

Nordea

Nordea XCCY monthly

\$-premium in focus following the invasion



Welcome to the XCCY monthly March edition!

The sentiment in the XCCY market the latest month has been risk-off driven by the invasion of Ukraine by Russia. This has pushed XCCY levels lower driven by the fronts - Overall steepening the XCCY curves across the board. The biggest movement observed was on the 28th of Feb on the back of the SWIFT announcement; spiking fear for USD liquidity initially heavily increasing USD premium affecting the fronts in XCCY significantly. On the issuance side we have seen Scandi banks with EUR prints, e.g., Handelsbanken and Nordea, in the beginning of the month, however, in the last few weeks we have observed very little action on the issuance front. In Scandies, changes has mainly been driven by re-pricing.

We've seen the fronts of tenor basis in both EUR and USD widening under the risk-off environment – essentially creating quite a divergence between the developments in RFR/RFR and BOR/BOR curves. In previous editions of the XCCY monthly we have highlighted our expectations to the new RFR curves, and now we see a case example of the positive tail risk exposure gained in being received in either EUR or Scandies vs. Sofr; as USDLibor does not cushion the blow to the XCCY in RFR, thus the positive tail risk exposure is even greater in RFR.

In this monthly edition we are covering our view on the key subjects potentially impacting XCCY. We cover expectations to the EUR and USD excess liquidity, DKK liquidity & DKK/EUR basis with focus on synthetic FX fwds, the new Stibor methodology and our expectations in relation to this, SEK liquidity, NOK curvature expectations & NOK liquidity.

EURUSD XCCY: A closer look at relative liquidity drains

The drain in EURs could be larger than in USDs, at least this year

- Russia's invasion of Ukraine will keep USDs in demand as financial risks include credit events, energy crisis and weaker recoveries, and will likely result in less aggressive monetary policy normalisation from the Fed and the ECB. We take a look at the relative liquidity drain in USDs vs EURs – Fed vs ECB!
- Fed will begin running off its balance starting during summer, probably to the tune of USD 100bn every single month. It cannot be much faster unless the Fed is willing to sell bonds. The drain of excess reserves is likely to be smaller as the reverse repo facility will partly mitigate the balance-sheet run-off.
- ECB will continue its tapering and balance-sheet run-off is years away. Yet (true) excess EUR liquidity will be drained when TLTRO terms are normalised during summer due 1) to early repayment of TLTROs and 2) a higher tiering multiplier to compensate banks for the cost of negative policy rates.
- It is quite easy to imagine a situation where excess liquidity drain will be larger in EURs than in USDs, at least in 2022, while the situation reverses once the ECB gets to zero interest rates and tiering is no longer necessary, which could still be early next year!

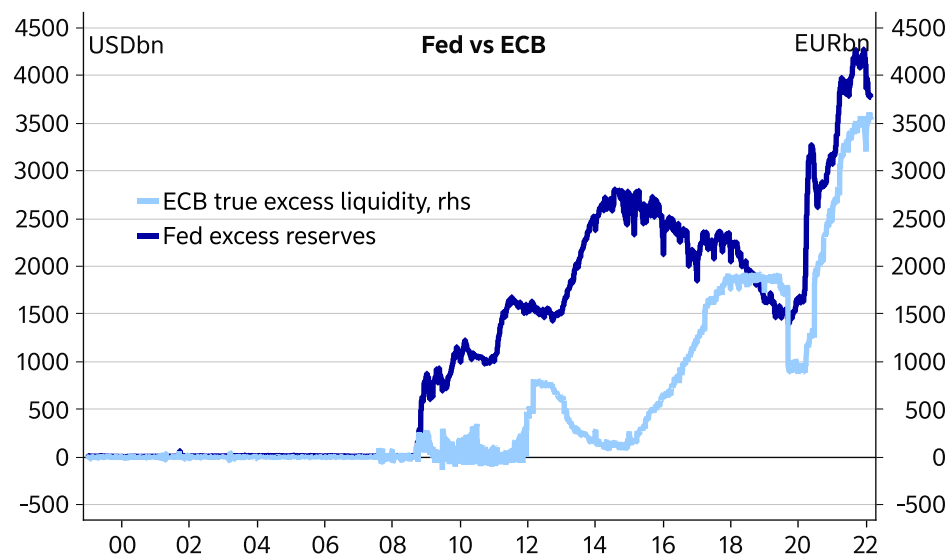
ECB vs Fed liquidity drain (neg means larger EUR drain)

End-'22 excess reserves/liquidity change, EUR vs USD

USD	EUR->	Mild drain	Baseline	Large drain
Mild drain		-123	-683	-2045
Baseline		243	-317	-1679
Large drain		420	-140	-1502

