May 2022

Nordea XCCY monthly

Continued high $-premium

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Welcome the May edition of the XCCY monthly!

The largest development in Scandies is the flattening of the NOK curve; Foreigners has been printing in 10Y+, with most of it 15Y+, which has added increased receiving pressure in the longer end of the curve.

SEK has moved lower in line with the overall sentiment in EUR, however, large price action in the front along with large demand for SEK cash has kept the front at elevated levels. Additionally, the Stibor fixings are adding some extra flavour to trading SEK XCCY in the front.

As the basis market is not trading vs. Libor or Euribor it's worth noting that the tenor basis in both Sofr/Bor and Estr/Bor has continued to widen, whereas, the implied tenor basis in SEK and NOK has not reflected the same development. This has been one of the key drivers in the widening pressure in Stibor/Euribor and Nibor/Euribor:

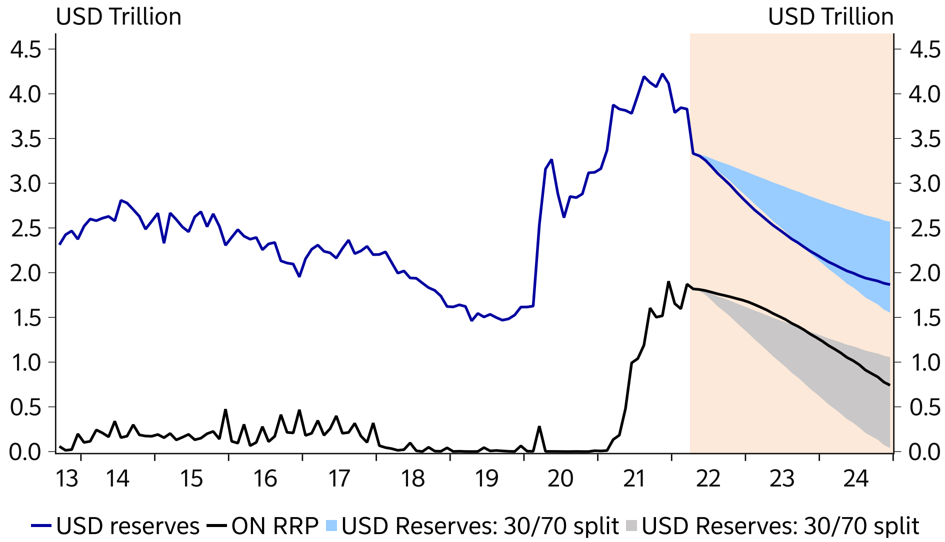
Key names printing the last month: KommuneInvest, KommuneKredit, Kommunalbanken, IBRD, KFW, NIB along with Spire's

