Nordea

FX Strategy

Global FX Strategy

EURUSD will fall.. If US falls

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EURUSD – The word is not enough

As a baseline, expect the EURUSD, maybe after a temporary correction (maybe to 1.3650-3700), go back to 1.3950 and ultimately above 1.40. The speculative positioning in EUR is neutral, but the predominant view among economists and analysts is still "sell EURUSD". The move above 1.40 will be unprepared for by many – and likely not pleasant (volatile).

GBP – Can it live up to expectations?

The GBP seems to have hit peak levels against most peers, maybe except for the USD. The important labour market report will be published on Wednesday – Expect the strong downtrend in the number of jobless to continue, but it is probably not enough to move the GBP significantly higher.

CHF – Where tail risk is priced

Whereas some of the fall in EURCHF for the last part of 2013 could be explained by euro weakening from ECB cutting rates that cannot explain the continued move in the beginning of 2014. Neither does pure risk aversion seem to be the reason behind the strong CHF for now.

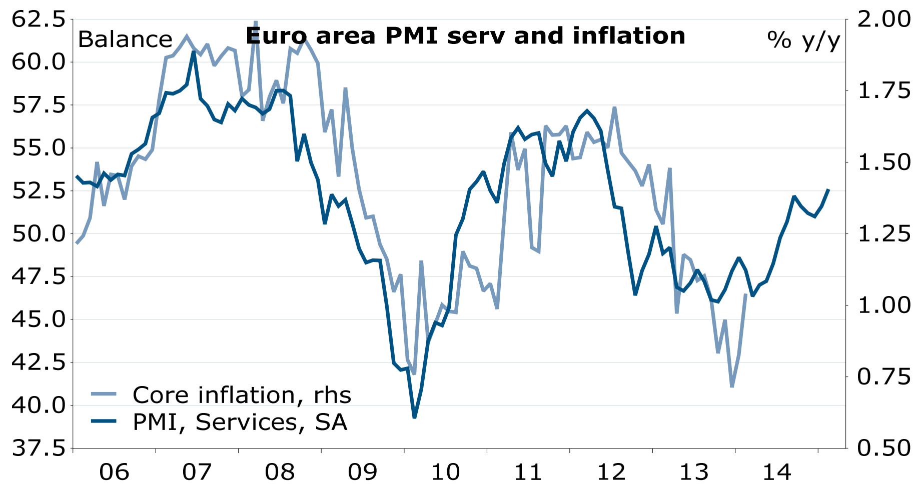
Sweden – Momentum to build up in SEK

We see EURSEK weakening into the summer due to positive macro momentum and possible flows connected to a Volkswagen/Scania deal.

Norway – Investments leaving Norway

EURNOK strength is not over yet – both a weak Norwegian flow picture, as well as negative surprises to Norges Banks forecasts will weigh on the NOK.

Chart of the month – Will the strong EUR end this pattern?



Source: Nordea Markets and Reuters Ecowin

Contents

Global Markets - overview

Macro

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US: spring is not here yet

Fed stays the course – it's the weather, stupid

Recent indicators suggest that US real GDP is on track for about a 2% rate of growth in Q1. This is actually not bad considering the weather. We continue to expect activity indicators to snap back once the weather normalises, but it might still take a few more weeks before this is generally reflected in data releases. The 175k rise in payrolls in February, despite a clear drag from the weather, was obviously encouraging and it more or less seals the case for the Fed to continue tapering its monthly bond purchases by USD 10bn, to USD 55bn, at this week's FOMC meeting, which concludes on Wednesday. It is also likely that the Fed will replace its threshold forward guidance with a qualitative approach, referring to a wider range of labour market indicators along the lines of the BoE. A move to qualitative guidance will make the so-called "dot chart" with each FOMC participant's projection of the appropriate funds rate path even more important for the markets. However, we expect no major changes to the dots at this week's meeting.

Euro area: Low inflation continuously a worry

Strong euro, low infation

Sentiment indicators suggest that in Q1 growth continued to the tune of 0.3% q/q. Retail sales started strongly into the year and industrial production is still on an upward trend in our view, despite the slight fall January. Meanwhile the euro has reached a 2½-year high against the dollar. On a trade weighted basis, the euro gained 10½% since Mario Draghi's "whatever it takes"-speech in July 2012. We expect headline inflation to bottom in March at 0.6% or 0.7% y/y. However, an even stronger euro could easily lead to even lower inflation rates in the summer half-year. ECB Governing Council members may well stress that they consider deflation risk to be limited. And to some degree, very low inflation rates reflect the unavoidable internal devaluation in troubled euro countries. But still, as long as inflation does not move at least a bit closer to the ECB target, there will be pressure on the ECB to do more. That pressure will increase if we get indications that the strong euro – or other factors like the Ukraine/Russia crisis – take a toll on growth.

