Nordea XCCY monthly

December Edition

Anders Skytte Aalund, Anders Svendsen, Erik Buch, Lars Barnekow, Lars Mouland, Mats Hydén, Phillip Madsen, & Sophie Jelstrup

Welcome to the December edition of the XCCY Monthly!

Over the previous month the main event has been the fronts driven by year-end turn.
We have seen some volatile days in the fronts for EUR, NOK and SEK vs. USD, not to mention some crazy moves in EURPLN.

The USD turn has cheapened and has driven all the fronts vs. USD higher. USD has cheapened around 2.5% to EUR. In the last two weeks SEK turn has gone more expensive, with a 4% move to EUR. Stibor has continued to be disconnected to the fwds, but remained on a stable path.

In regard to the fronts in Norway, NOK liquidity was scarce and in demand up to month-end, most likely driven by the tax payment start of December. In the first week of December, NOK cash has cheapened and pushed the front break lower, with the latest driver being the low CPI prints 9th of Dec, which also had a bear steepening effect on the NOK IRS curve.

Key issuance: IBRD, IFC, Kommunalbanken, NIB, Svensk Eksport Kredit

Please be sure to check out our QuantPack for extended graphs and details regarding curve changes and rolls (link can be found in the e-markets article).

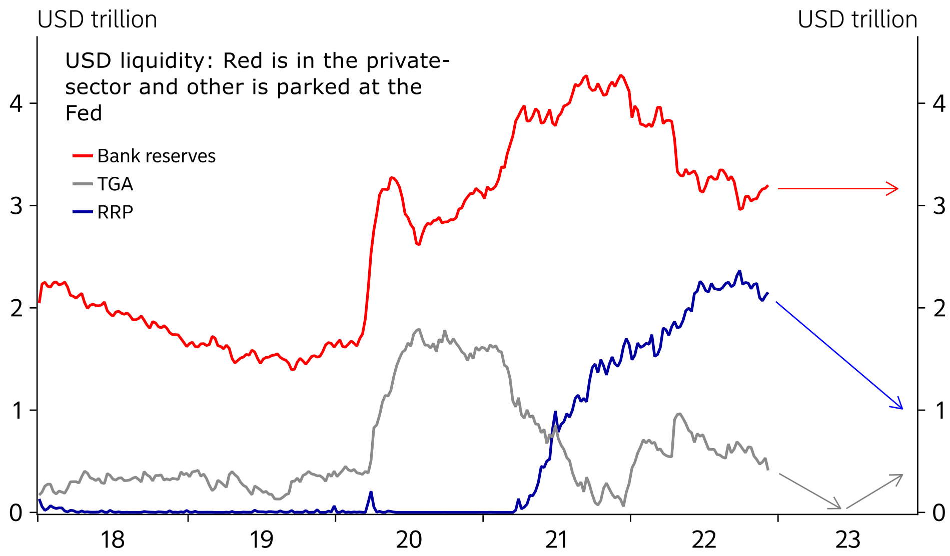
Enjoy the read & happy holidays!
- Next edition will be in Feb-23

