23 June 2017

Danske Daily

Market movers today

- In the **US**, the Markit PMI manufacturing and services for June is due out. Manufacturing PMI has cooled off since it peaked at 55 in January. The current level of manufacturing PMI points to GDP growth around 1.6% and even though this does not sound impressive, we believe that this level is representative of the underlying economic strength. Thus, we do not look for any significant changes to the PMI manufacturing. We expect PMI services to have increased to 54.2 and continue to believe that the moderate growth will be driven primarily by the service sector.
- Also in the **US**, Fed governors Bullard (non-voter, dove), Mester (non-voter, hawkish) and Powell (voter, neutral) are due to speak today.
- In the **euro area**, PMI figures are due out. Manufacturing PMI rose from 56.7 in April to 57.0 in May while the service PMI declined from 56.4 in April to 56.3 in May, leaving composite PMI unchanged. Seemingly, the weak manufacturing PMIs observed in recent months in the US and China did not drag euro area PMIs down in May, but could still weigh on the June figures. We expect PMIs to remain somewhat unchanged in June, as activity in the euro area is still strong, although risks seem tilted to the downside. New orders are currently at a six-year high and the order-inventory balance, which is usually a good leading indicator, has started to diverge and could drag manufacturing PMI down in June. Additionally, the weakness in the external environment already mentioned could drag on export orders.

Selected market news

After a week of significant turmoil in financial markets on the back of the plunge in oil prices, Asian equity markets are seeing a relatively quiet session this morning. Oil prices are also stabilising with the Brent oil price now having recovered over the past two days to USD45.4 per barrel. One supporting factor may be the relatively soft comment from Fed governor James Bullard, who said that while the rate hike yesterday was 'not such a big problem', the projection to raise the federal funds rate to 3% over the next 2.5 years is 'unnecessarily aggressive'. Bullard is known to be a dove, so the soft comments may not be so surprising, but nevertheless point to some disagreement within the Fed's policy committee about the outlook for monetary policy in the US.

In relation to the Brexit negotiations, Theresa May made an offer yesterday at the EU summit to allow the three million or so EU citizens living in Britain lawfully at the point at which the UK leaves the bloc in March 2019 to stay, and also not to require any families with EU citizens to be split up. This proposal clearly signals a softer stance by the UK administration, which has been on the defensive following the poor election result on 8 June.

Selected readings from Danske Bank

- *French Election Monitor No. 5: Macron on track to win majority*
- *Research UK: Minority government is weak from the beginning*

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Chief Analyst
Jakob Ekholdt Christensen
+45 4512 8530
jakc@danskebank.dk

Scandi markets

There are no significant market movers in the Scandi area today.

Fixed income markets

Norges Bank (NB) came out cautiously hawkish yesterday and removed the rate cut probability in the rate path. That said, the first hike is still not pencilled in before 2019. In general, we look for a steeper FRA curve in Norway. See *Norges Bank Review: 'Cautiously hawkish' - steeper FRA curve, limited NOK upside*, 22 June 2017. Today, we will see the release of the so-called Gjedrem report. It could contain a recommendation to lower the inflation target from 2.5% to 2.0%. If the target is lowered officially, it should add to the flattening of the Norwegian curve for 5Y10Y. However, even now, Norges Bank does not expect inflation to move above 2.0% during the bank's projection period. The target is de facto already 2.0%, one could argue.

5Y Germany continues to set the tone in the EUR FI market, displaying a large intra-day underperformance especially relative to swaps. While the implied repo in the futures contracts have normalised some (i.e. the expectation of the repo levels, especially over quarter-end, have eased), positioning seems to have added to the directionality of the move. Yesterday, Bobl ASW tested the lower levels last seen late last year, but ended the day slightly tighter.

An array of PMIs are due to be released today with the eurozone aggregate the centre of attention. The composite print is expected to drop, however only slightly, underlining the continued very high confidence in the euro area business climate.

It is Friday and that means possible rating action. Up for review by Moody's are Germany, France, Greece and Austria while Fitch is reviewing Belgium.

The Danish Debt Office has published its updated borrowing requirement for 2017 (see *here*). Despite a lower net financing requirement than originally assumed, the Debt Office kept the issuance target unchanged at DKK65bn for 2017 and will continue to focus on issuance in the 20s and 27s. It will continue to conduct buy-backs and support the market through switches. The Swedish market is closed today due to Midsummer. In *Reading the Markets Sweden*, 22 June 2017, we looked at the early signs of a lack of supply, especially in shorter maturities. This is due to two and a half years of QE, reduced supply in T-bills, government bonds and mortgage bonds, together with a large amount of redemptions.