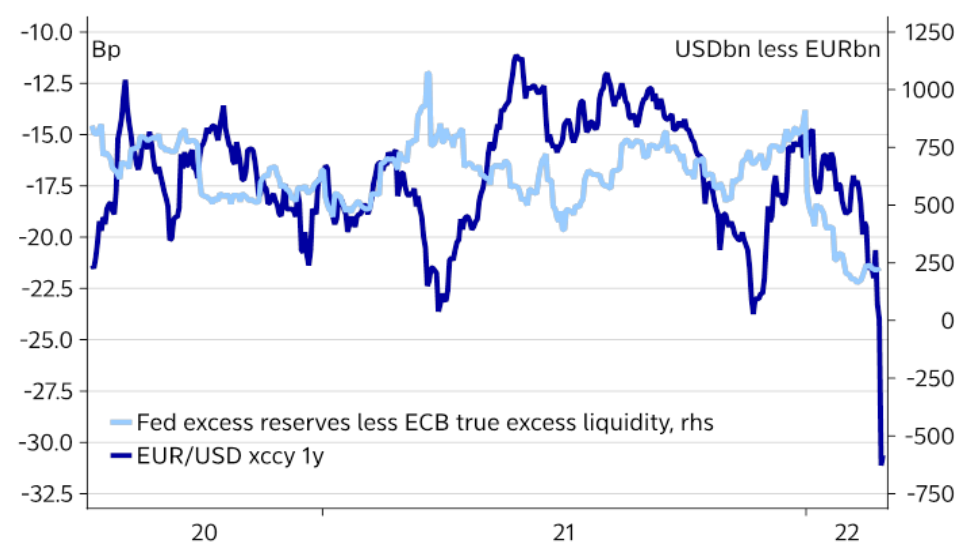
Note: Bank reserve depletion ratio vs RPP drain. Source: Nordea

Excess liquidity – Fed vs ECB



Source: Nordea and Macrobond

Relative excess liquidity vs 2y2y EUR XCCY



Source: Nordea and Macrobond

EURUSD XCCY: Hikes and QT

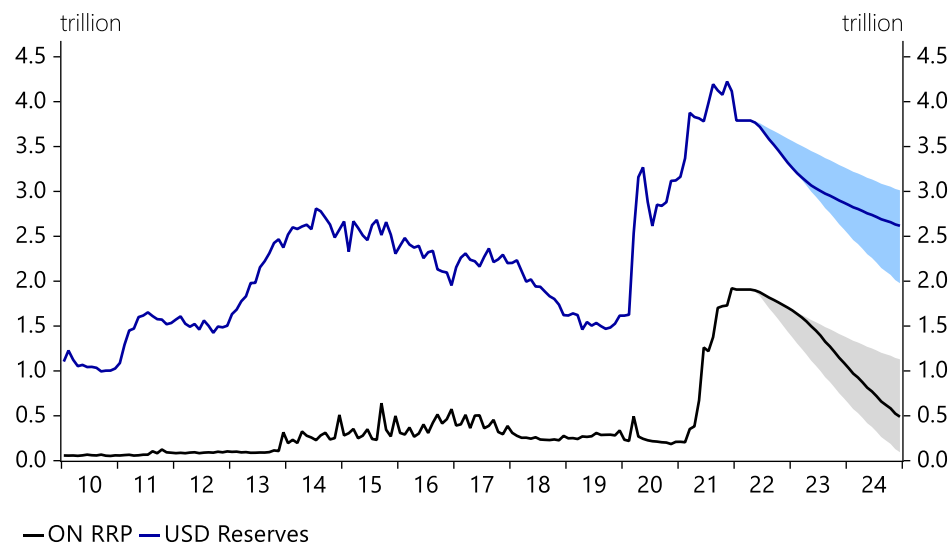
Most aggressive liquidity drain and hiking spree ever

- As mentioned before, Fed will begin running off its balance starting in the summer using three months to roll into its caps of treasuries by USD 60bn and MBS by USD 40bn. **Effectively, this shrinks Fed's balance sheet liabilities by USD 100bn every single month.**
- At the March meeting the **Fed will begin in a hiking spree** – hiking at consecutive meetings throughout the summer. This will likely result in less rate sensitive bank deposits flowing into more rate sensitive MMFs, in turn, out of the private sector and into Fed's ON RRP facility.
- During the same time, Treasury is very likely to keep a higher cash buffer around USD 700bn in the TGA (current level: ~USD 750bn) throughout QT – **so no big change in the TGA.**
- Overall, we will likely see bank deposits leaving the system first – as evidenced during the recent rebuilding of the TGA. Less deposits will free up banks' balance sheets and banks will start to compete for funding. Gradually, SOFR will rise as reserves become scarce. This will result in MMFs leaving the ON RRP capturing higher market rates – draining the ON RRP

