FI and FX Daily Brief

Summary

The EUR weakened on a broad basis yesterday, where the focus in the FX market remained on French politics and debt as well as high energy prices. Notably, EUR/USD traded close to the 1.12 level, while EUR/NOK fell to a new low of 10.55. Yields rebounded and the yield curve steepened - a bit more in the US than in Germany and the Scandies. The rates market seems to disregard next week's policy decisions from the ECB and the Fed and remained locked in on possible hikes in December.

Majors FI

Yields rose modestly during the European session, with the 10Y EUR swap around 3bp higher at 3.56%, about the same level at which we closed a week ago. Following the violent protests in France over the weekend, the 10Y OAT-Bund spread widened by about 10bp to 148bp. At the same time, Germany's ASW spreads were close to unchanged. In an interview with Bloomberg, German chancellor Merz commented that a decision to fill upcoming vacancies at the ECB could be reached "very quick" if needed.

During the US session, US yields moved higher across the curve by 6-7bp in the 2Y to 10Y segment of the UST curve. With break-even inflation rising only by around 1bp, the move was primarily driven by real rates. Overnight, AI jitters resurfaced during trading hours in Asia, but USTs have moved sideways.

Today, we will get supply from the UK (GBP 4.25 billion 10Y), Germany (EUR 500 million each in the 1.8% 2053 and 2.1% 2029 maturities) and Finland (5Y and 10Y). In terms of data, we get UK labour market data and Germany's ZEW survey, with the expectations index expected to show a small decline from 34.7 to 30.0, while the current situation measure is expected to rise from -47.1 to -44.5.

Majors FX

EUR/USD declined only modestly through Monday's session despite initially opening sharply lower. That said, the broader market environment pointed towards the risk of further declines later in the week. The OAT-Bund spread widened some 10bp, US tech stocks rebounded and Brent oil price rose back to USD110/barrel. UST and Bund yields rose in tandem across the curve, which meant EUR/USD FX forwards were little affected. 3M cross-currency basis has widened by 1bp since last Thursday.

In broader G10, yesterday's moves seemed to reflect more idiosyncratic EUR weakness, than a typical "risk-off" sentiment. Safe-havens JPY and CHF weakened, while commodity exporters AUD and CAD led the gains. Markets are now pricing up to 84% likelihood that

Bank of Canada will deliver its first rate hike of the cycle next week, up from just 30% last week. The move came after hawkish remarks heard from Governor Macklem over the weekend, and despite slightly softer-than-expected Canadian September CPI print yesterday (3.1% y/y, cons. 3.2%, Aug 3.0%).

Democrats are still seen as the favourites to win majority of both House and Senate in US midterms, which are now just two weeks away. The outgoing Republican congress will have a busy schedule for the roughly 2-month "lame-duck" session between the election date, and the start of the new congress. Republicans will likely attempt to pass through at least the government funding bills for the next year, as well as one more reconciliation bill that could include another increase to the debt ceiling. That said, whether especially the latter passes, is far from certain. We discuss the implications as well as the near-term factors affecting USD liquidity outlook in this morning's Reading the Markets USD - Republican agenda for the lame-duck session, 20 October.

Scandies

EUR/SEK trades around 11.10, USD/SEK around 9.90 and NOK/SEK around 1.05. The small SEK strengthening yesterday, mostly towards EUR, was supported by renewed euro weakness following the weekend unrest in France, alongside a narrowing 2-year rate spread towards EUR.

EUR/DKK opened the week below 7.4750 as the broad weakening of the EUR amid concerns about French politics and debt also weighed on the pair. This effect has countered the effect from higher carry on long positions as the 3M FX forward has dropped below -80 pips - the lowest in about two months. The downwards pressure on FX forwards stems in part from easy DKK liquidity conditions.

Since yesterday, the NOK has strengthened slightly against both the USD and the EUR, although broader FX moves have remained fairly muted. Oil has been the key driver, with Brent remaining elevated but volatile, while gains were capped by the Russia sanctions waiver softening the crude rally.

Tactical views

FX

EUR/USD - On a structurally declining trend

EUR/NOK - Tactically neutral. Strategically bullish.

EUR/SEK - Back below our 1M target, a buy-on-dips from hereon

EUR/GBP - Tactically neutral and strategically bullish

USD/JPY - Looking for strategic selling opportunities

EUR/DKK - DN to cap EUR/DKK around the 7.4760 peak from August

USD/CNY - Tactically sell on rallies, strategically bearish

Fixed Income

Europe - Bund ASW-spreads to tighten

US - 10Y US Treasury yield at 5.20% in 12M

Sweden - Look for SEK underperformance vs EUR

Norway - Look to enter steepeners in the coming month

Denmark - Long high-coupon callables versus DGBs and swaps

Commodities

Oil - to stay elevated near-term on tight supply conditions

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