

Nordea

Nordea XCCY monthly

Hike-mania and a cut

Welcome to the XCCY monthly April edition!

Starting March, we saw the main activity in key XCCY crosses such as EUR, GBP & JPY. Mid-month issuance picked up across the board with Scandies printing in EUR & USD and SSA's in Scandies, e.g., KBN, KFW, Kommuneinvest, Nordea, SpareBank 1 & Telia.

In this edition we will take a further look at the drivers and expectations in the tenor basis that is prevalent in trades vs. \$Libor3M and €Euribor3M. Depending on the positioning on the trades you have on the book it might be a good time to take an extra look at the tenor basis. We also cover our view on liquidity in Scandies along with expected impact from Hikes on bond portfolio in SEK, Norges Bank purchasing of foreign currency, and potential increased government spending (military) in DKK.

Furthermore, we are back with the XCCY Quant Pack now featuring RFR Cross-Currency analysis!

Outside of Scandies, we have seen Canadians printing in both EUR and CHF adding pressure to both the CAD and the CHF curve. JPY having quite a volatile month with BoJ out stating they will be buying unlimited of specific bond tenors; A policy that is in sharp contrast to other central banks hawkish tone. Furthermore, we also have JPY issuance season to top it, so heavy receiving pressure from both factors.

EURUSD XCCY: Precautionary liquidity

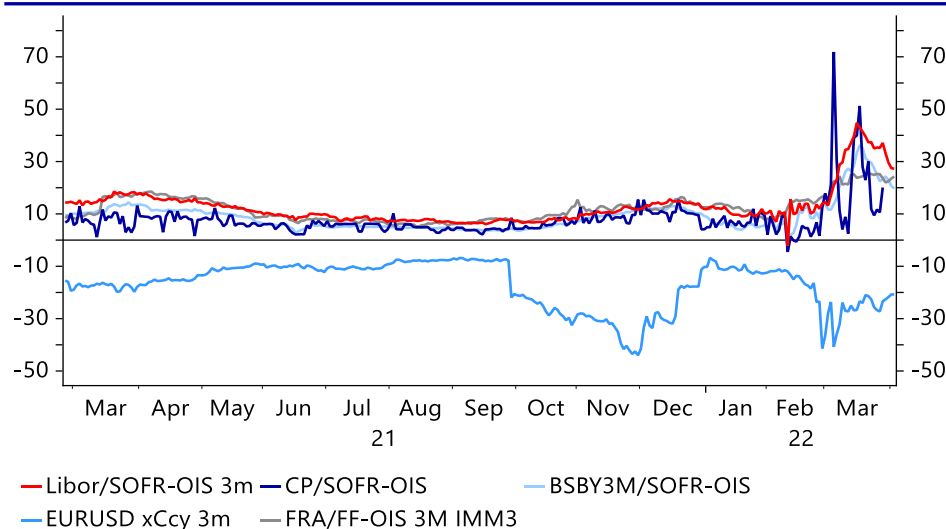
USD mismatch between supply and demand

- The volatile price action in the money market is a reflection of **precautionary liquidity**, not a liquidity crisis. The US banking system is still very awash in liquidity.
- **Banks are raising term funding** against the geopolitical risks and potential spillovers from sanctions and rising commodity prices. The sudden increase in term funding resulted in a huge **mismatch in supply and demand**. Money market investors are short duration due to the huge uncertainty to the Fed's policy path and a positive rolldown.
- We expect **spot Libor/OIS to remain wide** in the range of 25-35bp in the coming 3-5 months (fwd imply 16bp). Money market investors are unlikely to increase their WAM and banks are likely to keep term in their war chest and rollover maturing funds until we see a real de-escalation.
- Lastly, **SOFR traded through the RRP** as a result of the rapid cheapening in the short-end of USTs and a persistent supply/demand imbalance in money markets. We would not be surprised to see SOFR trading in a sub 5bp as markets continue to price a hawkish policy tail risk and we see a lack of T-bills and high demand for repos. So secured funding will not cheapen.