Expected evolution for Fed QT

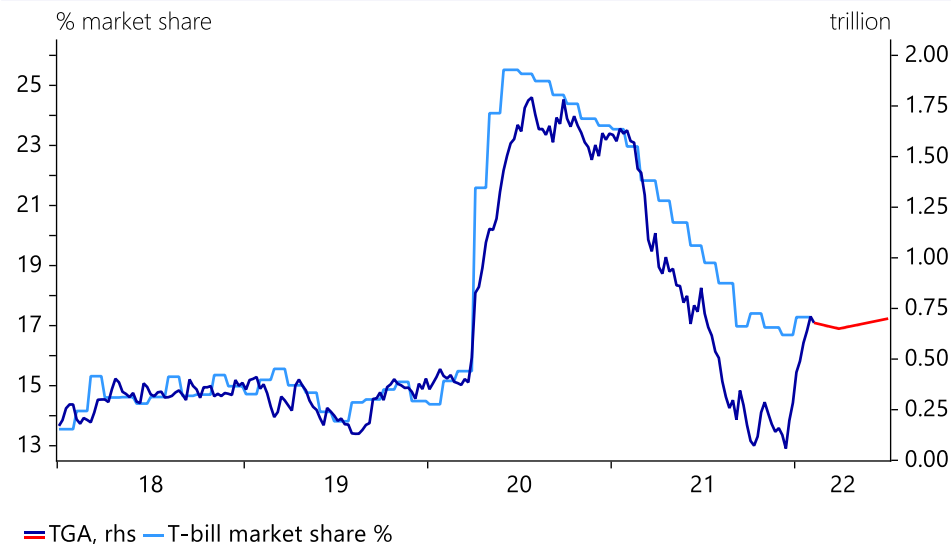
Phase	Activity	Reserves and On RRP	QT size
1	Bank deposits will flow into MMFs and the ON RRP	70/30% depletion in favour of bank reserves to ON RRP	USD ~500bn
2	Banks compete for funding. MMFs shift out of ON RRP	Depletion ratio tilts towards more RRP depletion	USD ~1.750bn
3	Scarce USD liquidity: Banks compete and MMFs move out of RRP	This phase will see a majority of RRP leaving the system	>USD ~1.750bn

