24 August 2018

Week Ahead - Curve confusion

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- Curve confusion prompting a late-cyclical mindset
- But yield curve apologists in control of the Fed
- US macro momentum the next shoe to drop

Curve confusion

A lack of conviction describes the market over the past week. Neither President Trump's comments on the Fed and the dollar, US domestic politics (Cohen's confession) nor a deterioration in US economic data have put more than a dent in the dollar or in US Treasury yields. The follow-through has been limited despite what appeared to be some significant technical damage for instance to the dollar.

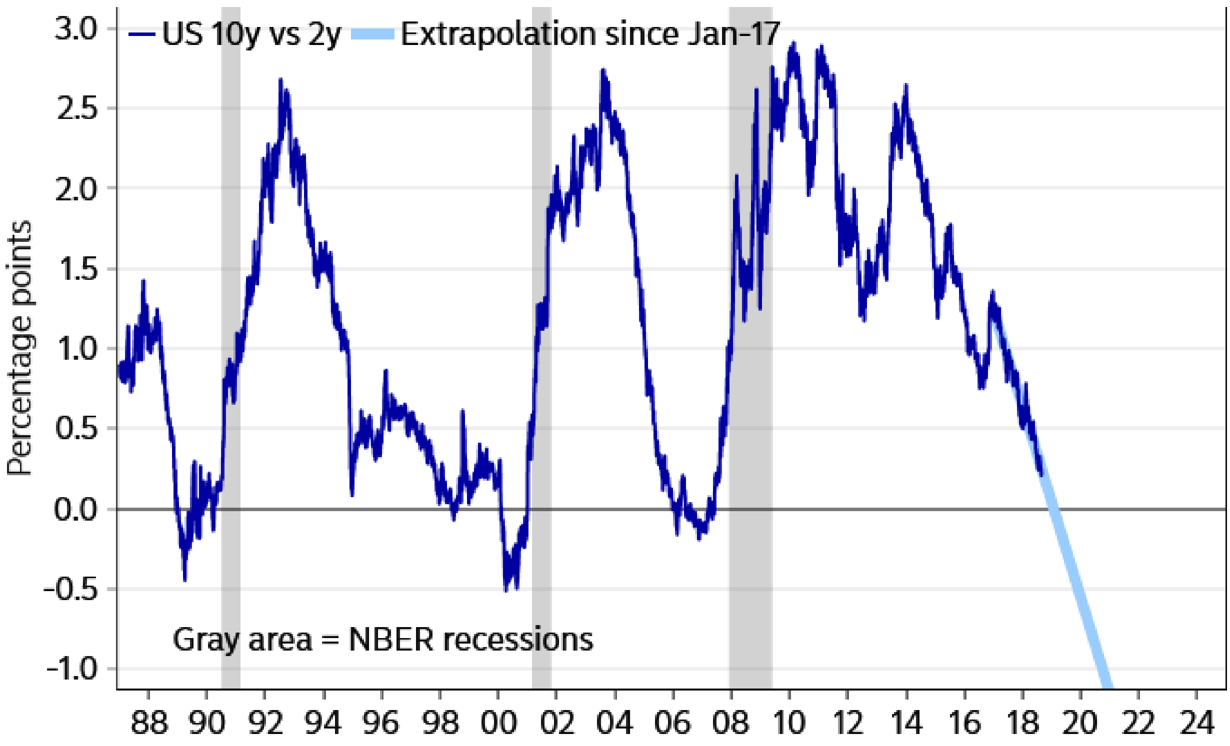
Chart 1: US domestic politics suddenly making some waves

Source: Nordea Markets and PredictWise!

The ongoing flattening of the US yield curve remains hotly debated, both outside and inside the Federal Reserve. At its current flattening pace, the 10y/2y yield curve will invert by early next year, and this is making some officials worried. According to minutes from the Fed's July meeting, several Fed officials noted that "inversions of the yield curve have often preceded recessions". There are, however, many "yield curve apologists" out there among policy makers. Indeed, the consensus within the Fed, and among central bankers in general, is that this time is different, i.e. the yield curve is not telling us much (because of QE, forward guidance and new high demand for long rate products).

Old hands note that both Fed chair Greenspan as well as Fed chair Bernanke voiced similar arguments in the run-up to the global financial crisis a decade ago. That the market is showing a late-cyclical mindset should thus not come as a big surprise, although market participants' conviction on the general macro trajectory admittedly appears low.

