19 September 2017

Danske Daily

Market movers today

- Today, German ZEW expectations. In August, the figure dropped to 10.0, due to weaker exports and the growing scandal in Germany's automobile sector. Together with the appreciating euro's pressure on exports, this could cause economic sentiment to deteriorate. However, both business expectations (Ifo) and German PMIs increased in August, signalling still increasing optimism on the part of business. Overall, we expect the ZEW expectations to show a small decline to 9.5.
- The Central Bank of Hungary will hold its monetary policy meeting today, where it might expand liquidity further by lowering the cap of the three-month deposit and/or cutting the O/N interest rate, despite inflation starting to pick up recently.

Selected market news

It has been a relatively quiet session overnight both in terms of news and price actions as investors await the FOMC meeting tomorrow. In the US, equity indices ended the day higher with S&P500 and Dow Jones gaining 0.15% and 0.28%, respectively. In Asia this morning, trading is more mixed with most regional indices trading lower while Japanese equity indices are up 1.3-1.5%.

While a large part of today's outperformance in Japanese equities can be explained by Japan catching up yesterday after returning from holiday, rising expectations of an early election might also boost the rally. Japanese equity markets have previously gained ahead of the dissolutions of the parliament on calls for elections. According to several media, it seems increasingly likely that Japan's Prime Minister Shinzo Abe will dissolve the Lower House later this month and call for a general election. If an early election is called this month, the Bank of Japan (BoJ) and consumption taxes are likely to come to the fore of political discussions. In particular, the questions about who will lead the BoJ when Haruhiko Kuroda's current five year terms ends in April is a theme that could induce uncertainty about the BoJ's monetary policy, as investors will probably link the fate of the Abe administration with the current accommodative policy regime (Abenomics).

In a speech last night in Washington, Bank of England (BoE) governor Mark Carney echoed the surprisingly hawkish statement from the BoE last week and signalled that the MPC might soon hike the Bank Rate as global factors in combination with a decline in the economy's potential due to Brexit have increased the chance of overheating and warrants higher interest rates. We expect the BoE to hike in November. See *FX Forecast Update: A tale of three central-bank camps* and *Yield Outlook - Central banks gradually turning more hawkish*, 15 September, for details.

There were no surprises in the minutes from the Reserve Bank of Australia's (RBA) meeting on 5 September published this morning. The RBA expects the economy to pick up gradually but there was no signal that the RBA is about to change its policy rate. We expect the RBA to deliver one 25bp hike within the next 12 months, which is in line with market pricing.

Selected readings from Danske Bank

- *Yield Outlook - Central banks gradually turning more hawkish*
- *FX Forecast Update: A tale of three central-bank camps*

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Scandi markets

No Scandi releases today.

Fixed income markets

Portugal was the big winner yesterday after the S&P upgrade into Investment Grade (IG). The outright 10Y level dropped 36bp to 2.39% – 194bp above Germany and 33bp above Italy. Any discussion of Portugal losing its QE eligibility is now gone and the focus is on the possible inclusion into Investment Grade bond indices, which would require one more IG rating. Remember, both Fitch and Moody's have Portugal on positive outlook. We expect Fitch to follow S&P and upgrade Portugal to IG on 15 December. We have now reached our 10Y 200bp spread target against Germany. However, we could see a bit more performance today as investors continue to position for Portugal moving fully into the IG indices and to get the carry Portugal offers.

The positive rating cycle is positive for our long-held bullish periphery market view, and we continue to see value in periphery markets despite the ECB talking about an 'exit'. The liquidity in the market will still be ample, QE purchases are expected to continue well into 2018, and after that reinvestment flows will be supportive. Core markets on the other hand were slightly under pressure as risk appetite was strong and as Mark Carney confirmed that some monetary tightening might be needed in the coming months – though importantly he stresses that any tightening would be limited.

