

Danske Daily

Market movers today

- **In the UK, the key release today is the labour market report for June.** Average weekly earnings growth has decreased in recent months and the subdued wage growth highlights the lack of underlying inflation pressure, diminishing the likelihood of a rate hike by the Bank of England for the remainder of 2017. We expect the unemployment rate to stay unchanged.
- **In the euro area, focus is on the first release of Italian Q2 GDP figures, where we expect growth of 0.4% q/q in line with positive signals from leading indicators such as PMI.** Although we project the modest economic recovery in Italy to continue, with annual GDP growth of 1.4% this year, risks are still looming in the background for the country; see also *Significant Challenges for Italy: All you need to know about key issues*, 14 August 2017.
- **The minutes from the FOMC meeting in July are due for release in the US.** Focus will remain on the discussions of the timing of quantitative tightening (we still expect tightening to be announced in September) and any comments on how concerned the Fed is about the low inflation which it now describes as 'below 2%' (previously 'somewhat below 2%').
- **Today the UK government will publish a position paper on possible solutions to the issue of the border between Northern Ireland and the Republic of Ireland following Brexit.**

Selected market news

Risk-on sentiment continued yesterday and the 10Y German bund yield rose another 2.5bp and the yield curve steepened further. The move in the 10Y German yield was almost mirrored in periphery yields, hence the spreads stayed broadly stable yesterday. While a more sustained sell-off does not seem to be looming near-term, this week's risk-on sentiment has retraced most of last week's gains.

EUR/USD slid further but in our view this is a consolidation phase with the cross taking a breather before the next move higher. In the short-term, the upside in the cross is likely capped with stretched positioning long EUR/USD and a US economy regaining strength as reflected in the US retail sales figures released yesterday. The stronger US data could point to a continued fall in EUR/USD but in our view the underlying forces for higher levels should dominate. Instead, the USD is likely to continue strengthening versus the JPY.

Swedish inflation in July surprised on the upside and solidly breached the 2% line. The acceleration was mainly due to package holidays which showed an all-time high yearly rate of 30.3%. This extreme development seems to come from a combination of a new calculation method, strong demand for holidays abroad and possibly some lagged krona effects. The Riksbank minutes from July mentioned package holidays' contribution to inflation and argued that the high inflation outcome may support inflation expectations and hence a loosening of monetary policy but it still concluded 'underlying inflationary pressures in the medium term have probably still not risen'. We expect the governing board to stick to that interpretation for now. Note that the SEK is already trading 2.5% stronger than the Riksbank forecast (see *Swedish inflation breaches 2%*, 15 August 2017).

Selected readings from Danske Bank

- *Yield Outlook: Range trading in yields to continue for now, but asymmetric risks are increasingly skewed to upside*
- *Swedish inflation breaches 2%*

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Fixed income markets

The sell-off in EUR FI gained further ground yesterday with 10y Germany closing another 2.5bp higher while country spreads remained broadly unchanged. While a more sustained sell-off does not seem to be looming near term, the sell-off this week has retraced most of last week's gains.

Another slow day is ahead in terms of economic releases in the euro area. However, Italian Q2 GDP figures are due, where we expect growth of 0.4% q/q in line with positive signals from leading indicators such as PMI. While the Italian economy has seen a modest recovery, plenty of risks still loom. See more *Significant Challenges for Italy: All you need to know about key issues*, 14 August 2017.

Minutes from the July FOMC meeting will be released today. The timing of quantitative tightening will remain in focus as will any comments on how concerned the Fed is with the sluggish inflation prints. We expect quantitative tightening to be announced at the September meeting and commence in October.

In Sweden, the higher than expected July CPI print (driven by the volatile package holiday component) caused a sharp market reaction with swap rates moving 6-8bp higher and SGBs underperforming relative to Germany. The 5Y benchmark closed some 5bp wider and is now trading 25bp wider vs Germany compared to just over a month ago. See more in *Swedish inflation breaches 2%*, 15 August 2017.

FX markets

The batch of decent US data out yesterday provided some support to USD and while we see this as another signal the US economy is recovering, we stress that we prefer to position for USD strength near term vis-a-vis JPY rather than EUR as present as we deem the underlying forces for higher levels in EUR/USD are not to be played around with at present. Notably, yesterday we sent a recommendation to buy USD/JPY in the Danske FX Trading Portfolio; see *Danske Bank FX Trading Portfolio: Buy USD/JPY spot*, 15 August 2017.

Yesterday's upside inflation surprise out of Sweden showed inflation is back at (and above) 2%, but we stress that some of the key drivers look temporary and we see the Riksbank looking through the high level of the CPIF which is set to persist for the next few months. The Riksbank may take another step towards less accommodative monetary policy in September – not least if the ECB does – but we think it will err on the side of caution to mitigate any premature tightening of financial conditions, including too fast an appreciation of the krona. Note that the SEK is already trading 2.5% stronger than the Riksbank forecast. EUR/SEK has now established a lower range of 9.40-9.60 and a sustained break below 9.40 cannot be ruled out, but must in our view be followed by a clear hawkish shift in Riksbank language and policy stance, which we do not expect to see in September.

The Swedish inflation uptick adds some upward pressure on NOK rates even if the substantial cooling of the housing market in Norway and below target inflation are important differences facing Norges Bank compared with the Riksbank. But yesterday the effect of higher Norwegian rates on the NOK was broadly countered by NOK/SEK selling following the release as well as heavy trading in oil. For now, we stick to our view that EUR/NOK is a range play in the weeks to come but the probability of a move lower has risen following Swedish CPI.

Key figures and events

Wednesday, August 16, 2017

				Period	Danske Bank	Consensus	Previous
8:00	SEK	Prospera inflation expectations					
10:00	ITL	GDP, preliminary	q/qly/y	2nd quarter		0.4% 1.5%	0.4% 1.2%
10:30	GBP	Unemployment rate (3M)	%	Jun		4.5%	4.5%
10:30	GBP	Average weekly earnings ex bonuses (3M)	y/y	Jun		2.0%	2.0%
11:00	EUR	GDP, 2nd release	q/qly/y	2nd quarter	0.6% 2.1%	0.6% 2.1%	0.6% 2.1%
14:30	USD	Building permits	1000 (m/m)	Jul		1240	1275.0 (9.2%)
14:30	USD	Housing starts	1000 (m/m)	Jul		1225	1215.0 (8.3%)
16:30	USD	DOE U.S. crude oil inventories	K				-6451
20:00	USD	FOMC minutes					

Source: Bloomberg, Danske Bank

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of the research report is Pemille Bomholdt Henneberg, Chief Analyst.

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Expected updates

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Date of first publication

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