

Danske Daily

US curve flattens again and the recession fear is once again out of the bottle

Market movers today

- It is another relatively quiet day in terms of data releases, and hence market focus will be on political developments, notably in Europe following the EU elections.
- The risk of a battle between the EU and Italy is looming after the EU signalled the launch of an EDP on the deviation of Italy's 2018 fiscal figures from the EU targets. Statements from the Italian government suggest Italy will not stand down.
- The Bank of Canada (BoC) is widely expected to leave policy rates unchanged at today's interim monetary policy meeting. At the previous meeting the central bank removed its modest tightening bias and focus today will be on any new policy signals. We do not expect any significant news and see the potential for a moderately stronger CAD on an 'on-hold' announcement.
- In Sweden, first-quarter GDP numbers are released today, where we expect a weaker-than-consensus number (see page 2 for further details).
- In Norway, we have retail sales, where after some weak months we see upside risks that would come after the strong oil investment survey yesterday (see page 2).

Selected market news

US equity markets came under strong pressure last night and closed with broad-based losses and we can expect a negative opening in Europe this morning. Asia is also in red. Lower equities and trade war concerns have pushed 10Y US treasuries yields down to 2.24%, the lowest level since the autumn of 2017. The 2s10s curve flattened further to 14bp. The curve has flattened 7bp in less than two weeks and the discussion of whether the curve is a reliable recession indicator is back on the agenda.

The market continues to focus on Italy, where the more conciliatory rhetoric from Italy we saw late last week is gone after it has become clear that the EU Commission has sharpened its rhetoric towards Italy. Yesterday, Deputy Prime Minister Salvini said that he will devote all his energy to changing the "old and obsolete rules" of the EU. Hence, BTPs remained under pressure yesterday, though it helped sentiment somewhat that EU Commissioner for Economic and Financial Affairs Moscovici said that he is not in favour of sanctions against Italy. The EU Commission and Italy will "exchange views" he added.

The political clean-up after the EU elections over the weekend yesterday spread to Germany. Bloomberg reported that Merkel apparently decided that CDU party leader Annegret Kramp-Karrenbauer (AKK) is not up for the job to succeed her as chancellor and that Merkel will stay in her position until her term ends in 2021. The CDU's weak election result on Sunday was probably the main reason why Merkel 'ditched' AKK.

This morning, the Trump administration published its semi-annual FX report and put nine countries on a watch list for being currency manipulators. Importantly, China was again on the list, but was not named as a 'currency manipulator', which could have been in a new escalation of the trade conflict.

Selected reading from Danske Bank

- *FX Strategy - Why is the NOK so weak?*
- *Macro Strategy Views Podcast: The global slowdown and what it means for markets*
- *Harr's view - The global slowdown and what it means for markets*
- *Flash Comment - Let the EU 'Game of Thrones' begin*
- *China Weekly Letter - US pulls out the heavy weapons by targeting Huawei*

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Scandi markets

In Denmark, we get the national accounts figures for Q1. GDP growth was 0.3% according to the GDP indicator, and it will be interesting to see what the main drivers were. Our assessment is that demand has been significantly stronger than GDP growth, which is based on supply, suggests.

Furthermore, in Denmark, we also get unemployment for April, the May business confidence indicator and the foreign portfolio investment figures and securities statistics for April. Unemployment as a share of the total labour force stands at 3.7% – the lowest level since February 2009. Manufacturing confidence has been trending higher of late, albeit from a modest level – which does not fit particularly well with the recent very strong growth in industrial production.

In Sweden, first-quarter GDP data is due at 09:30 CEST. Our GDP indicator, based on primary data including industrial and services production and private consumption, suggests a sharp drop to c.1% y/y after the surprisingly strong Q4 numbers. Net exports is the joker, although we assume that the contribution will be positive on the back of weak imports. For comparison, the Riksbank and consensus both expect a stronger number, 1.7% y/y. If we are right, growth started on a much weaker note than the Riksbank has assumed and hence it would need to lower the forecast at the July meeting. Eventually, we think growth alongside inflation will dash ‘hopes’ for a rate hike later this year.

In Norway, April retail sales figures will be published this morning. Retail sales have been extremely volatile since November, but the underlying trend has clearly been weak. A lot of this is structural, as on-line shopping is increasing, but some of the weakness has probably been due to high electricity prices, which have weakened households’ purchasing power. As this headwind is gradually disappearing, we expect retail sales to pick up, and expect +0.3 % m/m in April with some upside risk.

