12 August 2019

Danske Daily

Continued 'schwarze Null' discussions in Germany

Market movers today

- There is no tier 1 data out today, although DKK CPI is due out this morning, where we expect a further decline to 0.3% from 0.6% in June (see page 2), so focus will continue to be on political risks from the US-China trade war and the political situation in Italy.
- Later this week attention turns to German ZEW (Tuesday), US core inflation (Tuesday) and Chinese data on industrial production and retail sales (Wednesday).
- Markets will also keep a close eye on any policy signals from Fed and ECB members following the recent market turmoil and escalation of the trade war.
- In the Scandies, Swedish inflation data is due for release (Wednesday). The Norges Bank meeting (Thursday) will give more guidance on the outlook for rate hikes.

Selected market news

In Germany, discussions regarding the government's 'schwarze Null' policy, essentially committing the German state to a balanced budget at all times, continued over the weekend, with German defence minister Annegret Kramp-Karrenbauer defending the measure in an article in *Welt am Sonntag*, while members of the Bundestag from both the SPD and Die Grüne were asking for more public investments. The debate comes after a week when a government source said that the finance ministry was currently reviewing its funding options ahead of an upcoming climate package with costs reaching EUR30bn, which could see the 'schwarze Null' policy violated. The debt brake was introduced in 2009 and prohibits Germany's Länder from running a budget deficit and limits the structural deficit of the federal government to 0.35% of GDP. The measure has been popular so far among voters, but questions were raised already in the spring; however, mostly from academics, where discussions went along the lines of the nominal interest rate of debt being below the nominal growth rate of GDP, implying that the debt burden to future generations from raising new debt will be manageable under this condition. For now, however, it seems all coalition partners remain fixed on 'die schwarze Null'. The discussions should be seen as part of a more fundamental shift and willingness among Europe's political leaders to embark on financial stimulus in a scenario of potentially impotent monetary policy measures, with Germany being one of the few countries able to do so. See more in *Government Bonds Weekly*.

Japanese 10-year yields (-2bp to -0.22%, thus below the lower bound of the target range of the Bank of Japan (BoJ)) continues their decline despite the BoJ cutting long-end purchases, in a bid to steepen the yield curve, as well as a surprisingly strong Q2 GDP figure last week. The outlook for the Japanese economy is dimming and the continued flattening of the curve reflect the markets' expectation of further QE.

The People's Bank of China (PBOC) continues to signal an orderly depreciation of the yuan with another fixing in line with expectations. In a statement over the weekend, the PBOC also indicated a further opening of the bond market including improving overseas access to the repo market.

Selected reading from Danske Bank

- *US-China Trade: Three trade war scenarios - 'no deal' now our baseline*
- *FX Strategy: EUR/USD FX forwards driven by turn pricing, debt ceiling and Fed*
- *Harr's view: Slowdown set to worsen but no recession yet*
- *Government Bonds Weekly We expect lower yields/flatter curves but what could trigger a Bund selloff/steepening?*

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Scandi markets

In Denmark, Danish July CPI inflation is due this morning. We expect a further decline to 0.3% from 0.6% in June. A key (temporary) factor comes from last year's July 30% increase in package holidays, which exits inflation along with a big food price increase. More lasting effects will come from the adjustment of the PSO tariff on electricity, which is now zero in Q3. The remaining district heating plants that did not hike prices in January, when a government subsidy for plants producing electricity was removed, will have adjusted their prices in July. There is some uncertainty connected to this, but we do not expect a price correction nearly as extensive as the 8% increase we saw in January. Clothing prices remain a wild card, as we have seen a steep downward trend this year. After another surprisingly large decline in June, we expect the July price decline to be more muted.

Fixed income markets

This week, there will be continued focus on the political situation in Italy and we could see more volatility in Italian government bonds, but we believe the spread widening should be seen as a time to buy Italy as markets have rallied, when there is more clarity on the political situation. Hence, we would recommend going long Italy in the 5Y segment or stick with a curve flattener on the Italian curve.

The positive rating cycle continues in Euroland as Portugal was raised to a positive outlook on Friday by Moody's. This comes after Moody's raised the macroeconomic profile from moderate to moderate + on 24 July. Furthermore, Fitch confirmed Italy's rating despite the political uncertainty.

This week in Scandinavia, we have Danish CPI data today and Swedish CPI data on Wednesday as well as monetary policy in Norway. Inflation is expected to fall further in Denmark and remain more or less unchanged in Sweden. There is no press conference due after the policy meeting in Norway, but the market will be looking at the press statement to see if there are any changes to policy and whether Norges Bank is becoming less hawkish given global developments.

FX markets

Our estimate for July CPIF inflation (Wednesday) at 1.6% is two tenths higher than consensus and three higher than the Riksbank. If correct, it should benefit the SEK (lower EUR/SEK). That said, almost everything else has moved in the wrong direction for the Riksbank. Hence, we would not make too much of that especially since inflation is heading lower in the next few months. For EUR/SEK, it could provide a buying opportunity. In the meantime, risk sentiment will be key for EUR/SEK, where the negative correlation seems to be back in play.

In EUR/DKK, Novo Nordisk will pay interim dividends to shareholders next week – ex date is on Friday. During every Novo Nordisk dividend payments since 2015, EUR/DKK has risen between the ex date and the date payable, most times around 20pips, as the dividend payments are large and the company has a large foreign ownership share. Hence, there is potential for a brief comeback in EUR/DKK after the dropback last week.

The drop in Q2 UK GDP on Friday triggered a sharp rally in EUR/GBP up to 0.93. A setback in growth was expected after the inventory build-up in Q1, but not a contraction. The GBP was already facing headwinds from Brexit anxiety and negative global risk sentiment. As a consequence, the market has started to raise the odds further of a Bank of England rate cut in November.

Key figures and events

Monday, August 12, 2019				Period	Danske Bank	*Consensus*	Previous
-	JPY	Mountain Day (obs)					
6:00	SEK	Maklarstatistik Swedish housing price data					
8:00	DKK	CPI	m/m|y/y	Jul	**-0.3%|0.3%**	*..|0.6%*	-0.2%|0.6%
20:00	USD	Budget statement	USD bn	Jul		*-123.0*	-8.5

Source: Bloomberg, Danske Bank

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