

Nordea

Nordea XCCY monthly

February edition

Welcome to the February edition of the XCCY Monthly!

The primary focus of this XCCY monthly is the Riksbank and its impact on USDSEK/EURSEK XCCY.

But before that deep-dive, a short look at what has happened this year: Issuance season started early with a lot of activity. Non-Domestic issuance has been tapped in various markets, USD, EUR, CHF, GBP, AUD, NOK & SEK. Most notable, has been the SSA flow & looking at single events; The Canadian prints in EUR mid-Jan significantly widened the EURUSD basis.

As mentioned in previous publications, we deem that the relative liquidity outlook in EUR vs. USD (incl. debt ceiling event story) favors tightening bias in the front end of the EURUSD basis along while potential EUR issuance 5-10Y area, all else equal, favors a flattening bias of the curve. More on that in the EUR & USD segments of the publication.

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).

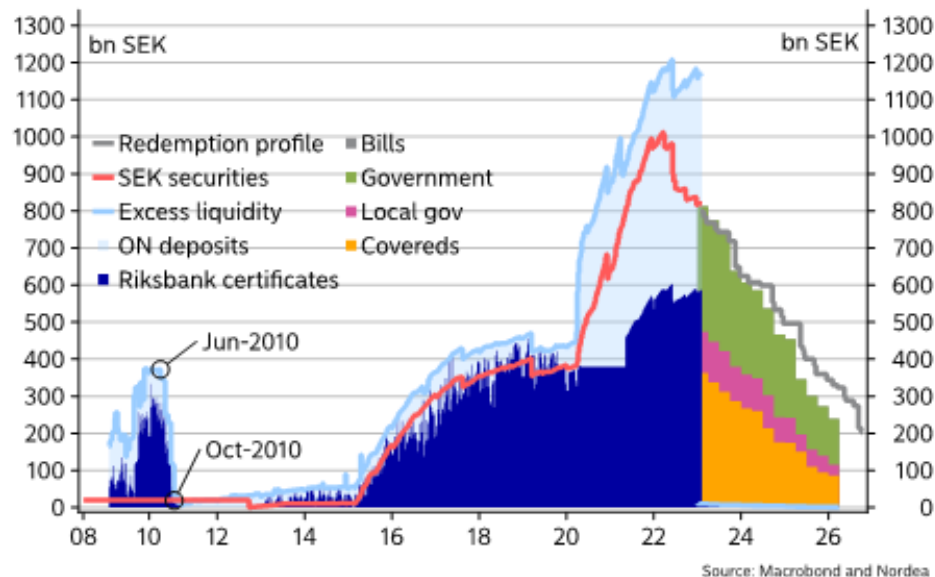
Enjoy the read!

SEK XCCY: Riksbank special (1 of 2)