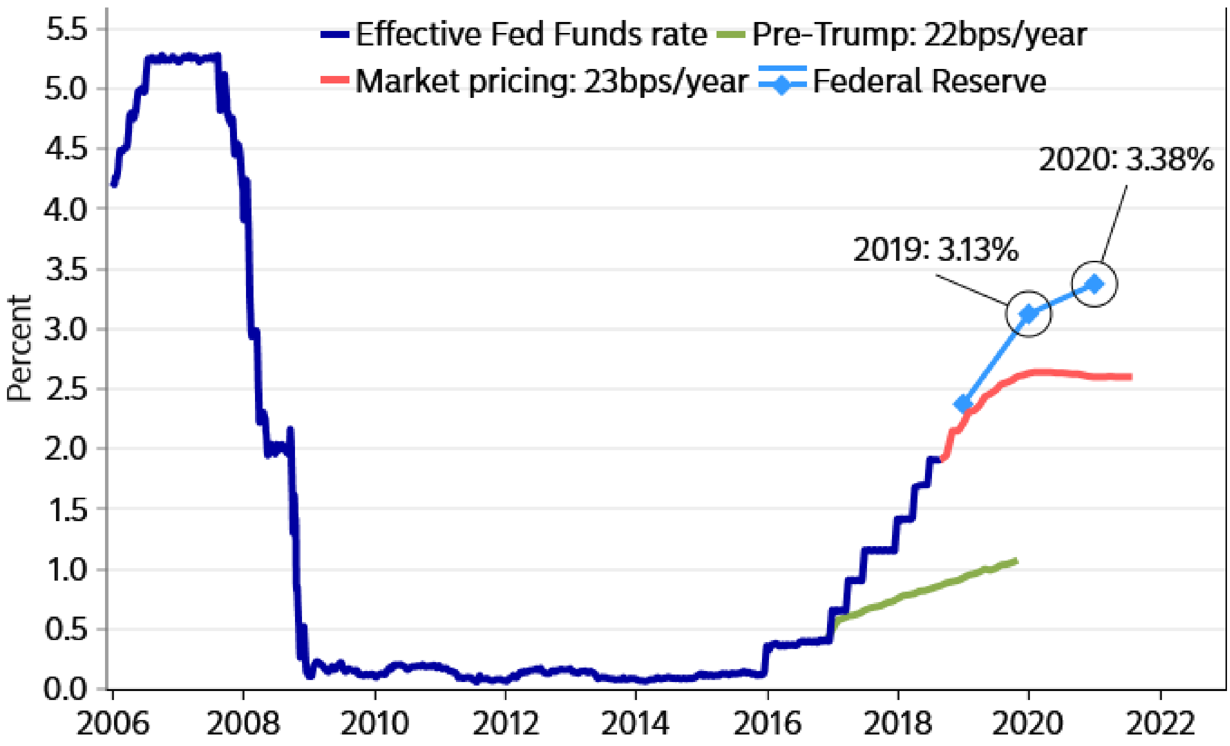
Chart 2: US yield curve keeps flattening



Source: Nordea Markets and Macrobond

Over the next few months we expect to see more weakness in various US leading indicators (ISM manufacturing and other gauges), as the past tightening of US financial conditions (the year-to-date gains of the dollar), higher rates and yields make themselves felt, and recent emerging market turmoil "spills back" to the US. **Our best guess for now is thus that the flattening trend will persist.** In this scenario it will also be tricky for the market to price in Fed hikes beyond March 2019 (something it has been struggling with recently).

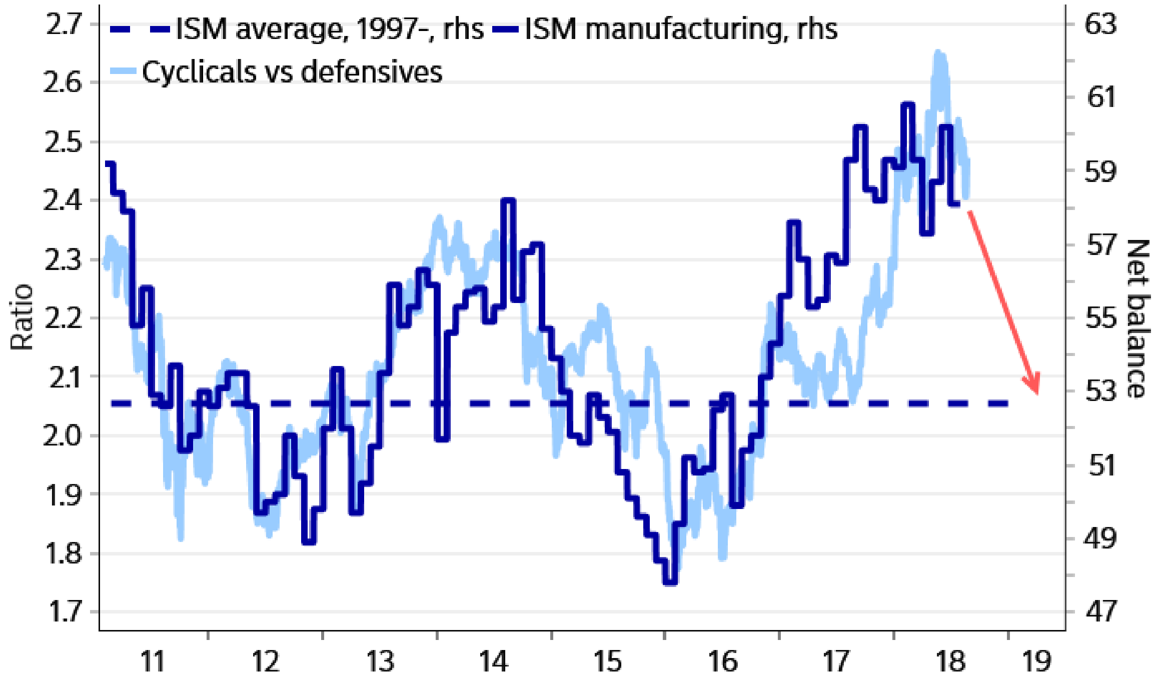
Chart 3: Late-cyclical mindset preventing pricing-in of rate hikes in 2019-2020



Source: Nordea Markets and Macrobond

Chunks of the equity market also shows late-cyclical beliefs, it would seem. If the ISM manufacturing index is heading south, then a negative repricing of cyclical equities vs defensives would seem reasonable. And US cyclicals have underperformed defensives since the beginning of the summer. If the following pattern holds, then cyclical equities might underperform by 15%, should the ISM mean-revert to its long-term average.