- **Short EUR/USD positions (i.e., positioned for tighter USD Libor-OIS and wider E/E) could be restructured now rather than when Libor ceases to exist as Libor-OIS may not tighten as forwards imply, and as longer Libor-SOFR rates trade below the fallback rate.**
- **Scandi/EUR positions in 3m vs 3m could be restructured to €STR. The reason being that Scandi/USD seems surprisingly steady when E/E moves even though Scandi is vs 3m and USD is vs SOFR, EUR/USD is stable too since it is €STR/SOFR, and thus E/E moves actually moves Scandi/EUR in 3m vs 3m. Thus, if we're right that E/E will widen (third page), the EUR basis should be in €STR rather than Euribors.**

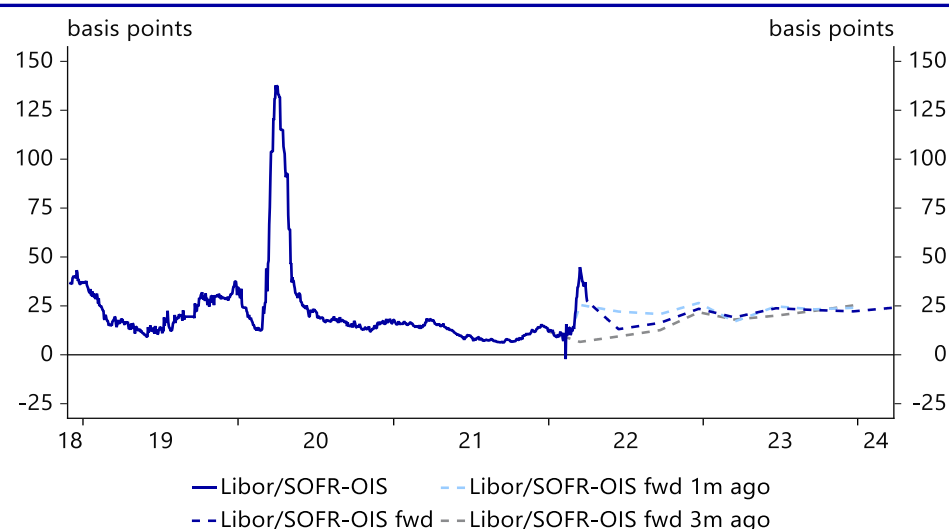


USD funding stress has moderated in the last week



Source: Nordea and Macrobond

Libor/OIS fwd – unsecured funding is expected to moderate further

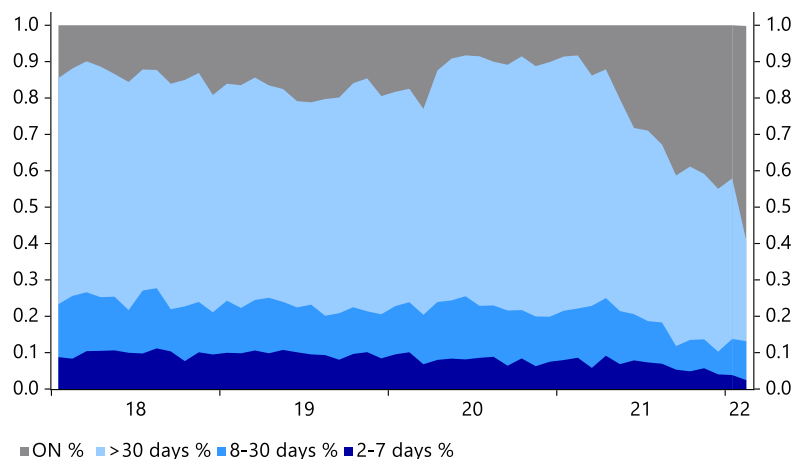


Source: Nordea, Bloomberg and Macrobond

EURUSD XCCY: Precautionary liquidity

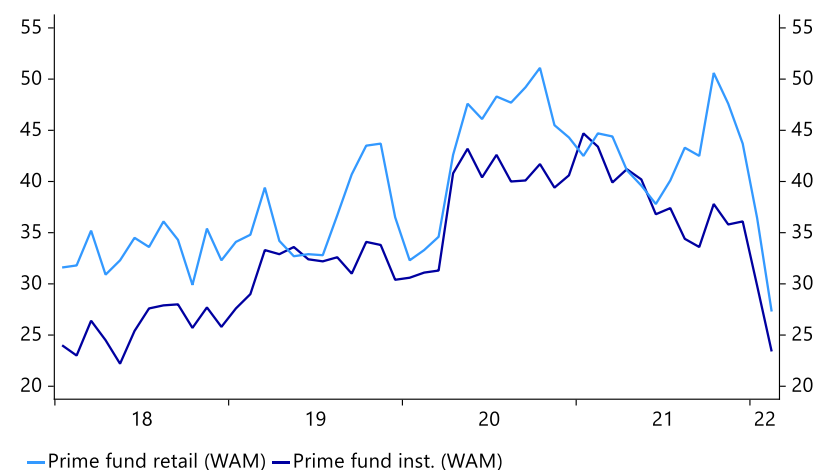
USD mismatch between supply and demand

MMFs have shortened their duration



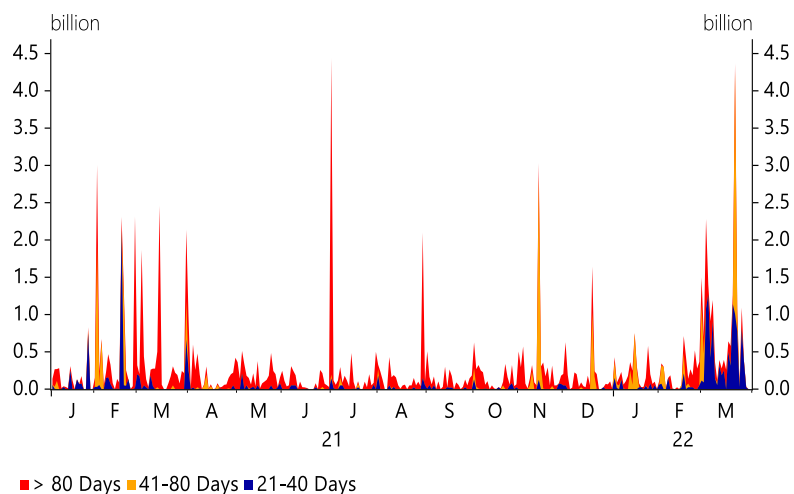
Source: Nordea and Macrobond

Prime MMFs reduced their WAM to 24 days



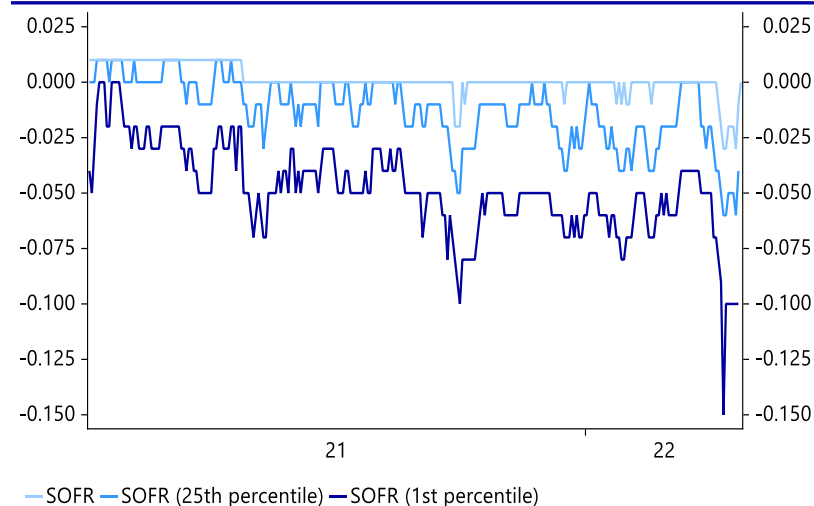
Source: Nordea and Macrobond

Issuers have sought term funding (especially financials)