EURUSD XCCY: Rising USD funding and steady liquidity

Collateral to overwhelm cash

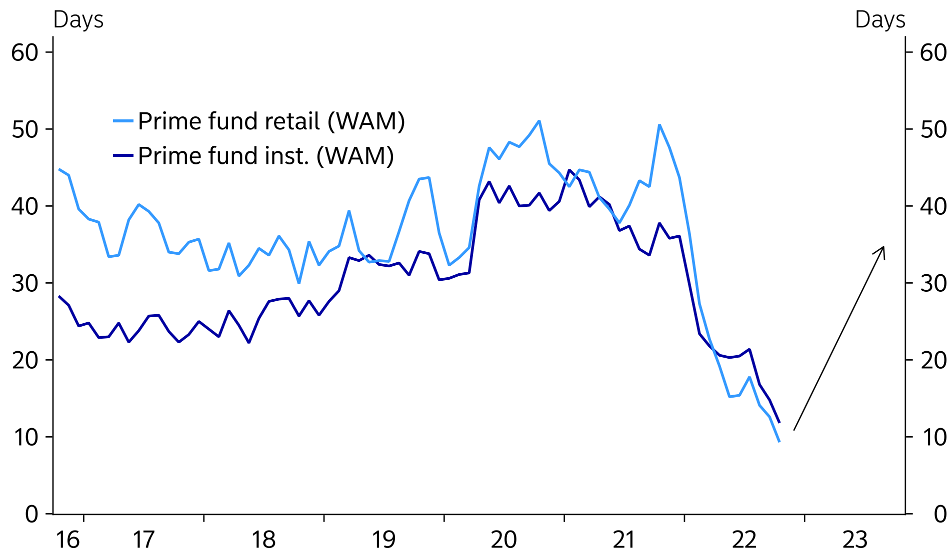
- This year USD liquidity saw a sharp decline from excessive levels as investors placed their cash in the Fed's Overnight Reverse Repurchase Facility (O/N RRP) and the Fed reduced its bond portfolio. In 2023 the drain in bank reserves will be put on a halt. We expect rising USD funding costs resulting in a large decline in the O/N RRP. Meanwhile, the US treasury will add liquidity in the first half of 2023 as it draws down its Treasury General Account (TGA) prior to the debt limit resolution in August. After the debt limit resolution, the US treasury is likely to rebuild its account by issuing a large load of bills. This is likely to put an upwards pressure on money market rates and result in an even more pronounced decline in the O/N RRP.
- Next year the overnight reverse repurchase facility will decline as two key conditions have been met. First, investors and money market funds will extend out the curve as the risk of being "out-hawked" by the Fed has decreased. Secondly, front-end paper has cheapened, which justifies leaving the O/N RRP. This year cash has overwhelmed collateral, but next collateral will overwhelm cash. Bill supply has increased since the summer and Federal Home Loan Bank debt issuance has also risen sharply. We expect more cheapening of paper in the next year, especially when US Treasury rebuilds their account in the second half of next year.
- Bottomline: Next year bank reserves will stay close to $3.000bn as the O/N RRP will decline by more than $1.000bn. The TGA will first fall from $600bn to around $100bn and then be rebuilt to $600bn in the second half of next year. These projections will see collateral overwhelming cash and funding costs rising.

Next year bank reserves will stay elevated as the O/N RRP falls



Source: Nordea and Macrobond

Investors and money market funds will extend out the curve



Source: Nordea and Macrobond

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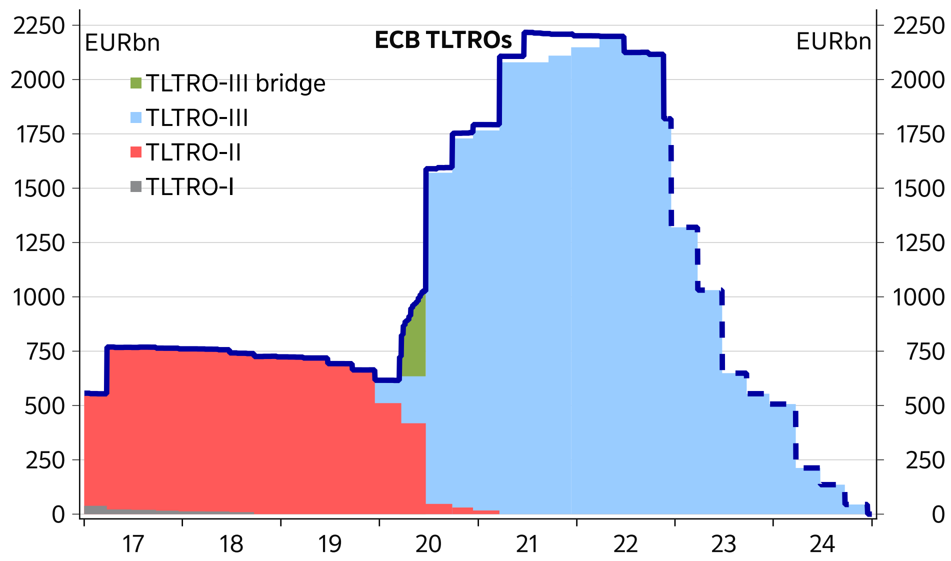
EURUSD XCCY: Falling EUR excess liquidity

