FI and FX Daily Brief

Summary

Energy prices were on the rise again yesterday, which again benefitted the NOK, where EUR/NOK fell below 10.50. EUR/CHF also dropped as the bearish EUR sentiment grew together with a new rise in the French CDS. EUR/USD also briefly fell below 1.12. Yields dropped across the curve both in US and Germany. Notably, the 10Y US Treasury yield fell below 5% for the first time in a month.

Majors FI

The OAT-Bund spread came under renewed pressure yesterday with the 10Y around 15bp wider, the largest one-day move during the recent episode. The OAT-Bund move also spilled over to Italy, where the 10Y bond also widened by 9bp vs Germany. 10Y Bunds closed 9bp lower, with the Bund ASW trading 3bp richer. The 2Y Schatz yield fell 9bp and Schatz ASW performed 3bp, while the 2Y EUR inflation swap fell by 2bp. Notably, this decline in the front-end happened at the same time as Brent oil rose further to USD 113 per bbl. The risk-off sentiment was reinforced during the US trading hours, with renewed pressure on the AI sector leading to steep declines in USYT yields. Both the 2Y and 10Y UST closed 17bp lower, and the 10Y is now trading below the 5.00% level again. Although it has been an eventful week in markets, the economic data calendar has been thin, and the highlight of the week comes today with the flash PMI releases for the major economies.

Later tonight Moody's have France up for a rating review. Moody's has France on negative outlook and an Aa3-rating, and there is a significant likelihood of a downgrade. Given the spread widening since September, then this is fully priced in as France trades more like a BBB-rated country with a debt-to-GDP ratio above 150%. Hence, a downgrade should not have a significant impact and if Moody's places France on a stable outlook, then the focus on the rating should diminish. Furthermore, France will still be in the major bond indices and eligible for the various collateral pools. Hence, the downgrade should not lead to forced selling. On top of the French Debt Management Office stepped up its purchase of 1Y and 2Y government bonds in September. If this continues in Q4, then it will reduce the redemptions in 2027 and thus the issuance target of EUR 340bn (excl. buy-backs) for 2027 will be reduced. This should be positive for the front end of the OAT curve, where investors could purchase OAT 0.75% 02/28. This has declined some 50 cents since late August and is trading with a cash price of 96.4 (indicative mid-market) and will be part of the buyback from the Debt Office.

If we look at the French agencies (such as Cades and UNEDIC) then they have followed the rating of France. There is a risk that they might lose their HQLA level 1 status if they are downgraded to single-A. This has put additional pressure on the French agencies, as

the loss of the level 1 status and a move to level 2A would imply a higher spread to, for example, OATs.

French covered bonds have also been under pressure, but to a much lesser extent than OATs. Here there is enough leeway between the sovereign rating and the rating of the covered bonds looking at the Fitch and S&P ratings. There is also enough leeway for the private sector French covered bonds relative to the Moody's rating, but Moody's rating of public sector covered bonds could come under pressure. However, there should be enough OC to protect the AAA rating of e.g. CAFFIL. Furthermore, there has been a repricing that takes this into account. Hence, the French covered bonds are cheap relative to peers and here investors can focus on the front end.

Majors FX

Yesterday's combination of broadening cross-asset risk-off sentiment and continuing rise in energy prices set the tone also for FX markets. JPY, CHF, CAD and NOK were the strongest performers in G10, while NZD and SEK underperformed. EUR/USD stabilized just above 1.12 after temporarily trading all the way down to 1.1190.

The 10Y OAT-Bund spread widened to new highs above 170bp, but unlike in early October, the risk-off mood was not contained in just French bonds. Bund and US Treasury yields turned sharply lower across the curves, and in equities, financials and industrials sold off alongside tech. In other words, markets are growing concerned that rising energy prices and tighter financial conditions will eventually have a negative impact on global economic growth, and not just an idiosyncratic effect on select economies or industries. Consequently, markets now price in less than 10% risk of the Fed or ECB hiking rates next week (see our meeting previews for the Fed and ECB).

Front-contract Brent rose to USD113/barrel, the highest since last May, while TTF natural gas reached another YTD high above EUR90/MWh. But as the correlation between EUR short-end rates and energy has weakened, relative rates no longer help balance out the EUR-negative terms-of-trade shock. If energy prices continue rising further, we would expect EUR/USD spot to trade lower from here. We adjusted our 6-12M target down to 1.10 in Wednesday's FX Forecast Update (from 1.12).

EURUSD XCCY widened yesterday - notably the 2Y tenor has dropped to -5bp. The move followed further rise in the French CDS today to around 100bp. The 2Y-5Y part of the basis curve now trades close to the level from the start of the month when the French debt concerns first peaked. The big difference from then is the front end of the curve. The 3M tenor trades around -3bp today compared to -7bp at the start of the month. We expect the basis to widen further, if concerns around France continue to grow.

Scandies

EUR/SEK trades around 11.10, USD/SEK around 9.90 and NOK/SEK around 1.06. SEK weakness yesterday was primarily externally driven, with increased oil prices and the global equity selloff weighing on risk sentiment.

The NOK strengthened yesterday, with EUR/NOK falling below 10.50 for the first time since December 2022. The move was supported by domestic data, as industrial confidence rose to its highest level in six quarters and the trend unemployment rate remained unchanged at 4.6%. Higher oil prices also helped sentiment, with Brent crude trading back above USD 113 per barrel. USD/NOK also fell further, reaching around 9.32 at its lowest. However, the EUR/NOK move was larger than the NOK's gain against the USD, suggesting that euro-specific weakness also played a role. Concerns around France's fiscal outlook and political uncertainty weighed on the euro more broadly, while a risk-off tone supported traditional haven currencies.

Tactical views

FX

EUR/USD - On a structurally declining trend, 6-12M target 1.10

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 - Buy 2Y SGB ASW vs Sell 10Y SGB ASW

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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