Source: Nordea and Macrobond

Secured funding has been trading lower



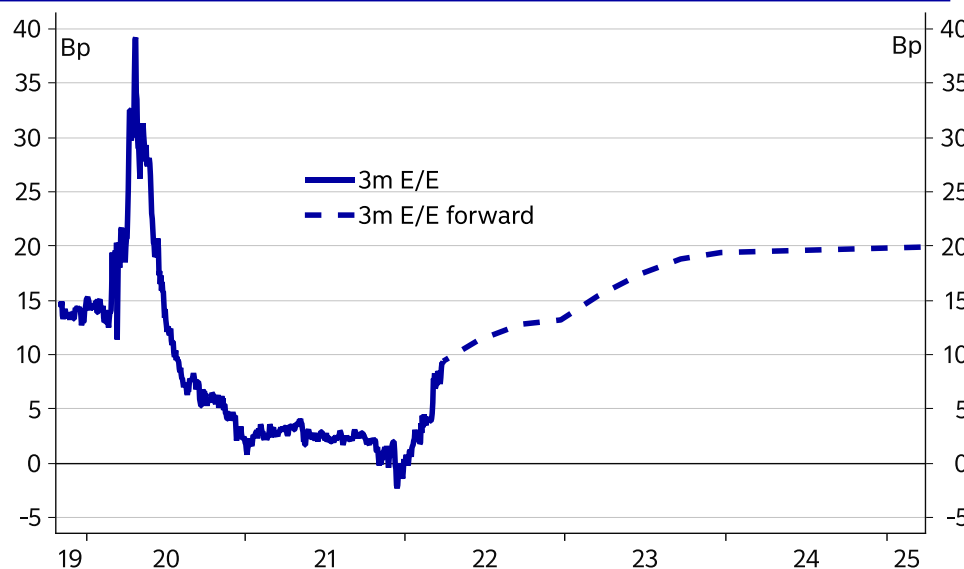
Source: Nordea and Macrobond

EURUSD XCCY: Basis widening

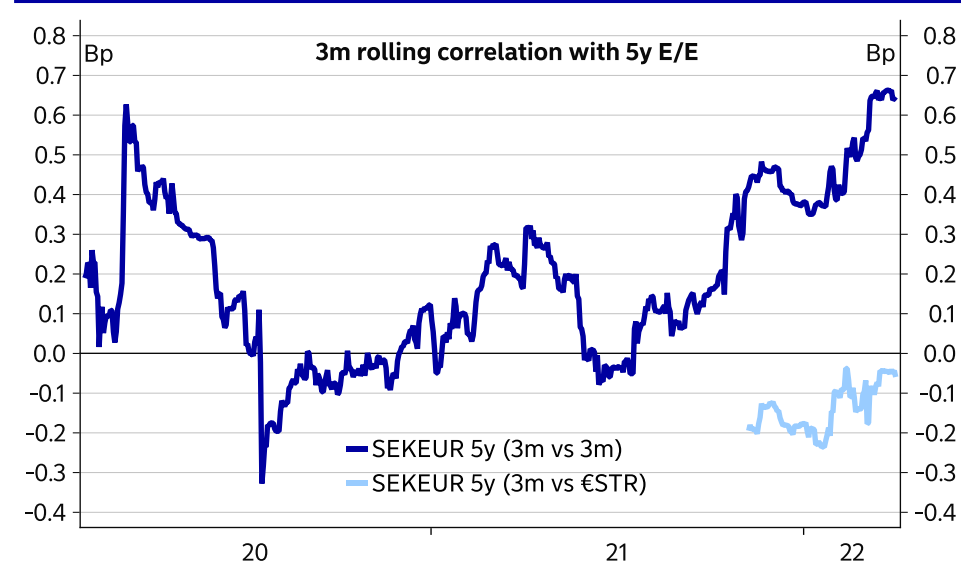
Four factors for E/E widening

- First of all, we still see EUR issuance swapped back to Scandies and other currencies even if there is a small premium now to issue in EURs. It seems that prudent risk management still has the overhand – establish funding in EURs while it is possible – as well as the desire to build active benchmark EUR programs.
- **Secondly, there is a clear preference to swap from EURs to local currency vs Euribors rather than €STR even if the xCcy market is now an RFR market. That leaves trading books with the need to do E/E widenings, which is not at all the case in USDs where market and client needs align in SOFR.**
- Thirdly, TLTROs will no longer be renumeralated at -100bp from July. That is likely to decrease liquidity and thus widen the E/E basis spread. Moreover, the likely increase in the tiering multiplier to support monetary transmission through the banking channel should exacerbate this widening. And, finally, banks may start repaying TLTROs from autumn.
- Fourthly, the ECB is expected to hike rates with the first hike priced in July (if 10bp) or September (if 25bp). More hikes are likely to widen E/E further too.
- The market is pricing a good deal of widening already from around 9bp at present to around 14bp at year-end and closer to 20bp from the end of '23 and further out. Given that the 14bp was the norm before the pandemic, it seems quite reasonable. With the above factors in mind though – and given that E/E peaked at 40bp when the pandemic struck and risks related to the Russian invasion of Ukraine, as well as the risks of a potential growth fallout from the spike in commodity prices remain elevated – wider spot-starting E/E is likely to be on the cards.

3m E/E forward (FRA/OIS)