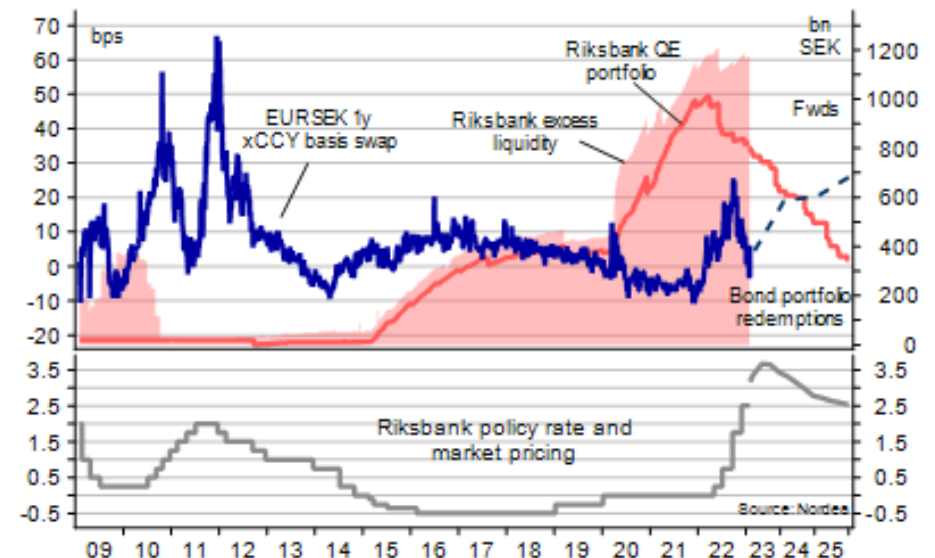
Liquidity drainage has not started yet

- Despite decreasing bond portfolio in 2022, SEK excess liquidity was unchanged as a consequence of the Riksbank's buying of foreign currencies
- The reduction of excess liquidity will not start until this year
- The Riksbank's active selling of SGBs will add about 25 bn to the reduction
- The comparison in reduction excess liquidity to 2010 looks like this:
 - Excess liquidity 2010: -365 bn in 4 months
 - Excess liquidity in 2022: +35bn in 12 months
 - Excess liquidity in 2023: -215bn in 12m
- Less excess liquidity should mean dearer SEK, higher EURSEK basis and wider spread between 3m Stibor and the risk-free rate

Excess liquidity in this cycle and in 2010



Less liquidity will mean a lot for both basis and the SEK bond markets

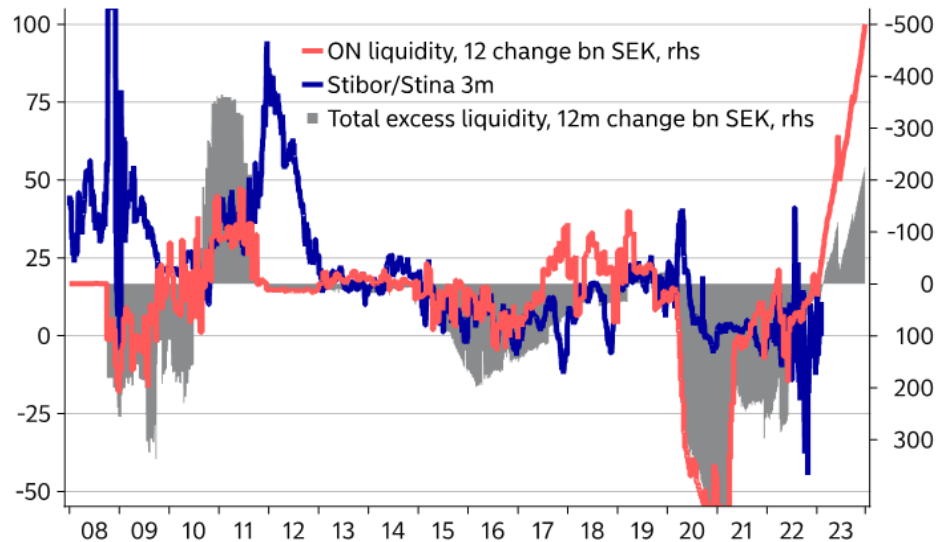


SEK XCCY: Riksbank special (2 of 2)

