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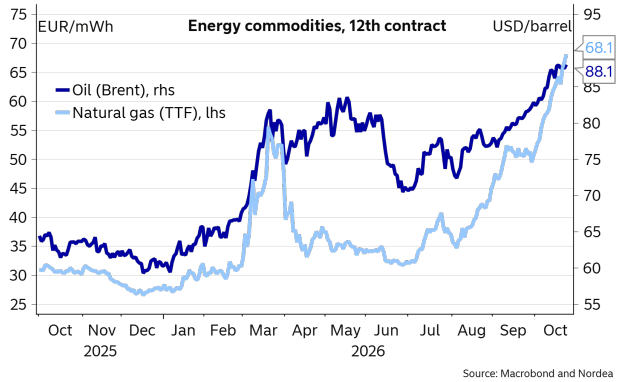
Macro & Markets: French OATs in focus

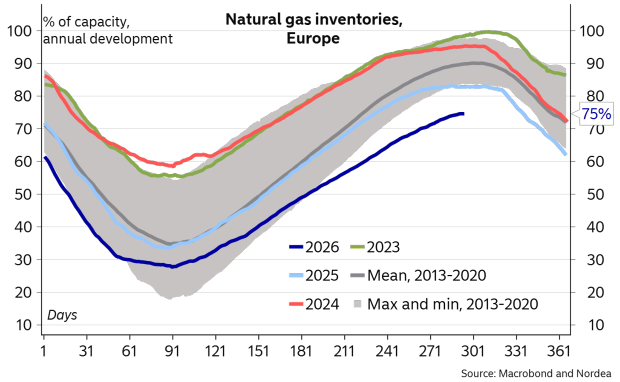
Marketing communication

Joel Lundh

Europe is at the centre of market attention, with French OATs reaching new multi-year highs. While the euro has remained stable, currencies such as the NOK and SEK are being rewarded for their fiscal discipline and low public debt.

In recent weeks, oil prices (Brent) have stabilised around USD 110 per barrel while European natural gas prices have moved above EUR 90 per MWh – the highest level this year. The situation in the Middle East remains fragile with no immediate resolution in sight. The lack of development has also contributed to the 12-month forward contracts rising further across each respective energy commodity. The situation is especially difficult for Europe with a high energy import dependency and lower-than-normal gas inventories for the season. Thus, the risk of elevated energy prices is increasing as we enter the winter season.