Chart 4: Cyclical equities have underperformed since the beginning of the summer



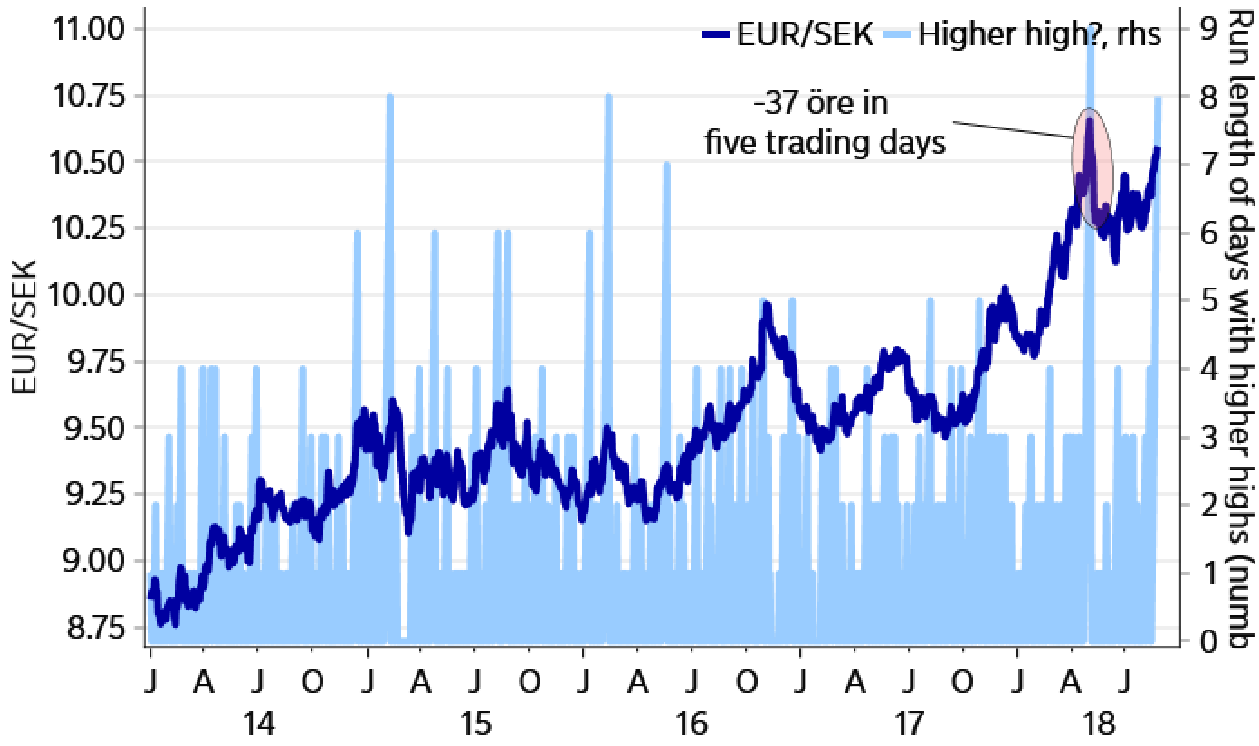
Source: Nordea Markets and Macrobond

Our call remains that the cyclical downturn will generally be larger than anticipated. In our view, this would usually spell trouble for risk sentiment, especially as **rising cost pressures will prevent eg the Federal Reserve from taking a breather in the rate hiking cycle.** The combination of macro trends, liquidity risks and stretched equity valuations/margin expectations for 2019 should lead **to a rocky road with higher volatility and a negative tilt for risky assets** (see Nordea View).

Scandinavia: Swedish election and Riksbank angst spilling over to Norway

The SEK has continued to weaken, with the upcoming Riksbank meeting on 6 September and the general election on 9 September being two domestic negative drivers. The two most positive things which can be said about the krona currently is: i) it is cheap and ii) speculative accounts are likely short the krona – and that when exiting SEK shorts the door may be quite narrow. A pattern of higher highs in the cross was a sign of momentum funds selling the krona in late April, and the door got crowded when the Riksbank eventually triggered position-squaring in May.

