

Nordea

Nordea XCCY monthly

Risk off!



Welcome to the March edition of the XCCY Monthly!

Overall February was a slow month for XCCY in Scandie space, mainly due to the majority of market participants off on winter holidays. March prints of note for Scandie issuers has been NIB 5Y in USD and KommunInvest 4Y in EUR. One of the larger events of the February was the hawkish Riksbank pressuring the SEK curve higher. Going into March, additional hikes were priced in cash but not in the fixings, which has kept the front-break elevated in the first two weeks of the month, up until last Friday. The SVB event clearly showed up in XCCY space with all fronts lower vs. USD and widening across the curves. In this edition, we give our view on outlook for Scandie & EUR XCCY.

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!

EURUSD XCCY: Risk-Off and EUR/USD Basis Widening

Risk off! Fear of banking crisis vs sticky inflation

- Last month we closed our EUR/USD basis tightener because we feared that the macroeconomic landscape would be a catalyst to higher interest rates, lower stock prices and wider credit spreads. Looking ahead, we prefer EUR/USD basis wideners.
- Fund managers came into this year expecting an immediate recession with falling inflation and central banks slowing down and eventually shifting into a more dovish stance. This has clearly been wrong. Economies have proven to be more resilient, and inflation has continued to move sideways at a too high level. We think inflation will force central banks to lift their policy rate, which will stoke investors with fear of a recession fear and be a catalyst for risk-off across asset classes. The joker is SVB and the fear of a banking crisis. Front rates have been prices much lower today and on Friday.
- This narrative is likely to revolve around tighter monetary policy and its purpose to weaken the economy. Ultimately, interest rates will have to be brought up to a level that pressure businesses profit margins and produce an earnings decline, which will force businesses to stop hiring and start laying off workers, a process that will bring income and spending growth down to levels consistent with 2% inflation.
- Despite significant moves already, we think the best risk/reward is EUR/USD basis wideners.

EUR-USD basis curve (eod Friday)



1y EUR-USD basis

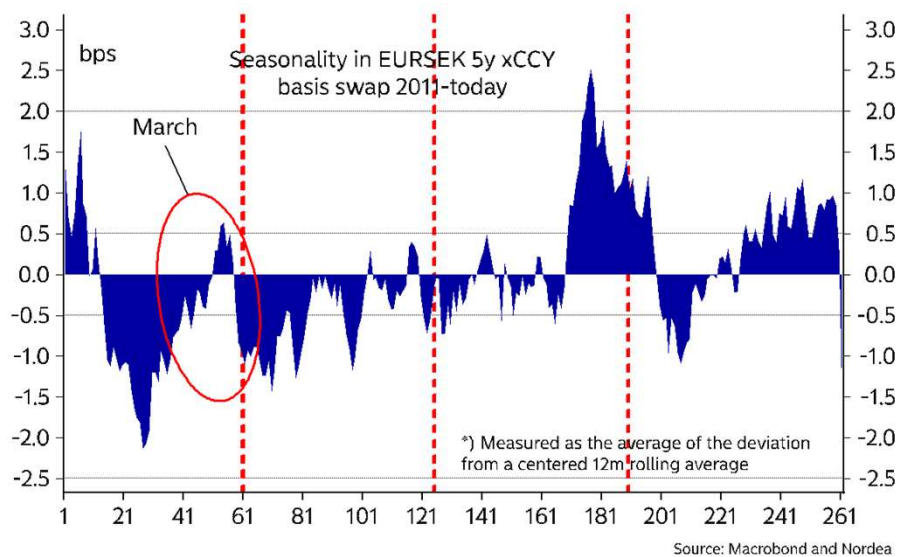


SEK XCCY: Possible pause in bond demand, and there is QT

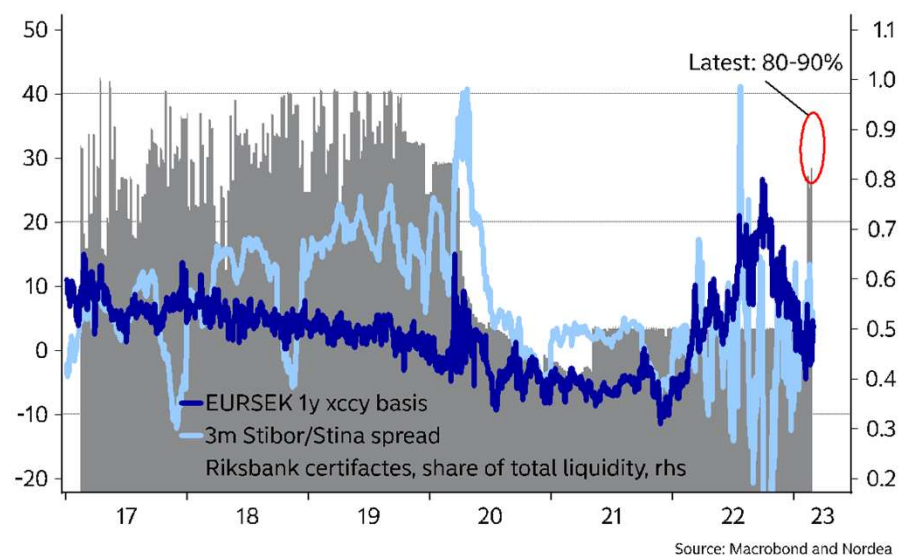
Through March and into the wilderness of QT in April

