Danske Daily - Danske Bank Research

*Ella Schlüntz,*Assistant Analyst

In focus today

- In Germany, the ZEW indicator for August is released. The assessment of the current situation is expected to increase by consensus due to the ongoing resilience of the economy amid the energy shock and as the fiscal easing is increasingly supporting growth.
- In the UK, the latest labour market report is released today. The labour market is expected to remain on a cooling trend with modest decline in jobs and easing wage pressures, suggesting limited second-round effects on inflation. Wage growth is expected to come down from an elevated level of average weekly earnings above 4%, while unemployment is expected to stay below 5%. Hence, this alone does not warrant a change in policy stance from the Bank of England (BoE). Markets price one rate hike from BoE by year-end, while we expect the Bank Rate to remain unchanged.
- In the US, July industrial and manufacturing production data is due, with both expected to show slightly stronger growth than in June. Housing data is also due.

Economic and market news

What happened overnight

In commodities, Brent crude rose above USD91/bbl as geopolitical tensions in the Middle East intensified. The original 60-day MoU signed by the US and Iran in June expired without an extension or a final resolution, while Reuters cited a senior official in Iran saying Tehran would shift to a "fully offensive" stance if diplomacy with the US fails. Progress towards normalising tanker traffic through the Strait of Hormuz has stalled, and Trump's threat of military action against Oman added to tensions. Meanwhile, the Houthis claimed an attack on vessels near Bab el-Mandeb.

What happened yesterday

In the US, both the NY Fed Empire Manufacturing Index and the NAHB Housing Market Index came in higher than expected in August. The Empire index rose to 20.6 from 15.6 in July, above consensus expectations of 11, while the NAHB index edged up to 35 from 34, slightly above expectations of 33.

In Sweden, Origo inflation expectations edged higher in August, mainly at the 1-year horizon, rising to 1.97% from 1.83%. At the 2-year horizon, expectations increased to 2.07% from 2.02%.

In China, the July data batch pointed to another weak month. Retail sales slowed to 0.6% y/y (cons.: 1.5%, prior: 1.0%), while industrial production fell to 4.5% y/y (cons.: 5.0%, prior: 5.3%). The housing market remained weak, with new home prices down 0.18% m/m and property investment continuing to contract sharply, by close to 20% y/y year-to-date, although home sales showed tentative signs of stabilisation. The figures underline continued weak domestic demand, with exports and high-tech still driving growth. They also highlight the need for more policy support, although Politburo signals in late July suggest further stimulus rather than a big policy lift.

Equities: Equities were lower on Monday, for a second session in a row, as energy and yields continued higher. S&P 500 edged down -0.5% and Stoxx 600 -0.2%. The move lower in equities did not give "risk off", however. In fact, tech was in green yesterday, and particularly semiconductors, while software sold off -2% after a strong run. AI buildout names like Applied Materials, Micron and LAM all 4-5% yesterday while Meta and Microsoft shed 3-4%. The preference between cyclicality vs defensiveness was less clear though. Health care continues to do well and particularly biotech, which is interesting given how fast risk-free rates have been rising, which would normally limit risky biotech funding. Instead, consumer staples kept underperforming, down almost -2% yesterday, due to higher rates spilling over negatively to the bond-proxy sector, coupled with the increase in energy prices increase costs while also restraining household purchasing power. US futures are negative this morning.

FI and FX: EUR/USD briefly broke 1.16 yesterday before reversing and, in overnight trading, moving back below 1.1580. Oil prices are rising, with Brent crude above USD 91/bbl, as the original 60-day MoU between the US and Iran ended yesterday without any extension or final resolution in sight. Global yields are trading higher in a bearish steepening move, and 30-year US Treasury yields hit the highest level since 2007, underscoring concerns about US debt. NOK is benefiting from higher energy prices and reduced Fed rate-hike expectations, and we maintain a neutral-to-positive near-term view on the NOK. EUR/SEK continues to hover around the 11.00 mark.