Chart 5: Strong upwards momentum in EUR/SEK – a little like in April-May



Source: Nordea Markets and Macrobond

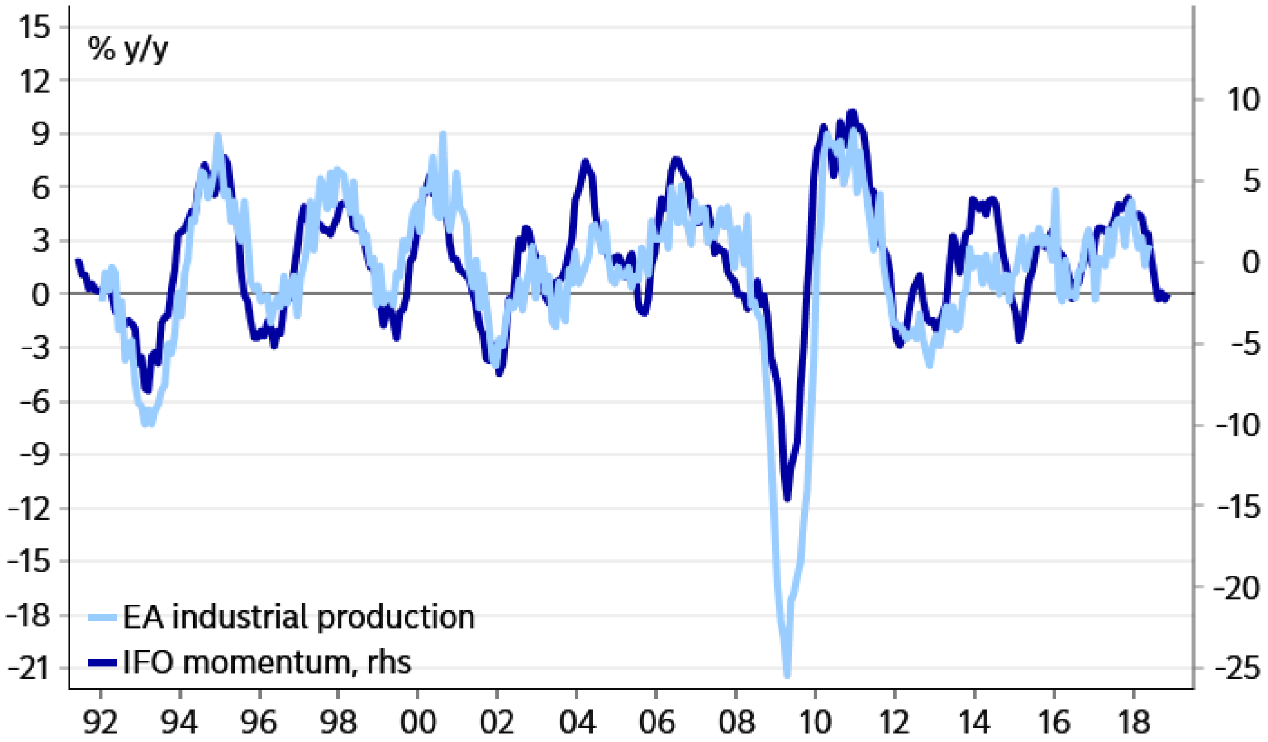
Despite a looming rate hike from Norges Bank and inflation topping expectations, the NOK appears to be hit by the Swedish disease, not that the late-cyclical mindset of many market participants is helpful. Both USD/NOK and USD/SEK tend to rise ahead of an inversion of the US yield curve: as market participants fear the US expansion may be in the late innings (potentially bad news for risk sentiment) it may hold them back from buying the Scandinavian currencies.

What is most important in the week ahead?

Politics are likely to remain important across global markets. Trade tariffs, sanctions and US politics are all likely to keep affecting markets. A Chinese delegation is visiting the US in late August, to discuss the trade situation. And a sudden cooling of tensions may seem unlikely but cannot be ruled out, should it serve the US President's political agenda ahead of mid-terms.

The yield curve discussion will be informed by upcoming inflation and survey data. Weaker leading indicators and a slowing of industrial growth momentum would generally imply further flattening pressures unless inflation picks up, that is. The key macro events over the next week is thus Germany's Ifo numbers due out on Monday 27 August, US core PCE inflation on Thursday 30 August and Euro-area core HICP inflation on Friday August 31.

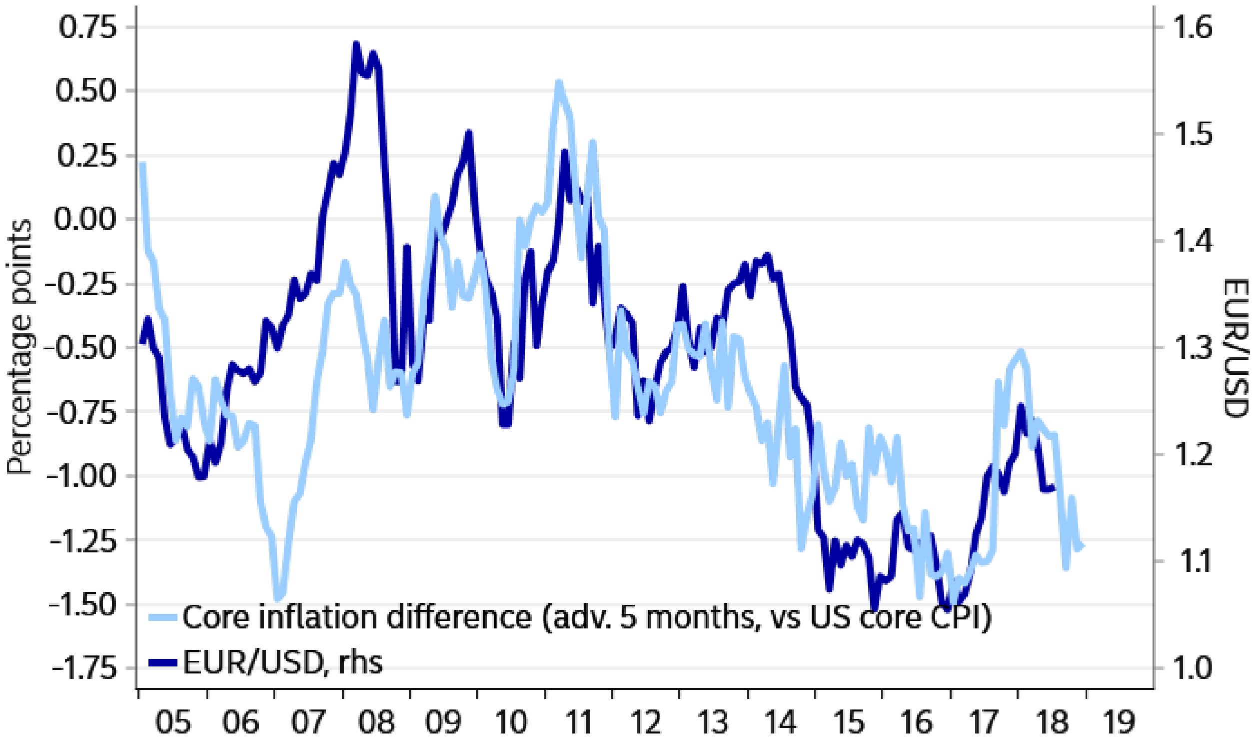
Chart 6: Ifo momentum must pick up if not to suggest downside risks to EA growth estimates



