07 September 2017

Danske Daily

Market movers today

- Today's most important event is the **ECB meeting**. The announcement will take place at 13:45 CET and Mario Draghi's press conference begins at 14:30 CET. We do not expect any major announcements, as the ECB has hinted that there will be no decision on the QE programme before the October meeting. Instead, the focus is likely to be on how big a problem the current pace of euro appreciation is for the ECB. For more, see *ECB Preview: Dovish stance due to strong euro*, 1 September. Based on the OECD's new global model, the 4% stronger effective euro should drag down headline inflation by an accumulated 0.3pp after two years, see *Euro Area Research: Stronger EUR keeping inflation far from the ECB's target*, 27 July.
- This morning at 09:30 CET, only a few hours before the ECB meeting, we do not expect the **Swedish Riksbank** to change either the repo rate or the repo rate path. Also, we do not expect any message about terminating the QE programme now. In our view, this is likely to come in October or December.
- Today at 11:00 CET, we will get **euro area** GDP data for Q2 including subcomponents (for the first time).
- In the **US**, initial jobless claims in the week ending 2 September are due out at 14:30 CET. Do not be surprised if we see a sharp increase due to Hurricane Harvey, although a jump should be only short-lived based on previous experiences.

Selected market news

The main events overnight has been the deal struck between President Trump and the Democrats in the Congress regarding the debt ceiling such that there will be funding until mid-December. This was positive for the short-dated T-bills, but T-bills maturing after mid-December have seen a rise in yields.

Furthermore, the resignation of Fed Vice Chairman Stanley Fischer leaves four spots open at the FOMC committee out of seven. Finally, the Bank of Canada took the market by surprise by hiking rates yesterday by 25bp, which led to a solid rise in Canadian government bond yields and a stronger CAD versus the US dollar.

The deal on the debt ceiling took a bit of focus away from the tensions with North Korea and Hurricane Irma as the equity markets in the US bounced back and posted small gains. This has been followed by small gains in the Asian equity markets this morning.

The dollar is trading a bit weaker against the yen and the euro on the back of the tensions with North Korea, Hurricane Irma, which is moving towards Florida as well as the focus on the upcoming ECB meeting today.

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Selected readings from Danske Bank

Research Poland: Polish economy powering ahead amid external tensions

ECB Preview: Dovish stance due to strong euro

Strategy: Event risk to the fore

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Scandi markets

The main event is the Riksbank meeting this morning. Swedish inflation has risen recently well above forecast (but it is only temporary, in our view), and we expect the Riksbank to express a comfortable but cautious view. The economy is growing strongly, but the Riksbank must contain any further SEK appreciation. We do not expect any changes to the repo rate or announcement that it will not extend the current QE programme, we expect such a message in October or December. See more in *Reading the Markets Sweden*, 31 August 2017. The Riksbank's rate decision is due to be published at 9:30 CET.

Fixed income markets

The ECB will take centre stage today. While little is expected of the policy decision, the press conference will prove much more interesting. Draghi has yet to comment on the EUR appreciation and the problem it poses for the ECB's inflation forecast. Furthermore, focus will be on the future of QE and the feasibility of a QE extension. We expect a downward revision to the inflation forecast for 2018 to 1.2% and 2019 to 1.5% (0.1pp lower both years) and little (if any) hints regarding QE. See *ECB Preview: Dovish stance due to strong euro*, 1 September.

The Spanish Debt Office will be in the market today with taps in the 22s, 27s and 33s as well as the 27 Linker. The French Trésor is also in the market with rather duration-heavy supply as it is conducting taps (EUR 8-9bn) in the May-27s, May-36s, Apr-41s and Apr-60s.

The Fed's Vice Chairman Fischer's resignation leaves four vacant seats at the committee and with Janet Yellen's term as Chair coming to an end in February 2018, the structure of the Fed and the future of US monetary policy remains highly uncertain. The Democrats and Republicans seem to have agreed upon a three-month increase of the debt ceiling (in connection with the Harvey aid). As this is only a temporary 'fix', it is merely the Trump administration 'kicking the can down the road' with the debt ceiling to be reinstated on 15 December. However, it does postpone a government default (by more than three months) as it allows the US Treasury to 'refill' its buffer for extraordinary measures.

The Bank of Canada seems to be the sole 'hawk' in a central bank community populated by 'doves'. With the unexpected 25bp hike yesterday (second in a row), the BoC has shown it is determined to 'normalise' rates and at a rather quick pace, despite market expectation and low inflation.