Small premium to issue in EUR

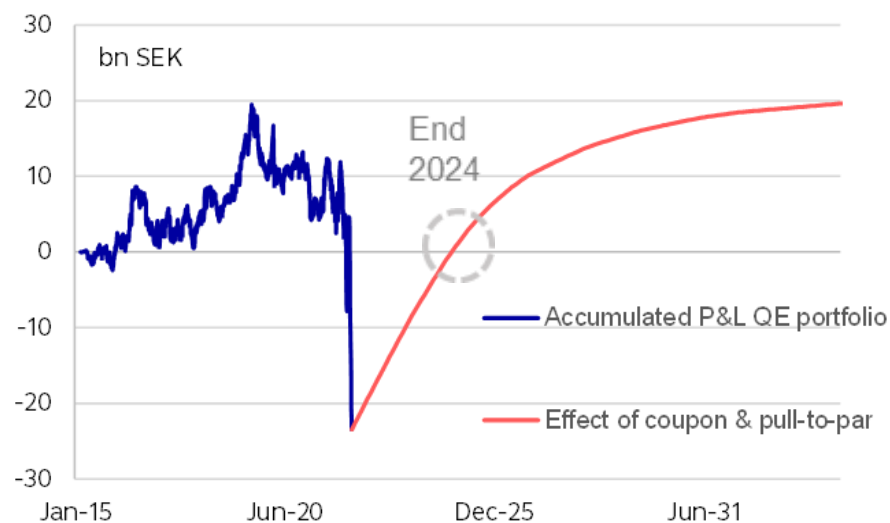


SEK XCCY: Less QE reinvestments in the pipeline

Rate hikes will add to negative bond portfolio P&L

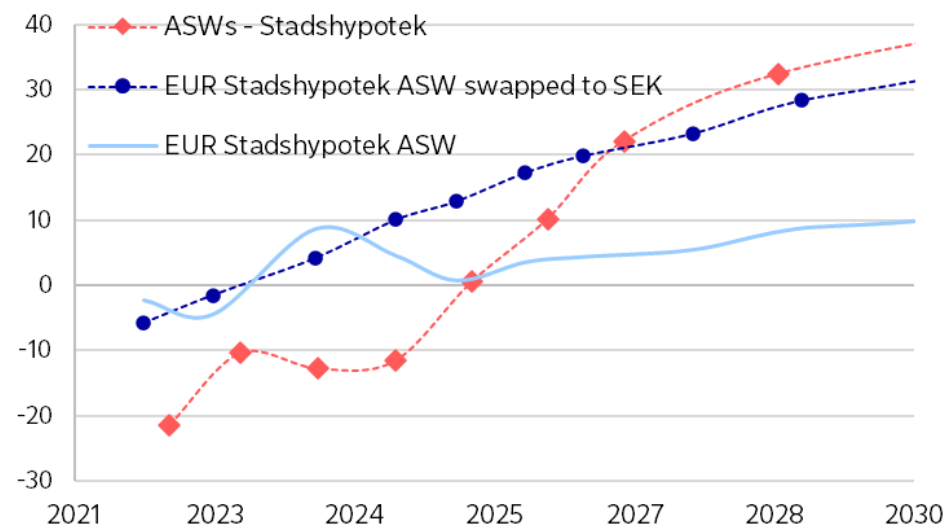
- The Riksbank has lost around 30bn SEK in the QE bond portfolio year-to-date. Although all this loss will be regained over the years to come through coupon payments and pull-to-par, additional negative contributions to the yearly expenditures may come from policy rate hikes.
- The excess liquidity created since 2015 is close to 1,200 bn SEK. The market prices ~100 bps of rate hikes in 2022. If these hikes are delivered, the yearly cost to the Riksbank will be ~12bn (interest paid to the monetary counterparts on excess liquidity).
- For obvious reasons, the cost of raising the policy rate may have an influence on the decision to let the bond portfolio roll off through redemptions. The board was split at the February meeting on the decision to start scaling down liquidity or not. The odds for less QE bond reinvestments are falling!
- We also note, that the SEK covered bond yield curve continue to look rich relative corresponding funding curve in EUR (when swapped to SEK). From a short-sighted cost perspective, Swedish issuers should start to look at issuing more in SEK than in EUR.