Fast TLTRO repayments and QT roadmap on the cards

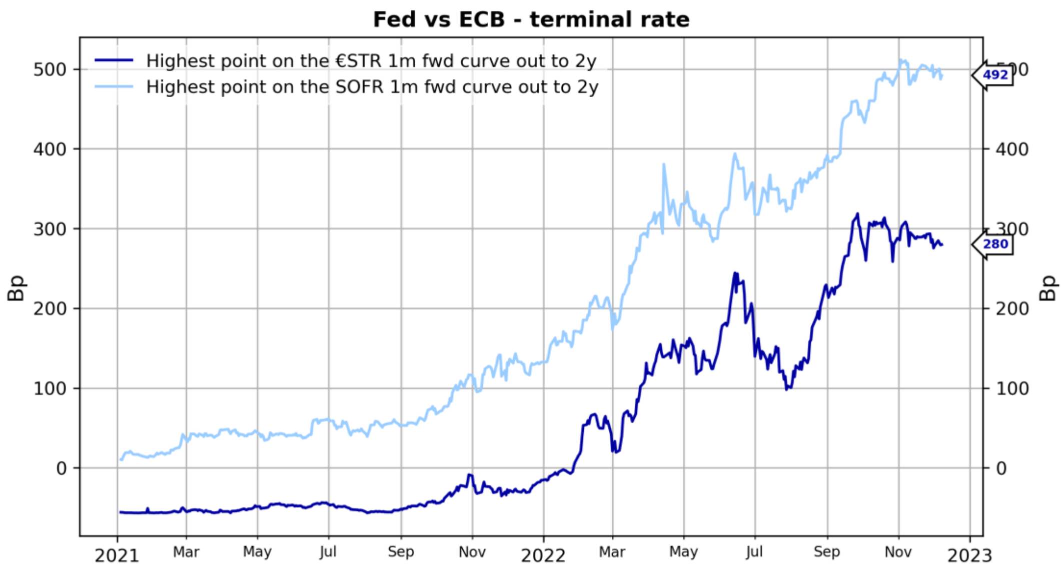
- TLTRO repayments are picking up after the ECB changed TLTRO terms at the October Governing Council meeting. Banks repaid 296bn early in November and will repay another 447bn early on 21 Dec. On top of that, the TLTRO-III.2 expires on 21 December, adding another 52bn to a total drop in outstanding TLTROs of 796bn to 1318bn.
- The drop in TLTROs is 1:1 a drop in excess liquidity. Excess liquidity remains amble enough to keep €STR 10bp below the ECB deposit rate for now, but continued repayments during 2023 could lead to a 5bp higher €STR relative to the deposit rate. However, in 2020 especially, it looked like TLTROs were quite important for Euribors – and markets price 10bp higher E/E at Dec IMM, when the TLTRO repayments settle.
- TLTRO repayments also free up collateral, which could support German ASW even if it probably isn't a lot of German bonds used.
- Looking into 2023, TLTRO repayments will continue. Only 39bn remaining TLTRO-III.3 expire in March before 600bn TLTRO-III.4 expire in June.
- QT will come on top. We expect some form of road map from the ECB this week, but probably passive roll-off of say 20bn starting in Q2. A 75bp ECB rate increase this week probably means a less aggressive QT, while a 50bp hike probably means a more aggressive QT. In either case, QT will have a much slower and much more predictable impact on excess liquidity than TLTROs.
- Excess liquidity could end 2023 around 3000bn, down from 4000bn at the end of this year.
- We believe relative liquidity developments will favour USD over EUR in 2023, while the Fed will be cutting faster and deeper if conditions will end up supporting rate cuts in the second half of the year, which is highly uncertain.

Fast TLTRO repayments



Source: Nordea and Macrobond

Faster and deeper Fed cuts relative to ECB, if conditions support cuts



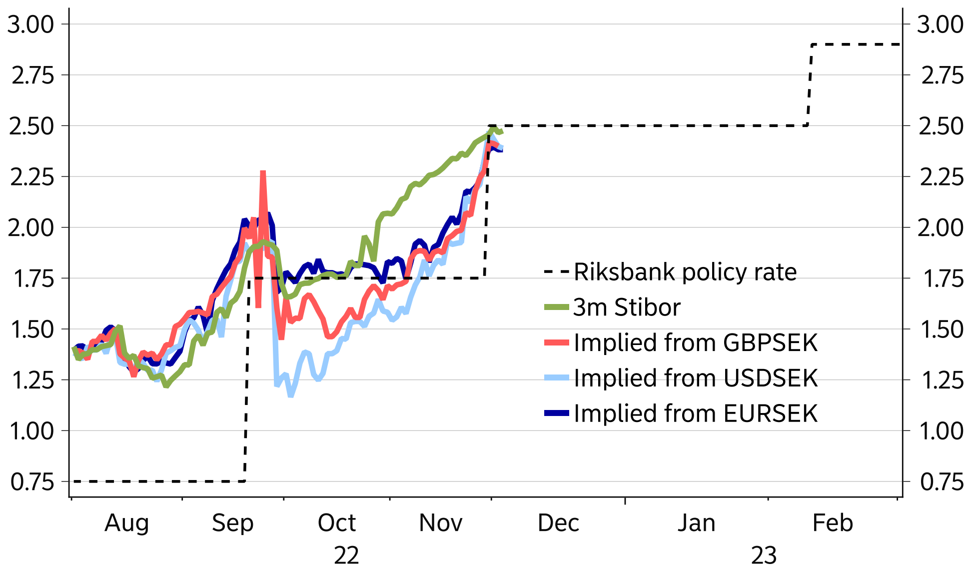
Note: Fed Funds curve before SOFR and EONIA-8.5bp before €STR. Source: Nordea Markets