Chart1. US labour market is basically fine

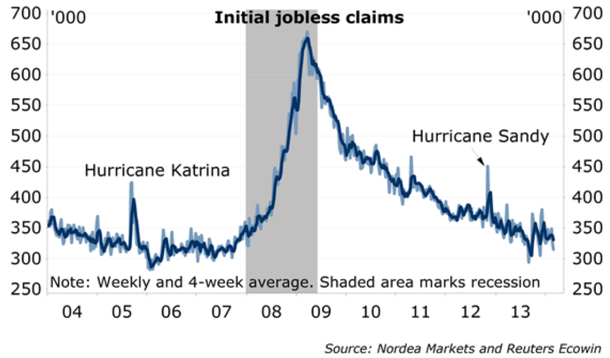

Chart 2. Euro gaining strength

FX Overview: The goldilocks against USD

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The USD has taken another turn lower…and likely not the last: expect the EURUSD to keep edging higher on complacency, lack of volatility, lack of commitment, and hope. The underlying theme: US data is weak, but it's mostly due to weather. We will not find out the truth until April/May – and only if US keeps disappointing then, the EURUSD will turn lower together.

Against most peers peak levels seem to have been reached for the GBP, but more upside cold be in the cards against the USD. The labour market report from UK is out this Wednesday, and even though we think that the downtrend in the jobless rate will continue, it will probably not move the GBP a lot higher, except for just around the publishing time. The Bank of England (BoE) has moved from quantitative to qualitative forward guidance, which is why the unemployment rate is far from a stand-alone indicator of the timing of the first hike. Indicators such as productivity growth and wage growth are also of great importance to BoE, and here the real data has a lot of ground to cover before reaching the forecasts from the central bank.

Over the last months CHF has strengthened on a trade weighted basis to levels not seen since the 1.20 EURCHF floor was imposed. With peripheral spreads back to almost pre-crisis levels it is clear that something else is driving the Swiss currency for now. Whereas some of the fall in EURCHF for the last part of 2013 could be explained by euro weakening from ECB cutting rates that cannot explain the continued move in the beginning of 2014. Neither does pure risk aversion seem to be the reason behind the strong CHF for now.

In Scandiland, we see a weaker Norwegian economy than Norges Bank and a negative flow picture the coming months. Swedish macro momentum could gather further pace heading in to the summer, and with a possible Volkswagen acquisition of Scania, that could be the main trigger of rather substantial SEK purchases leading EURSEK to levels around 8.70. This off course leave risks tilted to the downside for NOKSEK, also if you look at the pure technical/quantitative picture.

Chart 3. US: Weather, oh really? Coming months will tell

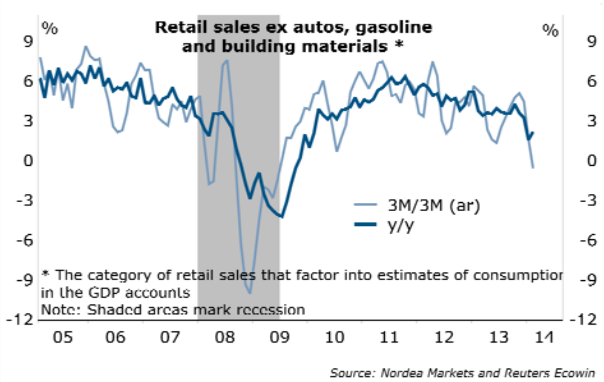

Chart 4. Foreign deposits have increased in CHF

EURUSD – the word is not enough

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EURUSD will fall…if US falls

As hinted last month (*"EURUSD - toward 1.40"*), a benign relatively low volatility environment with the hope that the US data weakness is temporary, has brought the EURUSD up, almost to the projected level (1.3967). What's next?

The data from the US remains key for the EURUSD, since so many hopes have been pinned on the strong US recovery this year, and that's why ultimately haven't seen a large correction in major stock indices yet. So far, the data has been a mixed bag: payrolls not a disaster, but total earnings growth decelerating, and retail sales momentum is weakest since…2008 recession (*Figure 1*). It is partly weather related, but to which extent, we will only find out in April/May. If US data keeps weakening in Q2, then the EURUSD could take a sharper turn lower. But that's not our economist's official view. Contrary to the common understanding, the best chance for the US dollar to strengthen is if/when we begin to talk about the USD recession again. You can read more in my latest piece (USD (Hi)Story: bottom?).

