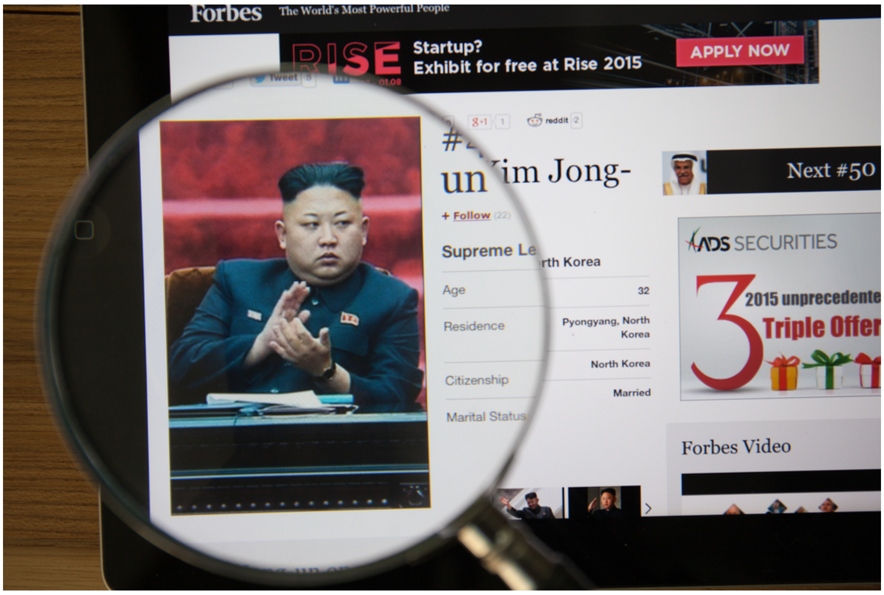
The new North Korean normal?

Despite increasing tensions in the Korean peninsula, global asset markets continue to perform well



President, North Korea

Asset markets performing well

Markets seem to be getting used to North Korea's sabre rattling. The risk-off move on the back of yet another North Korean nuclear test in European Government Bonds gives that impression. Either that or they're increasingly convinced that a military response from the US is unlikely. On Monday, 10-year Bund yields edged 1.5 basis points lower and core EGB curves actually steepened, admittedly in part due to the large amount of long-end supply due to hit markets this week.

Elsewhere, the S&P 500 is quietly edging up to its highs of the year. Measures of volatility, (for example, the CBOE's VVIX) are declining to levels last seen in early August. Unless there's fresh news from Korea, Tuesday's events look set to extend this benign run.

As an aside today, we see that Norges Bank is proposing to cut its EM bond investments (currently 12%) from the nation's fixed income portfolio. The rationale is that diversification in fixed income is not delivering the same benefits as the diversification in equity investments. The market may choose to ignore this news, but Norway's government pension fund has been one of the most forward-looking Sovereign Wealth Funds over recent years and the news looks certain to prompt a debate. We're looking for the Dollar Index to drift to 92.00, since it is heavily weighted to safe havens of the euro and the Japanese yen.

EUR: Waiting for Thursday

EUR/USD looks becalmed until Thursday's ECB meeting. We look at the different scenarios in our ECB crib sheet below but suspect the ECB will struggle to generate a lasting correction in the buoyant EUR. For today, EUR/USD may well trade inside a 1.1850-1.1950 range. Elsewhere, Swiss 2Q17 GDP disappointed and with what should be a low CPI figure released later (0.4% YoY) should serve as a reminder that the Swiss National Bank will 'out-dove' the ECB.

Draghi's alternatives

	Inflation outlook	Growth outlook	Reference to the EUR level	*QE taper* guidance	EUR/USD
Current stance	"Underlying inflation is expected to rise only gradually"	"The risks... to growth outlook are broadly balanced"	"The repricing of the exchange rate has received some attention..."	QE "to run until the end of December, or beyond, if necessary"	
Dovish	**Significant revision** to CPI **lower by 0.4%** (for 2018&19)	**Downward revision** to GDP growth (by 0.4% for 2018/19)	**EUR overshooting** / **"abrupt" move** in the exchange rate	**Hint at QE tapering later than in Jan** due to tight fin. conditions	1.16
ING Base Case	**Revision** to CPI **lower by 0.2%** (for 2018&19)	**Downward revision** to GDP growth (by 0.2/0.1% for 18/19)	**Unwarranted tightening** of monet. conditions	No hint at timing of the QE tapering; **QE easing bias kept**	1.20
Hawkish	**No downward revision** to CPI (for 2018&19)	**No downward revision** to growth outlook (for 2018)	The EUR level is a **reflection of fundamentals**	Internal committee "**tasked**" to assess QE tapering options	1.22
Very hawkish	**No downward** revision to 2017 CPI, 2019 CPI around 2%	"**Risks** to growth outlook are **balanced**"	The current EUR level **not a concern** to the Gov Council	ECB "**already hinting**" at details QE tapering	1.25

GBP: PMI services the highlight

Noise-levels regarding Brexit remain elevated and look set to extend further. Brexiteers are once again pushing for a Hard Brexit (no deal with EU) and there is now focus on a potential speech from the Prime Minister, Theresa May on Sep 21, where we doubt she'll take a harder line. PMI services is the focus today, Tuesday, but we doubt sterling finds much solace from the data over the coming months. EUR/GBP looks steady around 0.92.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com