SEK XCCY: Higher Stibor in 2023 leads the way for basis spreads

Spreads may oscillate, but we expect no sustained tightening

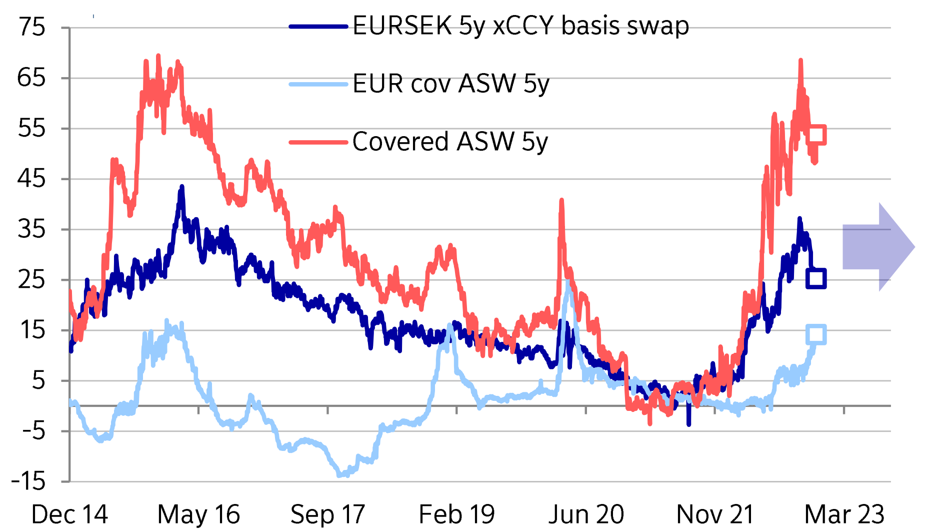
- This year-end was expected to be more volatile than normal due to the first live test of the new calculation method. The plunge after the start of the fourth quarter was severe, but the gradual increase thereafter was a surprise as well. Historically, 3m Stibor has started to climb around late November, early December.
- The event of the public pension flows (PPM flows) in early December is visible in FX forwards, and although it should not leave a lasting impact on Stibor, the factors that contribute to a lower Stibor in Q4 seems to be exhausted around the same time as the PPM flows. Fake correlation? Probably.
- Into 2023, we see a high probability for 3m Stibor to average somewhat above the risk-free rate as the Riksbank reduces excess liquidity.
- Rising yield levels, a macro economic recession, massively lower house prices, households struggling under high leverage, the possibility for flares in risk-aversion during H1 … Do not be surprised if SEK cross-currency basis spreads stay wide on longer tenors jus like covered bond swap spreads should.
- Although also ECB will be reducing excess liquidity and reduce bond purchases, we believe that the less liquid and the not so deep SEK bond market will suffer more in relative term than its Euro peer. Thus, issuance in EUR by SEK issuers may linger into 2023.