ECB talks the talk…

Meanwhile, the ECB have revealed the estimate of currency effects on inflation: *"each 10% permanent effective exchange rate appreciation lowers inflation by around 40 to 50 basis points* ". Draghi's comments a week after the ECB meeting have been taken by markets gleefully as an attempt to bring the EUR down. But in order to.keep the EUR from strengthening, talk is not enough: ECB need to walk the walk – a deposit rate cut, which we are not going to see unless EURUSD moves well above 1.40, if at all. Not only the level, but the speed of the change happens and, even more importantly, the macro environment in which it happens. So far, inflation has been stably low (bottoming out), and the survey/sentiment indicators have been trending up, justifying the "do nothing" stance from the ECB.

As a baseline, expect the EURUSD, maybe after a temporary correction (maybe to 1.3650-3700), go back to 1.3950 and ultimately above 1.40. The speculative positioning in EUR is neutral, but the predominant view among economists and analysts is still "sell EURUSD". The move above 1.40 will be unprepared for by many – and likely not pleasant (volatile).

Chart 5. US: weather, really? Coming months will tell

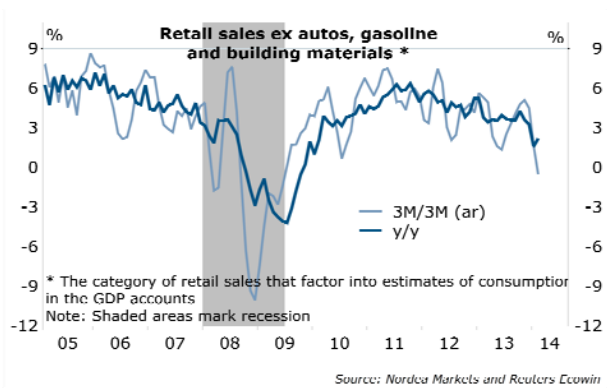

Chart 6. Euro area inflation…will EUR stop this?

GBP – Can it live up to expectations?

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More upside versus USD, but take care against EUR

The 7% unemployment threshold will be breached soon

The labour market report is out this Wednesday from UK. This is of course one of the key figures that have received the most attention as of lately due to the 7% unemployment threshold that BoE set up as part of their forward guidance scheme. The latest job report marked a slight setback, as the unemployment rate ticked up to 7.2% from 7.1% - Most indicators though point to this being an isolated incident, hence expect the jobless rate to drop again this week. Two of the most solid indicators of the unemployment rate, the claimant count and the consumer survey on expected unemployment over the next 12 months point at something around 6.7 to 6.8 % within a reasonably tight time horizon. So with that in mind, why would we still be a bit cautious on the GBP?

From quantitative to qualitative forward guidance

The soft indicators that really matters for BoE, may actually surprise on the downside of expectations.

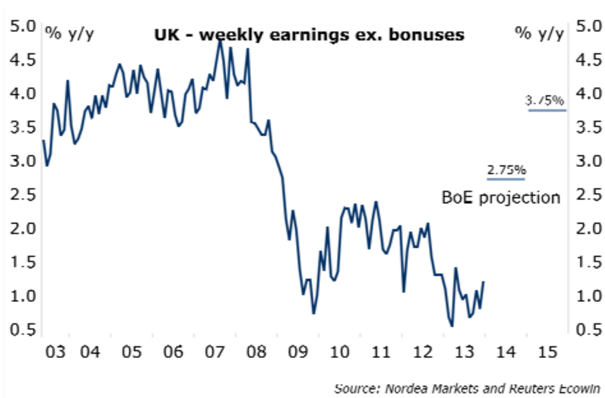
There are two major reasons why the unemployment rate does not remain an extremely significant factor in terms of the markets pricing of the BoE's rate path. First of all, it seems widely acknowledged that the threshold will be broken rather sooner than later, and secondly the latest inflation report from BoE marked a move from quantitative to qualitative forward guidance. The unemployment rate is not what really matters for BoE now. What they are really after is growth in both productivity and wages. And especially for wage growth, they actually price in a rather large jump. Even though wages have slowly started to move up, the risk for wage growth not meeting the forecast from BoE seems large. And therefore one of the indicators that now really matters for the BoE in terms of timing of the first hike, may actually surprise a bit on the downside, to what both BoE and the markets price in. Wage growth will most likely eventually come, if the labour market continues at the same lightning pace, but it will come later than forecasted.