The USD 2.500.000.000.000 liquidity drain ambition



Source: Nordea and Macrobond

Treasury to keep a large buffer in the TGA

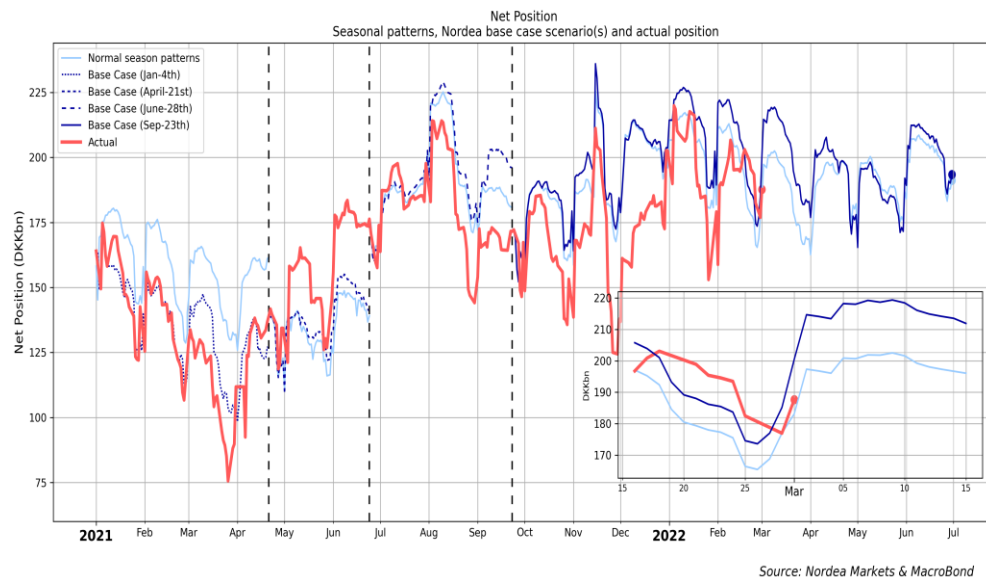


Source: Nordea and Macrobond

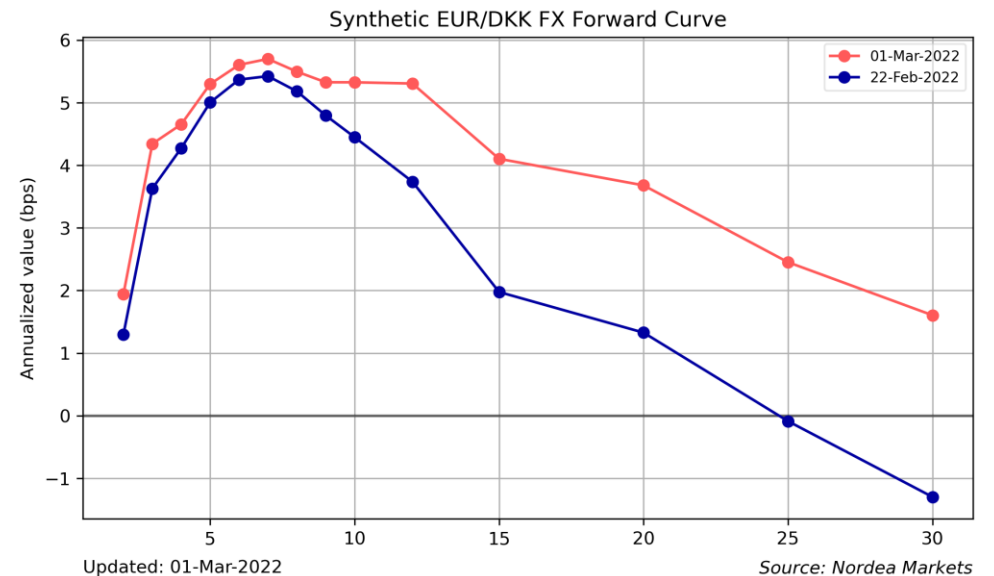
DKK – Standard factors points to lower FX forwards. This could however easily be dwarfed by spill-over effects from the war

- After the Russian invasion of Ukraine, we have seen a tightening of EURDKK, but the level is still above the FX intervention level. Our forecast predicts that liquidity will move sideways from the current level the coming months so unless FX intervention takes place the liquidity situation will not impact the FX. The postponed tax & VAT of DKK 25bn is set to be repaid the 1st of April, but whether and how this will take place is still uncertain. If banks ends up buying these loans it will not be at par level, but this will still give a drain in the liquidity.
- The seasonality, however, points to some months with further tightening pressure on EURDKK which could lead to FX interventions and eventually a rate cut from the Danish central bank. We note that the liquidity situation have improved after the massive intervention in December. This makes us believe that the Danish central bank will make less FX intervention than we saw in December before they eventually cut rates. In total this points to lower FX forwards over the coming months, but the uncertainty due to the war could very well makes this effect be dwarfed by declining equities and other factors.
- The volatility in EURDKK FX forwards increased much following the invasion but now trades around the levels from before the invasion in the short end, whereas the long end is trading 2-3bps higher.

The Net Position.