Stibor's year-end ultra-volatility coming to an ending



Source: Macrobond and Nordea

EURSEK basis swap spread should stay elevated in H1 2023



Source: Nordea

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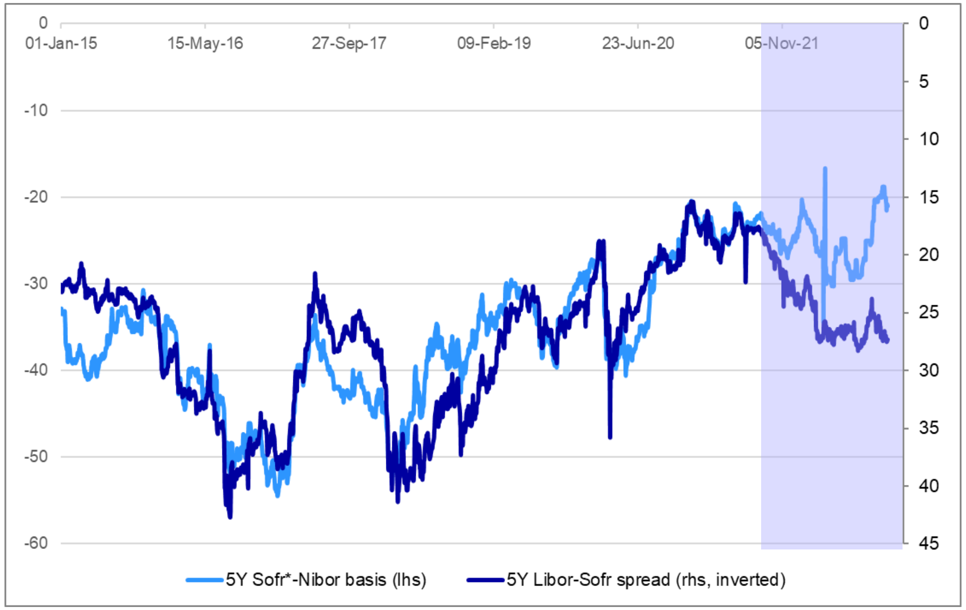
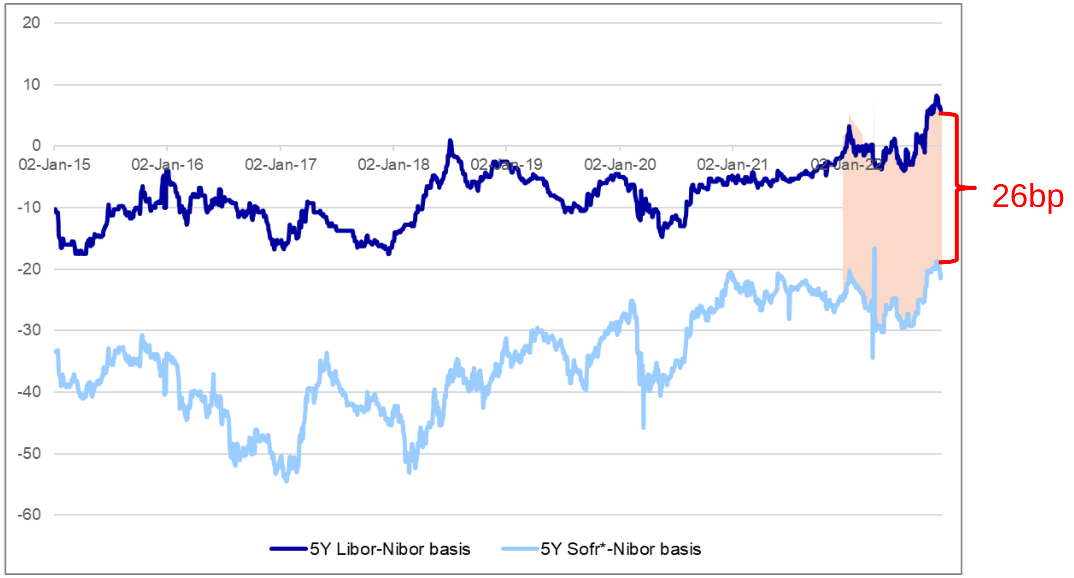
Is the XCCY market really expecting lower $Libor-OIS going forward? Or is Sofr-Nibor basis way too high?

- USDNOK basis (aka Nibor-Libor) have kept rather stable for a number of years, even as other bases have been rather volatile. The historically tight relationship between Nibor-OIS and Libor-OIS stemming from Norwegian banks reliance on foreign currency funding probably can explain this to a large degree.
- At first sight it then looks fair to assume the new USDNOK basis (aka Nibor-Sofr), should also be stable? But, looking back, it is evident that a stable Nibor-Libor basis means Nibor-Sofr basis should trade in line with an inverted Libor-Sofr spread.
- As Libor is discontinued next summer and replaced with Sofr+26bps, it is impossible to know what the market really expects of USD Libor (aka US bank domestic unsecured funding rates) going forward. Using the historical tight relationship inherent in Sofr-Nibor basis it looks like answer is a record tight 15bps.
- We are skeptical and suspect some of the reason for the high Sofr-Nibor basis is rather stemming from old habits. If something bad happens (a US recession, high credit spreads anyone?), we expect to see basis move as if Libor-OIS really is higher...