- Riksbank announced active selling of bonds to start in April (no exact date is given). The amounts are small: 3.5 bn/month. Peanuts for the money-market, but still an off-printing of liquidity that will accumulate together with redemptions of bonds.
- For Stibor and SEK liquidity, Riksbank's QT is obviously on the upside. But for SEK XCCY, the impact is more unclear. ECB's Euro draining and possible burst of risk-aversion and dollar demand may prove more important.
- At the same time, a smaller and less liquid market should be the driver in a spread. So risk should also be on the upside for EURSEK XCCY, but just barely.
- Riksbank's decision to full allotment in certificates has remove all but around 100 bn from ON deposits. This will move effective market rate up by up to 5 bps as is already reflected in Sofr/Stibor XCCY.
- Seasonality in EURSEK XCCY basis may be viewed as an indicator of domestic demand for bonds in SEK. Usually this is very high in January and February, but takes a breather in March. A continued uptick in EURSEK XCCY basis may thus be warranted. From April on-wards it will all be about Riksbank's QT and then further on about the colossal ECB TLTRO run-off. For the moment, the play-board should be set for some further upticks in SEK XCCYs.

Seasonality points at less heavy domestic bond demand in March



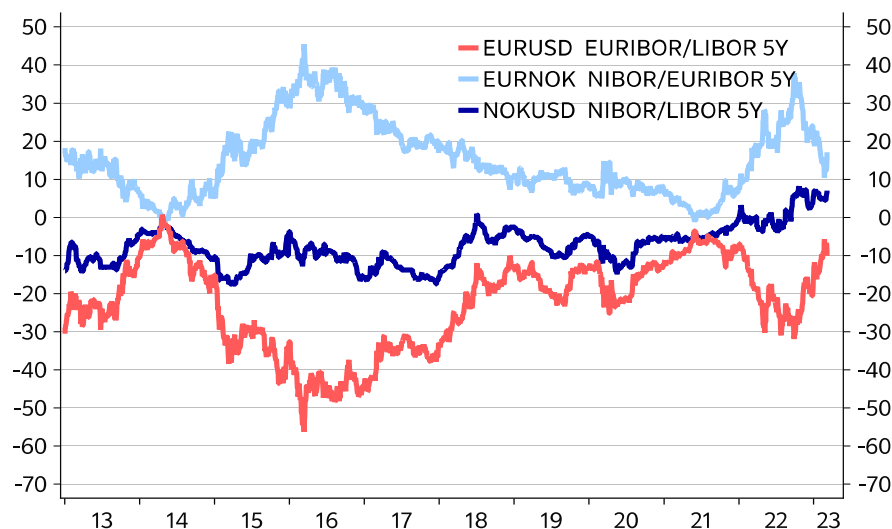
Riksbank certificate policy matters, at least on the margin for basis and Stibor



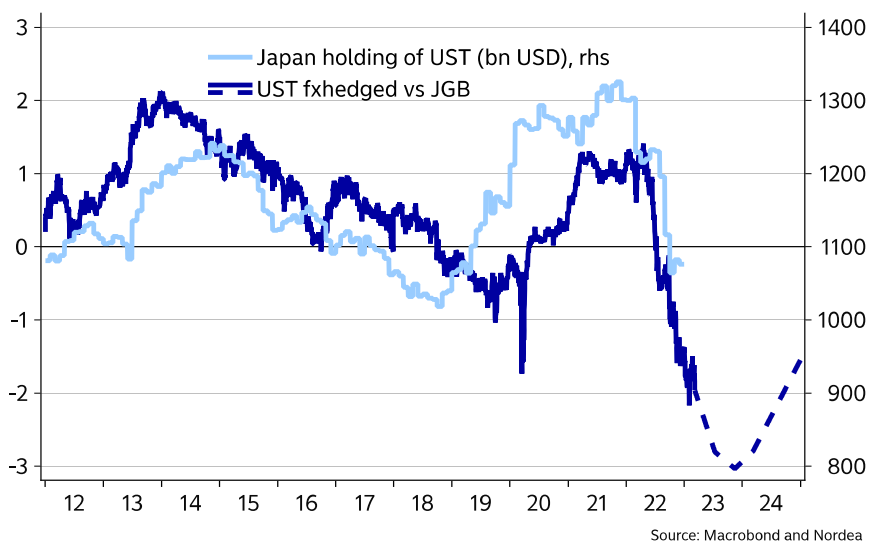
NOK XCCY: Flatter US curve drives EURNOK basis lower

- The massive flattening of the US rates curve, mainly driven by aggressive rate hikes have seriously dented demand to borrow USD in the FX-swap market pushing USD basis higher. As the FX-hedged carry for Japanese investors in the US treasury market has evaporated and turned into a drag, they have been large net sellers by some 200bn last year, reducing their borrowed USD exposure.
- Cheaper USD basis has moved out the curve and been the main driver behind the cheapening of EUR-USD Basis in various forms in addition to somewhat less excess liquidity in the Eurosystem (this will be very important to follow over the next year...).
- The large moves higher in Libor-Euribor basis have more than outweighed a still elevated Nibor/Libor basis supported by steadily lower USD Libor-Sofr short end spreads, pushing Euribor-Nibor basis lower.