EURUSD XCCY: The end of easy money

Hike mania and the QT bomb

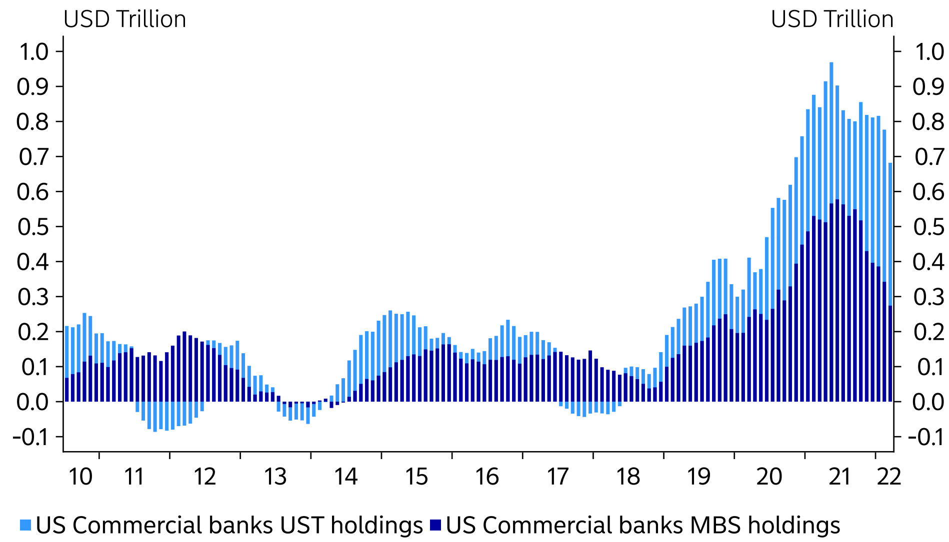
- The Fed is set to hike rates by 50bp and announce its balance sheet run-off. The balance sheet reduction will consist of run-off caps of $60bn USTs and $35bn MBS, which will result in $95bn per month. Treasury bills will be used to fill gaps between caps and actual redemption.
- We see the fastest possible drain of USD liquidity with excess USD reserves in the banking system leaving first and the Overnight Reverse Repurchase Facility (ON RRP) staying at high levels. This means the quantitative tightening (QT) will drain USD liquidity from the commercial banking system, while USD liquidity outside the system will stay at high levels. Therefore, of all types of QT, we foresee a rather aggressive one with little cushion from RRP, until USD funding goes more expensive. The two main reasons are:
    - I. Front-loading interest rate hikes is likely to keep liquidity in Money Market Funds (MMFs) in the overnight funding market, which will be placed in the ON RRP until short-term rates becomes more attractive. Moreover, front-loading interest rate hikes is likely to result in deposits shifting into MMFs and ultimately the RRP until banks start to compete for deposits.
    - II. The Fed will use treasury bills to fill gaps when redemptions do not hit the caps, which liquidity in the ON RRP could have swallowed.
- We think this results in an earlier than expected end of an era of cheap USD funding. In the current risk-off environment, with focus on stagflation and recession fears, we expect a drainage of liquidity (which has been highly correlated to asset appreciation) to increase volatility in equities and rates, which should keep USD demand bid.

The evolution of QT: Where is the RRP cushion ?



Source: Macrobond and Nordea

Who will buy? US commercial banks are leveraged and constrained



Source: Nordea and Macrobond

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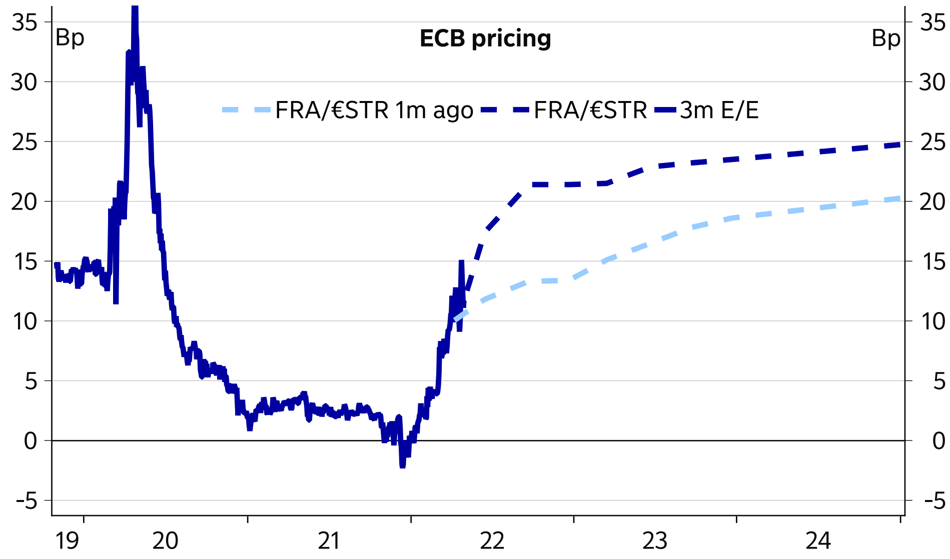
EURUSD XCCY: Faster, Higher, Longer

