16 February 2017

Danske Daily

Market movers today

- **We face a very thin data calendar, so focus – apart from the ECB minutes – will primarily be on markets evaluating the last days' strong US data and coinciding rally in risky assets.**
- Traditionally, the **ECB minutes** have contained very little new information, however, that was not the case in January where a lot of detail on QE considerations was revealed. This time around an interesting insight could be the degree of diverging views within the governing council. Concerns regarding the QE impact on the German repo levels in particular would also attract market attention.
- In the **Scandies** focus will be on the Swedish labour market report and on Norges Bank's Governor Olsen's annual address. For more info see 'Scandi Markets' on page 2.

Selected market news

Yesterday's bunch of **US releases** were all on the strong side (see below) boosting market expectations of when the next Fed hike is due: we now estimate the implied probabilities at c. 30% for March and 60% for May while markets more than fully price one hike in June and an accumulated 2.3 hikes for 2017. When should we expect the next Fed hike? Arguably recent data has been better-than-expected, but given Yellen's recent communication deferring from talking about a rate hike 'soon' and instead referring to an 'adjustment' (singular) of the Fed funds target at the 'upcoming meetings', we **still think June is the most likely time even if March and May have become increasingly probable**.

US CPI surprised on the upside with the core measure beating expectations by rising 2.3% y/y (see *chart*). The headline measure also surprised, as the largest monthly headline rise in four years drove the yearly rate to 2.5% resulting in zero real wage growth (measured against average hourly earnings) in January; the first time since June 14. Meanwhile, the coinciding release of January **retail sales** did not suggest any purchasing power headwinds for consumers, as the control group rose 0.4% m/m with positive revisions. **Manufacturing production** also confirmed the highest quarterly growth rate in two years (see *chart*).

Despite the monthly **Treasury International Capital System (TICS) data** revealing that China returned as a net-buyer of US Treasuries in December, the release still confirmed that 2016 marked the largest annual Chinese disposal of Treasuries. China held USD 1.06tn worth of treasuries at the end of 2016 compared to USD 1.25tn one year ago. With a holding worth USD 1.09tn, Japan maintained its position since October as the world's largest owner of Treasuries.

In **oil markets**, data from the US Energy Information Administration showed that US crude stocks rose 9.5mb last week, i.e. in line with the 9.9mb increase reported in the API data reported Tuesday. Hence, the upwards trend in crude stocks continue. The rise in US crude stocks seen in recent weeks is likely a result of average-to-mild winter weather in the US and thus lower than normal seasonal demand for heating oil and hoarding of oil towards the end of last year in response to the OPEC, non-OPEC decision to cut output.

The monthly labour market report released in **Australia** gave mixed emotions, as the higher-than-expected employment print was driven by a rise in part time employment, while full time employment fell (see *chart*).

Selected readings from Danske Bank

- *Yield Forecast Update – higher yields an H2 17 theme*
- *China – rise in inflation set to trigger monetary tightening*

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Scandi markets

In **Norway**, it has become time for the central bank governor's annual address. The market's strong interest in the speech is down to previous governor Svein Gjedrem having used it a couple of times to announce sea changes in monetary policy. The truth is, though, the annual address has mostly been used to stress the need for structural reforms – in other words put pressure on the politicians – and this has continued to be the case during Øystein Olsen's tenure. Especially since oil prices collapsed, there has been a focus on the need for policies to promote economic transformation in favour of reduced dependency on oil. Should, against expectations, there be any signals about monetary policy, it would most likely come in the form of a discussion of alternatives to the inflation target. There is debate in this area internationally too, and a number of research projects are under way in Norway to assess the options. When it comes to Norway, there are two key issues. 1) First is how to address spiralling housing prices and debt (financial stability) in the formulation of monetary policy, something which Norges Bank included explicitly in its reaction function for the very first time in December. 2) Second is the choice of an inflation target of 2.5%, as against 2% in neighbouring countries, in recognition of the way that phasing oil revenue into the economy will require real appreciation of the krone over time. Now that there is the prospect of more stable spending of oil revenue, the need for this real appreciation will evaporate, so a reduction in the inflation target to 2% could be on the cards.

In **Sweden**, the January labour market report is due for release. In seasonally adjusted terms, Swedish unemployment is declining very slowly (we expect s.a. unemployment to hold steady at 9.9% in January). In more general terms labour market conditions are strong but split in the sense that some groups have a low degree of attachment to the job market while at the same time some industries such as construction face labour shortages. The Riksbank hopes that a tight labour market eventually will result in higher wage pressure ,but so far signs of that are absent.

