19 May 2020

Danske Daily

Germany and France propose a EUR500bn recovery fund

Market movers today

- We get the German ZEW indicator today. Expectations showed a strong bounce back in April and it will be interesting to see if the upbeat mood continues and whether it will begin to reflect in current economic conditions.
- We will monitor the gradual opening of economies across the world and potential escalation of US-China tensions. Pressure is mounting on China, as US, *EU* and Australian officials are *calling for a WHO investigation* into China's handling of the virus. China has agreed to this.
- **Fed Chair Powell's hearing before the US Senate Banking Committee takes place this afternoon**. His prepared remarks were released yesterday and did not contain any surprises. The Fed remains *'committed to using our full range of tools to support the economy'* and *'we expect to maintain interest rates at this level until we are confident that the economy has weathered recent events'*. We expect Powell to repeat that negative policy rate is not in the cards right now.

Selected market news

After a relatively uneventful day yesterday news broke that Germany and France have come with a common proposal for the EU recovery fund. There is a strong political signal for solidarity in the design of the recovery fund. We are positively surprised on the details of the recovery fund compared to expected – but we have to highlight that it is not a done deal yet. Sebastian Kurz, the Austrian Chancellor, *tweeted* that the Northern European countries' position remains unchanged. The (temporary) recovery fund, which is set at EUR500bn, is expected to issue long term (at least 2028 maturities) and focus primarily on grants (EU contributions raised from 2028, so the value of the grants is unknown). The timing of the supply is unknown but we expect after summer at the earliest (recovery fund could be approved on 18-19 June, if rest of the EU approves).

Yesterday the S&P 500 index rose the most in six weeks (3.15%) and is now back to the level in early March supported by news that Moderna Inc. has said it is closer to a COVID-19 vaccine. Asian stocks are also up this morning. In general, risk has been supported by easy economic policies, numbers of new COVID-19 infections moving in the right direction and many countries about to or have already started a gradual re-opening of the economies despite 'old risks' like US-China tech war and Brexit re-emerging. Oil prices are also moving slightly higher.

US President Trump has said that 'if the WHO does not commit to major substantive improvements within the next 30 days, I will make my temporary freeze of US funding to the WHO permanent and reconsider our membership'.

In the UK, Bank of England's Silvana Tenreyro said that negative rates in the euro area 'have had a positive effect in the sense of having a fairly powerful transmission to real activity' adding fuel to the speculations that BoE may cut its Bank Rate below zero too (currently 0.1%).

Selected reading from Danske Bank

- *Spending Monitor: As the economy opens up, we see a significant improvement in spending*
- *Yield Outlook: QE capping long-term yields through 2020, despite large supply*
- *Euro Area Research: The road to recovery*

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Scandi markets

No Scandi market movers today.

Fixed income markets

The news on the Germany-France proposal for a EU recovery fund led to some late spread tightening led by BTP rallying 19bp and Bunds selling off by 6.5bp yesterday. We expect tighter spreads led by periphery and steeper curves to prevail this morning. The (temporary) recovery fund, which is set at EUR500bn, is expected to issue long-term (at least 2028 maturities) and focus primarily on grants (EU contributions raised from 2028, so the value of the grants is unknown). The timing of the supply is unknown but we expect after summer at the earliest (recovery fund could be approved on 18-19 June, if rest of the EU approves). The recovery fund will be established by the EU on behalf of the EC focussing on long maturities and the rating is not given that it would be AAA rated. EU is AAA by Moody's, Fitch and DBRS and AA from by S&P. ESM is AAA by Moody's and Fitch. ESM does not have a S&P rating.

On ECB purchase details, yesterday's release on PEPP and PSPP holdings from last week rose 28.9bn and 10.9 respectively. **This shows that the PEPP pace slowed down, close to its long run average (5.8bn /day last week vs 5.7bn / day average)**. This is equivalent to PEPP package being exhausted by early October (assuming 5.7bn/ trading day).

The Kingdom of Norway yesterday mandated four banks including Danske Bank to lead manage its benchmark tap issue of NGB 1.375% 08/19/30 (NST 482). The syndicated tap was preannounced in the *Information for 2020 Q2* that Norges Bank published on 30 March 2020. Norges Bank has said it will issue NOK14-21bn in Q2 and we estimate a deal in the range of NOK8-10bn, as Norges Bank could opt to prefund into Q2 or cancel one or more auctions. For more see *FI Strategy Norway: Buy 10Y NGB ASW at syndicated tap* that was published this morning.

We have no scheduled supply today, but tomorrow and Friday will be quite heavily supplied with EUR21bn coming to the market and as such exert upward pressure on yields. Germany, France and Spain are in the market on Wednesday and Friday. For more see *Government Bonds Weekly - Irish and Belgian government bonds under pressure as Brexit is back on the agenda*, 18 May.

FX markets

While US-China tensions and talk of negative rates (or not) may be key FX drivers near term, the coronavirus FX legacy medium term remains key to watch. How different countries unwind crisis measures and how/whether more permanent facilities are set up will be decisive for how natural rates will evolve, more in *FX Essentials: COVID-19 FX legacy vol 3: shifts in natural-rate spreads?*. **Natural rates shift only slowly over time, but in the meantime short USD/CAD looks like an attractive recovery bet**: we see little case for a clear drift in the natural-rate spread but the spot has been running away from the spread - both over the past decade and in face of the COVID-19 shock - plus the cross is overvalued on fundamentals according to our MEVA model. Further, EUR/USD may be at risk from renewed divergence of natural rates in favour of the US if investment/growth opportunities in a broad sense continue to outpace European peers.

The market was going all in yesterday and it seems like we are moving towards disregarding all the risk inherent with Brexit, EU institutional risks, coronavirus and renewed US-China tensions. Super-cyclical positions such as DAX, small caps and EM FX in BRL, TRY and ZAR are leaping ahead. Notice also the new highs in equity indices at a point in time where many have highlighted outright crash risk. In our view, the market attitude towards risk may well have pivoted from the previous few weeks of wait-and-see towards being pushed further out the risk-curve. **This suggests EUR/USD may very well end the week in the 1.09-1.10 range and we remain cautiously upbeat on short-term upside risk**. **In EM FX, the laggards in Eastern Europe and ZAR could also do some catch-up.**

Key figures and events

Tuesday, May 19, 2020				Period	Danske Bank	*Consensus*	Previous
6:30	JPY	Industrial production, final	m/m|y/y	Mar			-3.7%|-5.2%
8:00	GBP	Unemployment rate (3M)	%	Mar		*4.4%*	4.0%
8:00	GBP	Average weekly earnings ex bonuses (3M)	y/y	Mar		*2.6%*	2.9%
9:00	SEK	NIER economic forecasts					
11:00	DEM	ZEW current situation	Index	May		*-85.0*	-91.5
11:00	DEM	ZEW expectations	Index	May		*30.0*	28.2
14:30	USD	Building permits	1000 (m/m)	Apr		*1000*	1350.0 (-7.0%)
14:30	USD	Housing starts	1000 (m/m)	Apr		*950*	1216.0 (-22.3%)
16:00	USD	Fed chair Powell (voter, neutral) speaks					
16:00	USD	Fed's Kashkari (voter, dovish) speaks					
18:00	USD	Fed's George (non-voter, hawkish) speaks					
20:00	USD	Fed's Rosengren (non-voter, hawk) speaks					
21:30	USD	Fed's George (non-voter, hawkish) speaks					

Source: Bloomberg, Danske Bank

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