Faster rate hikes have implications for EUR liquidity

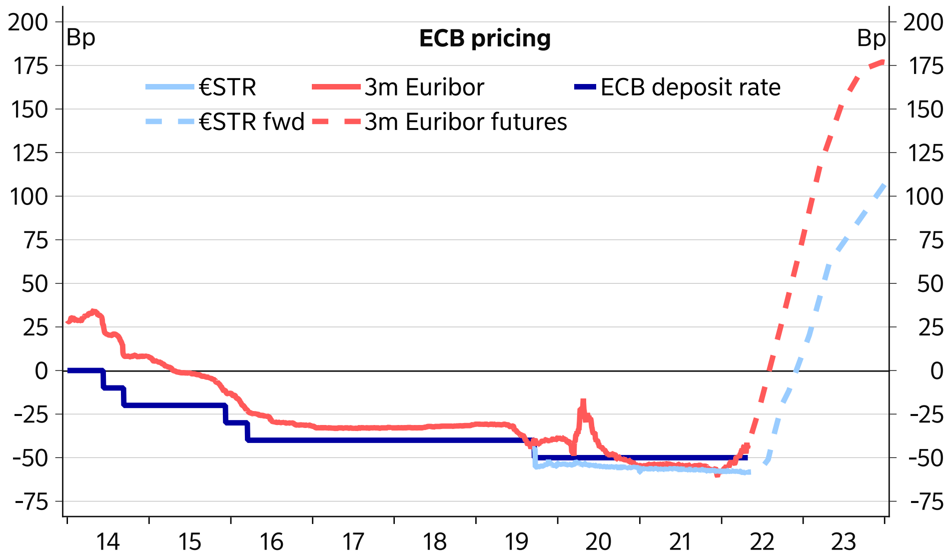
- ECB President Lagarde joined the choir hinting at a July rate hike. An end to the APP purchases in July are likely to be agreed upon at the June meeting alongside a plan to hike rates for the first time at the July meeting unless something happens in-between. Markets are almost pricing rate hikes in Jul, Sep and Dec and are getting closer to pricing an Oct hike as well. Thus, markets continue to price faster ECB rate hikes and a higher terminal rate.
- Implications for EUR liquidity are quite significant. As TLTROs will no longer be obtained at -100bp from June, the ECB intends to compensate banks for the cost of negative interest rates by hiking the tiering multiplier, which in effect will reduce the part of excess liquidity that pays -50bp at the ECB's depo facility and therefore lift €STR fixings at least a few bp. However, with the fast-track hiking cycle, negative policy rates could be history already in September and hence tiering will be but a summer flirt and its effects on €STR fixings as lasting.
- On the other hand, banks may choose to repay TLTRO early as the favourable rate won't be extended, which would also reduce excess liquidity in the Eurosystem. The TLTRO-III.1 expires in September but was very small. However, the big TLTRO-III.4 with an uptake of more than 1300bn or more than half the outstanding TLTROs becomes shorter than 1 year, which makes it less useful as the Net Stable Funding, potentially prompting some banks to return the TLTROs to the ECB.
- E/E has picked up quite a lot already, but more is likely to be on the cards; more and faster rate hikes are being priced in and this trend can continue for a while even if we think the ECB might eventually struggle to deliver; and still not one is talking about falling (true) excess liquidity in EUR, but part of this effect may now prove short-lived.

3m E/E forward (FRA/€STR)



