12 October 2018

Danske Daily

Better markets in Asia

Market movers today

Market focus continues to be on equity market sentiment, developments in Italy and the US-China trade war, which got a slight relief from the message yesterday that US President Donald Trump and Chinese President Xi Jinping will meet at the end of November during the G20 Summit in Buenos Aires.

There is not much on the data front today. Euro industrial production and US import prices are not likely to move the markets.

Selected market news

The sell-off in global equities continued last night and all the major indices in the US ended the day with sizeable losses. The slump in US equities is now the biggest under Trump's presidency. Volumes continue to be very high and the VIX index surged further to a level not seen since February when we had the last stock rout. The verdict is still out as to why global equity markets are under pressure. Is this 'just' a correction, especially in tech stocks, after the strong rally earlier this year or is the Fed to blame as Trump claims?

The answer is probably that equities face a wave of negative factors at the moment. Global trade jitters continue, Italy continues to spook investors and the Fed seems inclined or forced to hike as the labour market continues to tighten. Furthermore, US treasury yields are being pushed higher by weak international demand due to the expensive FX hedge and supply is booming and will continue to do so as the growing US budget deficit needs to be funded.

One of the factors that can probably stabilise risk markets is a setback or at least a stabilisation in US longer yields. Ten-year yields moved above the psychologically important 3% level at the beginning of October and have stayed there since, despite the recent turmoil. This said, note that equities in Asia are more stable and that US equity futures are now in green. These could be the first signs that the worst of correction is now behind us. Also noteworthy is that Bloomberg is reporting that the US Treasury department will not label China a currency manipulator when the semi-annual report on trading partners is due next week. This should ease trade concerns, together with news that Trump and Chinese president Xi Jinping will meet at end-November.

One comforting signal that should ease concerns that US yields will end the year significantly higher was the muted US CPI data that came in 0.1 percentage point below consensus. If we look at the annualised level for the past three to six months, it is well below 2%. In contrast to the 10Y US treasury auction on Wednesday, yesterday's 30Y treasury auction was characterised by strong demand.

In the European market, Italy continues to take centre stage. Last night, Reuters reported from 'ECB sources' that the ECB will not come to the rescue if the Italian government or bank sector runs out of money as the article puts it, unless the country secures a bailout from the EU. This is nothing new but underlines the current stand-off between Italy and first and foremost the EU, as the new budget is up for approval in Brussels next week.

Selected readings from Danske Bank

- *Flash Comment - Will the US label China a currency manipulator? Not likely*, 10 October
- *FX Strategy - 3M EUR/USD FX forwards to rise further in 2019*, 10 October

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Scandi markets

There is no news from Scandinavia today.

Fixed income markets

The correction in global equity markets set the agenda in the global fixed income markets. This morning we are seeing a stabilisation in Asian markets and US futures are pointing higher. US 10Y treasury yields are also edging slightly higher and are now back to the level seen when European markets closed last night.

Yesterday, we saw not only Italy but also Portugal and Spain wider versus Germany. Importantly, we see the widening for Portugal and Spain as a victim of the general weak risk sentiment and not as a sign that Italy concerns are now spreading to other periphery markets.

In this respect, it is noteworthy that we expect Portugal to regain an investment grade rating from Moody's (Ba1/positive), which has the country up for review tonight. Moody's is lagging Fitch (BBB-) by one notch and S&P (BBB) by two notches. S&P revised the Portuguese outlook to positive even with the higher BBB rating on 14 September and it is more than one year since Moody's put Portugal on positive outlook. Portugal also has an investment grade rating from DBRS, so if we are correct, it will be rated investment grade by all four rating agencies tonight. For more, see *Government Bonds Weekly*, 5 October.

FX markets

EUR/USD and EUR/CHF edged higher still yesterday, despite the continued risk sell-off – not your average safe-haven reaction, which would traditionally support both CHF and USD. Why? First, we do not think this is the start of a prolonged equity market derout but more a technical correction following the recent jump in US yields. The latter had been a key driver of USD strength up to the end of last week and its justification is now being questioned – hence, the current USD weakness. Further, the EUR has largely been able to shrug off Italy risks at a time when Brexit optimism has been brewing. This, coupled with news that Trump and Xi Jinping will meet in November, has helped limit the sense of political risk – hence, the lack of CHF strength. We note also that, as equities started to sell off this week, both JPY and CHF initially appreciated but CHF soon ran out of luck – possibly due to much more neutral positioning in CHF than in JPY, with the market stretched on JPY shorts versus neutral on CHF. What next? Because we cannot rule out more equity sell-offs and we think further Italy-EU confrontation is likely as are Brexit negotiation setbacks in coming weeks, we still see both EUR/CHF and EUR/USD risks as being on the downside.

EUR/SEK is gyrating between risk-off and December hike on. As noted, the upside inflation miss had a substantial impact on the SEK yesterday, with EUR/SEK instantaneously falling more than 10 figures, eyeing technical support at 10.35 (2 October low). The next key economic event in Sweden is the Riksbank's rate decision on 24 October. Does the September inflation data suggest the Riksbank will adopt a more hawkish stance? It cannot be ruled out and it is possible the market will trade that way in the coming two weeks (EUR/SEK lower). However, given that the outcome confirmed the Riksbank's forecast, we believe it will more or less repeat the message to hike in December or February, leaving the rate path for 2019 intact. We (still) believe in December and we think the first hike in seven years will support the SEK even though 25bp is almost fully priced.

Key figures and events

Friday, October 12, 2018				Period	Danske Bank	*Consensus*	Previous
-	EUR	Moody's may publish Portugal's debt rating					
-	CNY	Trade balance	USD bn	Sep		*24.6*	27.9
8:00	DEM	HICP, final	m/m|y/y	Sep		*0.4%|2.2%*	0.4%|2.2%
11:00	EUR	Industrial production	m/m|y/y	Aug		*0.3%|-0.3%*	-0.8%|-0.1%
14:30	USD	Import prices	m/m|y/y	Sep		*0.3%|...*	-0.6%|3.7%
15:30	USD	Fed's Evans (non-voter, dovish) speaks					
16:00	USD	University of Michigan Confidence, preliminary	Index	Oct		*100.8*	100.1

Source: Bloomberg, Danske Bank

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