Losses in the bond portfolio aggregates pain of rate hikes



Source: Nordea

Thin domestic market may nudge issuers towards EUR despite extra cost

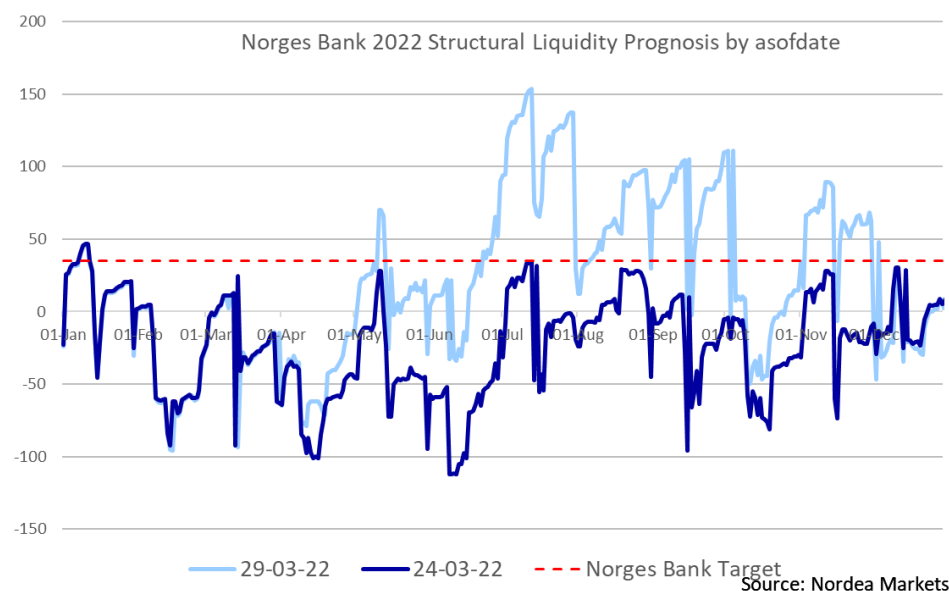


Source: Nordea

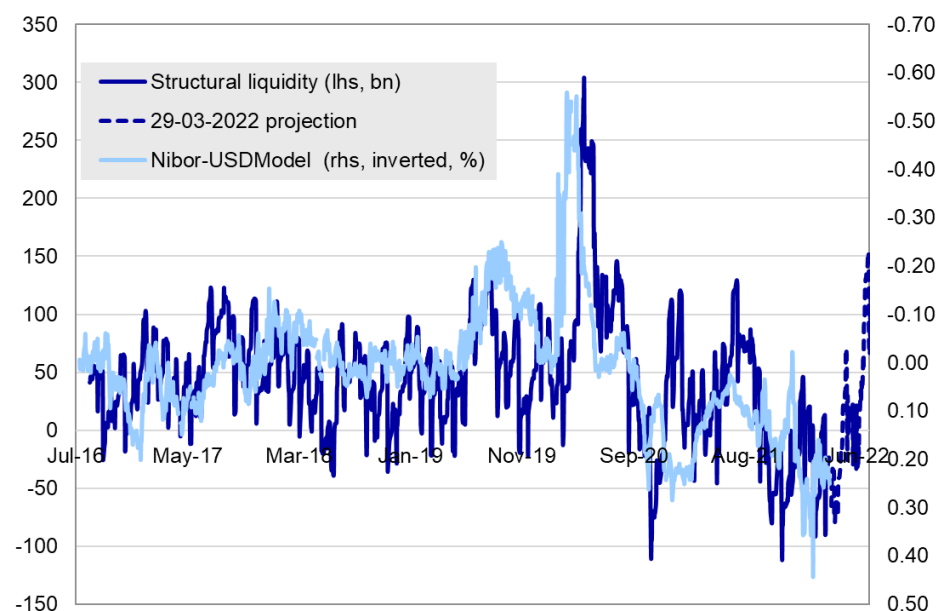
NOK: Norges Bank currency buying push Nibor lower

- Norges Bank's announcement to start buying 2bn in foreign CCY (NOK sales) already from the 1st of April is a game changer for structural liquidity. While we have advocated for such a move a number of times since October last year, the timing was highly uncertain.
- 2bn/day will increase structural liquidity by over 250bn this year. The effect is countered by a similar increase in expected oil & gas income. Hence, the prognosis for structural liquidity is unchanged at the end of 2022. However, since the oil taxes only increases from August onwards, we will see a large increase in liquidity in early summer.
- The ~100bn increase in liquidity for June and July has the potential to lower Nibor-OIS by 25bps. We could actually see 3M Nibor lower after the June rate hike than after the March rate hike.