Sofr-Nibor basis implies Libor-OIS at 15bps for next 5 yrs



From stable Libor-Nibor to stable Sofr-Nibor basis?



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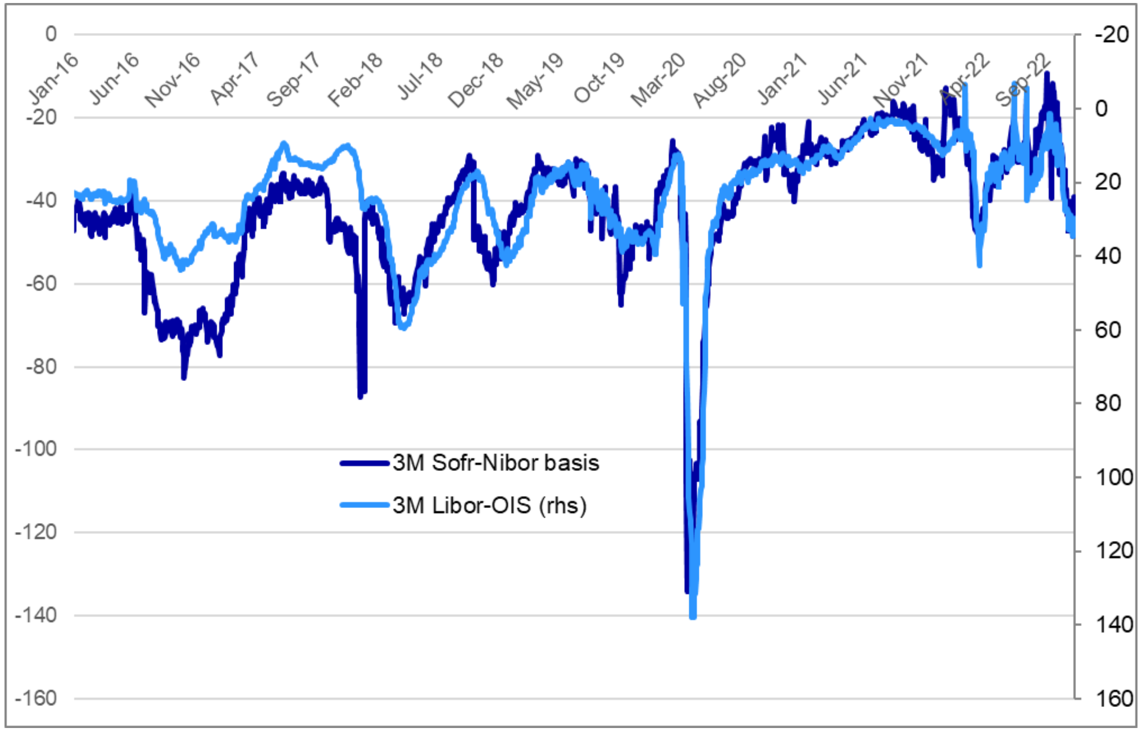
Confidential

Receiving Sofr-Nibor basis is a nice hegde if something really bad happens (and should continue to be so after Libor is discontinued)