FX markets

USD recovered some of its losses last night as the Trump administration struck a deal with the Democrats on Harvey aid and a suspension of the debt limit until mid-December. EUR/USD initially dropped from 1.1950 to 1.1910 and USD/JPY bounced from 118.75 to 119.40 on the news. The relatively muted reaction in FX markets probably reflects that the market's expectations of a US government shutdown and default were relatively low, but also reflects the still subdued risk appetite in markets due to the concerns about the US-North Korea tensions.

The three-month suspension of the US debt ceiling reduces the probability of a significant tightening of USD liquidity, which we highlighted in *FX Edge: The return of USD scarcity*, 29 August, and it is less likely that we will see a sharp widening of the EUR/USD CCS in the coming months although the impact of year-end is still likely to weigh. With the new suspension of the US debt ceiling it is less urgent for clients hedging USD assets to roll hedges maturing in Q4 forward at the current stage, in our view. However, tighter USD liquidity and a wider EUR/USD CCS may still be on the cards for 2018, as the solution of a three month suspension is basically just kicking the can down the road. Hence, we now see a risk of a government shutdown in December and/or a government default in spring 2018, and assuming that a longer-term solution to the debt ceiling is found in December, it only postpones the issue of an increase of the US cash balance into Q1, which is then likely to collide with the Fed's quantitative tightening.

Today, focus will be on the central bank meetings at the ECB and the Riksbank. As we are unlikely to get any details on the ECB's possible extension of QE beyond 2017, the main thing to look for is whether Draghi addresses some concerns about the past months' pace of EUR appreciation. Yesterday, we got yet another hawkish surprise from the BoC – another large central bank that has shifted bias over the summer and has now hiked twice since July (four months ago the market priced in a 30% probability of a BoC rate cut). In its statement, the BoC argued that low inflation and low wage pressures will prove temporary and maintains a strong belief in the Phillip's curve. Interestingly, the statement did not contain any worries on CAD strengthening – even despite the significant USD weakening. This is very different from, e.g. RBA and RBNZ communication where worries of currency appreciation are emphasised, and today, the ECB will have to show which camp it is in. With EUR/USD trading above 1.19 there could be some room on the downside for the cross if Draghi addresses the recent EUR appreciation. However, we maintain that dips in EUR/USD will be short-lived, and we believe any decline should be used to position for a further move up in EUR/USD on a 6-12M horizon.

We think that the Riksbank will try to avoid giving a too hawkish a message in order to mitigate any further tightening of financial conditions, especially given the unknown outcome from the ECB. If correct, we think EUR/SEK could edge a little higher, but probably turn well below 9.60 post the Riksbank meeting. If it is more hawkish than we think, a break below 9.45 is likely. Key support is at 9.4100.

Key figures and events

Thursday, September 7, 2017				Period	Danske Bank	Consensus	Previous
-	CNY	Foreign exchange reserves	USD bn	Aug			3080.7
7:00	JPY	Leading economic index, preliminary	Index	Jul		105.1	105.9
8:00	NOK	Credit indicator (C2)	y/y	Jul		5.5%	5.7%
8:00	NOK	Manufacturing production	m/m|y/y	Jul	1.0%|...	0.1%|...	-0.6%|1.0%
8:00	NOK	Industrial production	m/m|y/y	Jul			0.3%|5.4%
8:00	DEM	Industrial production	m/m|y/y	Jul	0.7%|...	0.5%|4.5%	-1.1%|2.4%
9:00	CHF	SNB balance sheet, intervention	CHF bn	Aug			714.3
9:00	DKK	Industrial production	m/m	Jul			-3.7%
9:30	SEK	Budget balance	SEK bn	Aug			-10.1
9:30	SEK	Riksbank, rate decision	%		-0.5%	-0.5%	-0.5%
9:30	SEK	Average house prices	SEK m	Aug			2.87
13:45	EUR	ECB announces refi rate	%				0.00%
13:45	EUR	ECB announces deposit rate	%				-0.40%
13:45	EUR	ECB's monthly asset purchase target	EUR bn	Sep			EU60
14:30	EUR	ECB's Draghi speaks at press conference					
14:30	USD	Initial jobless claims	1000				
14:30	USD	Unit labour cost, final	q/q	2nd quarter		0.6%	0.6%
17:00	USD	DOE U.S. crude oil inventories	K				-5392
18:15	USD	Fed's Mester (non-voter, hawkish) speaks					

Source: Bloomberg, Danske Bank

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