Fixed income markets

Lower equities and trade war concerns pushed 10Y US treasuries yields down to 2.26%, the lowest level since the autumn of 2017. The 2s10s curve flattened further to 14.3bp. The curve has flattened 7bp in less than two weeks and the discussion of whether the curve is a reliable recession indicator is back on the agenda.

BTPs remained under pressure yesterday, though it helped sentiment somewhat that EU Commissioner for Economic and Financial affairs Moscovici said he is not in favour of sanctions against Italy. The EU Commission and Italy will “exchange views” he added. Portugal, on the other hand, continued to perform after the positive ‘outlook’ from Fitch on Friday.

FX markets

10Y US yields made new YTD lows yesterday, but failed to move USD/JPY lower. As for EUR/USD, Italian political headlines continued to weigh on the cross. In the bigger picture, we note that the inflation swap market is trying to get the ECB’s attention ahead of next week’s meeting, marking new cycle lows. In our view, this will continue to put underlying appreciation pressure on the EUR until the ECB responds and reverses course.

Yesterday’s oil investment survey in Norway was important as it showed a larger rise in oil investments than Norges Bank had expected, see [chart](#). This is a key reason why Norway has been, and will continue to be, better insulated against weaker global growth impulses. It’s also a key argument for why we strategically still expect a stronger NOK

even if the NOK has failed to gain terrain recently on wider rate spreads. For more information see *FX Strategy – Why is the NOK so weak?*

EUR/SEK traded on a heavy note already ahead of the key macro numbers yesterday and basically defied the weak NIER data. A weak GDP number today close to our 1% y/y estimate (see Scandi section), should weigh on the SEK though, given that consensus and the Riksbank look for 1.7% y/y. Admittedly, the estimates are surrounded by a lot of uncertainty - a higher number than 1.7% would almost certainly pull the cross lower.

The GBP is starting to have a bit of a more stable track record. In line with our expectations, headlines tend to still be negative but the marginal impact has seemingly hit zero. Markets too can sometimes be hit by fatigue and we think the trend is for consolidation or even strengthening of the pound, as we have a more constructive view on the political reality: May might be stepping down but we need clarity if the pound is to weaken further, not uncertainty, and the former is not coming near term.

Key figures and events

Wednesday, May 15, 2019				Period	Danske Bank	Consensus	Previous
-	PLN	Polish central bank rate decision	%		1.5%	1.5%	1.5%
4:00	CNY	Industrial production	y/y	Apr		6.5%	8.5%
4:00	CNY	Retail sales	y/y	Apr		8.6%	8.7%
4:00	CNY	Fixed assets investments	y/y	Apr		6.4%	6.3%
8:00	DKK	GDP indicator	q/q	1st quarter	0.4%		0.8%
8:00	SEK	Prospera inflation expectations					
8:00	NOK	Trade balance	NOK bn	Apr			13.9
8:00	DEM	GDP, preliminary	q/q y/y	1st quarter		0.4% 0.7%	0.0% 0.6%
8:45	FRF	HICP, final	m/m y/y	Apr		0.3% 1.4%	0.3% 1.4%
11:00	EUR	GDP, preliminary	q/q y/y	1st quarter	0.4% 1.1%	0.4% 1.2%	0.4% 1.2%
11:00	EUR	Employment, preliminary	q/q y/y	1st quarter			0.3% 1.3%
12:00	EUR	Portugal, GDP, preliminary	q/q y/y	1st quarter			0.4% 1.7%
14:30	USD	Retail sales control group	m/m	Apr		0.3%	1.0%
14:30	USD	Empire Manufacturing PMI	Index	May		8.0	10.1
14:30	CAD	CPI	m/m y/y	Apr			.. 1.9%
15:15	USD	Capacity utilization	%	Apr		78.8%	78.8%
15:15	USD	Industrial production	m/m	Apr		0.1%	-0.1%
15:15	USD	Manufacturing production	m/m	Apr		0.1%	0.0%
16:00	USD	NAHB Housing Market Index	Index	May		64.0	63.0
16:30	USD	DOE U.S. crude oil inventories	K				
22:00	USD	TICS international capital flow, Net inflow	USD bn	Mar			-21.6

Source: Bloomberg, Danske Bank

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Each working day.

Date of first publication

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Report completed: 29 May 2019, 06:25 CEST

Report first disseminated: 29 May 2019, 07:15 CEST