

Danske Daily

Steeper JPY yield curve and Italy's deficit targets for 2020 as expected

Market movers today

- This morning, we have published our quarterly Nordic Outlook with updated economic forecasts for the Nordic countries. We have downgraded the growth outlook for 2020 for all countries in line with our more negative take on the global economy, see *Nordic Outlook*.
- In terms of economic data releases, focus is on preliminary HICP inflation in September in the euro area. The combination of sliding inflation expectations and core inflation hovering around 1.0% in the last two years, despite a decent pick-up in wage growth, is challenging the ECB's credibility. With energy price inflation falling further into negative territory and core inflation stuck at 1.0%, we expect headline inflation to print at 0.9%.
- Today, we get PMI manufacturing for most countries including Norway and Sweden. We expect PMI manufacturing to fall in Norway (see below), Sweden and the UK but we could see a small pickup in the US ISM manufacturing index in line with the Markit PMI and regional PMIs.
- The UK Conservative Party Conference continues today so look out for any Brexit related headlines.
- Note we are hosting a short conference call (30 minutes) on the risks of a forthcoming global recession at 10:00 CEST today. The invitation including dial-in information can be found [here](#).

Selected market news

Yesterday the BoJ signalled further willingness to re-steepen yield curves, as the October purchase plan under the QE programme showed cuts to purchases in maturities longer than 3 years and even showed a potential end to purchases above 25y maturities. On top of this, Japan's Government Pension Investment Fund in a statement this morning said that it would re-categorize FX hedged foreign currency bond holdings into domestic debt, effectively freeing up JPY 1.3tn, that the fund can now invest in foreign debt. JGB yields are generally higher this morning as the curve steepens 5-6bp 2s10s. The 2s10s curve is at its steepest level since February. It will be interesting to see whether the recent curve steepening can remain intact despite a lack of inflation and growth expectations.

The first step in Italy's draft budgetary plan (which is to be submitted to the Commission and Eurogroup no later than 15 October) was approved yesterday evening in the Cabinet – as expected a deficit/GDP at 2.2% and real GDP growth of 0.6% for 2020 is targeted. The target will, according to the Ministry of Economy, bring down the debt-to-GDP ratio from currently 136% to 131% by the end of 2022, however, the structural deficit will widen by 0.1 ppt. instead of improving the balance by the committed 0.6 ppt. Also, the planned sales tax hike is avoided for 2020, which has been a key promise for premier Conte.

Selected reading from Danske Bank

- *FX Strategy: USD: what will it take to halt dollar strength from here?*
- *FX Essentials: Scandi valuation? Not in itself an argument against shorts*
- *Reading the Markets Norway: Still upside potential for Norwegian interest rates*

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Scandi markets

In Norway, there was a marked correction in the PMI to 53.8 in August after a sharp fall in June and July. We think much of this fluctuation could be due to problems with seasonal adjustment over the summer months, so we may see somewhat weaker figures for September. On the other hand, oil-related industries are so strong at the moment that there is little reason to fear that the index might collapse towards the levels of its European counterparts. We therefore anticipate a moderate decrease in the PMI to 52.8 in September, which would be consistent with growth slightly above trend.

Fixed income markets

The main event in the European fixed income markets today will be the Euroland preliminary inflation data for September. We expect core-inflation to remain steady at 1% y/y and headline inflation at 0.9% y/y. This is in line with consensus. Furthermore, as 5y5y EUR inflation expectations have continued to decline and are now very close to the historical low of 1.13% seen in June 2019 there is pressure on ECB even after the recent stimulus package. Hence, although EU rates/yields are low and EU curves flat, the risk is for lower rates and more flattening of the curve.

There are no tap auctions or syndicated deals in the European government bond market today. We have published our *Nordic outlook*, where we have revised down our growth outlook for especially Sweden, where economy is developing worse than expected. We have thus lowered our growth forecast for Sweden to just 0.7% in 2020, calendar adjusted. On the other hand, Norway remains supported by strong oil investment growth despite the weaker global outlook.