Fixed income and FX markets

FI Majors

Global yields ended the day modestly higher in a bearish steepening of the curve. Brent crude rose above USD91/bbl as geopolitical tensions in the Middle East intensified. The original 60-day MoU signed by the US and Iran in June expired without an extension or a final resolution, while Reuters cited a senior official in Iran saying Tehran would shift to a "fully offensive" stance if diplomacy with the US fails. Progress towards normalising tanker traffic through the Strait of Hormuz has stalled, and Trump's threat of military action against Oman added to tensions. Meanwhile, the Houthis claimed an attack on vessels near Bab el-Mandeb. It is a light data calendar today with the German ZEW indicator for August being released and ECB's Lane speaking this afternoon.

Yesterday, 30Y US Treasury yields hit the highest level since 2007, underscoring the rising debt concerns in the US. With the share of T-bill issuance exceeding the TBAC recommendation that T-bill issuance should account for 20% of total outstanding debt, we expect the US Treasury to increase nominal auction sizes next year due to a culmination of the OBBB, IEEPA tariff repayments and a record amount of maturing debt. We expect this to add further upward pressure to long-end US yields over the coming year.

FX Majors

Yesterday, EUR/USD briefly broke above 1.16 for the first time since mid-June, before reversing some of the gains later in the session. Yesterday marked the end-date of the original 60-day MoU that US and Iran signed back in June, but with no signs of either an extension or a final resolution in sight, oil prices moved above USD91/barrel, which weighed on cyclical currencies vis-à-vis USD. In this morning's *Reading the Markets USD - The many faces of declining US participation*, we discuss the drivers and implications of the recent sharp decline in US labour force participation rate. The decline cannot be explained by any single driver alone, but we evaluate three possible explanations that could be in play simultaneously, 1) decline in net immigration, 2) loss of entry-level job opportunities and 3) early retirements. A sudden loss of labour supply that goes beyond the expected extent of the immigration slowdown is both a downside risk to real growth and an upside risk to inflation. We think the Fed will remain on hold in its upcoming September meeting, but eventually hike rates in December and March.

Scandi markets

EUR/NOK approached its August lows in yesterday's session, trading just above 10.90. The cross has generally trended lower so far this month, with rising oil prices, broadly benign risk sentiment in a still relatively low-volatility environment, and reduced Fed rate-hike expectations all supporting NOK strength. On the domestic front, last week's broadly expected hawkish Norges Bank hold does not alter our call for a final hike in September, as we expect August core inflation to creep back above 3%. With inflation still sufficiently above target, we believe Norges Bank will need to tighten further to contain inflation and inflation expectations. That said, the probability of another hike has fallen significantly and is now a close call. A downside surprise in August inflation and/or materially weaker-than-expected growth data could prompt us to revise our view. We maintain a neutral-to-positive near-term view on NOK against both EUR and USD.

Oil

Oil prices rose yesterday on rising geopolitical tension in the Middle East. Brent crude rose above USD91/bbl - the highest in about three weeks. While the root cause of the upwards pressure and volatility in the oil market is the tight supply conditions owing to the disruption of traffic through the Strait of Hormuz, we also highlight the role of the recent weakening of the USD. DXY slipped back to the lowest in about two months yesterday. A weaker USD makes oil cheaper for non-USD-based consumers and pushes prices up.

Tactical views

FX

EUR/USD - USD debasement has come to an end, target 1.12 in 12M

EUR/NOK - Tactically neutral to slightly bearish. Strategically bullish.

EUR/SEK - Neutral, upside-risk in case of a dovish Riksbank

EUR/GBP - Tactically neutral and strategically bullish

USD/JPY - Looking for strategic selling opportunities

EUR/DKK - DN to cap EUR/DKK around the 7.4758 peak from June

USD/CNY - Tactically sell on rallies, strategically bearish

Fixed Income

Europe - Bund ASW-spreads to tighten

US - 10Y US Treasury yields to hit 5% over the coming year

Sweden - Receive SEK front-end vs EUR over the Riksbank meeting

Norway - Look to enter steepeners in the coming month

Denmark - Long high-coupon callables versus DGBs and swaps

Commodities/Energy

Oil - remains in the hands of developments in the Middle East

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