29 October 2019

Danske Daily

Brexit drama gets extension

Market movers today

- There is a thin calendar today, as **markets await tomorrow's FOMC meeting**.
- Markets will focus on **the political turmoil in the UK on the debate of a general election** after the EU agreed to (yet another) extension until 31 January next year.
- Overnight Japanese retail sales tick in. We expect to see a surge in the run up to the October VAT hike.

Selected market news

Risk-on sentiment spurred Asian markets, as China-US trade deal optimism prevails and the earnings season is delivering encouraging results, while a Fed rate cut tomorrow remains broadly priced in. The American S&P 500 index closed at an all-time high again, while the Japanese Topix index has been trading at 2019 highs.

The oil price is heading down, as markets await US crude inventory data to get a better picture of oil demand trends. Concerns about slower economic growth are present despite new hopes of a trade truce between China and the US. Yesterday, US President Donald Trump declared he expected to sign a significant part of the trade deal with China ahead of schedule but did not give any details.

Yesterday the EU agreed to a Brexit delay of up to three months accepting the UK's request for a flexible extension of Brexit until 31 January 2020 (we have been calling for another extension since April). If no EU country objects within 24 hours - by Tuesday afternoon - the delay will have been formally adopted. The EU27 agreement on the Brexit extension was reached after talks over the weekend to get France's support, as President Emmanuel Macron opposed any attempts by the EU to gather countries behind a Brexit delay to 31 January.

In the UK, the House of Commons once again rejected PM Johnson's call for a general election but he may be more lucky today, as both LibDem and SNP have sounded positive supporting his call for a December election (although he meets some opposition within his own party, as some think it is better to try to force the Withdrawal Agreement Bill through Parliament, as they fear losing a potential election). Unfortunately, it is very difficult to predict the outcome of UK elections due to the voting system, despite the big Conservative lead at the moment.

A potential plan B for the UK government is to pass a new one-line bill amending the FTPA to set the date for the next election on 9 December (supported by LibDems and SNP). This would only require a simple majority but the drawback is that such a motion is amendable (i.e. a majority can add conditions like votes for 16-years olds, votes for EU citizens etc.).

Selected reading from Danske Bank

- *FOMC preview: Divided Fed is likely to cut again without pre-commitment*
- *Harr's View: The reversal interest rate and cross asset rotation*
- *China Weekly Letter: China climbs further in World Bank 'Doing Business' index*

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Scandi

Next Swedish piece of data is the PMI numbers on Friday. In the meantime, global developments will steer.

Fixed income markets

The combination of an extension of Brexit, a partial deal between US and China on trade as well as some increased political uncertainty in Italy and no upgrade sent bond yields and swap rates higher yesterday. Furthermore, the upcoming tiering by ECB did have an impact on the short-dated repo-rates for Italian government bonds, which became less negative with some 5bp across the curve. The risk is that rates continue to move higher, even though in the longer run we see limited scope for significantly higher rates.

Today, the City of Oslo sells a 5Y benchmark with a yield around 2%. The recent auction in the 10Y benchmark was well received and we expect the 5Y to be met with solid demand as well given the yield pick-up to both Norwegian government bonds and other SSA paper in the 5Y segment such as KfW and EIB. Furthermore, if we hedged in USD, there is also a solid pick-up to US treasuries. See *Strategy: Where can you get an AAA-rated 5Y bond with an outright yield of 2%: City of Oslo*, 28 October.

In the Danish mortgage bond market we saw an increase in the prepayments for the January-term in yesterday's numbers. Given today's numbers we still expect prepayments in total of DKK160bn to DKK180bn for January 2020-term. The pace has slowed down as rates have moved upwards, but it will still be close to what we saw in the October 2019-term. It is the 2% and 2.5% bonds (2% 2047 and 2% 2050-series) that dominate the prepayments for January 2020.

FX markets

EUR/SEK is printing new 'post-Riksbank' highs, even though a full 25bp hike in December is now 84% priced in and with continued strong momentum in Swedish equities which may prompt SEK-negative rebalancing flows. See *FX Essentials: Freeze at zero? Yes, but it does not change SEK direction*, 28 October.

EUR/USD remained steady - close to 1.1100 level - yesterday as Wednesday's FOMC meeting draws closer. Now that Brexit anxiety has eased, the market has scaled back on short positions in EUR/USD (see *IMM Positioning Update - large reduction in net EUR/USD shorts*, 27 October). However, we see a risk that Fed could come out on the hawkish side in its forward guidance tomorrow, which should keep a lid on EUR/USD. The market is about priced for a 25bp cut tomorrow and priced for another 8bp cut in December.

Key figures and events

Tuesday, October 29, 2019				Period	Danske Bank	*Consensus*	Previous
8:45	FRF	Consumer confidence	Index	Oct		*104.0*	104.0
15:00	USD	Pending home sales	m/m|y/y	Sep		*1.0%|...*	1.6%|1.1%
15:00	USD	Conference Board consumer confidence	Index	Oct		*127.8*	125.1

Source: Bloomberg, Danske Bank

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