Source: Nordea and Macrobond

Aggressive ECB pricing



Source: Nordea and Macrobond

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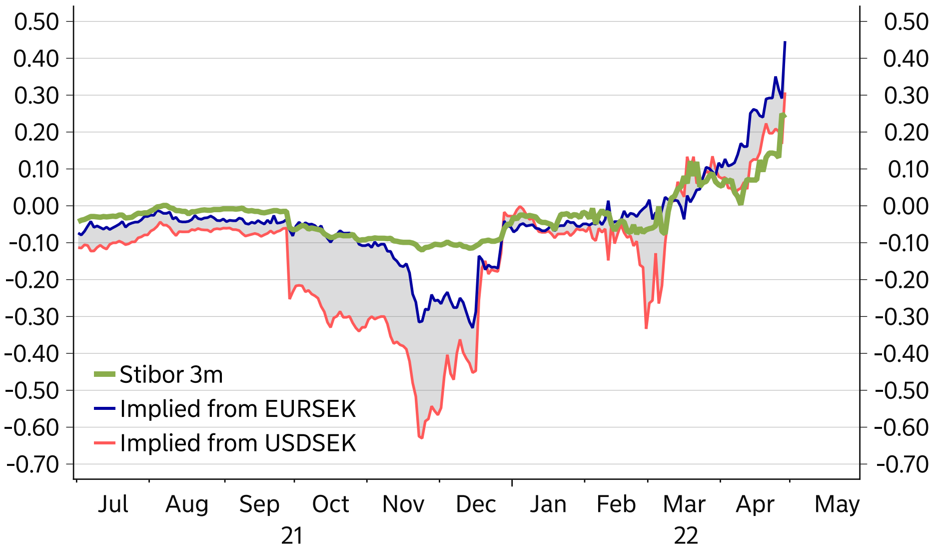
SEK: A new epoch of rate hikes and less excess liquidity

The Riksbank has hiked the policy rate and will reduce QE portfolio in H2 2022

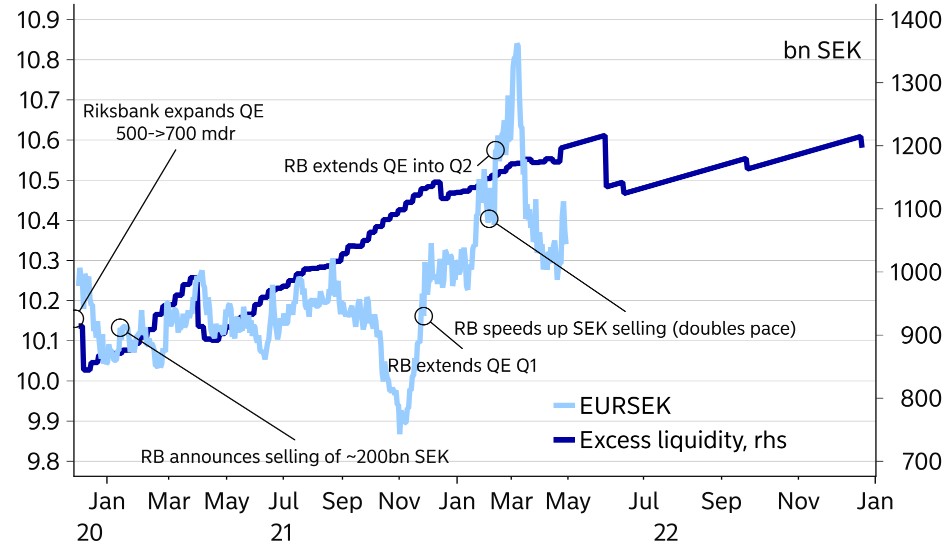
- The Riksbank has started the hiking cycle by a 25 bps hike at the recent April meeting. Rate hike expectations during the remainder of this year will make 3m Stibor to average above the policy rate.
- The Riksbank also announced that it will cut its bond purchases by 50% in H2 2022 and not reinvest maturating bills. This will decrease the balance sheet marginally. The ongoing SEK selling by the Riksbank aimed at change the funding of the FX reserve continues however to add excess liquidity. The net impact on SEK liquidity should be marginal, but no doubt that quantitative tightening (QT) is a different regime compared to quantitative easing. Would the Riksbank ramp up the QT, then tighter SEK liquidity will be the consequence by design.
- 3m Stibor continues to display an erratic behavior. The new calculation method, based on actual transactions and approximations of such, has added significant day-to-day volatility and reduced transparency. Since the new method is a part of the application of Stibor to be approved as a critical reference rate, any changes in the method is unlikely. Expect continued high level of noise in Stibor!
- Although the rate hike by the Riksbank was expected by the market, for many households it came as a surprise. The downside scenario for Swedish house prices has gained traction in a big way. Lower house prices, struggling households and a higher policy rate that worsen the carry calculus for foreign investors may make domestic issuance less attractive down the road.