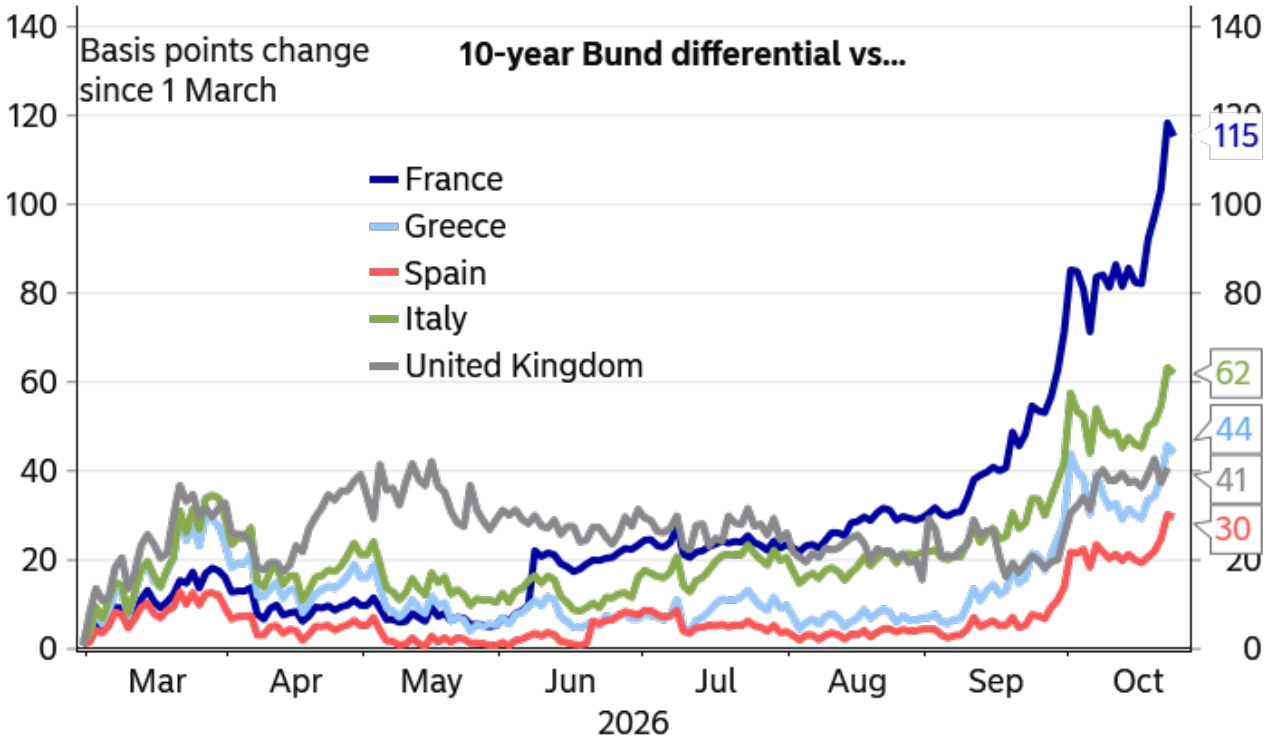


Broader equity indices have been under increased pressure in recent weeks as investors reevaluate the earnings outlook and refinancing situation for tech-related companies. The US Nasdaq100 has declined by 7% since the peak earlier in October, while Asia's Nikkei225 and KOSPI have fallen by more than 10% and 20%, respectively. Volatility, measured by the VIX, has ticked up but remains well in line with its historical average suggesting that the recent decline might only be a temporary correction.

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The movement in equities has nevertheless contributed to a nervous risk-off sentiment in markets with investors increasing their exposure to bonds. Longer-term government bond yields in the US and Germany have declined by 15-30 bp over the same period, albeit from high levels. Shorter-term bonds have moved sideways contributing to a flattening of the yield curve. In Europe, France has continued to be the centre of attention with escalating tensions over the past weekend. Market confidence in French fiscal stability and outlook is quickly fading, illustrated by the 10-year OAT yield, which reached a new year-to-date high above the 5% (5.05) mark. The OAT-Bund spread for the same tenor has climbed by roughly 30 bp over the week to 170 bp. While the bond movement in France is an increasing concern for markets and the ECB, it has mostly remained in isolation compared to other European countries. We'll cautiously await Moody's updated review of France's sovereign credit later tonight – a downgrade could potentially trigger another round of bond sell-offs.



Source: Macrobond and Nordea

It's been a quiet week for the US dollar index which has moved sideways despite higher commodity prices and risk-off sentiment. Market attention has been on the euro which has depreciated against other European currencies while it has held steady against the USD. The move has been more pronounced towards markets with low government debt, rewarding the NOK, SEK and CHF. The GBP has also appreciated on the back of hawkish inflation and labour-market data, in line with our call, but also for showing greater fiscal prudence compared to France.

The development over the last week does not materially change our baseline forecast, and we continue to see more room for the USD to perform. With regards to the ECB, further deterioration in sentiment around France

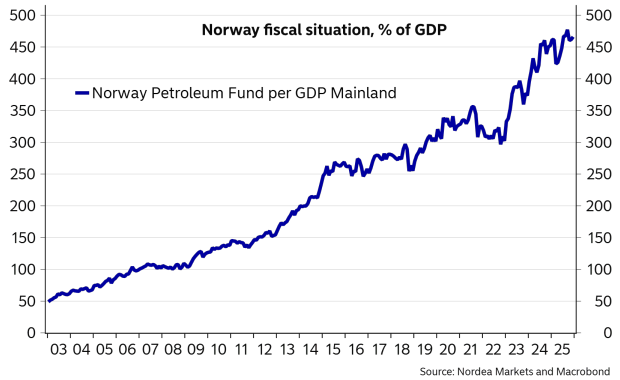
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may dampen the central banks hiking mood. However, higher energy prices will continue to put upward pressure on the inflation outlook.

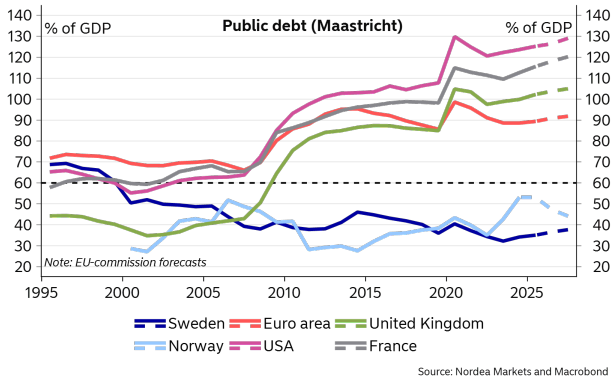
Thematic: Scandies as safe-haven currencies

With the renewed focus on global debt and unsustainable fiscal outlooks, the NOK and the SEK have emerged as attractive safe-haven options in the FX- market. Here we outline the structural advantages for both economies in the short and medium term.

The fiscal situations in Sweden and Norway are a definitive advantage, clearly standing out among their European peers with low public debt. This should offer further support for both currencies in the short run, especially if the situation in Europe worsens. In the medium term, stricter national fiscal policy frameworks coupled with the lower debt levels also increase the likelihood of the Nordics to implement the necessary investments towards defence, infrastructure and energy without markets losing confidence in the public finances.



Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

The GDP gap is at similar levels between Sweden and Norway, but the growth outlook varies between the countries. Sweden is expected to outperform going forward with an estimated GDP growth at around 2-3% year-on-year between 2026 and -2028. The corresponding growth in Norway is estimated at around 1-1.5%, according to Nordea's forecast. This puts Sweden at a slight advantage compared to Norway in the medium term. However, markets have largely neglected the better macroeconomic scorecard in the Nordics this year, unless it has translated into tighter monetary policy.

The inflation outlook has contributed to a widening policy rate differential between Norway and Sweden. Norges Bank has on the back of elevated inflation, hiked twice this year by 25 bp, in May and September, bringing the policy rate to 4.5%. The Riksbank, on the other hand, has left the policy rate unchanged at 1.75% due to low inflation. We expect the policy rate gap to narrow starting in November as the Riksbank begins its hiking cycle. For next year, inflation may very well turn out higher than expected which poses upside risks to our call for the Riksbank. This could warrant a higher policy rate than we currently expect, 2.25% at year-end 2027, which ultimately should further support the SEK. In the long term, Nordea assesses the neutral rate for both economies to be higher, roughly 1 percentage point, than currently communicated by the central banks. The Riksbank estimates the median neutral rate at 2.25% and Norges Bank at 3.0%. Our call for the neutral rate should be an additional factor supporting especially the NOK in the medium term, while a Riksbank

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policy rate at 3% can be restrictive in Sweden in the shorter term due to the upsurge in household debt over the past 30 years.

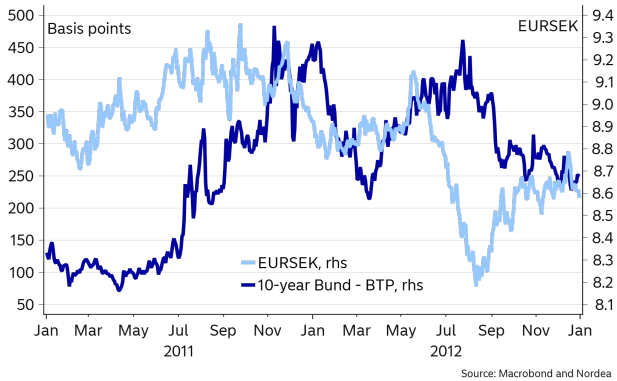
The main advantage for the NOK as a safe haven over the SEK is the correlation with commodity prices. This year the NOK has benefited from being an oil and a geopolitical hedge, strengthening around 8% against the USD and 16% against the SEK. The risk scenario with regard to the situation in the Middle East is therefore twofold for the Scandies, with the SEK benefiting from a settlement and the NOK benefiting if the conflict persists.

One drawback for both the currencies is the sensitivity to market volatility. Historical data clearly shows that whenever equities sell off and the VIX surges, investors reallocate from the NOK and SEK into the major currencies.

What would be a potential roadmap for the Scandies in the event of a new euro debt crisis? For the NOK and SEK, we'd likely see two stages – first depreciation, followed by appreciation. The depreciation would stem from the initial risk-off reaction and higher volatility. In that scenario, the ECB would intervene in the bond market and most probably lower the policy rate, but to which degree may depend on the inflation outlook. Once the dust settles, interest rate differentials and confidence in Nordic public finances should make the SEK and NOK attractive options, strengthening both currencies. A review of the events of the 2012 euro crisis reveals some parallels. The SEK and the NOK remained largely stable during the first spike in bond spreads between Germany and Greece/Italy. VIX also surged, but once it fell back in late 2011 the SEK and the NOK started strengthening. The second round of NOK and SEK strengthening came over the summer during the second spike in bond spreads. VIX remained low, but the massive inflow into CHF assets resulted in the SNB buying foreign currencies to defend the FX- floor. Consequently, the SEK and NOK strengthened between 5-10% from top to bottom between May and August 2012. The SNB abandoned its EUR/CHF target in 2015 making a similar intervention less likely if the same crisis- event were to occur again.



Source: Macrobond and Nordea



Source: Macrobond and Nordea

Week ahead

The focal point in the week ahead will be the interim monetary policy meetings of the Fed, ECB and Bank of Japan. None of the central banks will update their economic projections, hence the press release and conference will be the important communication channels. Markets have scaled back expectations of back-to-back rate hikes despite hawkish inflation prints and higher energy commodity prices. The central banks will, however, signal readiness to further tighten monetary policy with a focus on the upcoming meetings

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in December. Both the Fed and the ECB are expected to hike in December, according to Nordea's forecast, bringing the policy rate to 4.25% (upper bound) and 2.75%, respectively.

UK Chancellor John Healey will present the Autumn Budget Bill on Wednesday 28 October. The challenge for the government will be to avoid surprising markets and to display fiscal discipline with the ambition to lower the budget deficit without raising taxes to such an extent that will hamper economic growth. The fiscal headroom for the government has been greatly reduced by higher interest rates and inflation over the past six months. This limits the fiscal scope, and if markets are dissatisfied with the measures presented in the budget, both gilts and the GBP could come under increased pressure.

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