20 September 2018

Danske Daily

Norges Bank set to hike rates today

Market movers today

- Today's highlight is without comparison Norges Bank, where we expect a first rate hike in seven years (more on page two).
- The two-day informal EU summit meeting continues, which, following media reports yesterday, suggests a very difficult discussion. UK PM Theresa May is said to have rejected EU Chief Negotiator Michel Barnier's offer.
- Tonight after European close, the ECB's Chief Economist Peter Praet is due to speak on 'Challenges to monetary policy normalisation'.

Selected market news

The US 10Y yield rose further yesterday to as much as 3.09% and the 2Y-10Y yield curve has steepened to its widest level in over a month. Higher inflation expectations in the US have been a contributing factor to the recent rise in long-term US yields, which also help to explain why the USD has not followed yields higher.

Italy's Prime Minister Giuseppe Conte pledged yesterday to keep the Italian budget deficit below 2% of GDP in order to produce a 'credible' budget and ensure investor confidence in Italy's public finances. He thereby dismissed a call from the Five Star Movement for a budget deficit as large as 2.5% of GDP.

US crude oil inventories declined another 2mb last week. The news pushed oil prices higher, but mainly impacted the price on WTI crude, which rose above USD71/bbl, while the price on Brent crude is holding steady at close to USD80/bbl.

US President Trump plans to nominate Nellie Liang to one of the vacant seats on the Federal Reserve Board of Governors. She is currently a senior fellow at Brookings Institutions, but has previously led the Federal Reserve's Board division in charge of financial stability policy and research. The Federal Reserve Board under Chair Jerome Powell is beginning to take shape, as Richard Clarida was confirmed as Vice Chairman at the end of August.

The US and Canada continued talks on a new NAFTA deal yesterday and hinted that some progress is being made. Talks are set to continue today.

Selected reading from Danske Bank

- *Riksbank doves more neutral*
- *US-China Trade Update - China unlikely to give in to Trump's demands despite new tariffs,*

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Senior Analyst
Jens Nærvig Pedersen
+45 4512 8061
jenpe@danskebank.dk

Scandi markets

Norway. The stage is set for the first rate hike for more than seven years. The economy has left the oil crisis well behind, capacity utilisation will soon be back to normal, unemployment is falling and wages and prices are accelerating, so it is high time to begin the process of normalising interest rates. Just as noteworthy as the actual decision will therefore be the signals Norges Bank puts out about where its policy rate is headed. We expect Norges Bank's overall assessment to result in the probability of a further rate hike as early as December, increasing to more than 50%, with a further 2.5 hikes signalled for 2019, two for 2020 and 1.5 for 2021. As there is still considerable uncertainty about the economic outlook for next year, the rhetoric concerning the chances of another hike now in December will be the most exciting part.

Fixed income markets

BTPs came under pressure once again yesterday as news stories suggested that a budget deficit as high as 2.5% was the goal of the Five Star Movement. It still below the important 3% EU threshold line but well above the 1.6% deficit that Finance Minister Giovanni Tria has been talking about several times. It underlines that the market consensus has probably moved below 2% and that the risk of a 'market disappointment' is growing in Italy.

However, not just the periphery was under pressure and 10Y bund yields almost tested 0.50% as the US curve continued to steepen and 10Y US treasury yields seem to have finally broken the technical important 3% level.

We expect the negative FI sentiment to continue today in Europe as the market braces itself for heavy supply from Spain and France. Spain is doing a quadruple tap in the 3Y, 4Y, 7Y and 10Y segments. France is tapping no less than three nominals (3Y, 6Y and 8Y) and three linkers (10Y, 12Y and 18Y). Note that the negative net cash flow seen this week (EUR26bn) will continue next with another EUR20bn. See slide 5 in *Government Bonds Weekly,* 14 September.

The big event in Scandinavia this week is the Norges Bank meeting today. We expect a rate hike today and importantly a revision to the rate path; so it implies an above 50% probability of a new rate hike as early as December and 2.5 rate hikes in 2019. We recommend to position for outright higher yields in the short-end of the NOK curve and a stronger NOK. For more see *here*.

FX markets

In Scandi FX all eyes today turn to the Norges Bank (NB) meeting and specifically the revised rate path as a rate hike is fully expected. For FX markets the two key questions are: (a) will NB explicitly mention December as the most likely time for the next rate hike and (b) how many hikes will NB signal for 2019. Our expectations are on the hawkish side as we – unlike consensus – think December will become a 'live' meeting (see above). If proven right, this would add support to our short EUR/NOK trading recommendation (for details see *here*) and we would expect EUR/NOK to test the key support levels in the low 9.40s. If Norges Bank instead 'signals' March but at the same time lifts the rate path signalling three 2019 hikes, we would expect a more modest NOK appreciation. A dovish scenario would be Norges Bank maintaining its rate path intact, thereby signalling only roughly two hikes per year in 2019 and 2020. All in all, however, we think the balance of risk is for a lower EUR/NOK in today's session.

A rather volatile session for GBP yesterday. EUR/GBP initially dropped from 0.89 to 0.886 on higher-than-expected UK inflation data and then bounced back a couple of hours later following a Times report that Theresa May was said to have rejected Michel Barnier's proposal for an 'improved Irish border'. The informal EU Summit continues today and we expect EUR/GBP to remain volatile and sensitive to Brexit news. We generally see risks skewed to the upside for EUR/GBP in coming weeks ahead of the annual conservative party congress, which starts on 30 September. Hence, corporate clients should take advantage of the recent decline in EUR/GBP and high implied volatility when hedging GBP income. See *Corporate Hedger - use GPB recovery and high volatility to hedge GBP income,* 14 September.

The Swiss National Bank (SNB) is set to keep policy measures unchanged at its quarterly meeting today but the situation is somewhat more challenging than at the June meeting as the effective CHF up more than 4% since then. While there is a risk the SNB could sharpen its language on CHF overvaluation, we think it will stick to the saying that CHF is 'highly valued' and keep the intervention option open. As a result, we expect EUR/CHF to trade heavy still.

Key figures and events

Thursday, September 20, 2018				Period	Danske Bank	*Consensus*	Previous
-	EUR	Informal EU summit (including Brexit talks)					
0:45	NZD	GDP	q/q|y/y	2nd quarter		*0.8%|2.5%*	0.5%|2.7%
8:00	DKK	Consumer confidence	Net. bal.	Sep	**8.6**		7.8
9:30	CHF	SNB 3-month Libor target rate	%			*-0.75%*	-0.75%
10:00	NOK	Norges Banks monetary policy meeting	%		**0.75%**		0.5%
10:30	GBP	Retail sales ex fuels	m/m|y/y	Aug		*-0.4%|2.2%*	0.9%|3.7%
14:30	USD	Initial jobless claims	1000				
14:30	USD	Philly Fed index	Index	Sep		*15.0*	11.9
16:00	EUR	Consumer confidence, preliminary	Net bal.	Sep		*-1.9*	-1.9
16:00	USD	Existing home sales	m (m/m)	Aug		*5.38*	5.34|-0.007

Source: Bloomberg, Danske Bank

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