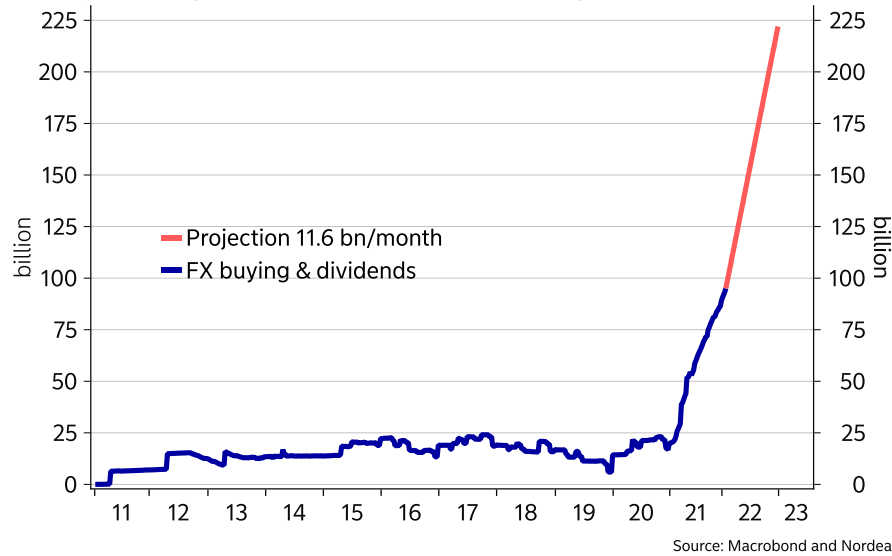


Synthetic FX forwards from XCCY

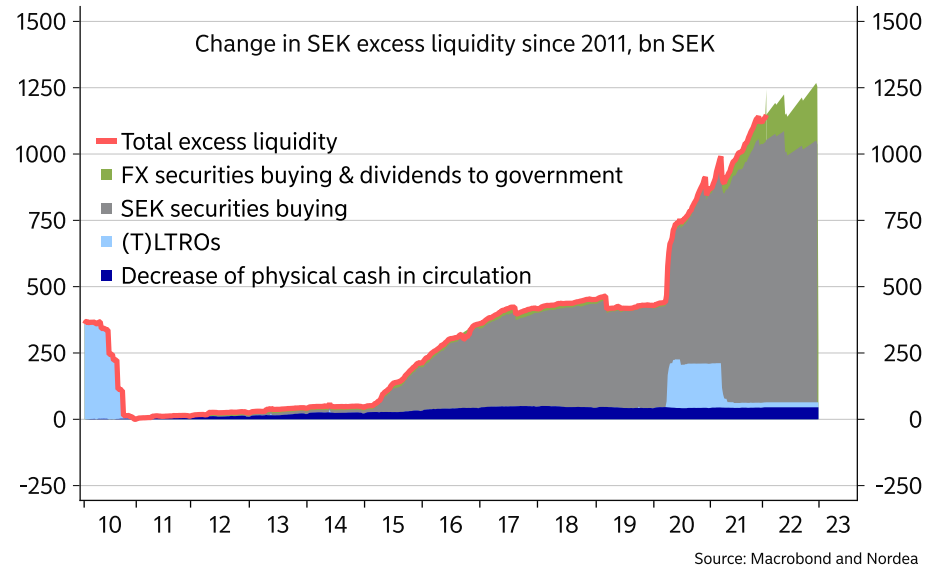


Riksbank: The printing press keeps working as foreign currencies are bought

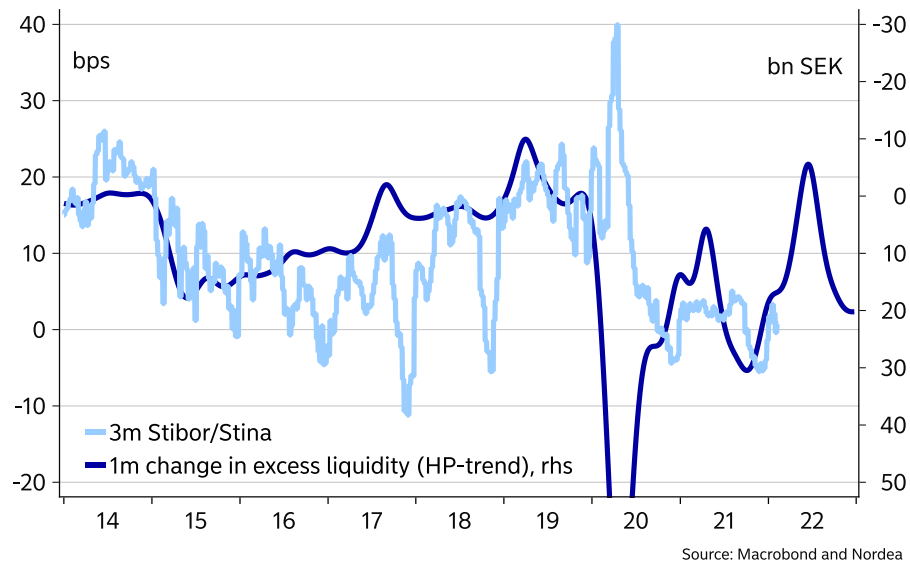
1. Early 2021, the Riksbank announced it would “re-finance” ~200bn SEK of the FX reserve by selling SEK. The consequence buying FX vs SEK is that the excess liquidity in the money-market system increase, i.e. “electronic money” is printed



