Nordea XCCY Publication

Q4 Outlook

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Welcome to the Q4-23 XCCY Publication!

Activity since our last publication has continued to be muted with limited issuance in the Scandinavian space. EUR covereds from Scandinavian names have been lacking behind historic behavior, along with continued SSA interest, have resulted in flatter curves and lower levels in NOK & SEK vs. USD & EUR.

Scandinavian issuance in EUR & USD:
Sparebanken Vest (EUR), DNB (EUR), SPABOL (EUR), KBN (USD)
Jyske Bank (EUR), NYK (EUR), Denmark Government (USD), KK (USD)
SEB (EUR), KI (USD), Swedbank (EUR)

SSA Issuance: IDA (NOK)

EUR issuance looks attractive for Norwegian issuers for the tenors 5Y and out (5-6 bps arbitrage ex. costs). However, for Swedish issuers the domestic market remains the cheapest alternative, given continued investor interests.

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!

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EURUSD XCCY: Cheap now, expensive later

We still prefer to receive EUR/USD basis

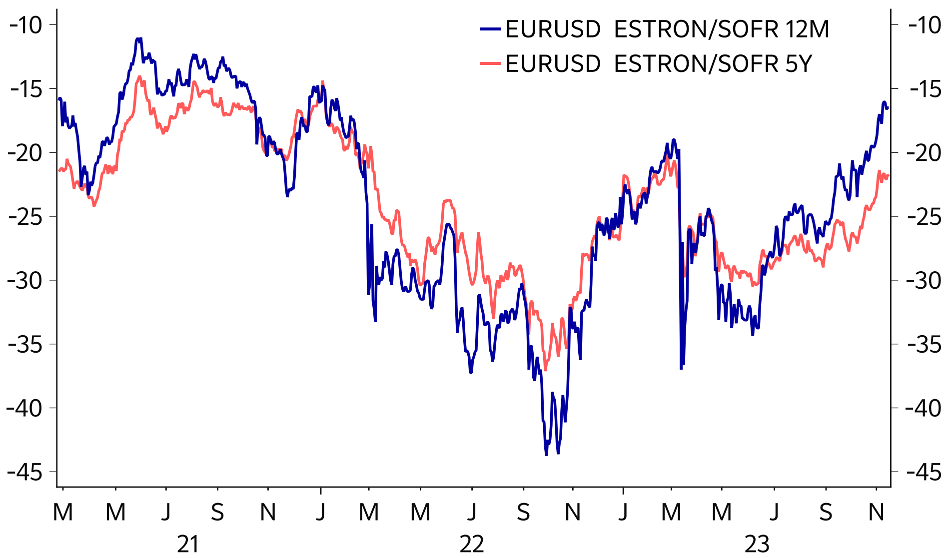
- **Tight EUR/USD basis.** Since July, the EURUSD basis has tightened to its highest level since 2022. In our view, this development primarily reflects higher than expected USD liquidity and falling EUR liquidity, but it also reflects an economic reality that has proven to be stronger than expected. We like to position us for the opposite scenario – worse USD liquidity and weakening economic activity – which raises the probability that dollar funding will become more expensive.

- **EUR liquidity will fall very slowly.** In the next foreseeable future, the only reduction in EUR liquidity will come from the ECBs Asset Purchase Program run-off, which will reduce EUR liquidity by EUR 30bn per month. PEPP run-off could add up to 20bn per month, but only from the middle of 2024.

- **USD liquidity shielded but vulnerable.** Since the summer, USD liquidity has increased because the US Treasury has funded itself by issuing a large amount of treasury bills versus coupons, which has pulled liquidity out of the Fed's Reverse Repurchase Facility (RRP). The problem is that this cannot go on forever. The RRP facility is down to $1tn and the US Treasury has breached its own recommendation of bills not exceeding 20% of the total outstanding debt. The tricky part is that these two forces could keep USD liquidity amble the next couple of quarters, before USD liquidity will inevitably start to be drained.