A new monetary regime may mean a lot for basis

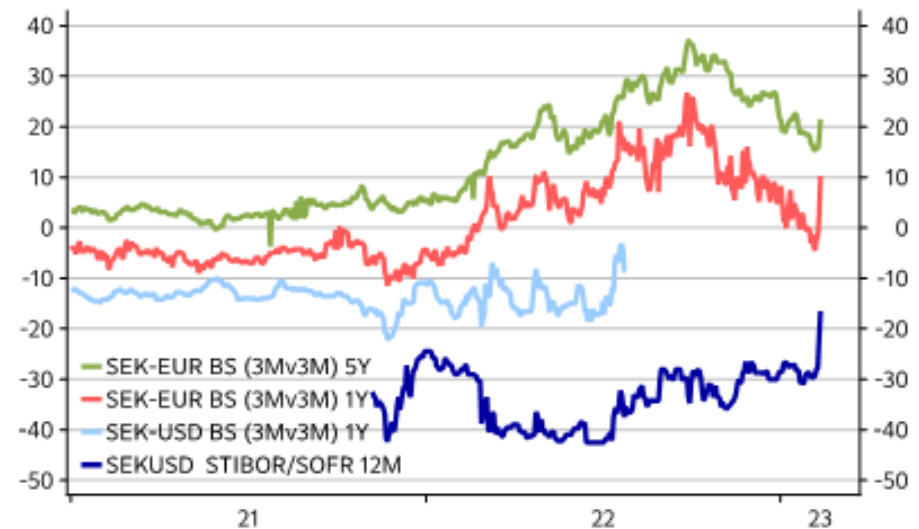
- The Policy announcement last week marked an abrupt break with the old regime
- The "old Riksbank" believed in a large balance sheet for the long-term and massive ON liquidity provision through the deposit facility
- The "new Riksbank" seems committed to a small balance sheet in steady-state and no flooding of ON liquidity
- The announcement of active selling of government bonds in a squeezed market and U-turn in liquidity management was not in the consensus expectations
- Little wonder SEK basis spreads are widening ... and there may be more to go. Remember: bond market liquidity/depth also matters for SEK basis. Bond prices in free-fall may contribute to rout in basis

Change in excess liquidity less sharp than in 2010, but ON liquidity drainage potentially worse



Source: Nordea Markets and Macrobond

Sudden shift in ON liquidity a potential game changer



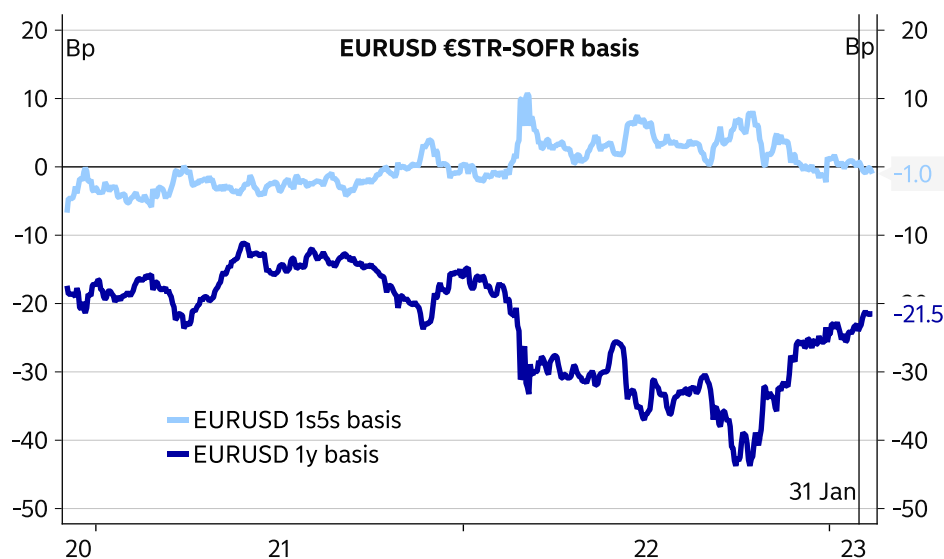
Source: Macrobond and Nordea

EURUSD XCCY: Risk off is knocking on the door

Three arguments for a short-term tactical EURUSD basis flattener or tightener (31 Jan)

