FI and FX Daily Brief

Summary

European yields declined in a broad fashion yesterday despite the hawkish surprises in country-level flash inflation data from Germany, Italy and France. Even so, long-end OATs continued to increase, pulling the OAT-Bund spread wider yet to 126bp. USD swap rates and Treasury yields twist steepened, declining about 2bp in the front end and rising 5bp in the back end of the curves. US headline and core PCE inflation for August released below expectations, even if part of the surprise was explained by a technical revisions to past data. Broad USD remained on a strong footing yesterday with EUR/USD trading lower especially towards the European evening, which was somewhat unusual in light of the US curve steepening and the inflation data releases. Cyclical currencies, and not least NOK weakened further.

Majors FI

Yields across the Atlantic were split over yesterday's session. European yields declined in a broad fashion, except for long-end OATs that continued to increase, pulling the OAT-Bund spread wider yet to 126bp. Bund yields bull steepened, declining about 8bp to 3.20% in the 2Y and 5bp to 3.58% in the 10Y. The move in bond markets looked through the otherwise hawkish surprise to September inflation readings for Germany (3.4% y/y), Italy (4.1% y/y) and France (3.4% y/y). The ECB's Lagarde said that if she steps down as president before the end of her term, it will only be a matter of a few months. The ECB's Schnabel said the coming months would be important to get a "clearer picture" of how rising energy prices and rates are feeding through to the economy and inflation expectations, in what appeared to be a prominent ECB hawk adopting a wait-and-see approach to conducting monetary policy.

USD swap rates and Treasury yields twist steepened, declining about 2bp in the front end and rising 5bp in the back end of the curves. US headline and core PCE inflation for August released below expectations in a dovish signal to markets, that caused pricing for rate hikes at the Fed's October meeting to pull back for the second day in a row to about 9bp from 13bp.

Today, the final manufacturing PMIs for the euro area and the US are set for release and overnight the CPI inflation figures for Japan may confirm whether the smaller indicators for core pressures moving higher are correct. Additionally, a string of ECB and Fed speakers are set to be on the wires.

On supply, France and Spain are coming to the market selling in the 10-20Y maturity spectrum. France will sell upwards of EUR12bn across the 2036, 2037, 2038 and 2048

bonds, slightly less than usual. Spain will sell upwards of EUR5.5bn across the 2029, 2036 and 2046 bonds, with an additional EUR0.75bn in a 2036 linker.

Majors FX

Broad USD remained on a strong footing yesterday with EUR/USD trading lower especially towards the European evening. Yesterday's move looked unusual in light of the steepening of the UST curve, modest rebound in term premia and inflation data from both Europe and the US that at face value should have had the opposite effect. This could reflect a shift in positioning towards USD longs, which remain strong portfolio diversifiers during risk-off sessions like yesterday, or fiscal concerns in EUR (not least with OAT-Bund spread still widening). But it could also mean that the market is more prone towards a tactical correction towards weaker USD, in case oil prices suddenly tick lower, or if tomorrow's US Jobs Report surprises to the soft side. The latter is not our base case though, as we continue to forecast NFP at +100k, and remain even more confident after the stronger-than-expected ADP reading yesterday (+90k, cons. +75k). We remain structurally bullish on USD with a 12M EUR/USD target of 1.12.

USD/JPY rebounded above 158 overnight after BoJ's summary of opinions did not support the recent speculation of a back-to-back rate hike. Markets are now pricing in only around 20% probability of an October hike, down from 40% on Monday.

Scandies

The overall USD hedge ratio in the Danish pension sector rose in August - the first increase since January. The rise was driven by increased hedging to EUR as the overall allocation to US assets was about unchanged. The higher hedging followed the development in overall positioning in the USD market in August. In Reading the Markets Denmark, 1 October, we look closer at how the investment boom in the US AI sector could further increase Danish investors' allocation to US assets and the USD and thus make DKK more sensitive to changes in US stock prices and the USD exchange rate.

A review of the Riksbank minutes suggests that the Board is becoming more concerned about continued SEK weakness. Four of the five members explicitly discussed the weak krona, indicating that SEK developments are now playing a larger role in the inflation discussion. This should, all else equal, provide some SEK support. SEK was initially slightly stronger yesterday but ended up trading sideways, now around 11.3 in EUR/SEK, 9.9 in USD/SEK and 1.04 in NOK/SEK.

NOK weakened further despite a lack of notable domestic drivers and oil prices still holding above USD 100/bbl. The move appears mainly driven by the broader strong USD backdrop and weaker risk sentiment, rather than local rate developments.

Tactical views

FX

EUR/USD - On a structurally declining trend, target 1.12 in 12M

EUR/NOK - Tactically neutral. 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 7.4760 peak from August

USD/CNY - Tactically sell on rallies, strategically bearish

Fixed Income

Europe - Bund ASW-spreads to tighten

US - 10Y US Treasury yield at 5.20% in 12M

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

Oil - to stay elevated near-term on tight supply conditions

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