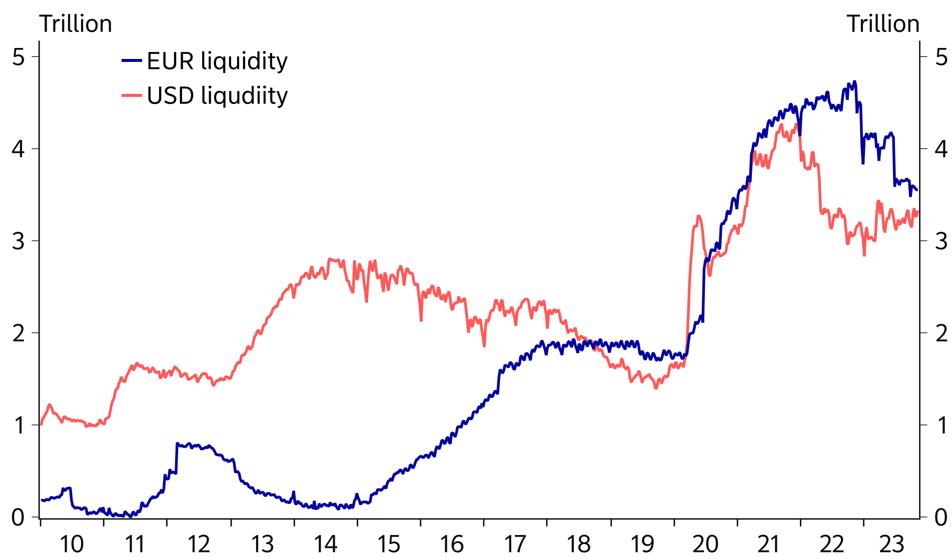
- **Economic outlook is highly uncertain.** We continue to think investors are putting too much weight on a soft-landing outcome at a time when unemployment is starting to tick upwards and interest rates are likely to remain high.