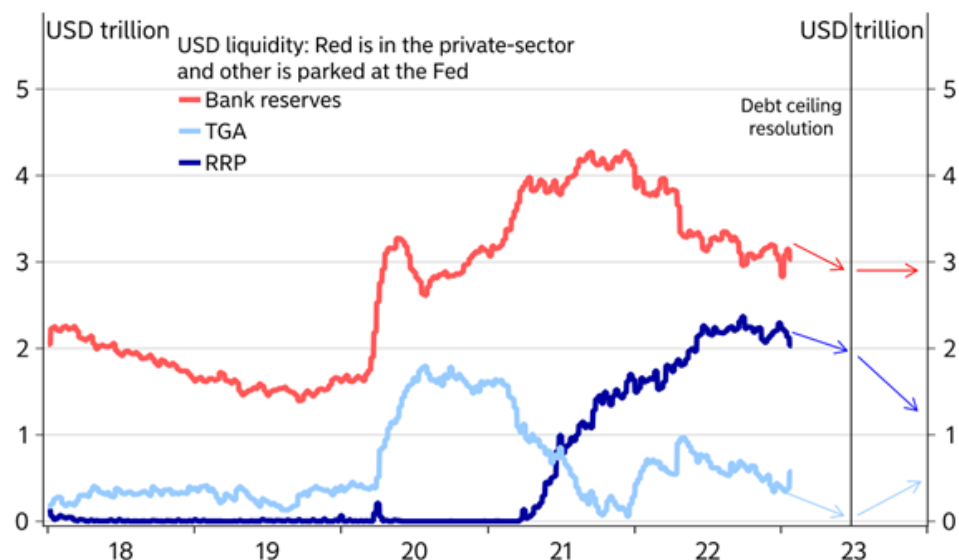
- **Trade idea recap.** Three macro arguments for a short-term tactical EURUSD basis flattener or tightener on 31 Jan.
 - 1. Liquidity favors EUR in the first half.** The ECB is pushing ahead for early TLTRO repayments, while USD liquidity will stabilise around current levels as the US Treasury has reached the debt limit and the Fed's RRP offsets quantitative tightening.
 - 2. Risk is on!** Credit spreads have tightened, equities are strong up on the year and the EURUSD basis is tightening. China's re-opening and better-than-expected economic key figures out of the Euro area have softened or at least postponed the economic downturns.
 - 3. Risk of could tighten EURUSD basis.** Risk off in the US, while the rest of the world is outperforming, could tighten EURUSD basis and should mean the Fed will cut interest rates sooner and deeper than the ECB.
- We argued that paying m3 -> 3m or spot-starting 1y EURUSD basis would be good ways to express this view. The preferred point to receive would be around the 5y point, so a 1s5s flattener. We argued for tight stops due to the obvious risks.
- The stronger than expected job report and ISM service indicator has made us worry that markets are due to a sharp reversal of falling stock prices, rising bond yields, and wider credit spreads. This constitutes a considerable risk to our trade recommendation, which is only marginally in the money. The 1y basis has ticked in our favor, while the 1s5s flattener action has been rather muted (see chart below). Considering risk versus reward, we close our tactical trade ahead of the US CPI reading, which we are inclined to think has the potential to be a catalyst to a sharp reversal of the last weeks risk-on.

