Danske Daily - Danske Bank Research

Danske Morning Mail: Growth, inflation and unemployment expected to converge around structural levels

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In focus today

- US final services PMIs for August are due. The August flash release increased markedly for the second month in a row to the highest level since December 2024. The details pointed to solid demand, rising backlogs and firmer hiring, while output charge inflation eased to a six-month low despite still-elevated input cost pressures.
- Also in the US, the Challenger layoff report for August is released. In July, layoff announcements were at their lowest level in two years, while levels are already low from a historical perspective. AI has accounted for around one third of layoffs in recent months.
- On the wires, Fed's Waller (voter) is expected to speak. In July, Waller mentioned that if core inflation was "hot", FOMC would need to consider tightening policy in the near-term.
- The final euro area service and composite PMIs for August are released today, which we expect to confirm the flash release. The flash services PMI was unchanged at 51.7 but still came in above expectations. Tuesday's final manufacturing PMI, which makes up 35% of the final composite PMI, showed a solid rebound, with Germany in the driver's seat.
- UK final services PMI is released. The flash release increased to 52.8 in August (July: 52.1), suggesting that the services sector continued to expand in August as demand conditions improved.
- In Sweden, services PMI for August is due. Services PMI eased in July to 54.2 from 56.5 in June. Broader indicators have remained strong and manufacturing PMI also increased on Tuesday, so we expect the services sector to continue to follow the strong trend seen so far this year.

Economic and market news

What happened overnight

We have published our new Nordic Outlook - New sources of growth*,* 3 September, with updated economic forecasts for the Nordic economies, the euro area, the US and China.

Broadly speaking, we expect growth, inflation and unemployment to converge around structural levels, although with major risks not least related to energy supplies. Consumer demand in many countries is dented by higher energy prices, but other sources, not least AI-related investments, largely offset this.

Overnight in China, the private RatingDog services PMI increased to 51.4 in August (prior: 50.4), with the improvement being driven mainly by stronger domestic demand, signalling a faster expansion in activity. The reading was in contrast with a softer official survey earlier in the week, where non-manufacturing PMI came in at 49.0. The divergence between the private and official PMI indices likely stems from differences in the surveys' coverage and sampling methods, according to Reuters.

In Japan, the final S&P Global services PMI increased to 52.5 in August (flash: 52.3, prior: 51.2), marking the fastest expansion in five months, as stronger domestic demand supported business activity and new work. Cost pressures remained elevated, with output charges rising at the second-fastest pace on record, which S&P Global said could strengthen the case for another Bank of Japan rate hike. The composite PMI also improved to 53.5 (prior: 52.7), the strongest reading in six months.

What happened yesterday

In the US, ADP private payrolls increased by 38k in August (cons.: 48k), while the July print was revised slightly higher to 46k from 44k. Sector details were mixed: Education & Health Services, Leisure & Hospitality and Construction had higher payrolls growth than in July, while Manufacturing and Professional & Business services declined by 17k and 16k, respectively. The release points to softer hiring momentum ahead of Friday's official jobs report, although ADP has been a poor guide historically to the BLS private payrolls estimate.

The Bank of Canada kept its policy rate unchanged at 2.25%, as widely expected and fully priced ahead of the meeting. The statement was broadly balanced but with a slightly hawkish tilt, as the Governing Council repeated that it is "prepared to adjust monetary policy as needed", while noting that "the upside risks to inflation have increased" and that new tariffs make the growth outlook more uncertain. USD/CAD edged lower on the release, slipping below 1.39, although near-term direction should be driven more by Friday's labour market data and external drivers.

In Denmark, the central bank resumed FX intervention in August, selling DKK5.6bn after no intervention in July and DKK0.7bn in June. This brings total intervention since June to DKK6.3bn. In our view, the amount remains modest and should not trigger speculation about an imminent unilateral 10bp rate hike in Denmark. We still expect the central bank to keep the policy rate spread at -40bp over the next 12 months.

Equities: Global equities were mixed yesterday with the overall index being virtually zero, with a slight defensive twist to it, after three days of declines. In the US, S&P500 rose 0.5%, with real estate being the only sector posting declines. Nasdaq rose 0.5% and Russell2000 rose 1.1%. Materials and com services were at the top of the table. There was no particular theme within the equity sector performance yesterday, to what we rather would call a relief rally. Overnight Asian markets are in green, also Kospi despite Broadcom's afterhours consensus-disappointing Q4 revenue forecast that led to its post trading declines. That said, Broadcom still saw a surge in sales during the coming years. European and US futures are in green.

FI and FX: European government bond yields continued to rise yesterday, while it was a more mixed picture in the US. 10Y German government bond yields have now risen 50bp since early July, while 10Y Treasuries have risen almost 40bp. The German curve has steepened between 2-10Y as the 2Y German bond has risen 40bp. The US curve has also steepened some 10bp. Today, we have several Fed speeches ahead of the US labour market report tomorrow.

In the currency market, there is again speculation of intervention in the JPY as it has strengthened from almost 160.5 to 157.7. Japan has already spent some USD 96bn over the past month in defending the JPY according to the Ministry of Finance. EURUSD is trading around the 116-level.