USDSEK and EURSEK FX forwards imply upside risk to Stibor



Source: Nordea Markets and Macrobond

Redemptions in QE portfolio reduces excess liquidity in early June

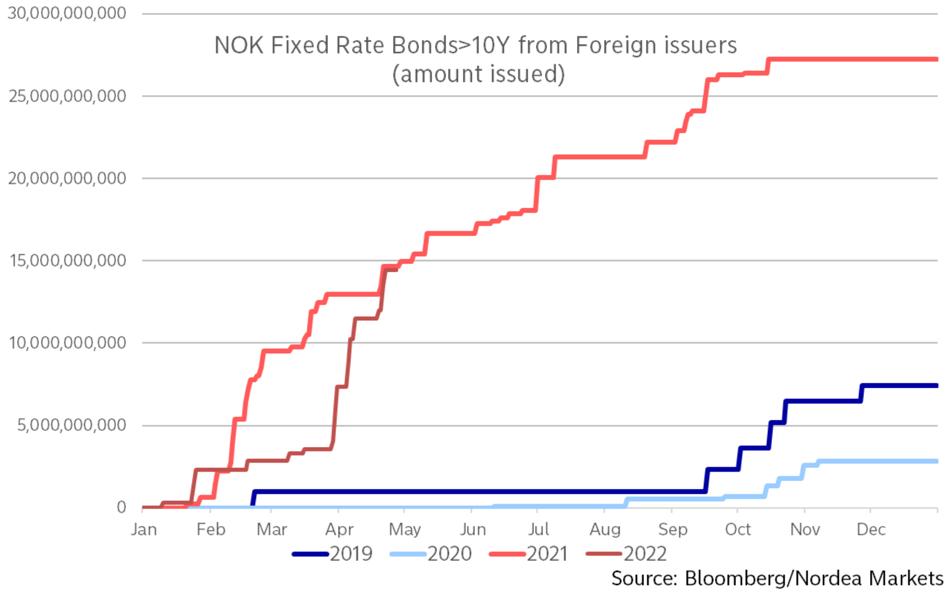


Source: Macrobond and Nordea

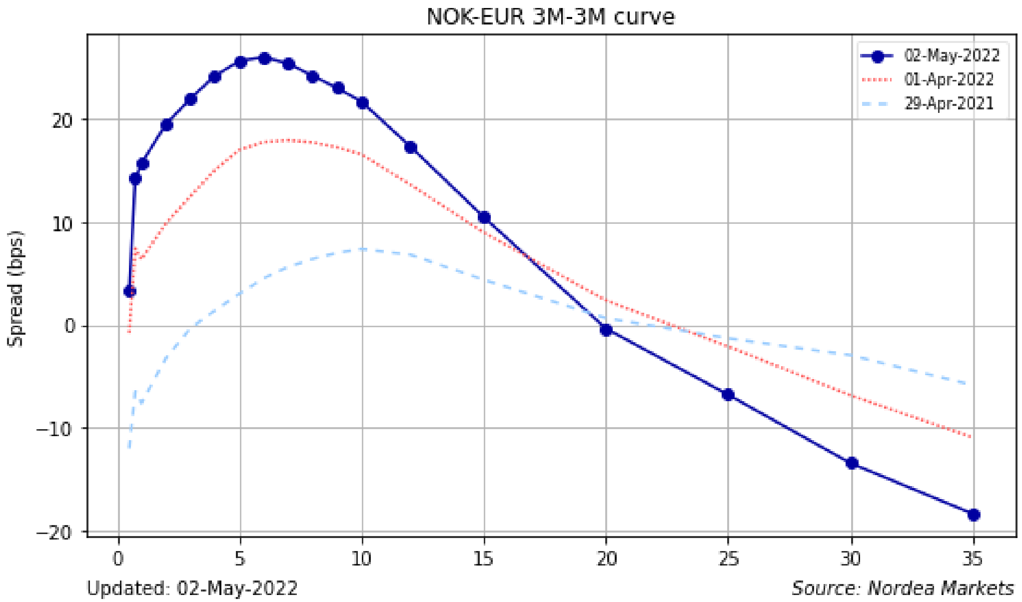
NOK XCCY: Foreign issuers are flattening the curve again

