Danske Daily - Danske Bank Research

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In focus today

- In Germany, the ZEW index for October is released, which will give us a hint of the growth assessment ahead of the PMIs on Friday. The assessment of the current situation is expected to rise further to the highest level since early 2023 while expectations are expected to decline.
- In the UK, labour market data for August will be released. Consensus expects the unemployment rate to remain unchanged at 4.9%. Wage growth, which remains in focus for the Bank of England, is expected to ease slightly further. The main driver of wage growth is lagged effects from public-sector pay increases.
- In Hungary, the central bank will make its rate decision. We expect them to keep interest rates unchanged at 5.50%.

Economic and market news

What happened overnight

In China, The People's Central Bank of China kept the 1-year and 5-year Loan Prime Rates unchanged at 3.00% and 3.50%, respectively. Thus, China kept its key lending rates at record-lows for the 17th straight month. This was in line with our expectations.

What happened yesterday

In the AI-space, rising demand for credit default swaps on AI-linked companies suggests investors are becoming more cautious about the debt-funded AI investment boom. AI-linked debts have sky-rocketed so far this year, with companies raising an estimated USD466bn. The sharp increase in CDS trading and wider spreads, even for stronger issuers such as Microsoft, indicates growing concern over whether heavy spending on data centres and chips will translate into sufficient free cash flow. While AI remains a key market theme, credit markets are increasingly treating funding risk as an important vulnerability.

In France, the government urges curfew in some areas after aweekend of riots. Violent protests over living costs and education conditions have reinforced investor doubts about the government's capacity to deliver budget consolidation ahead of the presidential election. The 10-year yield rose 0.14 percentage points to 4.93% and the spread to Germany climbed back to 1.47 percentage points. Unless the unrest eases and the

government can re-establish credibility on deficit reduction, volatility in France's bond market is likely to remain elevated.

Equities: US equity indices were stronger yesterday, led by the tech, while the less-tech exposed indices had a tougher day. Nasdaq rose 1.1%, while S&P500 rose 0.4% with only 35% of the names higher on the day. European Stoxx600 declined 0.8%. The consumer disc also had a strong day, ending 2.7% higher, however this was virtually only driven by SpaceX and Amazon. The tech-led rally yesterday was essentially a mirror image of last week, with a narrow set of names performing in tech, with the equal-weight index underperforming the market cap. The tech sector managed to rally despite another rise in Treasury yields, suggesting yesterday's move was less about easier financial conditions and more about investors seeing last week's sell-off as too much, with tonight's SpaceX earnings report as the near-term test for the AI-narrative. Overnight, Asian equities are mostly lower, failing to extend the tech rally in US hours yesterday. European futures are lower, while US futures are higher. It is particularly noteworthy again that the S&P500 leads futures higher, with Nasdaq trailing.

FI and FX: The EUR weakened on a broad basis yesterday, where the focus in the FX market remained on French politics and debt as well as high energy prices. Notably, EUR/USD traded close to the 1.12 level, while EUR/NOK fell to a new low of 10.55. Yields rebounded and the yield curve steepened - a bit more in the US than in Germany and the Scandies. The rates market seems to disregard next week's policy decisions from the ECB and the Fed and remained locked in on possible hikes in December.

Fixed income and FX markets

Majors FI

Yields rose modestly during the European session, with the 10Y EUR swap around 3bp higher at 3.56%, about the same level at which they closed a week ago. Following the violent protests in France over the weekend, the 10Y OAT-Bund spread widened by about 10bp to 148bp. At the same time, Germany's ASW spreads were close to unchanged. In an interview with Bloomberg, German chancellor Merz commented that a decision to fill upcoming vacancies at the ECB could be reached "very quick" if needed.

During the US session, US yields moved higher across the curve by 6-7bp in the 2Y to 10Y segments of the UST curve. With break-even inflation rising only by around 1bp, the move was primarily driven by real rates. Overnight, AI jitters resurfaced during trading hours in Asia, but USTs have moved sideways.

Today, we will get supply from the UK (GBP 4.25 billion 10Y), Germany (EUR 500 million each in the 1.8% 2053 and 2.1% 2029 maturities) and Finland (5Y and 10Y). In terms of data, we get UK labour market data and Germany's ZEW survey, with the expectations

index expected to show a small decline from 34.7 to 30.0, while the current situation measure is expected to rise from -47.1 to -44.5.

Majors FX

EUR/USD declined only modestly through Monday's session despite initially opening sharply lower. That said, the broader market environment pointed towards the risk of further declines later in the week. The OAT-Bund spread widened some 10bp, US tech stocks rebounded and the Brent oil price rose back to USD110/barrel. UST and Bund yields rose in tandem across the curve, which meant EUR/USD FX forwards were little affected. 3M cross-currency basis has widened by 1bp since last Thursday.

In broader G10, yesterday's moves seemed to reflect more idiosyncratic EUR weakness, than the typical "risk-off" sentiment. Safe-havens JPY and CHF weakened, while commodity exporters AUD and CAD led the gains. Markets are now pricing up to 84% likelihood that Bank of Canada will deliver its first rate hike of the cycle next week, up from just 30% last week. The move came after hawkish remarks heard from Governor Macklem over the weekend, and despite slightly softer-than-expected Canadian September CPI print yesterday (3.1% y/y, cons. 3.2%, Aug 3.0%).

Democrats are still seen as the favourites to win majority of both House and Senate in US midterms, which are now just two weeks away. The outgoing Republican congress will have a busy schedule for the roughly 2-month "lame-duck" session between the election date, and the start of the new congress. Republicans will likely attempt to pass through at least the government funding bills for the next year, as well as one more reconciliation bill that could include another increase to the debt ceiling. That said whether especially the latter passes, is far from certain. We discuss the implications as well as the near-term factors affecting USD liquidity outlook in this morning's Reading the Markets USD - Republican agenda for the lame-duck session, 20 October.

Scandies

EUR/SEK trades around 11.10, USD/SEK around 9.90 and NOK/SEK around 1.05. The small SEK strengthening yesterday, mostly towards EUR, was supported by renewed euro weakness following the weekend unrest in France, alongside a narrowing 2-year rate spread towards EUR.

EUR/DKK opened the week below 7.4750 as the broad weakening of the EUR amid concerns about French politics and debt also weighed on the pair. This effect has countered the effect from higher carry on long positions as the 3M FX forward has dropped below -80 pips - the lowest in about two months. The downwards pressure on FX forwards stems in part from easy DKK liquidity conditions.

Since yesterday, the NOK has strengthened slightly against both the USD and the EUR, although broader FX moves have remained fairly muted. Oil has been the key driver, with Brent remaining elevated but volatile, while gains were capped by the Russia sanctions waiver softening the crude rally.

Tactical views

FX

EUR/USD - On a structurally declining trend

EUR/NOK - Tactically neutral. Strategically bullish

EUR/SEK - Back below our 1M target, a buy-on-dips from here on

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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