20 March 2017

Danske Daily

Market movers today

- It is a very quiet day in terms of major economic data releases.
- In the **euro area,** wage growth for Q4 16 is due out. Wage growth has been subdued in recent years despite a continuously falling unemployment rate. Wage growth figure is important in explaining core inflation and the low wage growth is one of the main reasons core inflation also remains subdued. While the ECB predicts sharply rising wage growth and core inflation in coming years, we believe that ECB is too optimistic and we expect the wage growth figures for Q4 will be broadly unchanged from Q3. See *ECB's core inflation forecast is still too optimistic*, 14 March 2017.

Selected market news

On Friday last week, the US manufacturing production for February came out at +0.5% m/m (unchanged from January). Manufacturing production has increased for six consecutive months now, which is the first time since July 2014. Hence, hard manufacturing data is recovering as indicated by ISM/Markit PMI.

In addition, the University of Michigan consumer confidence came out strong at 114.5 in March from 111.5 in February. We still view private consumption as the main growth driver in the US, although real wage growth has slowed. More interesting though, was the big drop in the University of Michigan long-term inflation expectations to 2.2% y/y from 2.5% y/y, which is a new low. The long-term inflation expectations measure has declined significantly since around 2014 when it was around 2.7-2.8%. While it seems as if the Federal Reserve accepts that inflation expectations are not as high as previously, we think this could be a concern, as core inflation also remains somewhat below 2%.

On Friday in Sweden, the government proposed to reduce the Swedish currency reserve. This is in line with the 2013 Flam committee proposal and has wide parliamentary support. The idea is that RGK SEK250bn on-way lending to the Riksbank FX reserve is too costly. Now, it will be reduced by SEK250bn (no FX implications as both lending and assets are in foreign currencies). Aside from the remaining SEK200bn FX reserve, the Riksbank will have an extra SEK50bn at the Debt Office (if needed). This means that Sweden's overall government debt will fall by 5 percentage points of GDP.

Customer satisfaction

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Selected readings from Danske Bank

- *Fed's regulatory hurdle for starting quantitative tightening*
- *Our view on ECB core inflation*
- *Bank of England review*

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Fixed income markets

The main event in the FI market this week will be the fourth and final TLTRO II (allotment announcement Thursday). Intended or not, Mario Draghi made the case for a high TLTRO utilization even more appealing with some banks calling for a depo hike already in 2017. Note that the lending rate will be fixed, and for many banks it will be as low as -40bp. Hence, this could be the ultimate 'carry trade' or helping hand from the ECB, if the depo rate is hiked already in 2018 (lending at -40bp and placing at higher depo rate until March 2021). While the 'carry' trade has become less attractive, the lending rate also remains an extremely cheap source of funding. The utilization of TLTRO II has so far been EUR507bn, of which EUR401bn has been rolled from the previous TLTRO I. However, the total TLTRO II allowance is EUR1.693bn, implying that the final auction has a very large potential take-up. Danske Research is expecting EUR250bn but the recent development, including talk of a potential depo hike 2018, speaks in favour of an even higher TLTRO allotment. See *Expect a large take at the final TLTRO II auction,* 13 March 2017.

A large TLTRO take should have no impact on Eonia (excess liquidity already abundant at +1,300bn), but is likely to drive receiving interest in 4Y swaps (mainly Eonia and 3s) and potentially give some support to the periphery (and France) out to 5Y due to carry trades. Last week's tightening of Bobl ASW is likely to be related to pre-hedging from bank treasuries.

This week's supply is kicked off with Belgium tapping in the 10Y benchmark (BGB Jun'27), the Jun'38 and the Mar '41. It will be the first regular tap by the Belgium Debt Office this year after the big syndications in January and February where EUR12bn was raised in the market. The Belgian debt office has so far issued 34% of the EUR35bn target. For more on this week's supply see *Government Bonds Weekly: Still value in Portugal and too early to position for a Bund sell-off*, 17 March 2017.

FX markets

Given the relatively thin data calendar this week, it seems a suitable time for our monthly *FX Forecast Update – Approaching a base in EUR/USD*, 17 March.

For the majors, the most noteworthy change was that we have lifted the near-term bottom in EUR/USD as we expect the cross is close to forming a base. In our view, relative rates remain EUR/USD bearish as the Fed is slightly under-priced and the ECB is priced too hawkish. However, it appears that clarity with regard to US tax reforms has been postponed towards later in the year and hence is less of a short-term USD positive. We believe that it is most likely that Marine Le Pen will not become France's next president. Hence, in our base case, France's election will not hinder a gradual rise in EUR/USD. Medium term, we continue to expect EUR/USD to move higher on the large eurozone-US current account differential and the undervaluation of the EUR. In summary, we are 'rolling' our EUR/USD forecasts, predicting the cross at 1.06 in 1M (1.04 previously), 1.08 (1.05), 1.10 (1.08) and 1.14 (1.12).

In the scandies, we generally made few changes, albeit we have lifted the front end of our EUR/SEK and EUR/NOK profiles slightly, forecasting the two pairs in one month at 9.50 (from 9.40) and 9.00 (8.90), respectively.

For the NOK it has been a volatile ride over the past few weeks. We have highlighted how domestics have become very NOK positive whereas external factors have been challenging. Friday's NOK appreciation is likely to reflect a combination of (1) positioning that had become much more neutral (see *Tweet* by Danske Bank on 15 March 2017), (2) the Fed delivering a 'dovish hike' diminishing worries of near-term risk sell-off, (3) markets realising that the Norges Bank meeting is no game changer for the NOK as we highlighted in our *Norges Bank Review: Unchanged rates and neutral bias maintained*, 16 March 2017. Going forward, the Norwegian data calendar is very thin for the coming weeks. That means external factors should be followed very closely as this, in our view, is the primary potential derailer of the NOK strengthening that we have pencilled in.

Key figures and events

Monday, March 20, 2017				Period	Danske Bank	*Consensus*	Previous
10:00	EUR	Eurogroup meeting in Brussels					
11:00	EUR	Labour costs	y/y	4th quarter			1.5%
18:10	USD	Fed's Evans (voter, dovish) speaks					

Source: Bloomberg, Danske Bank Markets

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Date of first publication

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