Today, the market will be in wait-and-see mode ahead of the FOMC tomorrow. The market is now priced 50/50 as to whether or not we are going to see a rate hike in December. We remain in the bearish 'December rate hike camp' and in that respect we now recommend paying a 2Y/5Y/10Y USD fly 1Y forward as a way to express a bearish USD rates view with a non-negative carry (see *Fixed Income Strategy: Focus on three new trades*, 19 September). Following the re-suspension of the US debt limit (until mid-December), USD liquidity is likely to remain relatively ample short term. Hence, given a still fairly solid carry, we therefore also recommend to pay 3M1Y USD/JPY CCS. Moreover, we reiterate our recommendation to pay 5Y5Y NOK versus EUR from *Reading the Markets Norway*, 18 September 2017.

FX markets

EUR/GBP bounced a bit overnight as BoE governor Mark Carney's speech was interpreted as slightly dovish although he did signal that a rate hike is warranted. The market is currently pricing in an accumulated 19bp rate hike from the BoE in November, suggesting that there should still be some GBP appreciation potential in store ahead of the next BoE meeting on 2 November. We expect the BoE to hike in November and look for EUR/GBP to decline towards 0.87 around the meeting. Near-term risks are more balanced from a positioning point of view. Moreover, we note that political uncertainty related GBP is likely to increase in the coming weeks as Theresa May is scheduled to speak in Florence on Friday 22 September 'to update on Brexit negotiations so far'. The speech will attract a lot of attention in the financial markets, as it was the main reason why this week's Brexit negotiations was cancelled. Furthermore, political uncertainty and Brexit concerns could also become a theme again in connection with the Conservative Party congress running from 1-4 October. Hence, while we are moderately bearish EUR/GBP in 1-3M, we stress that some GBP selling pressure driven by rising uncertainty is likely to emerge in coming weeks. Finally, we stress that a November hike from the BoE is still conditioned on incoming labour market and inflation data. Hence, expect more two-way volatility in the coming months.

The NOK fended off oil price weakness yesterday. The key event this week is Thursday's Norges Bank (NB) meeting where we – like markets and consensus – expect rates to be kept unchanged. Focus will therefore be on NB's rhetoric and not least the rate path which currently does not pencil in a positive rate hike probability before Q1 19. We expect the rate path to be kept unchanged, in which case we expect a modest move higher in EUR/NOK of three-four figures (for more info see *Reading the Markets Norway*, 18 September). During the summer we argued that the downside potential for EUR/NOK was increasingly limited on the back of positioning and the oil price reaching the high end of its short-term trading range. In addition, over the past months, two factors have now also made relative rates a less likely factor to send EUR/NOK lower. First, it has become less likely that Norges Bank will send a hawkish signal to markets. Second, the postponement of the US debt ceiling issue means Nibor fixings are less likely to weigh on EUR/NOK in Q4 this year. We maintain EUR/NOK as a near-term range play but the risk of a correction higher has increased. On Friday we raised our 1M and 3M forecasts to 9.40 (from 9.30) and 9.50 (9.30), respectively. The higher 3M forecast primarily reflects the usual December seasonality supporting the cross. We left our 6M and 12M forecasts unchanged at 9.10 and 9.00, respectively.

Key figures and events

Tuesday, September 19, 2017				Period	Danske Bank	*Consensus*	Previous
10:00	EUR	Current account	EUR bn	Jul			21.2
11:00	DEM	ZEW current situation	Index	Sep	**12**	*86.0*	86.7
11:00	DEM	ZEW expectations	Index	Sep	**9.5**		10.0
14:00	HUF	Central Bank of Hungary rate decision	%		**0.9%**	*0.9%*	0.9%
14:30	USD	Building permits	1000 (m/m)	Aug		*1220*	1230.0 (-3.5%)
14:30	USD	Housing starts	1000 (m/m)	Aug		*1180*	1155.0 (-4.8%)
14:30	USD	Current account	USD bn	2nd quarter		*-110.5*	-116.8
14:30	USD	Import prices	m/m|y/y	Aug		*0.3%|2.2%*	0.1%|1.5%

Source: Bloomberg, Danske Bank

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