Last week saw a massive change in the 2022 Structural liquidity outlook



The 100bn increase in liquidity could push Nibor 25bps lower

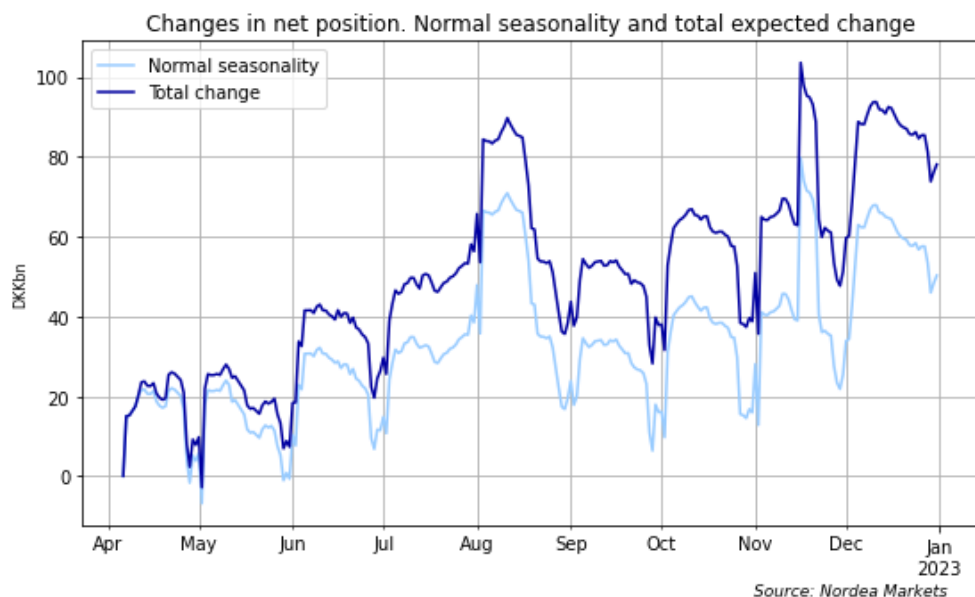


DKK XCCY: Higher net position / liquidity for the rest of 2022

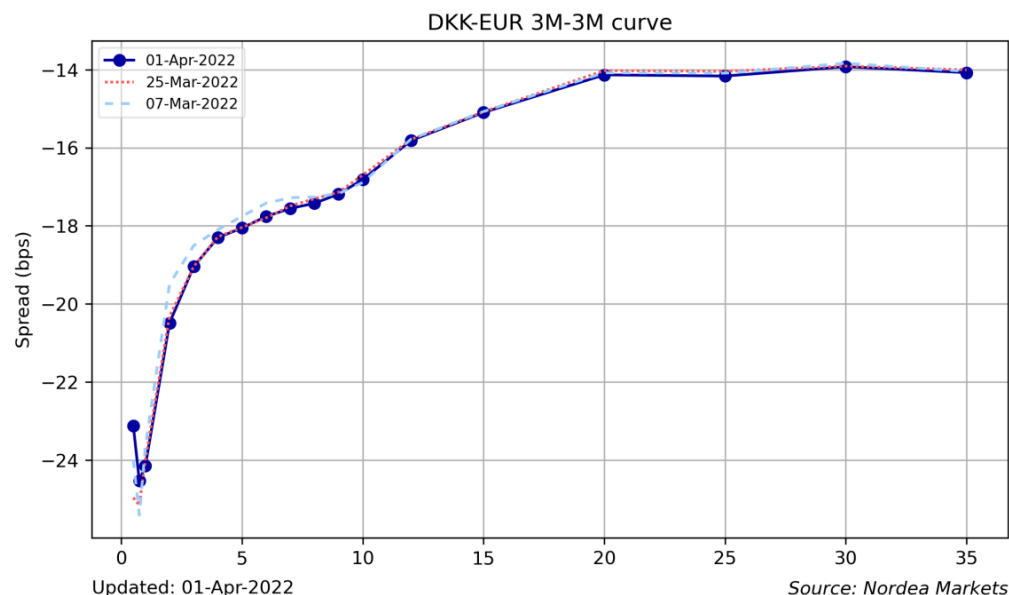
DKK not much above intervention level so the Danish central bank might soon need to intervene to avoid cutting rates

- The net position has drifted lower since the start of the year. This is due to high government revenues from pension saving taxes and repayments of corporate tax loans initiated during the corona crisis. However, end of Q1 most likely marked the trough for the net position. Government expenditures will increase more than planned by the Ministry of Finance; due to higher military spending and extra cost related to support refugees from Ukraine. In addition, government revenues will be negatively affected by the expected slowdown in the Danish economy. In the remaining of 2022 this will reduce government deposits at the central bank and thereby increase the net position substantially.
- Adding to this, the strong DKK that soon might lead to the need for intervention from the Danish central bank in order to avoid cutting rates when all other central banks are initiating a hiking cycle. This will further increase the net position if it gets necessary to intervene. In the coming quarters, the higher net position will all else equal result in downward pressure on DKK rates pushing FX forwards lower.
- The FX forwards continue to trade close to zero, so no major changes in the recent month despite the very volatile markets. The same goes for the XCCY curve that remains de-facto unchanged.

The changes to the net position during the rest of 2022.



DKK-EUR 3m-3m XCCY curves



Thank you!

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