Fixed income markets

Appetite for **French** government bonds will be tested today with a EUR 6 to 7bn tap in the 3Y and 5Y OAT and the introduction of a new Mar 0.1% 2028 linker. The French Tresor will sell up to EUR 2.5bn in the new linker. France has been recovering throughout this week although the spread vs Germany remains elevated.

Spain is also in the market today issuing EUR 4 to 5bn in the 2022, 2027 and 2028 bonds. In particular demand for the 2022 bond should be strong as it is trading special in the repo.

With a thin data calendar today the content of the **ECB minutes** could be in focus. Traditionally, the minutes have contained very little new info to the market, however, that was not the case in January where a lot of detail on QE considerations was revealed. This time around an interesting insight could be the degree of diverging views within the governing council. Concerns regarding the QE impact on in particular the German repo levels would also attract market attention.

The market will of course also continue to follow the development is **US politics**, but so far the market seems unaffected pricing in a relative high probability (40%) of a March Fed hike. The hike expectations got a boost after the stronger than expected US data last night and the Yellen comments earlier in the week.

In **Scandinavia** the market will continue to digest the new Riksbank report that came with a dovish twist as the rate path still sees a 6bp rate cut probability later in the year. The market continues to price in a much faster normalisation of Swedish policy rates. We strongly disagree, as we continue to see the Riksbank being too optimistic on inflation. Note that the Swedish Debt Office will tap in the 7Y and 10Y linkers today.

FX markets

The only 'surprise' for **scandi FX** market yesterday, was that the Riksbank maintained its 6bp easing bias. There were no formal dissents to that (though members may still have different opinions as in December). Hence, a tad dovish – but only small reactions in EUR/SEK. We think that the QE programme will be not be extended beyond June and that rates will not be cut further. However, we do not expect a first rate hike before well into 2018. A decision to end QE this summer – something that could be signalled as early as the April meeting – could push long rates and the SEK higher. To mitigate the 'risk' that the **EUR/SEK** falls too fast, it could choose to signal slower hikes and/or keep the current easing bias for longer. We remain strategically moderately bullish on the krona, but fair to say, the potential for large gains is perhaps not great. Look to sell on rallies. The RB lowered its KIX forecast; it now suggests a very slow SEK appreciation path.

We think the move lower in **EUR/NOK** both highlight a supportive risk environment for the NOK, but also the importance of NOK/SEK positioning. The latter is best illustrated by the initial EUR/NOK drop post the Riksbank announcement. As pointed out earlier, that does suggest some near-term upside for NOK/SEK; a risk for our call that EUR/NOK will remain range bound near-term. With few domestic drivers ahead of Olsen's speech later today, look out for important resistance levels in NOK/SEK around 1.0720-1.0730. Also note the 8.30-8.32 area in USD/NOK that has several important support levels. A break of either would be consistent with EUR/NOK testing 8.80, opening up for more near-term NOK strength than what we currently pencil in.

EUR/GBP once again bounced back to the 0.85 level after data yesterday showed weaker than expected wage growth in December. As such, the labour market report supports the Bank of England's view of the UK labour market where the Bank recently revised down the NAIRU estimate for the UK economy. This suggests that unemployment can decline further without creating significant wage pressure, implying a lower probability of a BoE rate increase in the coming year. We expect the BoE to remain on hold in the coming 12 months. We still expect EUR/GBP to increase as Brexit moves closer. However, the cross might still struggle to take off as long as EUR/USD remains under pressure. Moreover, we note that while European political uncertainty indeed is a potential EUR negative, we expect EUR risks to weigh only modestly on EUR/GBP ahead of the French presidential election. Hence, tactically we still like to buy EUR/GBP on dips below 0.8470.

Key figures and events

Thursday, February 16, 2017				Period	Danske Bank	*Consensus*	Previous
1:30	AUD	Employment change	1000	Jan		*10*	13.5
7:30	FRF	ILO unemployment	%	4th quarter			10.0%
9:30	SEK	Unemployment (n.s.a.|s.a.)	%	Jan	**7.4%|6.9%**	*7.2%|6.8%*	6.5%|6.9%
13:30	EUR	ECB account of the monetary policy meeting					
14:30	USD	Initial jobless claims	1000				234
14:30	USD	Building permits	1000 (m/m)	Jan		*1230*	1228.0 (1.3%)
14:30	USD	Housing starts	1000 (m/m)	Jan		*1230*	1226.0 (11.3%)
14:30	USD	Philly Fed index	Index	Feb		*17.5*	23.6
15:45	EUR	ECB's Coeure speaks in Maastricht					
18:00	NOK	Norges Bank governor Olsen delivers annual address					

Source: Bloomberg, Danske Bank Markets

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Expected updates

None.

Date of first publication

See the front page of this research report for the date of first publication.

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