EURUSD xccy basis has tightened significantly across the curve



Source: Macrobond and Nordea

USD liquidity is likely to be the next shoe to fall

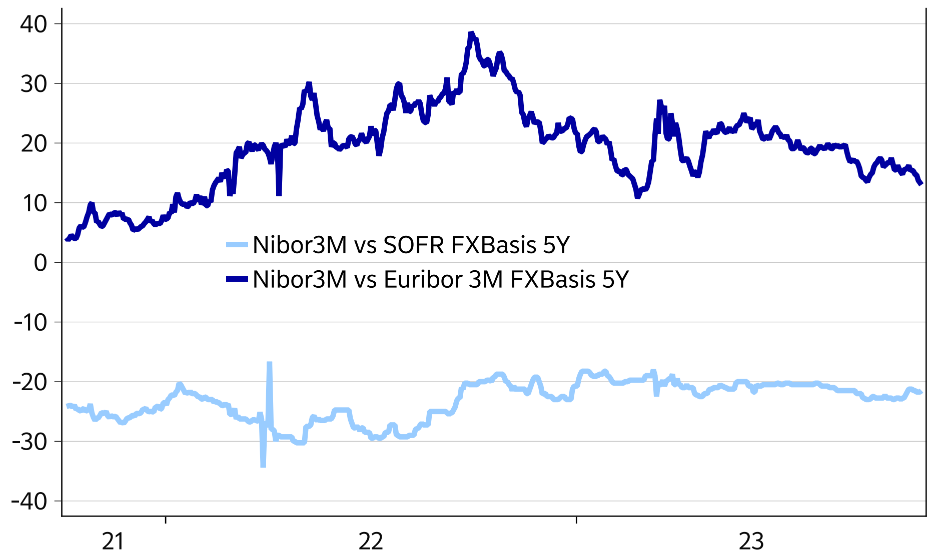


Source: Macrobond and Nordea

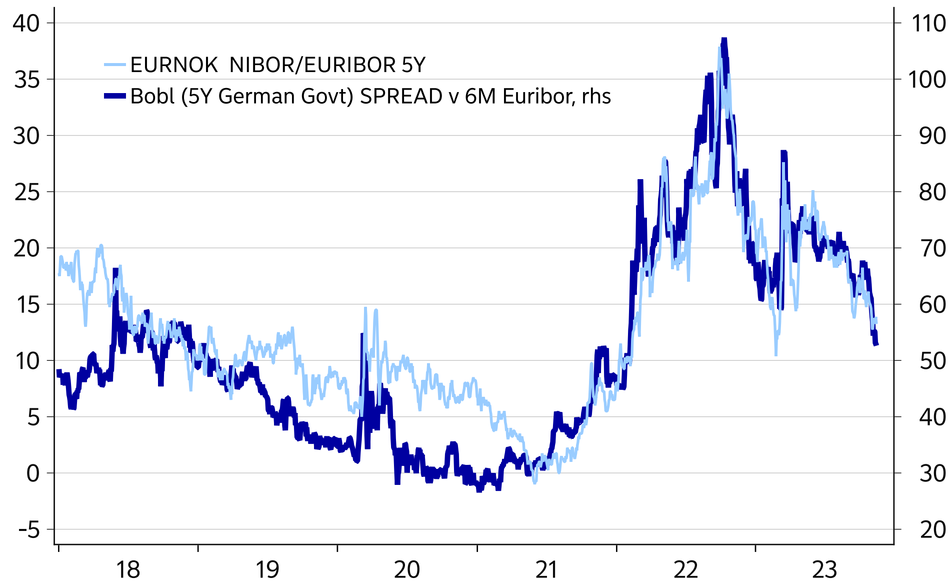
NOK XCCY: ECB policy more important than shrinking EUR covered bond issuance

- It is easy to attribute the 20bp fall in 5Y EURNOK 3M3M basis since the peak 12M ago to the sharp drop in EUR issuance from Norwegian covered bond companies as foreign issuance in NOK has increased over the same period. The 12M net foreign issuance balance has fallen from 400bn in 2019 to about 100bn to date.
- The flipside of lower foreign issuance from Norwegian covered bond companies has resulted in a massive increase in NOK-denominated covered bonds. So far, issuers seem to have little trouble filling up their local auctions. A marked-up and harder to come by NOK repo financing could be warning signs that the market is starting to become saturated, but more expensive repo is normal this time of year with banks less eager to increase their balance sheets before the EOY tally on bank resolution contributions etc. and we believe repo financing will be more ample again once we turn the calendar.
- On the question of EURNOK basis, you are however more likely to find the answer elsewhere. If the move in basis was driven by the shrinking foreign issuance balance, you would expect it to also show up in Nibor-SOFR basis with the EURUSD market easily shallowing the shift in Norwegian issuance. The still very tight correlation to Bobl ASW (vs Euribor) suggests that the main driver of EURNOK basis still lies with the ups and downs of the ECB balance sheet and the availability of EUR AAA paper. Our main assumption is that the ECB will keep shrinking its balance sheet, draining excess EUR liquidity and making more paper available at the same time. This will move the premium on German Government Bonds lower, dragging the EURNOK basis with it also next year.
- Cheaper bobls means less incentive to buy covereds (from foreign issuers) pushing more Norwegian issuance home with less need to pay the EURNOK basis.