FX markets

In Scandi FX markets, focus will remain on the NOK as markets digest Thursday's Norges Bank (NB) meeting and today's release of the Gjedrem report.

Following yesterday's meeting. See *Norges Bank Review: 'Cautiously hawkish' - steeper FRA curve, limited NOK upside*, 22 June 2017, EUR/NOK has fallen but the downside was as expected limited by the flatness of the rate path. Going forward, we emphasise that the global environment remains a headwind for the NOK. Hence, we do not see the NB meeting as a trigger for a sustained EUR/NOK trend lower – not least, the near-term oil price outlook seems challenging with markets focusing increasingly on weak demand amid OPEC losing its market influence (key for our cautious stance since early March).

Today's release of the Gjedrem report in Norway could contain a recommendation to lower the inflation target from 2.5% to 2.0%. If it happens, it would be a natural next step relative to the structural change of the Norwegian economy relative to peers; most recently reflected in the proposal to lower the use of oil money from 4% to 3% of the petroleum fund. An argument against lowering the target is the central bank's ability to cut the real rate at a time when the nominal rate is close to the lower bound. It is difficult to get a sense of consensus for tomorrow's release, but at least other Nordic banks have also stated that a change in the inflation target is not unlikely. What should it mean for the NOK? On balance, it would mean that NB should keep monetary conditions accommodative for a shorter period of time. This would mean a steeper

FRA curve and a stronger NOK. However, looking at NB's revised inflation forecast it is clear that a change would NOT lead to an urged tightening need as NB does not even expect inflation to move above 2.0% during the whole of the bank's projection period (ending Q4 20, gap illustrated *here* in a tweet by Danske Bank Markets). As a result, a change in the inflation mandate would increase the market sensitivity to positive inflation surprises going forward but is unlikely to drive a significant NOK-appreciation near term.

In summary, we are strategically NOK-bullish on constructive domestics but remain tactically cautious on global demand and the oil price outlook even if the Gjedrem report could add temporary support. We prefer to position for a lower EUR/NOK via options.

In South Africa, the rand strengthened against the USD yesterday after the high court found that any no-confidence vote in parliament could be decided by a secret ballot, but only if parliament demands the ballot to be secret. The decision is seen as increasing the chance of ANC members voting against the Jacob Zuma and hence ousting him. We expect political uncertainty to remain high over the next six months which will weigh on the rand.

Key figures and events

Friday, June 23, 2017				Period	Danske Bank	*Consensus*	Previous
-	EUR	Moody's may publish France's debt rating					
-	EUR	Moody's may publish Germany's debt rating					
-	EUR	Fitch may publish Belgium's debt rating					
-	EUR	Moody's may publish Greece's debt rating					
-	EUR	Moody's may publish Austria's debt rating					
2:30	JPY	Nikkei Manufacturing PMI, preliminary	Index	Jun			53.1
8:45	FRF	GDP, final	q/q|y/y	1st quarter		*0.4%|1.0%*	0.4%|1.0%
9:00	FRF	PMI manufacturing, preliminary	Index	Jun		*54.0*	53.8
9:00	FRF	PMI services, preliminary	Index	Jun		*57.0*	57.2
9:30	DEM	PMI manufacturing, preliminary	Index	Jun		*59.0*	59.5
9:30	DEM	PMI services, preliminary	Index	Jun		*55.4*	55.4
10:00	EUR	PMI manufacturing, preliminary	Index	Jun		*56.7*	57.0
10:00	EUR	PMI composite, preliminary	Index	Jun		*56.6*	56.8
10:00	EUR	PMI services, preliminary	Index	Jun		*56.2*	56.3
14:30	CAD	CPI	m/m|y/y	May			...|1.6%
15:45	USD	Markit PMI manufacturing, preliminary	Index	Jun	**53.0**	*53.0*	52.7
15:45	USD	Markit PMI service, preliminary	Index	Jun	**54.2**		53.6
16:00	USD	New home sales	1000 (m/m)	May		*600*	569.0 (-11.4%)
17:15	USD	Fed's Bullard (non-voter, dove) speaks					
18:40	USD	Fed's Mester (non-voter, hawkish) speaks					
20:15	USD	Fed's Powell (voter, neutral) speaks					

Source: Bloomberg, Danske Bank

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Expected updates

Each working day.

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