EURUSD basis has tightened slightly while the curve has remained flat



Source: Nordea and Macrobond

USD liquidity is unlikely to become scarce this year



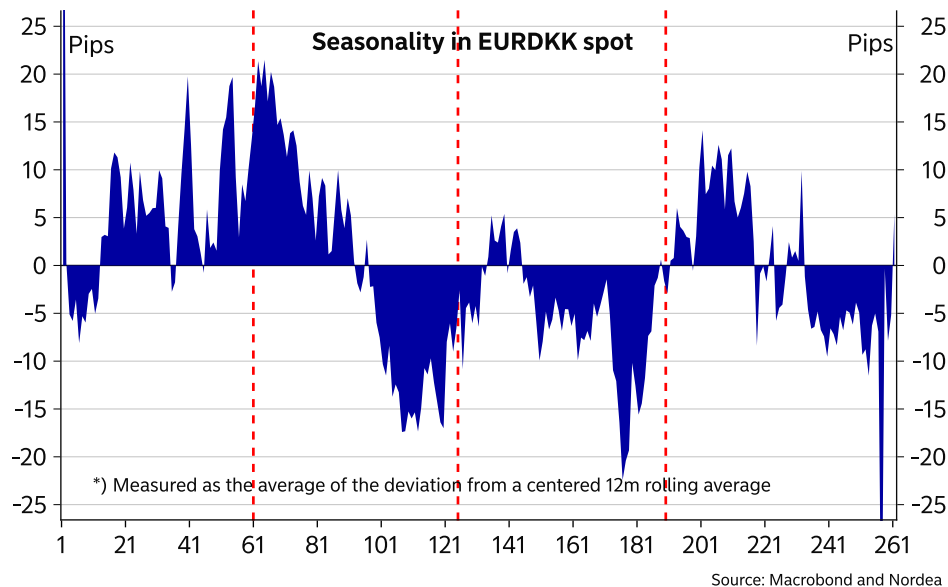
Source: Nordea and Macrobond

DKK XCCY: The new governor surprised the market

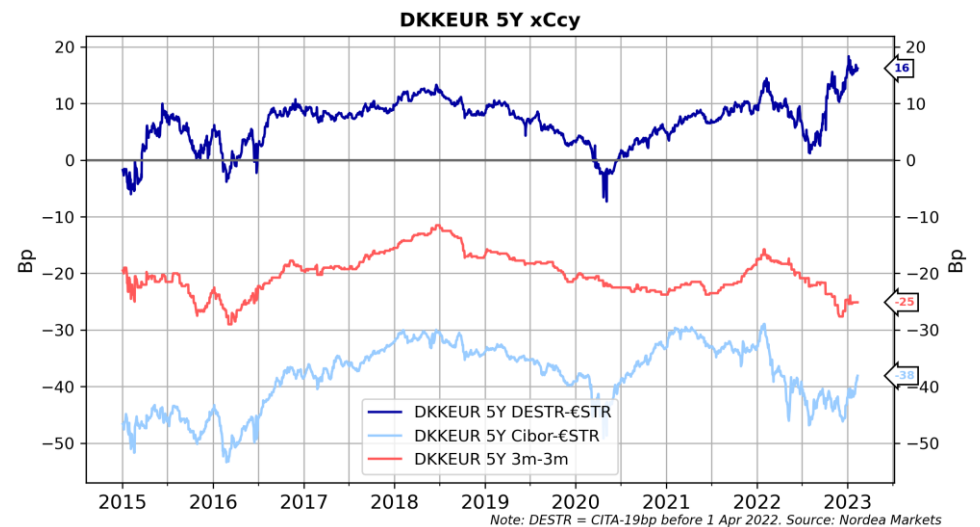
The Danish central bank surprised by hiking 15bp less than the ECB on 2 Feb

- The Danish central bank surprisingly hiked its key policy rates by 15bp less than the ECB on 2 Feb and caused relatively large moves in the market, at least for Danish standards. EURDKK FX forwards moved some 10bp deeper into negative territory and the funding rates improved relative to EUR, while EURDKK spot moved higher. The lower funding rates have resulted in performance of DKK bonds. EURDKK spot is now above the intervention level, which was the point of the relative rate cut, though it remains below the central parity.
- Looking ahead, we believe more relative cuts could be on the cards, as the current account surplus is structural, implying pressure on the DKK to strengthen could reemerge sooner or later. Moreover, we are inclined to think liquidity is plentiful with a net position in the banking sector above 200bn, which means FX interventions do not push overnight rates much lower, and thus, it makes FX intervention less powerful relative to rate cuts.
- Timing is difficult, but the dividend season offers some clues. Danish companies tend to pay dividends in March. That is DKK out of the country of which some will be sold, and the DKK weakens. Foreign companies usually pay dividends in April/May, which means FX in for pension funds, of which some will be exchanged for DKK and the DKK strengthens. Timing wise, the next relative rate cut is more likely in April/May than in March.

EURDKK FX forwards – large moves after the implicit 15bp cut to ECB



DKK-EUR 5y basis



Thank you!

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