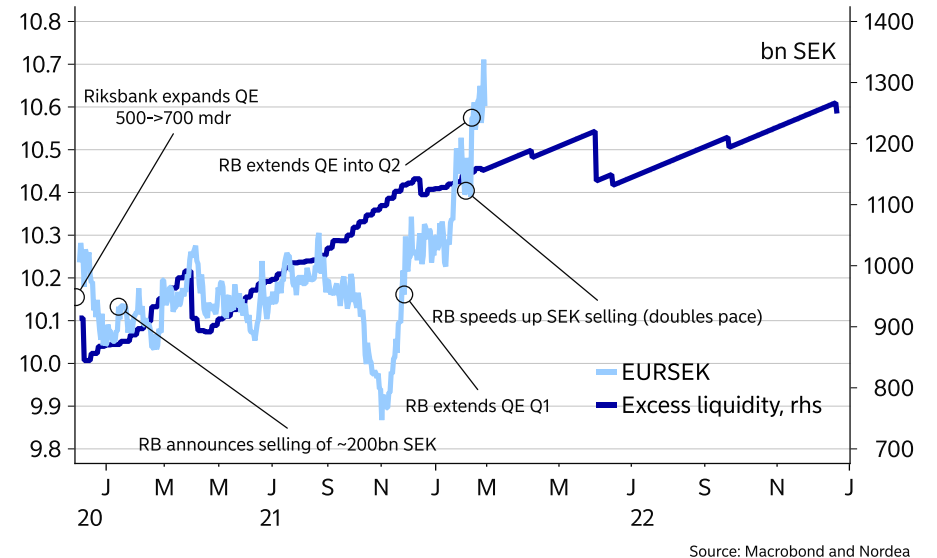
2. On the 3rd of February, the Riksbank announced it would more than double the pace of SEK selling to finish the program by the end of 2022. Despite not increasing SEK liquidity through SEK asset purchases, liquidity is increasing through non-SEK asset buying.



