and low rates continue*
- *ECB review - Christmas mood leaves QE exit decisions for 2018*
- *Norges Bank Review: Rate hike at end-2018, steeper FRA curve, stronger NOK*
- *Yield Outlook - Central bank exit but only modestly higher long yields*

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Scandi markets

There are no Scandi releases today.

Fixed income markets

The main events next week will be the Bank of Japan meeting on Thursday and the meeting in the Riksbank on Wednesday. There has been some focus on the potential negative impact of the negative deposit rate and yield curve control in Japan, but we do not expect the BoJ to change policy. The BoJ policy is to some extent pushing Japanese investors towards foreign assets, although it is getting increasingly expensive to hedge USD-denominated fixed income assets, while still 'cheap' to hedge DKK, SEK and EUR assets back into JPY.

The Riksbank is expected to end QE but as coupons and redemptions are reinvested, the Riksbank will still be buying bonds in 2018. However, the main focus is on the policy path and the first hike, where the market expects an early hike. We think differently and expect them to keep the rate path unchanged and avoid signalling a premature hike. See more in *Strategy: Sweden/Norway - receive SEKFRA and pay NOKFRA in a cross-country spread*, 15 December, as well as our weekly on the Swedish market, *Reading the Markets,* 14 December.

Fitch upgraded both Ireland and Portugal on Friday. Portugal received a two-notch upgrade to 'BBB' and stable outlook. This was more than we had hoped for and is bringing Portugal back into investment grade. Ireland received a one-notch upgrade to 'A+' and a stable outlook. The upgrades confirm our view that the rating cycle for the European countries has definitely changed and thus we are looking for more upgrades in 2018.

Finally, Denmark will publish a revised fiscal outlook for 2017 and 2018 on Monday. We have already received the revised funding need relative to the forecast in August. This shows a dramatic improvement in budget for 2017 as we go from a small deficit of DKK6bn to a large surplus of DKK27bn. This is most likely due to higher pension fund taxes. In 2018, the deficit will increase from DKK35bn to DKK50bn – most likely due to the increased funding for social housing but the funding will merely increase by DKK7bn as the Danish Central Bank has been buying back DGB 0.25% 2018 in 2017.

FX markets

Soft messages from the Fed and ECB helped to keep EUR/USD in check last week with the cross again trading in the 1.17-1.18 region. Ahead of the holiday season, the data calendar is light but there are a few possible events to deliver – possibly – some EUR/USD downside this week. First, the US Congress could pass the long-awaited tax bill, which should be a USD positive as this would be a signal that the Trump presidency is finally able to deliver; we will notably watch out for the scope of a Homeland Investment Act 2 as this could drive USD-supportive repatriation flows in early 2018. Second, the Catalan election on Thursday may well return in a hung parliament and, in any case, risks putting renewed focus on 'political risks' for the euro near term. Furthermore, USD is becoming increasingly expensive over year-end with the implied interest rate on USD in EUR/USD FX forwards hitting 20% on Friday. We thus see a good chance of EUR/USD dipping into the 1.16s this week.

USD/JPY gained on Friday on renewed hopes that the US congress could pass a tax bill within few days. Besides possible support to the cross from a US tax reform, the tight USD liquidity situation is also likely to continue to underpin the cross near term. However, investor appetite for selling JPY is likely to be limited ahead of the BoJ meeting, which ends on Thursday. Here, focus will be on the communication from Governor Haruhiko Kuroda during the press conference, as he might elaborate on recent tightening speculation.

EUR/GBP traded higher on Friday and peaked close to 0.8860 as the market was positioned for more positive news from the EU summit about Brexit. As expected, EU leaders agreed to move Brexit negotiations to phase 2, but comments from both EU officials and UK politicians on

Friday and over the weekend support our view that it is too early to reprice a Brexit risk premium as significant difficulties lie ahead in the second phase of negotiations. We still see EUR/GBP within the 0.8650 -0.90 range in coming months. We expect GBP to remain volatile towards year-end and sensitive to Brexit-related news.

EUR/SEK was bid on Friday. The cross even breached 10.00 and was rejected just below 10.04. Despite the temporary headwinds for the SEK related to PPM flows now being out of the way, the SEK has remained under pressure – just as we have argued could be the case. However, the coming week is all about the Riksbank. If it puts an end to QE without touching the repo rate path (our call), we could see some support to the SEK as the market may deem it as semi-hawkish. We still do not see the Riksbank raising the repo rate next year though and we still think the markets will ponder the consequences of the fragile housing market going forward. Therefore, we think that any rebound in the SEK will be limited. The outcome of the Riksbank meeting is admittedly very uncertain though, which is fairly reflected in implied vols and a more dovish decision like extending QE and/or delaying the first hike is clearly a possible outcome, although it is not our call. In that scenario, we should see another leg higher in EURSEK. For further details regarding our take on the Riksbank meeting, see *Reading the Markets*, 14 December.

The NOK followed SEK's suit and also came under pressure on Friday. This illustrates an important point that the NOK will remain vulnerable this side of New Year as key NOK buyers leave the market; Friday was for instance the last day where Norges Bank (NB) was active in FX markets in 2017. We still think that the monetary policy message given by NB on Thursday was important for our call that the NOK should move higher next year. See *Norges Bank Review: Rate hike at end-2018, steeper FRA curve, stronger NOK*, 14 December, but Scandi vulnerability should not be underestimated near term. The data calendar for Norway is very thin for the remainder of the year. The only noteworthy release this week is Friday's NAV unemployment report where we pencil in another strong report, indicating above-trend growth and higher capacity utilisation. In *FX Top Trades 2017*, 6 December, we are long NOK/SEK spot and short EUR/NOK via options.

In South Africa, the ANC party delegates will cast their votes today for a successor to Jacob Zuma. There are two front-runner candidates: 1) Zuma's candidate, and ex-wife (!), Nkosazana Dlamini-Zuma, is leftish leaning candidate promoting more rights to the black population and 2) Deputy President Cyril Ramaphosa, a pro-business businessperson, who is seeking to distinguish himself from Zuma's administration and corruption charges. Ramaphosa is currently the front-runner (benefiting the ZAR), but the outcome is far from given. As the voting begins, the ZAR hits its three-month high against the USD at 13.08, posting 7.3% of 1M total return. If Mr. Ramaphosa wins, the USD/ZAR may break below the 13 benchmark. However, in such event, there may still be a messy aftermath with Jacob Zuma fighting for his political survival as he can still sit out the term until the presidential election in 2019, but there overall there are downside risks to our current forecast of 13.7 in 3M for USD/ZAR.

Key figures and events

Monday, December 18, 2017				Period	Danske Bank	Consensus	Previous
0:50	JPY	Exports	y/y (%)	Nov		*0.1*	0.1
0:50	JPY	Import	y/y (%)	Nov		*0.2*	0.2
0:50	JPY	Trade balance, s.a.	JPY bn	Nov		*265.0*	322.9
2:30	CNY	Property prices	y/y				
11:00	EUR	HICP inflation, final	m/m|y/y	Nov			0.1%|1.5%
11:00	EUR	HICP - core inflation, final	y/y	Nov			0.9%
16:00	USD	NAHB Housing Market Index	Index	Dec		*70.0*	70.0

Source: Bloomberg, Danske Bank

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