Lower EURNOK basis not driven by the NOK leg



German AAA paper ASW a good guide to EURNOK basis since 2020



Source: Macrobond and Nordea

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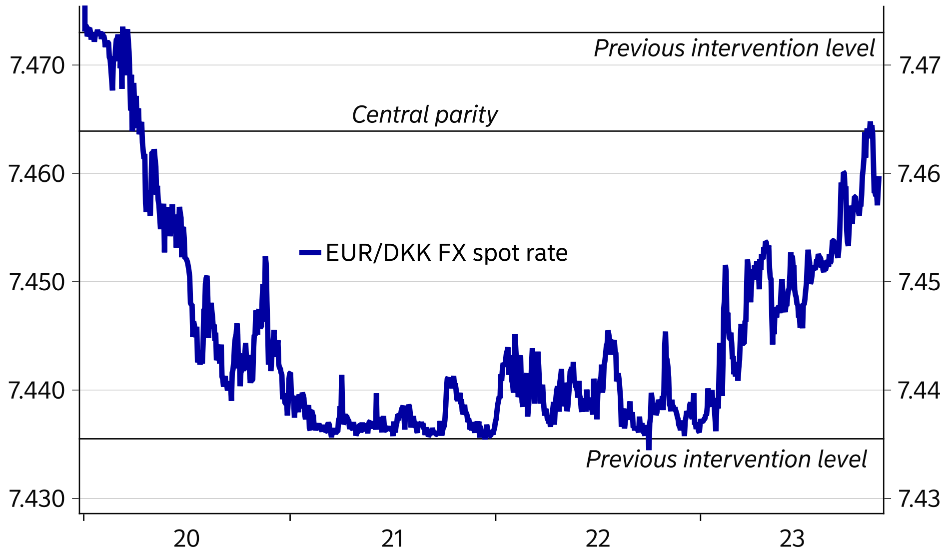
DKK XCCY: Consensus questioned

EUR/DKK FX spot to set direction

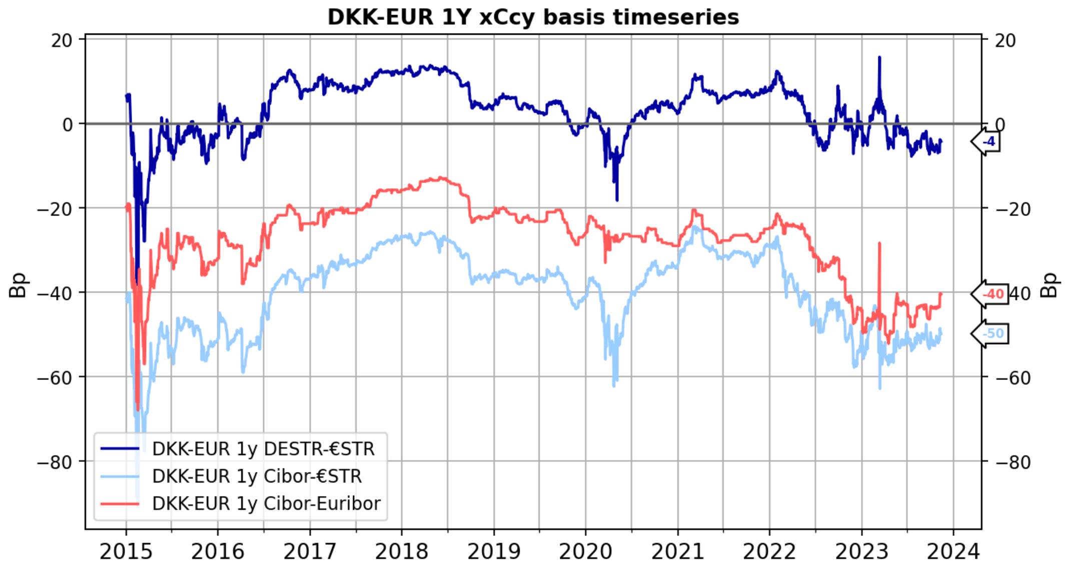
- The EUR/DKK FX spot move higher from recent years' lows is questioning consensus thinking that independent Danish rate cuts are more likely than independent Danish rate hikes from the current -40bp policy rate spread to the ECB. Weakening of the DKK stopped around the central parity so far.
- We expect intervention levels around 7.436 on the lower-end of the corridor and 7.470 on the upper-end. At these levels, FX interventions will start affecting DKK liquidity, measured by the net position.
- DKK liquidity is amble, implying that the central bank's reaction function could be asymmetric. Intervention to prevent a too strong DKK would have little impact on money market rates given that liquidity is already amble and an independent Danish rate cut could in turn follow without much intervention, whereas intervention to support a weaker DKK would bring the net position closer to normal and could in turn be continued for a bit longer before an independent Danish rate hike. We have no independent policy rate changes in our official forecast.
- Swaps have reacted to the FX spot moves, where as FX forwards have moved less. Thus, trades in the direction of the risk of independent rate hikes are better done in FX forwards, whereas trades in the direction of the risk of independent rate cuts are better done in swaps. xCcy is more likely to be affected at the upper end of the FX spot corridor where FX intervention is likely to be larger in case, draining DKK liquidity and making DKK more expensive.