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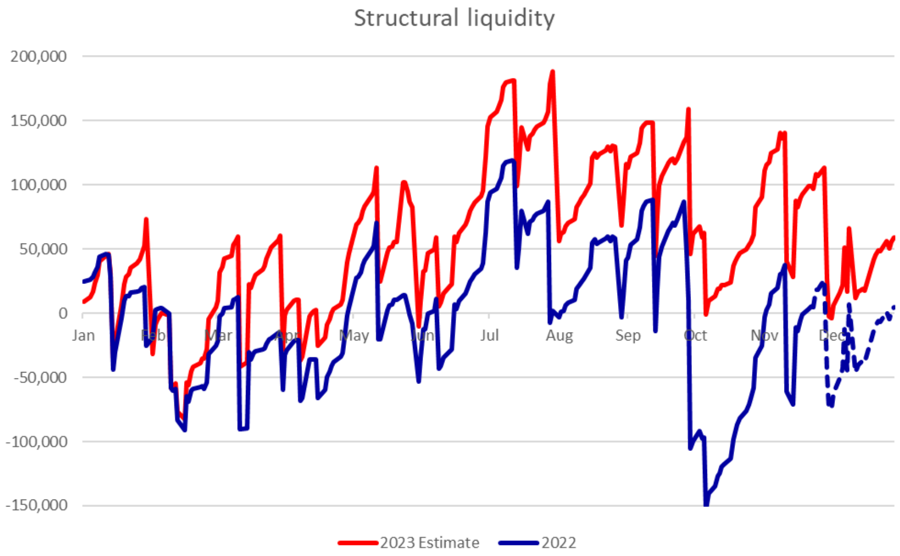
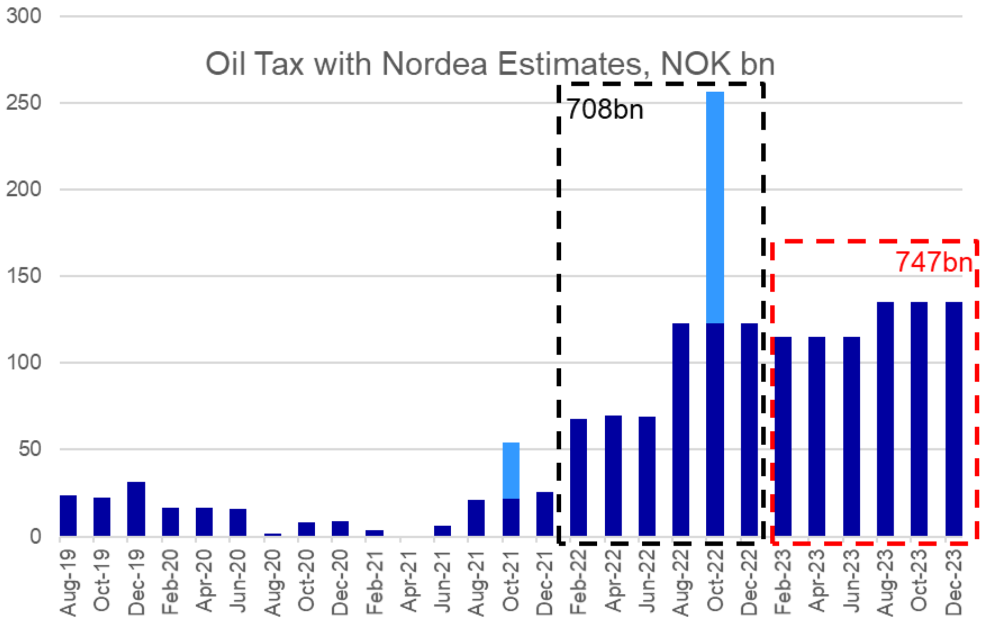
NOK Structural liquidity should be less tight next year



- The oil corrected budget deficit is set to decrease by 50bn for 2023
- 2023 liquidity to start off at +5bn
- Oil exports at 1800bn for 2023 - Bimonthly tax payments at 114bn until summer, 135bn thereafter
- Government bond maturity (NST475) to add 40bn in May
- End-of-year liquidity at ~50bn
- Norges Bank currency transactions at an even pace for all of 2023.
- Translates to NOK sales of 2.3bn/day given the above

Petroleum tax payments looks to be more evenly distributed next year



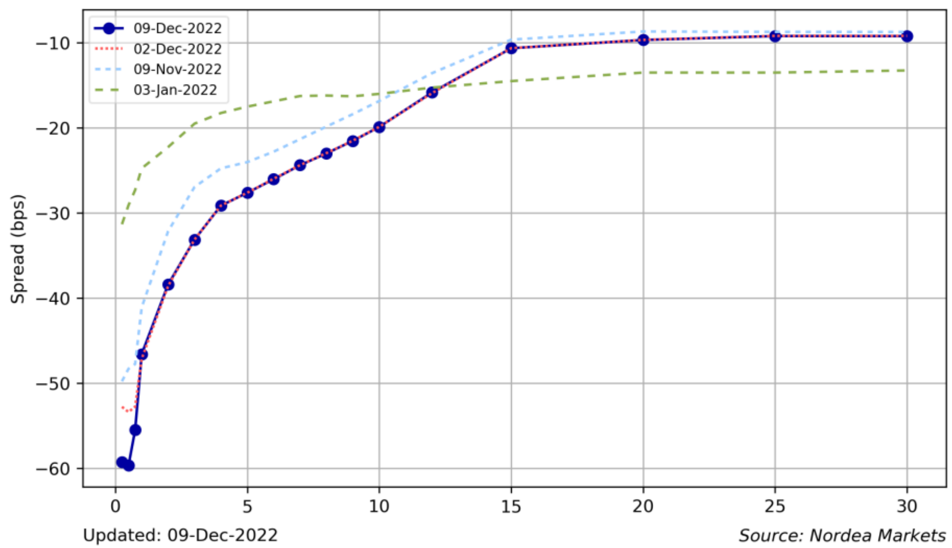
- Oil exports looks to be about at the same level next year
- The specifics of the tax calender makes for a very different pattern
- Massive additional tax payments in April and October looks unlikely