3. The relationship between excess liquidity and Stibor is sketchy. Slower growth of liquidity should mean less downward pressure on Stibor. The Riksbank’s announcement to sell SEK faster neutralize the impact of less SEK bond buying on liquidity and Stibor.

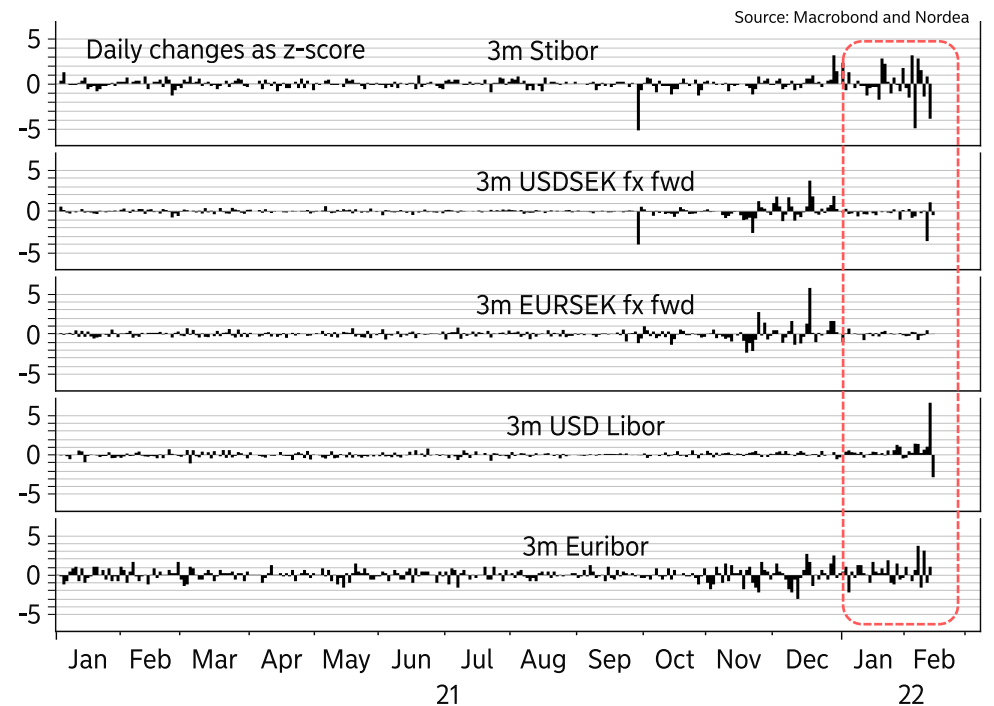
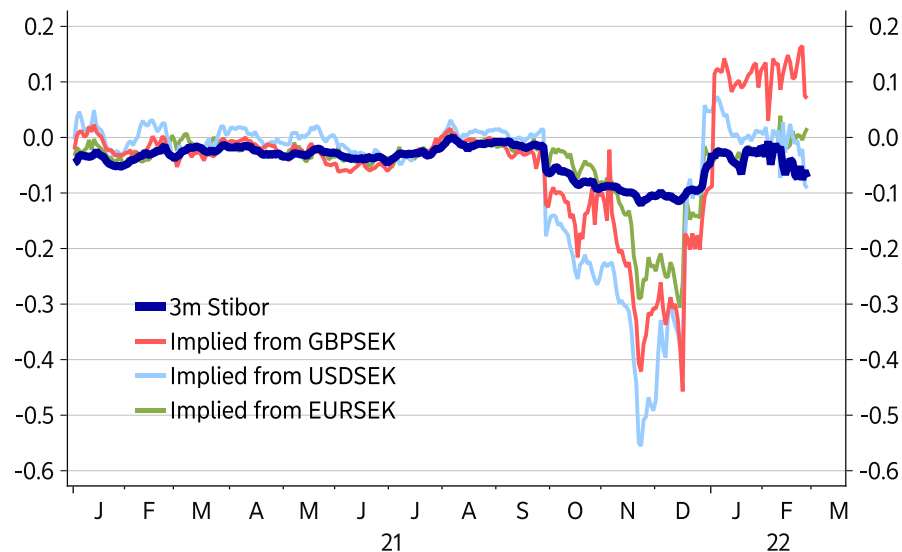
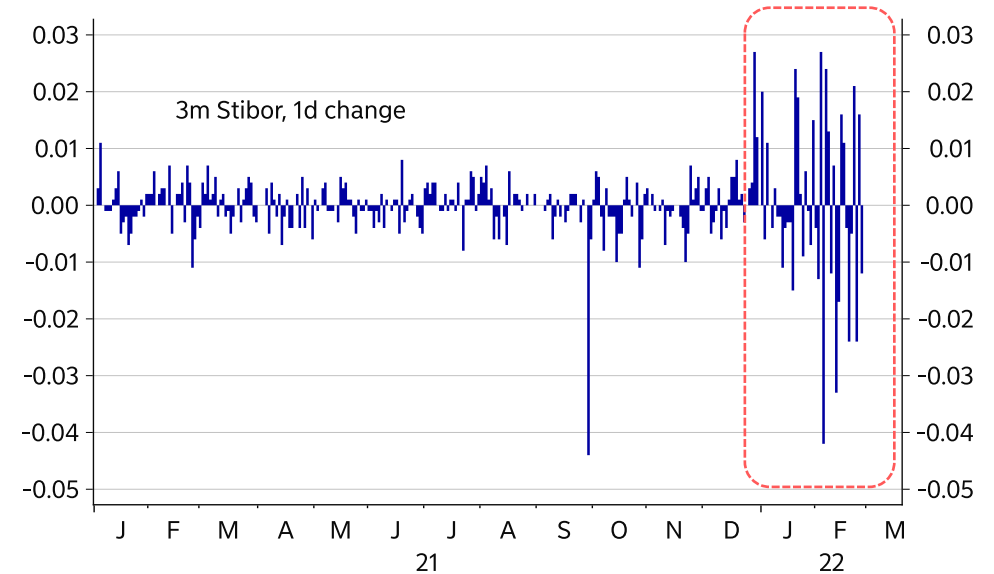


