21 January 2020

Danske Daily

Bank of Japan on hold for the near future

Market movers today

- We have a couple of tier-two data on the agenda today. Most interesting will be the UK labour market report for November as it will provide more input for the possibility of policy easing later this month. We look for an unchanged unemployment rate of 3.8%, while we expect wage growth (excl. bonuses) to moderate to 3.4% y/y from 3.5% y/y in October. We will also get more news on the pace of the global recovery with the release of flash PMIs for the euro area, the US, Japan and the UK (all Friday).
- The German ZEW expectations index has increased a lot in recent months and is one of the indicators that signals a turn in the cycle. We expect the index for January to continue this picture. Otherwise global markets await the ECB meeting later this week.

Selected market news

As expected, Bank of Japan (BoJ) kept its QQE with yield curve control and its forward guidance unchanged at a meeting ending this morning. USD/JPY is largely unchanged on the news. We also got new projections for growth and inflation and as expected the growth forecast was revised up as a consequence of the government's big spending package. The BoJ now expects 0.9% GDP-growth in FY2020 versus 0.7% back in October and it still sees the economy on 'a moderate expanding trend'. The forecast for inflation was revised slightly down. Even in FY2021, the BoJ expects only 1.4% inflation. Q4 data has been quite discouraging and we expect BoJ to remain on hold for the coming year as well. Several one-offs, such as the VAT-hike and typhoon Hagibis, have weighed on activity in Japan recently. Action has been taken with the government's big spending package from December and as long as USD/JPY remains off the 100-level, we expect the BoJ to conserve the small amount of dry powder it has left.

French President Emanuel Macron tweeted late on Monday that France and the US have agreed on a 'truce' on tariffs until the end of this year, to which US president Trump tweeted: 'excellent'. The two countries have been on collision course ever since France last year pushed ahead with a digital tax levied upon especially large US tech companies, after which the US threatened to retaliate by imposing additional tariffs targeting especially French agricultural produce.

The impeachment inquiry against US president Donald Trump is set to start in earnest on Tuesday afternoon, when the sworn-in senators of the senate and the seven house democrats that will lead the case against the US president will meet at 1pm ET, as they will do six days a week (Monday through Saturday) – firstly in order to establish the rules of the inquiry. The length of the process is for now unknown, but the senate majority leader Mitch McConnell yesterday put forward the proposed rules for the upcoming trial, which are expected to receive approval from the majority of republican senators. The proposal includes that the defence and the prosecutors each will receive 24 hours within a two-day period to lay out their case. Also whether the house democrats will be able to introduce fresh evidence or witnesses not included in the initial house inquiry will be decided by a simple majority senate vote.

Selected readings from Danske Bank

- *ECB Preview: Time to reveal the scope*
- *FX Essentials: Wake up from the volatility lull - buy CHF upside optionality*
- *Government Bonds Weekly: New 3Y bonds from Spain and France, Finland up for rating review*

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Fixed income markets

The weekly prepayment data from the Danish mortgage bond market showed a very modest increase in the prepayments for the April term. Prepayments rose DKK6bn to a total of DKK22.5bn. Hence, we have revised our forecast to DKK60-80bn. Prepayments are still especially modest in the 2% segment, see *Danish Mortgage Bonds: Low prepayments in 30Y 2% bonds move closer*, 20 January. The modest prepayments as well as modest issuance are supportive for the callable mortgage bonds.

It is a different story for the Danish government bonds. On Wednesday, the Danish Debt Management office is tapping in the 10Y benchmark as well as the 11Y linker rather than the usual 2Y and 10Y benchmarks. The long-dated linker DGBi 0.1% 11/30 has performed well recently given the expectations for a boost in the Danish inflation due to new tariffs on tobacco, but the ownership distribution is very skewed in the long-dated linker as it is owned entirely by Danish investors and especially Danish mutual funds. They hold almost 80% of the outstanding amount. Furthermore, Danish banks are short the bond and have been building up a sizeable short position of some 8%. Hence, we see a risk of modest bidding at the auction in the linker even though we would recommend buying the linker at the auction despite the recent performance. See *FI Strategy Denmark - Auction preview: Buy the linker despite strong performance and modest liquidity*, 20 January.

Today, Germany will sell up to EUR4bn in a new 2Y benchmark. The bid-to-cover at the Schatz auctions has been steadily rising in the second part of 2019. Hence, if this pattern continues we should see a solid auction with a bid-to-cover at more than 2.3. Furthermore, the Schatz is cheap relative to swaps as we have to go back to 2015 to find a tighter Schatz spread. Furthermore, we have seen the yield on the Schatz moving slowly towards -50bp since autumn 2019, but given that the ECB is on hold for a long period and combined with QE, it is difficult to see the Schatz move above -50bp.

FX markets

Disappointing Norwegian data (see *chart*), as USD strength, oil erasing gains and the Progress Party leaving the government has been a poor cocktail weighing on the NOK early this week. Due to the lack of global drivers and with no news on the domestic data calendar, risks are for a weaker NOK in the coming session as investors evaluate existing longs. We do, however, not pencil in a real NOK sell-off and in the absence of news we would expect renewed buying interest 0.5-1% from current levels supported by technical levels versus EUR, USD and SEK.

In Hungary, we have viewed the central bank as unwilling to lean against an elevated level of inflation, thus giving rise to an annual upwards 3-4% drift in EUR/HUF. Yesterday, the central bank seemed to be interpreted in markets as sending a slightly hawkish intervention-like signal after its weekly liquidity-providing operation was cancelled. If so, we think this is a quite weak signal and expect EUR/HUF to continue to move higher in coming months. Nonetheless, we will be watching upcoming speeches to gauge if a shift is underway.

Key figures and events

Tuesday, January 21, 2020				Period	Danske Bank	Consensus	Previous
-	JPY	BoJ policy rate	%		**-0.1%**	*-0.1%*	-0.1%
10:30	GBP	Unemployment rate (3M)	%	Nov	**3.8%**	*3.8%*	3.8%
10:30	GBP	Average weekly earnings ex bonuses (3M)	y/y	Nov	**3.4%**	*3.4%*	3.5%
11:00	DEM	ZEW current situation	Index	Jan		*-13.5*	-19.9
11:00	DEM	ZEW expectations	Index	Jan		*14.0*	10.7

Source: Bloomberg, Danske Bank

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