

Danske Daily

So close and yet so far apart on Brexit deal

Market movers today

- In the Scandi markets, focus is on the Swedish labour market data due out at 09:30 CEST, which will be important input for what the Riksbank is going to do. Unemployment has risen from 6% in April to 7.4% in August. Our forecast is that there will be a bounce back in the September unemployment rate to 6.8%.
- Brexit negotiations continue ahead of the EU summit starting today. A Brexit deal was not reached yesterday, as DUP is still not on board and without DUP's support it is difficult to see the deal pass in the House of Commons in a potential vote on Saturday. If DUP says yes, it is a game changer and then it looks much better for PM Johnson.
- The EU council meeting starts today with arrivals at 13:30 CEST. According to the agenda, the EU leaders are set to take stock of the Brexit negotiations today but depending on what happens it may be postponed to tomorrow. The EU leaders have other things to discuss besides Brexit like accession talks with Albania and the Republic of North Macedonia, Turkey's military operations in Syria and EU's long-term budget.
- We also have some interesting global data releases today, not least for the US. At 14:30 CEST building permits for September, the Philly Fed index for October, initial jobless claims and manufacturing production in September are all being released. We also have some more FOMC speeches ahead of the Fed's blackout period starting on Saturday.
- Note that Chinese industrial production and Q3 GDP growth are due out overnight.

Selected market news

Risk assets had a tough time yesterday gaining momentum with a lot of Brexit-related news. Global equity markets ended the day broadly unchanged, while the yields on European fixed income products ended higher (10Y German bunds rose 3bp to -39bp).

According to some UK political analysts, DUP repeated last night that 'gaps remain' explaining why no agreement was reached late last night. Without DUP's support to PM Johnson's Brexit deal, it seems very difficult for PM Johnson to get his deal over the finish line. However, as *Sky News explains in this video on Twitter*, it may be difficult even if DUP supports the deal (320 MPs are needed for a majority). If so, the question is whether the 19 pro-Brexit Labour MPs who want Brexit to get done and the 20 Conservative rebels will vote for the deal or not. Some pro-Brexit Labour MPs are having a hard time supporting Johnson's proposal, which is a harder version of Brexit than Theresa May's deal was (which they rejected). Some of the Conservative rebels have already hinted they will vote against the deal. Jennifer Rankin from The Guardian has a *Twitter thread* explaining what the Johnson-Varadkar-Barnier compromise looks like.

Yesterday, we published our new *Yield Outlook* and despite last week's upward trend, we expect yields to fall back in the near future with a Bund target of -0.6% in 3M.

Selected reading from Danske Bank

- *Yield Outlook: Downside to yields remains despite better risk appetite*
- *Brexit Monitor: 20% probability of a deal but another extension followed by a snap election remains our base case*
- *US-China Trade: 'Phase 1' trade-deal not a game-changer for the global economy*

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- *Weekly Focus*

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Scandi

Today, Sweden will release the important labour market data. We expect a relatively large drop in the seasonally adjusted unemployment rate to 6.8% from 7.4% given the significant spike higher over the summer. Consensus expects a 7.1% reading. However, the weakening of the Swedish labour market is not a statistical fluke and it remains significantly weaker than assumed by the Riksbank, even if our forecast is correct. Hence, if the market continues to increase Riksbank rate hike expectations after the release, this would be a good opportunity to position for a move the other way.

Fixed income markets

The global fixed income markets remained under renewed pressure yesterday, as markets continue to price in some kind of Brexit solution (deal or extension) most notably reflected in sterling. 10Y Germany rose another 3bp to above -0.40% for the first time since July.

Periphery markets remain well supported with Spain, Portugal and Italy outperforming the core. Especially, Italy did well after the 2020 budget was released. It did show a 2.2% expected budget deficit in 2020 and a weakening of the structural deficit by 0.1 percentage point compared to the EU demanding a 0.5 percentage point improvement. Despite the weaker structural deficit, we do not expect any disciplinary action from the EU Commission.

