FI and FX Daily Brief

Summary

The 10Y OAT-Bund spread tightened yesterday, with spillover effect to other EGBs. Meanwhile, the flattening of both the US and German yield curves continue. Despite the slight easing of fiscal tensions, within FX the main concern remains the rise in energy prices and as such EUR/USD ventured below 1.12 again, whilst NOK also saw strong performance. Meanwhile, EUR/SEK remains close to our 1M target at 11.10 and continues to be dominated by the EUR-leg rather than Krona-specific developments.

Majors FI

There was a solid rally in French government bonds yesterday on the back of the unchanged rating from Moody's on Friday last week. The 10Y OAT-Bund spread tightened some 13bp to 155bp. There was also a spillover effect to other EGBs and spreads tightened to Bunds for most of the periphery and semi-core bonds. Furthermore, German ASW-spreads tightened However, there is still room for more convergence, but here we need more information on the budget negotiations in France.

We still like the front end of the French government curve as well as French covered bonds and given the outright level for yields. Yesterday's French T-bill auction was also well received by the investors with a solid bid-to-cover especially in the longer-dated T-bills. The next French government bond auction will be next week, where the Debt Office is expected to tap up to EUR 14bn in long term bonds (+10Y).

The flattening of both the US and German yield curves between 2Y and 10Y continue. Hence, we keep pricing in the hikes from both ECB and the Federal Reserve given high oil prices and resilient economies. Hence, there will be full focus on the direction for monetary policy and if the flattening tendency will be maintained. We are more biased towards a steepening of the curves especially in the Eurozone given there is too much priced in for ECB.

Today, Germany will tap EUR 6bn in the 2Y benchmark Schatz 3% 2028, but Netherlands has cancelled their optional bond auction today. Italy will sell EUR 1.5bn in linkers and EUR 2bn in a 2Y benchmark. The primary market is also ongoing with European SSAs such as the City of Hamburg yesterday selling a new 10Y green bond which was met solid demand and a small NIP for the investors. Today, we have another Lander as the State of Thuringia is coming with an 8Y benchmark.

The Debt Office at Norges Bank announced a NOK 2bn tap in the 3Y and 10Y benchmarks for Wednesday. Hence, the Debt Office continue to tap in the 10Y benchmark despite the solid performance in the 10Y ASW-spread. The front end of the ASW-spread curve has

also performed despite the certificates auctions that was supposed to drain liquidity and thus make the bonds cheaper versus swaps. However, this has not happened which we attribute to the outright level in the front end of the NGB curve, which is attractive.

Majors FX

In broader cross-asset markets, Monday marked a partial reversal of the tensions seen at the end of last week. The OAT-Bund spread tightened, short-end swap rates rose on both sides of the Atlantic while tech and industrials led the recovery in equities. But in FX markets, the main concern appears to be the ever-continuing rise in energy prices. NOK, CAD and USD led the gains in G10 yesterday, and EUR/USD traded down below 1.1180.

The EUR/USD FX forward curve has inverted again during October as especially the 2-5-year tenors have declined despite the modest widening of the XCCY basis. This reflects markets pricing in relatively faster inflation in the euro area as energy prices are rising, while the real rate spread has remained essentially unchanged over the past couple of weeks. This helps explain why the seemingly EUR-positive shift in (nominal) relative rates has not provided support for the spot rate. Euro area's terms-of-trade are currently at the weakest level of the year, as natural gas prices have risen well above spring levels.

But in this week's Reading the Markets USD, we focus on the US inflation outlook. We discuss, what changes Kevin Warsh's inflation task force could deliver for US monetary policymaking over the next few months. See also our full preview for tomorrow's meeting (22 October).

Scandies

The krone strengthened further yesterday and has gained against all G10 currencies since Friday, most notably versus JPY and least versus USD. While there was no obvious single catalyst, the move coincided with firmer energy prices, with TTF rising to its highest level since 2022 on low storage levels, colder weather forecasts, supply disruptions in Norway and tighter LNG availability, while Brent also moved higher, albeit ending below its intraday highs. In EUR/NOK, the move may also have been helped by euro-specific concerns, including continued uncertainty around France's fiscal outlook. Overall, NOK strength appears consistent with supportive energy-related developments, some EUR softness and positioning rather than one clear domestic trigger.

EUR/DKK remained below 7.4750 yesterday amid a small relief in the EUR market after Moody's refrained from downgrading France's credit rating on Friday. The concerns around French debt and politics have contributed to easing the upwards pressure on EUR/DKK during October. If the market calms further, we see potential for EUR/DKK to rise back towards the 7.4760 ceiling again and vice versa fall towards the recent 7.4734 low if worries reignite.

The Swedish krona started off the week by trading weaker, with EUR/SEK edging higher to a mid-afternoon peak just shy of 11.15. However, during the latter part of the session we saw a complete reversal and are now back at where we started the week. Once again, looking at across SEK-crosses, the moves in EUR/SEK seem more related to the EUR-leg rather than being an expression of the Krona's outlook. With no important domestic data until Thursday, the Krona will continue to trade primarily on global developments, and we expect broad SEK to linger around current levels for now.

Tactical views

FX

EUR/USD - On a structurally declining trend

EUR/NOK - Tactically neutral. Strategically bullish.

EUR/SEK - Back at 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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