20 August 2019

Danske Daily

Trump wants many Fed cuts while Rosengren pushes back

Market movers today

- **There are no data releases worth mentioning today; however, focus will be on political events ahead of the important PMI data on Thursday.**
- **On Italy, markets will get a bit more clarity today on where the Italian government crisis is heading, as PM Conte is due to face a confidence vote in the Senate this afternoon.** Should Conte fail the vote, the initiative reverts to President Mattarella, who could either call for snap elections or try to broker a new cross-party alliance between Five Star and Renzi's PD to avoid interference with the 2020 budgeting season. Either way, political uncertainty in Italy will remain elevated for the time being.
- **This morning, we have published a presentation illustrating why we expect the Fed to deliver five more cuts from now until March**, see *Presentation: Five more cuts from the Fed (chart pack)*, 20 August.

Selected market news

Yesterday, the Fed's Rosengren pushed back against further rate cuts arguing that the US economy is still in good shape and he does not expect a significant slowdown. Rosengren, who voted against the first cut last month, said *"I just want to see evidence we are going into something that is more a slowdown"*. The Fed has been extraordinarily quiet in the past couple of weeks after the FOMC meeting and markets are awaiting more details from Fed chair Powell when he speaks at the annual Jackson Hole conference on Friday (we are also probably going to hear from some of the other FOMC members as well, but nothing is scheduled as of now).

In the other camp to Rosengren is US President Trump, who yesterday maintained the pressure on the Fed by *tweeting* that the Fed should cut rates by at least 100bp and possibly restart QE to support both the US and world economy. While we think the Fed will bark off the political pressure, we still think the economic reality means the Fed will deliver cuts over the next six months without pre-committing to more easing (see bullets above for more details).

Yesterday, the US delayed the Huawei ban for another 90 days as expected.

Ahead of Boris Johnson's meetings with Angela Merkel and Emmanuel Macron (tomorrow and Thursday), yesterday he sent a letter to EU Council President Donald Tusk to set out the UK's Brexit position, see *Tweet*. Basically, Johnson is saying that the deal in its current form is unable to pass the House of Commons due to the backstop. The EU has repeatedly rejected a re-opening of the Withdrawal Agreement and discarded the backstop insurance policy.

In China, the new lending rate, the Loan Prime Rate, aimed at lowering debt costs for Chinese businesses, was fixed at 4.25% versus the one-year lending rate at 4.35%.

Selected reading from Danske Bank

- *Macro Strategy Views Podcast: Why Germany should ease fiscal policy*
- *Harr's view: Why Germany should ease fiscal policy*
- *ECB: Mitigating side effects – gauging the tiering premium*
- *FOMC research - New Fed call: Five more from Fed*
- *Norges Bank Review: Keeping the tightening bias, but increasing downside risk*
- *Flash Comment Emerging markets: forget Argentina; focus on Fed, Trump and China*

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Scandi markets

No important Scandi releases today.

Fixed income markets

We have seen a decent repricing of the long end of the **European government bond** and EUR swap curve since the lows seen last week. The 10Y EUR swap rate has moved some 10bp, while the 30Y EUR swap rate has moved some 15bp since Thursday last week. There are various explanations for the solid upward move in EUR rates. This is partly due to a rise in US yields as well as the speculation of more issuance out of Germany, if the German economy falls into recession. Finally, as yields decline, the incentive to hedge liabilities from life insurance companies, pension funds and banks strengthens. However, given the recent rise in yields/rates and bounce-back in equities, the demand for duration is lessened. The rebound in yields/rates has also stopped the decline in both Bund and Buxl spreads, and we witnessed some solid moves in ASW spreads yesterday.

We still believe that yields can go a bit further down when both the Federal Reserve and ECB ease monetary policy. However, we also prefer to go long the Buxl spread despite the speculation of more issuance from Germany in 2020. This is due to (1) positive carry on a 12M horizon of being long the 30Y bond versus swaps and (2) the issuance 'story' has been priced, and the German Debt Agency is very focused on issuing mainly 2Y, 5Y and 10Y government bonds rather than 30Y bonds. Finally, (3) the restart of QE has not really been priced in.

In Italy, if 5SM and PD were to form a government, this would be seen as pro-EU and Italian government bonds would be likely to gain from such an outcome.

FX markets

Yesterday, the Fed's Rosengren propelled the broad USD to year highs and EUR/USD edged further below 1.11. The comments from Rosengren came a few hours after US President Trump tweeted that the Fed should cut rates by 100bp and restart QE. Clearly the market has more trust in the Fed than Trump here, suggesting that the risk the latter could resort to intervention is perceived as premature. It is increasingly clear that the Fed is not in a hurry, which will, in our view, keep the USD strong for the time being and notably keep the yen bid in the current easing-game environment, see also *FX Essentials: Downwards pressure on USD/JPY not over*.

Separately, **EUR/CHF** edged higher yesterday after the weekly sight-deposit numbers underlined that the SNB curbed CHF strength last week. We still expect the SNB to stay in the market to mitigate large moves in EUR/CHF, but given its revealed distaste for balance-sheet expansion, it is unlikely to have any clear red lines for the cross now that 1.10 has been crossed, i.e. the risk remains for a further dip as SNB will likely be forced to enter new territory on policy rates.

The Scandies appear to have stabilised somewhat in the absence of global risk deterioration in recent days; EUR/NOK is back below 10, while EUR/SEK remains above 10.70. Today, we will have a speech by Kerstin af Jochnick; while she will be leaving the Riksbank Board soon, her views have always sided with Governor Ingves and thus may be of interest even if the topic, 'cyber risks', does not immediately hint at policy implications. But with the Riksbank possibly in the mood for warming up to a shift away from a hiking bias, if she does comment on monetary policy, anything but a dovish tilt would be surprising and should be a SEK-positive. Nonetheless, we still see the SEK as a sell on rallies vs both the USD and EUR.

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