Source: Nordea Markets and Macrobond

The recent momentum in Germany's Ifo survey suggests further downside risks to German and by extension Euro-area growth momentum during the remainder of this year. **Unless the Ifo index picks up from today's levels, it indicates further downside risks to current growth estimates for the Euro area**.

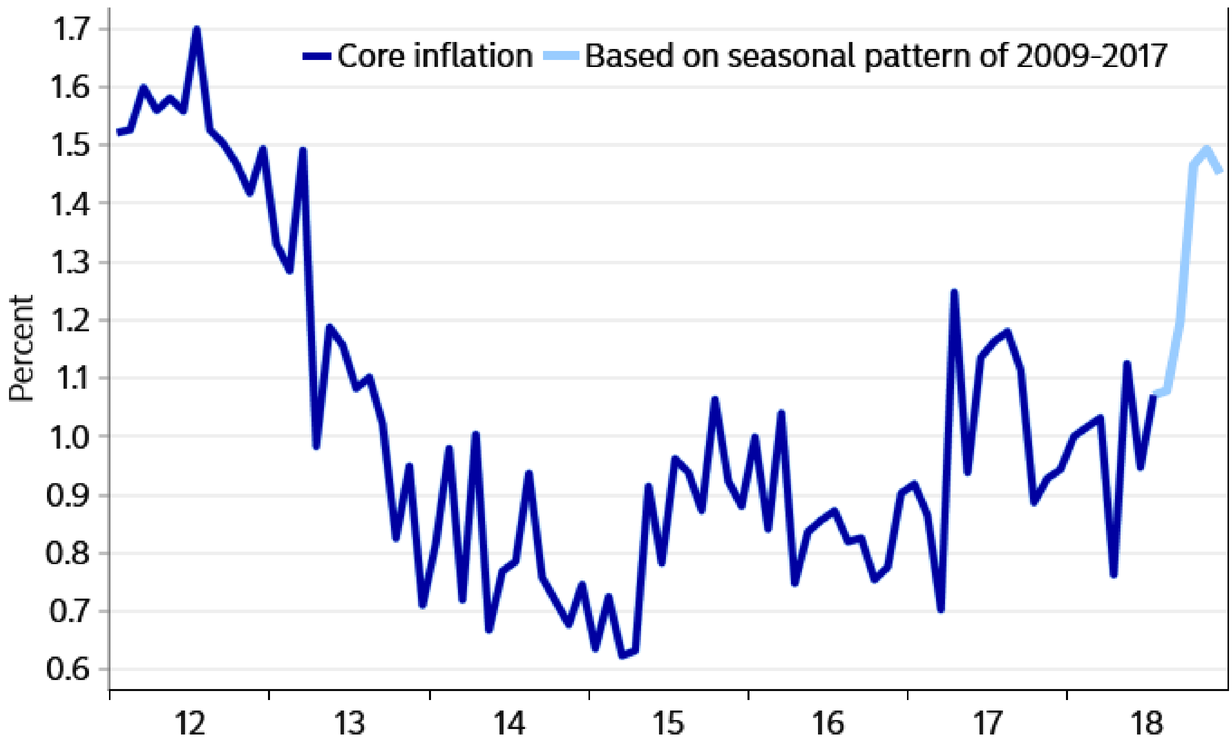
Chart 7: Relatively higher core inflation has been helpful for the dollar this year



Source: Nordea Markets and Macrobond

Core inflation readings in the Euro area and the US have been helpful in predicting the path of the dollar in recent years. Late this autumn the Euro-area core inflation reading is set to pick up to 1.5% due to base effects stemming from unusually low monthly inflation readings in eg October last year. Such a core inflation outcome would be the highest since 2013 and be a bit supportive of the EUR, at least for psychological reasons. We are not there yet, though. **The August inflation reading is unlikely to cause any such fireworks**, we see some downside risks to our forecast for core inflation of 1.1%.

Chart 8: Base effects to push EA core inflation to 1.5% later this year



Source: Nordea Markets and Macrobond

In Sweden, a raft of data is being readied by the usual flocks of statisticians: household lending, retail sales, confidence numbers and wage growth. Of these releases the wage growth numbers (Thursday 30 August) are the most important, as low wage growth is a key driver behind the Riksbank's perennial inflation disappointments.