EUR/DKK FX spot



Source: Nordea and Macrobond

EUR/DKK xCcy



Note: DESTR is CITA-19bp before 1 Apr 2022. Source: Nordea Markets

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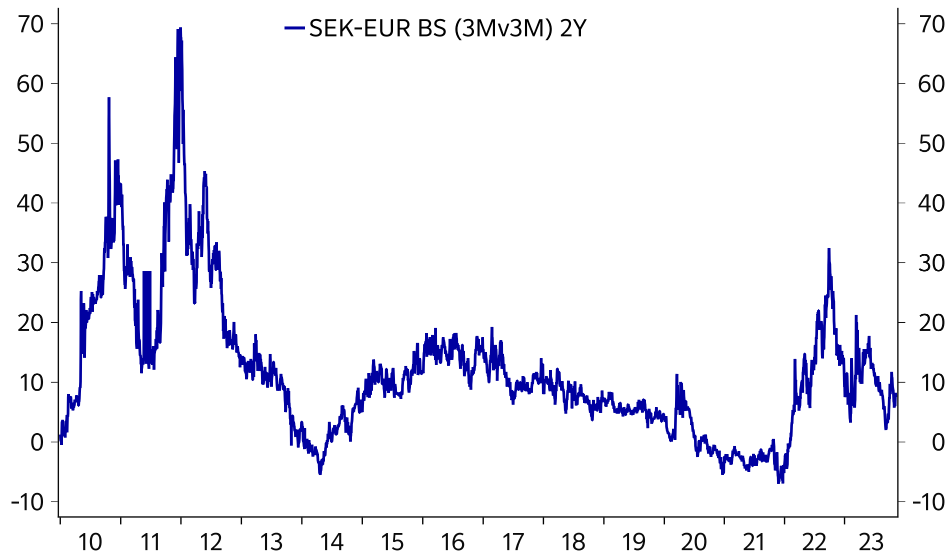
SEK XCCY: Less cash more collateral

- We are seeing a general preference shift from collateral to cash. EUR GC (German and other countries) trading ESTR+3-5bps in short tenors, ~5bps cheaper than 1m ago. The year-end in repo still negative, but collateral is cheaper than observed for many years. The primary driver seems to be southern European accounts chasing repo funding; as repo not included in minimum reserve requirements. For SEK this means that SGB repo rates should go up, however, this might take longer than in the development we've seen for EUR. Studies have shown little price elasticity in the Riksgälden repo facility, which could indicate that the price is too generous. If this holds true, it indicates that clearing price would be below the -30 swap floor without the facility, thus more time and/or QT is needed for the repo pricing to normalize in SEK; but it will happen.
- If we make a historic comparison to a previous episode around 2010 when Riksbanken tightened liquidity, we should see SEK going bid in the XCCY market. A complicating factor however, is that SEK still trades against STIBOR, whereas the theoretical basis (FRA-OIS) would likely widen and thus mitigate XCCY. move up.
- In anticipation/correlation with EUR: all ASWs should cheapen, all else equal, driven by reduced repo squeeze that should drive SGBs cheaper vs. swaps.

EURSEK 2Y spot



Source: Macrobond and Nordea

Asset swap spread

Source: Macrobond and Nordea

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Thank you!

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