

Danske Daily

Short-lived relief in Italy

Market movers today

- It is a very light calendar day, so market focus will remain on Italy and the situation in the Middle East and the killing of the Saudi Arabian journalist.
- Yesterday, **Italy** sent a letter to the EU Commission reaffirming its fiscal stance but opening up for a dialogue with the EU on the budget for 2019. As a result, our base case is that the Commission will give a negative opinion on the Italian budget draft and ask for a revision, maybe as soon as today. The relief rally in the Italian government bonds yesterday did not last long as 10Y Italian government bonds reversed the gain in the morning and ended more or less unchanged.
- Pressure is increasing on **Saudi Arabia** to give full details behind the death of journalist Khashoggi. Yesterday, Germany said they would block arms sales and the US expressed dissatisfaction with the account given by the Saudi government. The tense situation in the Middle East may have an impact on oil prices if tensions increase further.
- Overnight in **Japan**, we will get manufacturing PMIs. The manufacturing sector has shown some weakness recently amid global trade tensions and several natural disasters.
- In **Denmark**, the consumer confidence number is being released today and we expect the Danes to be more positive about both the future and the current situation after a steady decline over the summer. We expect the indicator to climb to 8.0 in October.

Selected market news

Equity markets have traded lower again in Asia, ending the strong rally in Chinese stocks yesterday. The rebound on Monday was probably partly due to Chinese state-backed funds buying, which is rarely enough to turn the market around. While we do see value in the Chinese market, we should expect continued high volatility as long as the US-China trade war is unresolved. However, more Chinese policy easing (tax cuts etc.) and reform announcements and a fairly strong housing market should support Chinese stocks as it reduces the risk of a hard landing.

In the US, President Donald **Trump has promised that Congress will pass a 10% tax cut for middle income earners** after the mid-term elections, see [Bloomberg](#). It may be an attempt to put pressure on the Democrats, who seem likely to win the majority in the House. It would challenge them going into the election as well as afterwards if they sit with the House majority and will not vote it through. The news took many Republican Party leaders off guard.

In another sign that a new cold war is brewing, **Trump warned yesterday that the US intended to build up its arsenal of nuclear weapons against Russia and China**. It comes two days after he warned that the US would withdraw from the Intermediate-Range Nuclear Forces Treaty. If implemented, it could mark the start of a new arms race, see [CNN](#). Some critics say the move would damage diplomatic pressure on Russia to comply with the Treaty without bringing clear military advantages, see for example [Foreign Policy](#).

Selected reading from Danske Bank

- *Poland, Czech Republic and Hungary: Short-term economic differences and common long-term challenges*
- *ECB Preview - vigorous Draghi, moderate inflation*
- *Harr's View: The shocks and the risks - Italy could dwarf Brexit*

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Scandi markets

There is no great news in Scandi today. Denmark is due to release consumer confidence but it is unlikely to have much impact. We look for a small increase.

Fixed income markets

The relief rally in Italian government bonds did not last long as the 10Y Italian government bonds reversed the gain in the morning and ended more or less unchanged relative to the close on Friday at 3.48% and a spread of 304bp to Bunds. The main reason was that the Italian government did not back down from a deficit of 2.4% in 2019, even though there were comments that the deficit of 2.4% was a 'ceiling'. It is now up to the EU commission to respond to the budget from the Italian government.

We have some important numbers out from the ECB this afternoon. This is the weekly balance sheet numbers, where we will see the redemptions from the PSPP programme. These should be fairly high given the large redemptions last week in Italy, Ireland and Austria. The potential is some EUR9.4bn, but in reality, it is probably closer to EUR6bn, as we do not expect the PSPP to have much for Ireland, as the bonds were most likely bought when the SMP programme was open.

The auction schedule is fairly light today as only the Netherlands is in the market with a tap between EUR1.5-2.0bn.

FX markets

In majors, for EUR/USD, the volatile EURUSD XCCY basis continues to attract attention. The market continues to put a high premium on USD over year-end, which keeps the basis wide. But we have seen the 3M EURUSD XCCY basis tightening towards -42bp level from -49bp last week, likely owing to a stabilisation of risk sentiment as seen in VIX index falling back slightly. Nevertheless, the EUR/USD spot continued to trade below 1.15 yesterday partly supported by climbing US real yields, e.g. the 10Y US real yield is now at the highest level since early 2011.

In the Scandies, EUR/DKK is still trading above the key 7.46038 level and the market thus remains alert to an uptick, which could potentially trigger DKK buying in FX intervention by Danmarks Nationalbank. Since the DKK8bn Treasury bill auction last week, EUR/DKK FX forwards have moved higher, supported by a tightening of the 3M EURDKK XCCY basis – we describe this development further in *FX Edge - EURDKK basis tends to tighten on big T-bill auctions*, 23 October.

Key figures and events

Tuesday, October 23, 2018				Period	Danske Bank	Consensus	Previous
8:00	DKK	Consumer confidence	Net. bal.	Oct	8.0		6.9
15:30	USD	Fed's Kashkari (non-voter, dovish) speaks					
16:00	EUR	Consumer confidence, preliminary	Net bal.	Oct		-3.0	-2.9
22:15	USD	Fed's Kaplan (non-voter, neutral) speaks					

Source: Bloomberg, Danske Bank

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