The Norwegian market also has a fair amount of releases to look forward to: unemployment (both measures), consumer confidence, retail sales, credit growth and Norges Bank's FX purchases. None of these releases are likely to rock the boat ahead of Norges Bank's next decision to hike the policy rate on 20 September. It's lift-off time!

/ Martin Enlund (Chief FX Strategist)

Key research pieces over the past week:

FX weekly: Fat-burning shorts (19 August)

Summer summary (20 August)

Fed Watch: September hike confirmed (22 August)

Emerging Markets View: Thunderstruck - August 2018 (23 August)

Table 1: Main releases to watch

Date	Key figure	Nordea	Consensus	Last
27-Aug	DE. Ifo, business climate (main)		102.0	101.7
30-Aug	US, PCE prices, core (y/y)		2.0%	1.9%
30-Aug	SE, Wage increases, Swedish National Mediation Office	2.7%		2.4%
31-Aug	EU, HICP, core (y/y)	1.1%	1.1%	1.1%
31-Aug	NO, Unemployment rate, registered (unadj. and excl. labour market schemes)	2.4%	2.4%	2.5%

Monday

Today's most important release will be the German Ifo numbers. Market participants will also keep an eye on the Turkish markets that will open again after being closed the week before because of holidays.

Monday, 27/08/2018				Nordea	Consensus	Previous
06:00	NO	Consumer Confidence	Q3			
08:00	DE	Retail sales (m/m)	Jul		-0.1%	0.9%
09:30	SE	Financial market statistics, household lending (y/y)	Jul			6.3%
10:00	DE	Ifo, business climate (main)	Aug		102.0	101.7
10:00	DE	Ifo, current assessment	Aug		105.4	105.3
10:00	DE	Ifo, expectations	Aug		98.5	98.2
16:30	US	Dallas Fed Man. Activity	Aug		30.0	32.3

Tuesday

US consumer confidence numbers are out today along with retail sales from Sweden. The ECB's chief economist Praet (dove) speaks during the day.

Tuesday, 28/08/2018				Nordea	Consensus	Previous
09:30	SE	Retail Sales (cal corr, y/y)	Jul		2.9%	0.2%
09:30	SE	Retail Sales (sa, m/m)	Jul			-1.8%
09:30	SE	Trade Balance	Jul			-0.5bnSEK
09:30	SE	Unemployment, Labour Force survey (AKU)	Q2			
16:00	US	Conf. Board Consumer Confidence	Aug		126.5	127.4
16:00	US	Conf. Board Present Situation	Aug			165.9
16:00	US	Conf. Board Expectations	Aug			101.7
14:30	US	Trade Balance, Advance Goods	Jul		-68.8bn	-67.9bn
15:00	US	House prices, S&P/Case-Shiller, national (m/m)	Jun		0.2%	0.2%
15:00	US	House prices, S&P/Case-Shiller, national (y/y)	Jun			6.5%
16:00	US	Consumer confidence	Aug		126.5	127.4
16:00	US	Richmond Fed manufacturing index	Aug		18	20

Wednesday

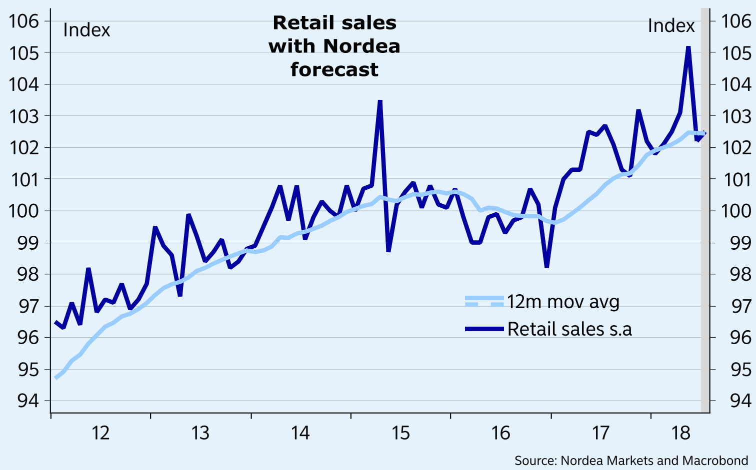
The calendar is very light on the data front today. Revised US Q2 GDP data are released.

Wednesday, 29/08/2018				Nordea	Consensus	Previous
11:00	NO	Auction of Treasury Bonds				
11:00	SE	SNDO to auction T-bills				
13:00	US	Mortgage applications, MBA	Aug			4.2%
14:30	US	GDP (q/q annualised, preliminary)	Q2		4.0%	4.1%
14:30	US	GDP deflator (q/q annualised, preliminary)	Q2		3.0%	3.0%
14:30	US	PCE prices, core (q/q annualised) (preliminary)	Q2			2.0%
14:30	US	Personal consumption (q/q annualised, preliminary)	Q2			4.0%
16:00	US	Home sales, pending (m/m)	Jul		0.5%	0.9%
16:30	US	EIA Crude Oil stock change	Aug			

Thursday

It is a big inflation day as we get the Fed's preferred inflation gauge, PCE core prices as well as German and Spanish inflation figures, which will give some strong indications of tomorrow's inflation numbers from the entire Euro-area. In Scandi land, Norwegian retail sales and the Swedish NIER economic tendency survey are out.