Fixed income and FX markets

Majors FX

EUR/USD ended yesterday's session back below 1.16 after spiking temporarily higher on rumors of possible JPY intervention during the afternoon. USD short-end rates have moderated relative to EUR this week, and EUR/USD FX forwards have reversed part of the rally seen after Kevin Warhs's Jackson Hole speech last Friday. ADP's August US private sector employment growth fell short of expectations at +38k (cons. +48k), while NY Fed's John Williams noted that it is 'not yet certain' whether the Fed will have to hike rates. Williams has been in the more dovish camp of the FOMC already in the past, but the remarks reminded markets that comments from hawks like Warsh and Hammack do not necessarily represent the views of the entire committee. In this morning's Nordic Outlook, we maintained our call for the first Fed hike in December. Today, we will keep a close eye on the Fed's Waller's remarks in the afternoon. We estimate that there are currently 3-4 hawks who will likely vote in favour of a hike in September, and we believe Waller could be one of the participants that end up deciding the outcome of the meeting. On the data front, we look out for US August Challenger Report for layoff announcements as well as the ISM Services index.

NZD/USD declined yesterday after the Reserve Bank of New Zealand (RBNZ) delivered a dovish 25bp hike. The move itself was widely anticipated and fully priced in ahead of the meeting, but surprisingly, RBNZ revised down their future rate path marginally. The updated rate path indicates two more rate hikes by end-2027, with around 20% implied likelihood for a hike in Q4. Governor Breman elaborated further at the Parliament select committee last night, saying that she 'expects core inflation to increase further' but also that the central bank 'can take time to assess the impact' of higher policy rates. We forecast NZD/USD to remain near current levels around 0.58 over the coming year.

The Bank of Canada (BoC) kept its policy rate unchanged at 2.25% yesterday, as widely expected and fully priced ahead of the meeting. The statement was broadly balanced but leaned slightly hawkish, with the BoC noting increased upside risks to inflation, while new US tariffs have made the growth outlook more uncertain. Markets focused more on the former, pushing BoC hike pricing higher and USD/CAD modestly lower. Still, with core inflation close to target and growth uncertainty elevated, we like our call for the BoC to stay on hold over the next 12M and see USD/CAD on an upward trajectory, supported by wide rate differentials and our constructive USD view.

Majors FI

Continued unrest between the US and Iran pushed European yields higher over yesterday's session. Bund yields gained about 3-4bp across the curve and the 10Y OAT yield crossed 4.25%. Brent crude remained around USD 95/bbl, despite China's President Xi offering temporary relief to energy markets, saying that he would work with Middle Eastern countries to safeguard the security of international shipping lanes and that external powers should abandon their double standards in the region. US Treasuries stayed flat due to weaker-than-expected ADP private sector employment growth of +38k in August (cons: +48k, prior: +46k), coupled with the Fed's Williams signalling that he does not see any urgency to hike with the trend in inflation slowly moving down. The BoC kept its policy rate unchanged at 2.25%, as widely expected and fully priced ahead of the meeting. The accompanying statement looked broadly balanced but with a slightly hawkish tilt from higher inflation risks.

Today, the Fed's Waller will be on the wires in the afternoon, and the final US Services PMI and Challenger layoffs report are set for release ahead of tomorrow's US Jobs Report. In the euro area, the final PMIs for August are expected to confirm the flash releases.

On supply, France will sell up to EUR 13.5bn in the long end of the curve, while Spain will sell in the 3Y to 9Y segments and the 15Y linker. Ireland is set for its second and last auction in Q3 and it will be interesting to see if the recent upgrade from Moody's to Aa2 (positive) will have an impact on demand at the auction.

Scandies

Danmarks Nationalbank (DN) resumed FX intervention in August. It sold DKK5.6bn in FX intervention on top of the DKK0.7bn intervention that took place in June. It was probably about in line with what the market expected. The upwards pressure EUR/DKK, and thus the need for additional FX intervention, has eased over the past week; hence, we do not think there is grounds for speculating in a near-term 10bp unilateral rate hike. The market discounts a small chance that DN hikes more next Thursday than the 25bp implied from following a similar hike from the ECB.

In conjunction with the Nordic Outlook released this morning, we make an adjustment to our Riksbank call and postpone the timing of our call for a rate hike in September to November. Subsequently, we expect a second hike in February to 2.25% (prev. December). We then expect the Riksbank to stay at 2.25% throughout 2027. Current market pricing is now exceeding our Riksbank call, and by some margin, with close to 100bp priced in for the coming year. From a risk/reward perspective, however, we are less convinced to go against current pricing. Especially as the energy market remains a clear driver of the front-end. On a relative basis, we see arguments for the Riksbank to deliver more hikes from here than the ECB. See more in New Riksbank call - not now, but soon - We now expect hikes in November and February to 2.25% (prev. September and December), 3 September.

The main drivers of recent SEK weakness are a cautious Riksbank, a stronger US dollar, and rising geopolitical tensions in the Middle East. Markets are increasingly pricing additional Riksbank hikes, but until the Riksbank validates those expectations through more hawkish communication and ultimately delivers the hikes we now forecast for November and February, the krona is likely to remain vulnerable. With the ECB set to move before the Riksbank, the policy rate differential could widen to a historically unprecedented 75bp, creating further upside risks to EUR/SEK. Meanwhile, the dollar has turned from a tailwind into a headwind for SEK as investors seek safe-haven assets with escalating geopolitical uncertainty.

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 - Dovish Riksbank skews risks to the topside in EUR/SEK

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 - Look for SEK underperformance vs EUR

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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