

Danske Daily

The Fed to cut more despite strong retail sales

Market movers today

- **This morning we have updated our Fed view and now expect the Fed to cut by 25bp at each of the next five meetings taking the target range to 0.75-1.00% at the March meeting.** We do not anticipate the Fed will pre-commit to more easing but that it will stick to its current ad hoc approach. If the Fed really wants to reflate the economy and markets, it may need to commit more to easing and/or cut more and faster eventually. For more details including the impact on FX and Fixed Income please see the full analysis here: *FOMC research - New Fed call: Five more from Fed*, 16 August.
- We have a **very light data calendar today in terms of economic data releases.** Hence focus will be on central bank signals and political signals (not least after ECB's Oli Rehn's comments yesterday, see below).
- In the **US**, University of Michigan's survey of consumer confidence will be in focus in particular after yesterday's strong retail sales number. The US consumer is one of the key forces holding up US growth amid weak investment growth.

Selected market news

Yesterday, ECB GC member Olli Rehn was interviewed to the *WSJ* (paywall) that the ECB was preparing a **'very strong package'**. He further said that *'it's often better to overshoot than undershoot'*. Rehn is among the most dovish ECB members, and his recent proposals called for a revisit of the inflation mandate back in March this year. We find the interview very interesting, however, **at current the juncture, we do see a risk of ECB not being able to over-deliver compared to the very dovish market pricing/expectations.** Markets are currently pricing 18bp cut for the September meeting (2bp lower than prior to the story). **We expect ECB to announce a 20bp depo rate cut, alongside 12months of 45-60bn/month QE, tiering system and extension of forward guidance at the 12 September ECB meeting,** see *ECB Research – New ECB call: rate cut and restart of QE*, 18 June.

US data yesterday were strong, not least US retail sales (control group) which rose 1.0% in July suggesting private consumption remains a strong growth driver in Q3. We also believe the fundamentals for continued private consumption growth are strong with e.g. high consumer confidence and solid real wage growth. Both the Philly Fed and Empire PMI manufacturing indices signal a rebound in ISM manufacturing in August. It may seem odd that the Fed is easing while economic data is strong but the Fed will be concerned whether data will continue to stay strong without further easing (see bullet 1 above).

Yesterday, **Norges Bank kept rates unchanged as expected and repeated the tightening bias from June.** That said, global turmoil has increased uncertainty about rates going forward. We keep our call for a slightly above 50% probability of a September hike. In our view, NOK will continue to trade on global risk sentiment. For more details please see *Norges Bank Review: Keeping the tightening bias, but increasing downside risk*, 15 August.

Selected reading from Danske Bank

- *FOMC research - New Fed call: Five more from Fed*
- *Norges Bank Review: Keeping the tightening bias, but increasing downside risk*
- *Flash Comment Emerging markets: forget Argentina; focus on Fed, Trump and China*

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Scandi markets

A quiet day without any important data releases. For our take on yesterday's Norges Bank meeting, please see *Norges Bank Review: Keeping the tightening bias, but increasing downside risk*.

Fixed income markets

The dovish comments from ECB's Rehn boosted the peripheral markets, where the curves continued to bull flatten and sent Bund and Buxl spread into a free fall despite the risk that a new QE programme may buy a lot German government bonds. We doubt that the ECB will deviate too much from the capital key if they reintroduce QE programme.

There are no major news or key economic releases on the agenda today, and we do expect to see some stabilisation in the spread between core-EU and the periphery. Hence, we expect a quiet session today. However, the downward pressure on spreads is expected to continue as investors "ignore" e.g. political uncertainty in Italy.

The large decline in bond yields and swap rates have a **significant effect on the Danish mortgage bond market, where 1% 30Y callables are closed for issuance and the new benchmark is 0.5% 30Y callables**. If yields stay low, it would trigger a solid rise in the prepayments of the 2% 30Y callables. Given the lack of alternatives with positive yield we believe that there will be a strong demand for 0.5% 30Y callables.

We have changed our Fed call and now expect five more Fed cuts. The big question is whether the Fed is capable of re-steepening the curve 2s10s after it inverted Wednesday. Normally, the US curve steepens as the Fed starts to ease monetary policy, as it creates optimism and pushes inflation expectations higher. However, we are in doubt whether this will be the case to the same degree this time, though we do forecast a positive yield curve 2s10s on a 6- and 12-month horizon. **We have decided to lower our 10Y Treasury yield forecast to 1.30% (3M), 1.00% (6M) and 1.20% (12M)**. For more see *FOMC research - New Fed call: Five more from Fed*, 16 August.

FX markets

Yesterday, despite recent global woes, Norges Bank signalled another policy rate hike this year even if the central bank did acknowledge the rising global risks. In the end, the message came across largely as expected and did not really move EUR/NOK. We stick to our view that a September hike is the more likely outcome as a hike will likely be warranted by still healthy domestic conditions. However, EUR/NOK should stay supported around the current level close to 10 short term by continued negative global economic and risk sentiment. EUR/SEK was volatile around the Norway announcement but is back in the 10.70 area.

In majors, the stronger-than-expected US retail sales failed to provide relief to risk sentiment, and USD/JPY is still trading with a heavy tone as global bond yields are making new lows and commodity prices remain under pressure; another test of 105 should be on the cards. Yesterday, dovish comments from ECB's Rehn regarding September's easing move took EUR/USD lower towards 1.11 after the pair had otherwise been surprisingly steady this week. A move to 1.10 is likely for EUR/USD short term. On a 6-12M horizon we do stress, however, that EUR/USD is likely to edge higher yet again as we are likely to see a Fed that moves more aggressively on easing than its recent hesitant approach points to, cf. our new Fed call: *FOMC research - New Fed call: Five more from Fed*.

Key figures and events

Friday, August 16, 2019			Period	Danske Bank	Consensus	Previous
-	EUR	Moody's may publish Netherlands's debt rating				
11:00	EUR	Trade balance	EUR bn		18	20.2
14:30	USD	Building permits	1000 (m/m)	Jul	1270	1232.0 (-5.2%)
14:30	USD	Housing starts	1000 (m/m)	Jul	1260	1253.0 (-0.9%)
16:00	USD	University of Michigan Confidence, preliminary	Index	Aug	97.1	98.4

Source: Bloomberg, Danske Bank

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Expected updates

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