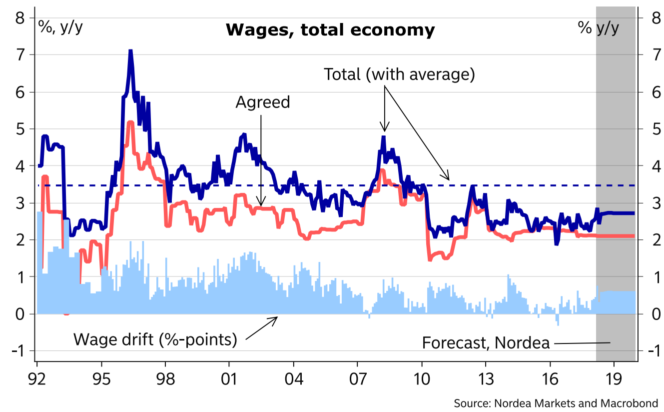
Thursday, 30/08/2018				Nordea	Consensus	Previous
08:00	NO	Consumption of goods indicator (m/m, sa)	Jul			
08:00	**NO**	**Retail sales (m/m, sa)**	**Jul**	**0.3%**		**-2.9%**



Retail sales fell sharply in June (-2.9% m/m) partly reflecting a rather strong May, but possibly also because shoppers preferred to stay at the beach. July was another month with nice summer weather and we assume retail sales remained at a rather low level. Our forecast for 0.3% m/m means that retail sales will be 0.3% below July last year compared to an average growth rate of 1.4% so far this year.

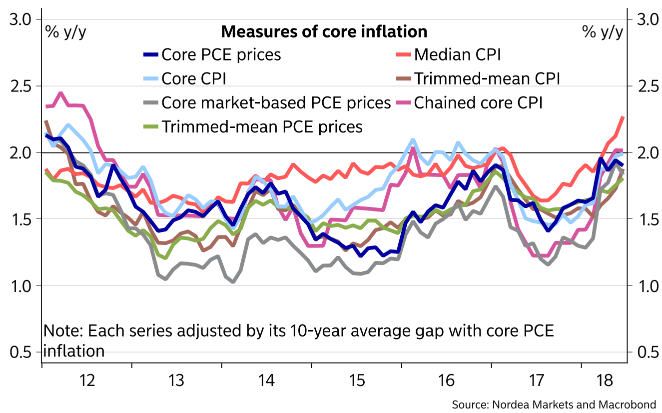
09:00	ES	Spanish CPI (m/m)	Aug			-0.7%

Thursday (continued), 30/08/2018				Nordea	Consensus	Previous
09:00	ES	Spanish CPI (m/m)	Aug			-0.7%
09:00	ES	Spanish CPI (y/y)	Aug			2.2%
09:00	ES	Spanish HICP (m/m)	Aug			-1.2%
09:00	ES	Spanish HICP (y/y)	Aug			2.3%
09:00	SE	CCI - Consumer confidence				99.8
09:00	SE	Economic tendency survey				109.6
09:00	SE	MCI - Manufacturing confidence				118.1
09:00	CH	Leading indicator, KOF	Aug			101.1
09:30	**SE**	**Wage increases, Swedish National Mediation Office**	**Jun**	**2.7%**		**2.4%**



The Swedish Mediation Office will present figures for May and June. So far, wage increases have been well contained, explaining why core inflation in general and services inflation in particular have been low this year. There are signs of higher pay rises globally, which may spill over to the Swedish labour market. So far, there are few signs of that.

09:55	DE	German Unemployment Rate	Aug		5.2%	5.2%
09:55	DE	German Unemployment Change	Aug		-8k	-6k
11:00	SE	SNDO to auction inflation-linked bonds				
14:00	DE	German CPI (m/m)	Aug		0.2%	0.3%
14:00	DE	German CPI (y/y)	Aug		2.1%	2.0%
14:00	DE	German HICP (m/m)	Aug		0.2%	0.4%
14:00	DE	German HICP (y/y)	Aug		2.1%	2.1%
14:30	CA	GDP (y/y)	Jun			2.6%
14:30	US	Jobless claims, continuing	Aug			1727k
14:30	US	Jobless claims, initial	Jul			210k
14:30	US	PCE prices (m/m)	Jul		0.2%	0.1%
14:30	US	PCE prices (y/y)	Jul		2.3%	2.2%
14:30	US	PCE prices, core (m/m)	Jul		0.2%	0.1%
14:30	**US**	**PCE prices, core (y/y)**	**Jul**		**2.0%**	**1.9%**



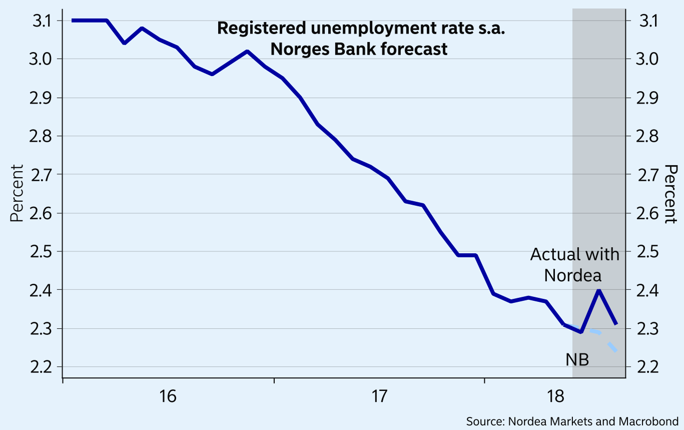
We expect US core PCE prices to have increased by 0.2% m/m in July, corresponding to an increase of 2.0% y/y, up from 1.9% y/y in June. Core PCE prints rarely surprise given that core CPI prints have already been released. Headline PCE is expected to have increased by 0.1% m/m and 2.3% y/y. PCE inflation will thus remain above the Fed's target at 2% with an underlying increase in price pressures, supporting the inclinations in the current dot plot of two more hikes this year.