In the Danish market there is significant focus on the reinvestment need from the mortgage market. There is a record-high amount of reinvestment from callables and noncallables, and we expect to see more performance in the low coupon 30Y callables at least in the short run. Furthermore, we have entered Q4, where Danish government bonds typically outperform Germany government bonds given the reinvestment need from coupons and redemptions on November 15. This year is no different even though the 10Y yield spread between Denmark and Germany is very low at just 2bp. Hence, we expect to see decent demand at the government bond auction tomorrow where the Danish Debt Office is tapping in 2Y and 10Y government bonds.

FX markets

On the back of weak German CPI and due to German institutions cutting growth forecasts, EUR/USD went to new lows of the year, at 1.0890, yesterday. As we noted on Friday (*FX Strategy: USD: what will it take to halt dollar strength from here?*), in order to meaningfully reverse the trend in broad dollar, we need: either an interim trade deal (we think it is 50/50 if it arrives) and/or Fed to become more proactive; but a Brexit solution would likely also help.

For Scandies, much depends on whether we are getting closer to a stabilization in global PMIs (the Chinese figures hint this might be the case). On the other hand, our broader macro-quant models hint that it is a bit too early to turn optimistic. Near-term, Scandies are facing headwinds and we do not think valuations are in themselves an argument against being short Scandies (notably, SEK) as the global environment remains fragile, see *FX Essentials: Scandi valuation? Not in itself an argument against shorts*.

Note, today also brings the release of US manufacturing ISM, which – if it come out decent (as we expect) – could drive EUR/USD even lower. Further, a host of second-round

manufacturing PMI surveys are out across Asia and Latin America. As it appears global PMIs might be rising (based on the preliminary prints from the US, Japan, China and Europe) that would conversely be part of the building blocks for going against the dollar. On net, we expect USD to stay strong until evidence of the contrary becomes stronger.

Key figures and events

Tuesday, October 1, 2019			Period	Danske Bank	Consensus	Previous
-	USD	Total vehicle sales	m	Sep	17.05	16.97
-	CNY	National Day				
1:30	JPY	Unemployment rate	%	Aug	2.3%	2.2%
1:30	JPY	Job-to-applicant ratio		Aug	1.59	1.59
1:50	JPY	Tankan large manufacturers index (outlook)	Index	3rd quarter	1.0	7.0 7.0
1:50	JPY	Tankan large non-manufacturers index (outlook)	Index	3rd quarter	20.0	23.0 17.0
2:30	JPY	Nikkei Manufacturing PMI, final	Index	Sep		48.9
6:00	DKK	Danske Bank publishes Nordic Outlook				
6:30	AUD	Reserve Bank of Australia rate decision	%		0.75%	0.75%
8:30	SEK	PMI manufacturing	Index	Sep		52.4
9:00	NOK	PMI manufacturing	Index	Sep	52.8	53.8
9:15	ESP	PMI manufacturing	Index	Sep		48.8
9:15	USD	Fed's Evans (non-voter, dovish) speaks				
9:45	ITL	PMI manufacturing	Index	Sep	48.1	48.7
9:50	FRF	PMI manufacturing, final	Index	Sep	50.3	50.3
9:55	DEM	PMI manufacturing, final	Index	Sep	41.4	41.4
10:00	EUR	PMI manufacturing, final	Index	Sep	45.6	45.6
10:30	GBP	PMI manufacturing	Index	Sep	47.0	47.4
11:00	EUR	HICP - core inflation, preliminary	y/y	Sep	1.0%	0.9%
11:00	EUR	HICP inflation, preliminary	y/y	Sep	0.9%	1.0%
14:30	CAD	GDP	m/m y/y	Jul	0.1% 1.4%	0.2% 1.5%
15:30	CAD	RBC manufacturing PMI	Index	Sep		49.1
15:45	USD	Markit PMI manufacturing, final	Index	Sep		51.0
16:00	USD	Construction spending	m/m	Aug	0.4%	0.1%
16:00	USD	ISM manufacturing	Index	Sep	50.0	50.5
19:30	EUR	ECB's Weidmann speaks				49.1

Source: Bloomberg, Danske Bank

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Each working day.

Date of first publication

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