The Spanish Treasury will sell a modest EUR2.5-3.5bn in the taps in the 2021, 2024 and 2029 bonds today. Given the positive risk sentiment, the upcoming ECB QE and EUR27.4bn in coupons and redemptions end-October from Spain, we look for strong demand. We remain overweight 10Y SPGB.

France is tapping in the medium-term segment (3Y, 6Y and 7Y) and linkers (5Y, 6Y and 10Y). France will see even bigger redemptions and coupon flow here in October. A total of EUR54.2bn is coming to the French market on 25 October.

FX markets

Yesterday EUR/NOK reached the highest level ever recorded (according to Bloomberg data) as the 2008 crisis top was surpassed. While Norway has experienced a negative terms of trade shock this year from falling gas, oil and salmon prices, it is still difficult to reconcile that with the magnitude of the latest weakness. Also the four rate hikes from Norges Bank on the back of strong growth and inflation have made the NOK a high-scorer in G10 carry space, which is not easily reconcilable with new NOK lows. In the bigger picture, Norwegian stocks are primarily characterised by energy and inflation sensitive industries; something the global investment environment does not favour currently. We think this is key. We prefer to stay side-lined for now simply because the technical backdrop is tricky. Fundamentally we think the latest weakness has come too far but we think it is too early to be brave.

As with the previous sessions, yesterday's session was also volatile for GBP (and EUR/USD), as the market was hit by conflicting messages all day long. Most notably, a story hit the wires that DUP had agreed to the terms of what is likely to become Johnson's deal, only to be firmly denied later in the day. In the bigger picture the key to unlocking either further GBP strength or unwinding all of the optimism is gauging if a deal can go through Parliament and DUP's view is at the heart of that. We also continue to see the deal in its currently known form to have a hard time passing parliament and maintain the view that EUR/GBP will come back to 0.90 in a few weeks' time. The alternative scenario is that Brexit optimism for once has been warranted, in which case we will likely need to revise our forecast to around 0.85 or thereabout. The main scenario remains 0.90 in 1M.

In the majors, EUR/USD moved higher yesterday approaching 1.11 on markets close to fully pricing in an October Fed cut. The primary driver was retail sales, which overall fell short of expectations despite positive revisions. That said, higher EUR rates on reduced Brexit fears also contributed to lift the single currency.

Key figures and events

Thursday, October 17, 2019					Period	Danske Bank	Consensus	Previous
2:30	AUD	Employment change	1000	Sep			15	34.7
9:30	SEK	Unemployment (n.s.a. s.a.)	%	Sep	6.3% 6.8%			7.1% 7.4%
10:30	GBP	Retail sales ex fuels	m/m y/y	Sep			0.0% 2.9%	-0.3% 2.2%
14:30	USD	Housing starts	1000 (m/m)	Sep			1320	1364.0 (12.3%)
14:30	USD	Philly Fed index	Index	Oct			7.1	12.0
14:30	USD	Building permits	1000 (m/m)	Sep			1340	1425.0 (8.2%)
14:30	USD	Initial jobless claims	1000					210
15:15	USD	Capacity utilization	%	Sep			77.7%	77.9%
15:15	USD	Industrial production	m/m	Sep			-0.1%	0.6%
15:15	USD	Manufacturing production	m/m	Sep			-0.3%	0.5%
17:00	USD	DOE U.S. crude oil inventories	K					2927
20:00	USD	Fed's Evans (non-voter, dovish) speaks						
22:20	USD	Fed's Williams (voter, neutral) speaks						
Friday, October 18, 2019					Period	Danske Bank	Consensus	Previous
1:30	JPY	CPI - national	y/y	Sep			0.2%	0.3%
1:30	JPY	CPI - national ex. fresh food	y/y	Sep			0.3%	0.5%
4:00	CNY	Fixed assets investments	y/y	Sep			5.5%	5.5%
4:00	CNY	Industrial production	y/y	Sep			5.0%	4.4%
4:00	CNY	Retail sales	y/y	Sep			7.8%	7.5%
4:00	CNY	Real GDP	q/q y/y	3rd quarter			1.5% 6.1%	1.6% 6.2%

Source: Bloomberg, Danske Bank

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