14:30	US	Personal income (m/m)	Jul		0.4%	0.4%
14:30	US	Personal spending (m/m)	Jul		0.4%	0.4%

Friday

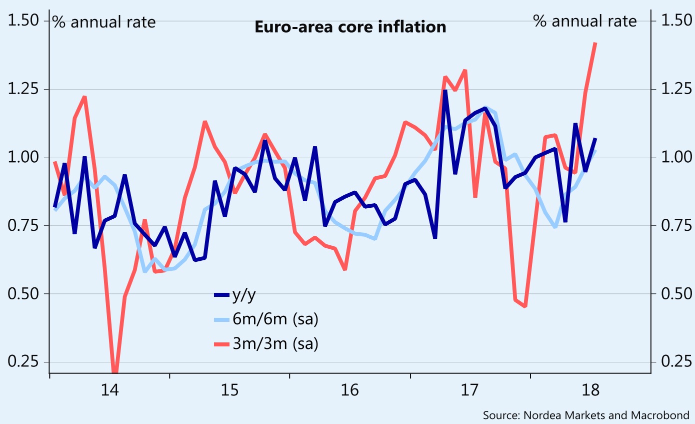
The day kicks off with the official Chinese PMI figures and Norwegian unemployment figures before this week's most important release, the Euro-area inflation figures, takes centre stage.

Friday, 31/08/2018				Nordea	Consensus	Previous
03:00	CN	PMI, manufacturing, NBS	Aug		51.2	51.2
08:00	NO	Credit growth	Jul			
09:00	DK	GDP (q/q sa, preliminary)	Q2			0.4%
09:00	DK	GDP (y/y sa, preliminary)	Q2			-0.6%
10:00	NO	Norges Bank publishes FX buys to Pension Fund-International	Sep			
10:00	**NO**	**Unemployment rate, registered (unadj. and excl. labour market schem**	**Aug**	**2.4%**	**2.4%**	**2.5%**



Registered unemployment increased in July due to new registration routines and a change in the timing of measurement. The effect of the timing should be reversed in August and that is why we expect unemployment to fall by as much as 3,000 persons well above the trend. The level will still be slightly above Norges Bank's forecast. However, that is mainly due to new registration routines, which mean that more of those actually being out work are covered by the statistics. That should have no effect on monetary policy.

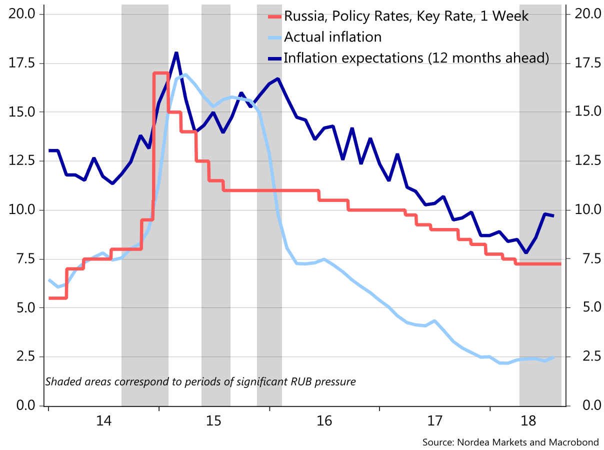
10:00	NO	Unemployment, registered and persons on labour market schemes (sa)	Aug			
10:00	SE	ESV publish their budget forecast				
11:00	EU	HICP (y/y, flash)	Aug	2.1%	2.0%	
11:00	**EU**	**HICP, core (y/y)**	**Aug**	**1.1%**	**1.1%**	**1.1%**



Euro-area core inflation surprised positively in July. However, the main reason for the positive surprise was - once again - prices of package holidays which rose more than normally in July. Whether that continued in August remains to be seen but there are low-side risks to our annual core inflation forecast at 1.1% and for headline at 2.1%. As usual, German and Spanish numbers are published one day prior to EA numbers and French numbers are out early on the same day.

11:00	EU	Unemployment Rate	Jul		8.2%	8.3%
15:45	US	Chicago PMI	Aug		63.0	65.5
16:00	US	Consumer confidence, U. of Mich., 5-10Y inflation (final)	Aug			2.5%
16:00	US	Consumer confidence, University of Michigan (final)	Aug		9.57	95.3

Friday (continued), 31/08/2018			Nordea	Consensus	Previous
16:00	RU Inflation expectations	Aug	10.00%		9.7%



During the week the CBR will publish inflation expectations data for August which is an important input for the CBR meeting scheduled for 14 September. We expect that the indicator will accelerate slightly from 9.7% observed in July in reaction to RUB weakening that started on 8 August. If inflation expectations increase further in the coming months the scenario of a key rate hike will become more probable.

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