EURNOK basis still mainly driven by EURUSD leg



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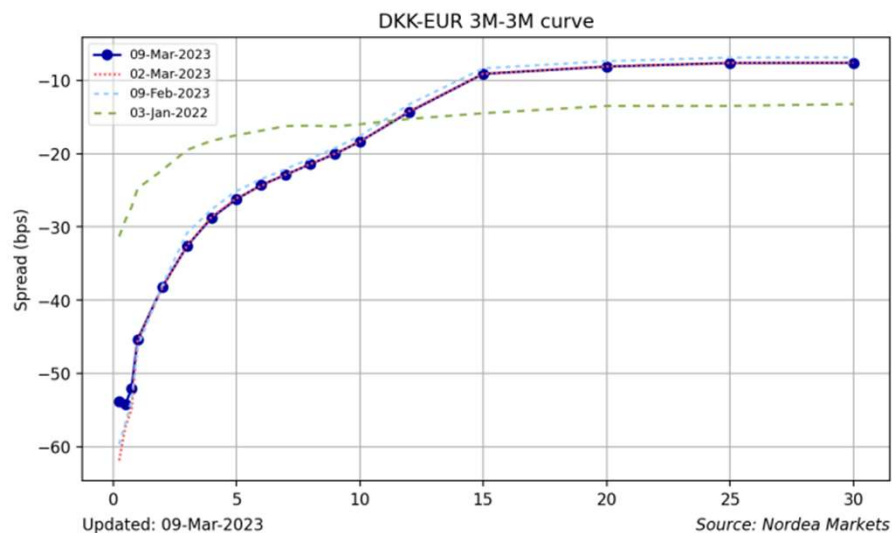
Source: Macrobond and Nordea

DKK XCCY: Be mindful of the seasonality

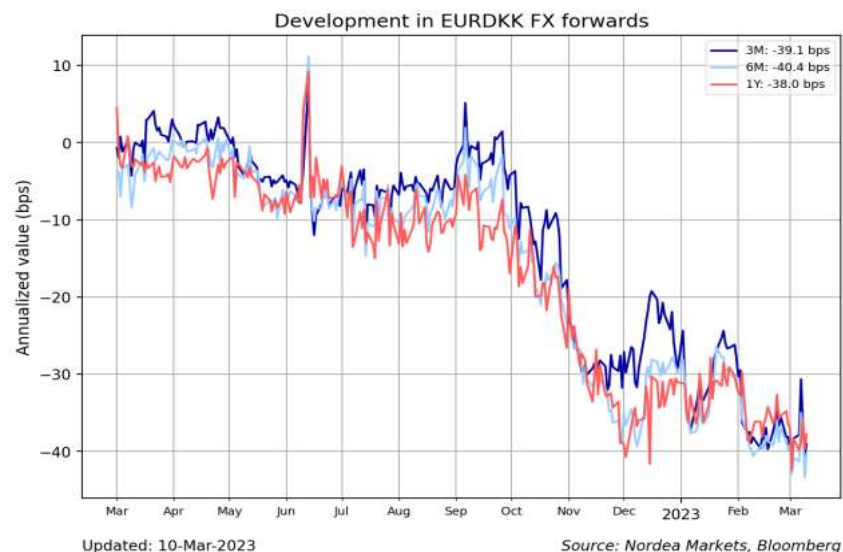
Approaching Q2 with strong DKK increase risk of additional relative rate cuts

- The effect on EURDKK of the 15bp implicit rate cut is now almost vanished. Combining this with normal seasonality of EURDKK – higher towards the end of Q1, where Danish companies pay out dividends, and lower during Q2, where foreign companies pay out dividend - and the high net-position, we have a cocktail that could result in a further expansion of the rate difference to EUR.
- It's our perception that the higher interest rate level combined with the high net-position have changed the reaction function of the Danish central bank such that less FX intervention is needed before policy rates are cut relative to ECB policy rates.
- Currently no relative policy rate cuts are priced relative to EUR (rather the opposite). Thus, betting on an implicit Danish rate cut by paying EUR rates and receiving DKK rates makes sense, for example by buying 1y EURDKK forward or by receiving 1y DESTR-€STR.
- EURDKK FX forwards is adds 40bp to Danish bond yields when seen from foreign investors, which will continue to support the short end of the Danish yield curve. Another relative rate cut in the spring will likely push spreads deeper into negative territory.
- With credit risks picking up from the US side, DKK-EUR xccy basis is likely to move deeper into negative territory. Receive the front in spot or forwards.

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EURDKK FX forwards going lower



Thank you!

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