DKK XCCY: Increased likelihood of relative cuts

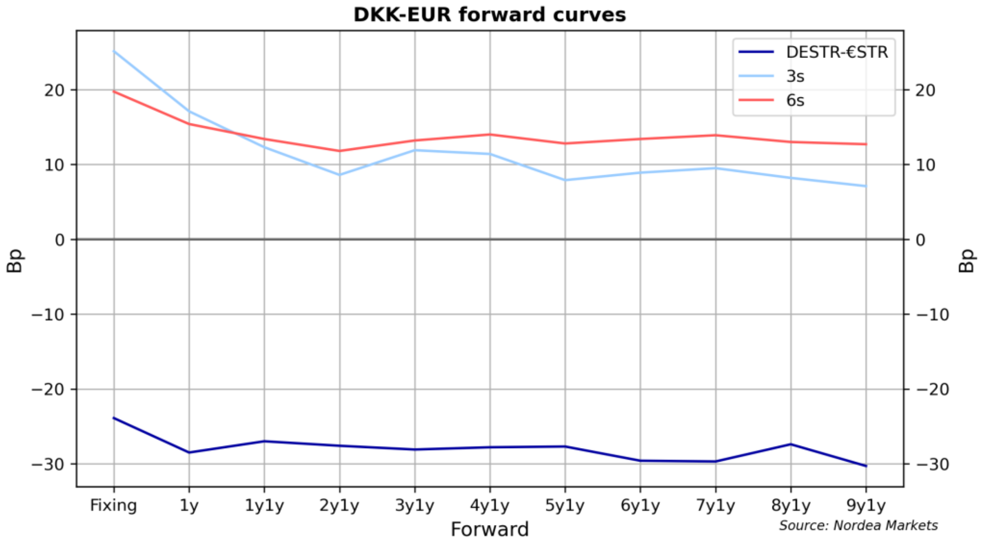
Structural inflow to DKK

- 54bp priced for the ECB this week. We think the Danish central bank will follow the ECB 1:1 this time, but there is an increasing likelihood of a relative rate cut. Most likely in February, if we're right that inflows could pickup towards the end of the year and prompt FX interventions – the central bank selling DKK and buying FX to mitigate inflows – in scale like last December. Around 5bp relative cut is currently priced.
- The central bank's dilemma is that the net position is already high and thus FX interventions do not affect money market spreads a lot. At the same time, the demand for DKK is more structural than speculative and hence rate cuts might not be too effective in preventing inflows either. Less effective tools at this point could imply the need to use them more to get the job done.
- Risks are starting to be skewed towards additional lower rates in DKK relative to EUR.
- Help is coming from the EUR side. TLTRO repayments and QT will push Euribors higher and Cibors are unlikely to follow.
- It makes sense to receive DKK-EUR IRS vs 3s around the 4y point, perhaps after Thursday in case of a small negative surprise if the Danish central bank follows the ECB 1:1. More relative cuts are priced in FX forwards in the near term, which means that it also makes sense to buy EUR/DKK 1y FX forward at a level below the current intervention level either as a carry trade or as a hedge against a weaker DKK.
- Looking further ahead, risks are skewed more towards cheaper DKK liquidity to fend off the structural inflow.

DKK-EUR 3m-3m xccy curve



DKK-EUR frw IRS curves



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Thank you!

Important information

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Nordea Bank Abp, Satamaradankatu 5, FI-00020 NORDEA, Finland, domicile Helsinki, Business ID 2858394-9
Further information on Nordea available on www.nordea.com