4. The link between the Swedish currency and SEK excess liquidity is even sketchier. More excess liquidity should work for a weaker SEK and perhaps the soft policy stance in combination with jacked up SEK selling may have helped push EURSEK to the upside.



Stibor: The new calculation method likely reason for rise in volatility

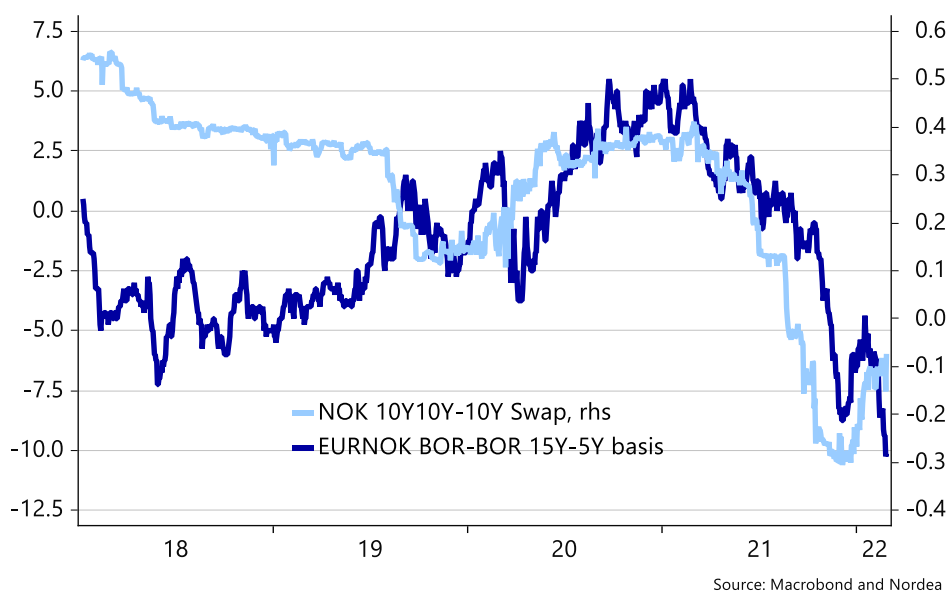
- The corporation that administer Stibor (Swedish Financial Benchmark Facility, SFBF) announced the 1st of February that the transition to a transaction based calculation method for Stibor was completed. For more info on the new framework see [“Swestr vs Stibor... the current situation and the future”](#), 25 Nov 2021 or [“Stibor determination framework”](#)
- In our view, most transactions underlying Stibor will be in foreign currency. The correlation to foreign currency funding and FX forwards will thus increase compared to the old framework.
- But since the funding levels in different currencies will differ at any given moment and since the number of transactions on longer tenors (such as 3m or 6m) will be few, the calculated Stibor fixing may change a lot between different days as the eligible transactions underlying the calculation may have occurred in different currencies due random factors. The result of this should be higher volatility in Stibor fixings day-to-day.
- The change in correlation and the higher volatility may be especially marked around year-end when funding in different currencies diverge and move around a lot. We see increased downside risk in Stibor in Q4.
- The new Stibor may also turn out to have a different sensitivity to risk-aversion: risk-aversion linked to the Stibor banks pulls Stibor up, risk-aversion in general pulls Stibor down (flight-to-quality may increase demand for USD and driver Stibor down).
- The migration from IBOR-rates to reference rates in USD and GBP could mean that there is additional uncertainty as the money-market structure in USD and GBP is partly changed.



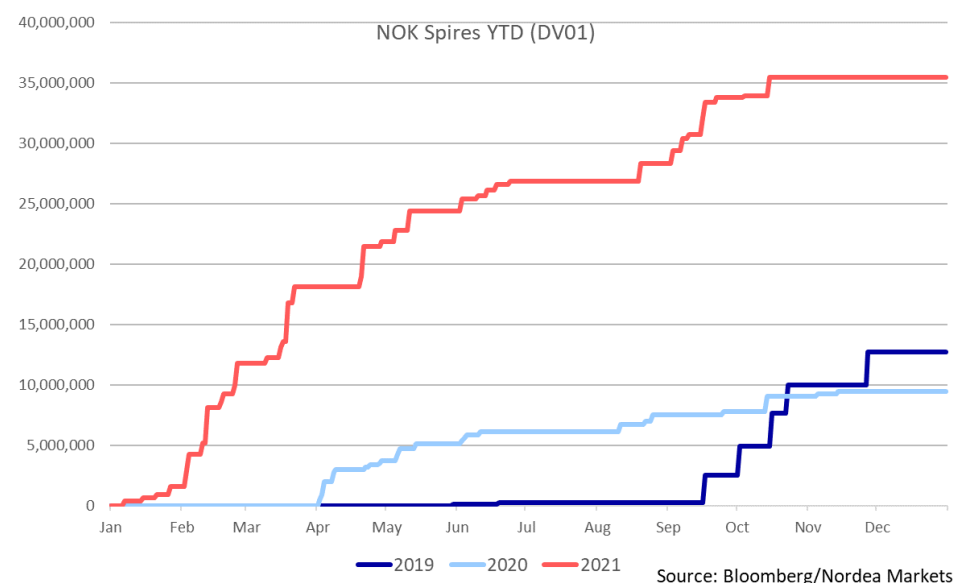
NOK – Expect the basis curve to steepen

- The flattening has coincided with a massive pick up in issuance of NOK denominated Spire Bonds (Foreign ccy bond swapped to NOK, average duration at 18yrs last year). These bonds are bought exclusively by Norwegian L&P companies which have seen the duration of their bond portfolios drop by a full year since 2015.
- Since October, issuance of NOK Spires have stopped and our impression from life and pension, is that they are happy with their respective bond durations and thus we expect reduced demand compared to previous years.
- A reduction of NOK Spire issuance will most likely alleviate the downward pressure on the long end of both the NOK basis swap and NOK rates curve and leave room for these curves to move back to previous levels.
- We expect no changes in our liquidity prognosis for NOK; We're expecting continued upwards pressure on Nibor and FXswaps moving towards the summer period. The increased gas prices adds further downwards pressure on the structural liquidity in H2-2022 (Taxes starting in August). We do not expect Norges Bank to change their prognosis until the revised budget in May.

EURNOK basis swap curve and NOK rates curve have flattened in unison since 2020



After a massive increase of NOK Spire issuance in 2021, it has been quiet since October



Thank you!

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