- After a slow start to the year, NOK issuance from foreign issuers have picked up massively in April. YTD we are now on par with the record volumes of last year
- In addition to Spire issuance, we have also seen several longer dated issues from Supras. More than half of the issuance in the 10Y+ space this year have been longer than 15 years to maturity.
- Most of these foreign issuers have no need for NOK, and as the proceeds are basis-swapped out of NOK, we have thus seen renewed downward pressure on the long end of the basis curve. In addition, Norwegian issuers in 5-7Y Euros are keeping the shorter end of the basis curve bid, leading to a much flatter 5Y-30Y curve.

Foreign issuers have been very active in NOK lately



The EURNOK basis curve is flattening further



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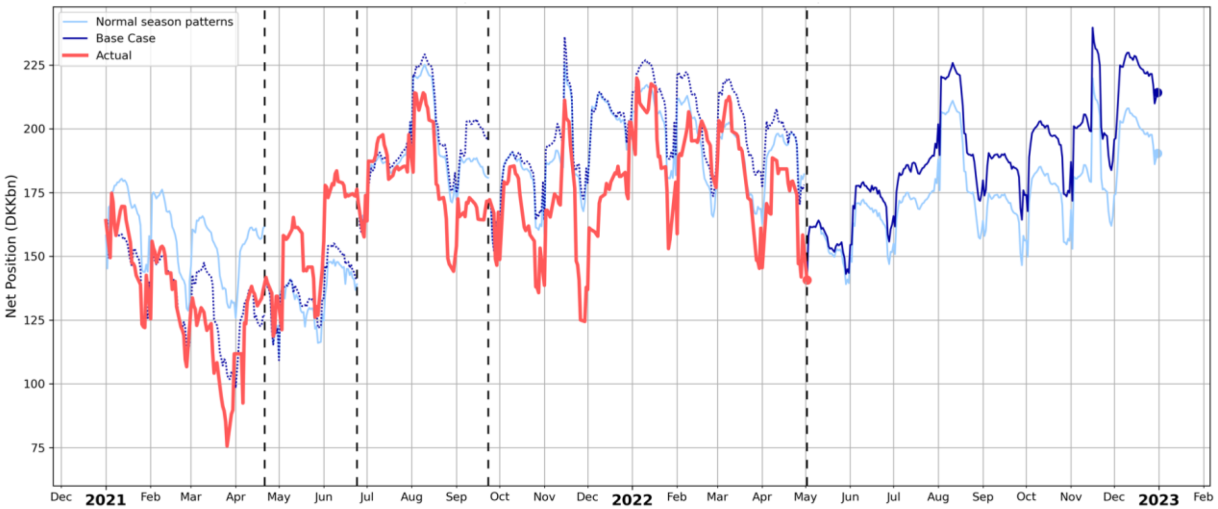
Confidential

DKK XCCY: Nothing to report

Nothing have happened and nothing will over the next month

- Nothing really happens in the Danish XCCY and FX-forward market currently. The FX forwards continue to trade close to zero and looking at our new estimate for the Danish liquidity (the net position) it will continue to trade sideways in May unless something major happens like a massive sell-off in equities.
- The situation will change over the summer and onwards since the liquidity situation will increase much toward the year end. This will push rates gradually lower in the rate corridor and eventually also give downwards pressure on FX-forward and XCCY. Note that the increase is larger than in normal years due the extra government spending related to the compensation of the mink industry and cost related to war in Ukraine.

The net position. Normal seasonality and our estimate



Source: Nordea Markets & MacroBond

Extra government spending throughout 2022

Extra drawing on gov. account in 2022 (DKKbn)	
Compensation to the mink industy	15.0
Higher military spendings	2.5
Cost related to refugees from Ukraine	2.5
Lower growth in the Danish economy	5.0
Total	**25.0**

Thank you!

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