Technically speaking

EURGBP has broken a long-term downtrend, which could leave more room for the upside. Currently the 200-day moving average is the next major resistance level around 0.8423. Support could be found around 0.8266. In terms of GBPUSD more upside towards the 1.689 area could be in the cards. So far a few small attempts to the downside have found support at the 50-day moving average, currently residing around 1.655.

Chart 7. 7% unemployment threshold soon to be broken

Chart 8. Still a long way to go for the wage growth



CHF – Where tail risk is priced

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Over the last months CHF has strengthened on a trade weighted basis to levels not seen since the 1.20 EURCHF floor was imposed. With peripheral spreads back to almost pre-crisis levels it is clear that something else is driving the Swiss currency for now. Whereas some of the fall in EURCHF for the last part of 2013 could be explained by euro weakening from ECB cutting rates that cannot explain the continued move in the beginning of 2014. Neither does pure risk aversion seem to be the reason behind the strong CHF for now.

During the heights of the European sovereign debt crisis in 2011(when the floor was imposed) VIX was rather steady around 30. Despite the tensions surrounding the Crimea crisis, VIX still trades within the 2013 range. VIX and equities at current levels suggest investors for now give a rather small probability for the East/West standoff to escalate into a military conflict. Instead, investors seem to flock into the franc to hedge tail risk. Likely it is not only tail risk surrounding the Ukrainian/Russian crisis, but also risks around the soft patch seen in the US data and EM/Chinese growth that make investors escape into the Swiss haven. Such flow can be seen in increasing foreign deposits at the Swiss central bank during the beginning of the year, see Fig 9. Also domestic banks' and institutions' deposits with the SNB have been rather flat for the beginning of the year, indicate that funds are not moved abroad in search of higher yields. Indeed, a resolution to the Russian/Ukrainian crisis and a pickup in Chinese and US growth will most likely spur the upside in EURCHF, and that lies within our main scenario. However, there are actually some arguments to go against this for now and sell the cross to hedge tail risk. In addition, a not so discussed topic is how other countries will view SNB intervening in the currency market going forward. As long as the European crisis was on top of the agenda this somewhat justified the floor. But when global focus now has moved towards fighting deflation, the EURCHF floor, might not be that political correct.

A lottery ticket would be to buy a sub 1.20 EURCHF put, as such would benefit if a new test of the floor is made on increased risk aversion. EURCHF risk reversals have lately moved down, suggesting a higher probability for a move towards/below the floor is priced.

Chart 9. Foreign banks' deposits have lately increased, according to the SNB

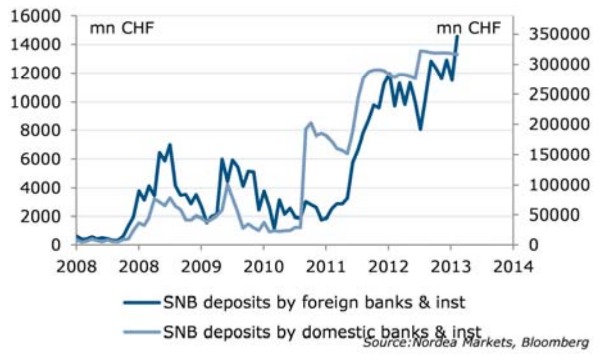

Chart 10. Volatility usually falls when EURCHF moves down, expect the opposite if the floor is tested

Scandi Corner

Sweden – Recovery but low inflation

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After a sluggish start to 2013 the Swedish economy began to recover in the latter part of the year. Domestic demand accelerated at a rapid pace whereas exports were subdued also towards year end.

This recovery continues at a good pace this year. Low interest rates and an expansionary fiscal policy line provide stimulus to the economy. Growth is moreover strengthened when global demand and exports regain momentum. With robust growth, the labour market will improve further.

Households are the main growth driver of the economy. Inflation is low, incomes are growing rapidly and household wealth has improved via higher equity and home prices.

Inflation to rise gradually

Rate hike before year-end

As improvements in the labour market take hold, inflationary pressures will increase, albeit slowly. As from H2 2014, CPIF-inflation will start rising from the current low levels. With healthy growth in the economy, the housing market heating up and somewhat higher inflation, we expect the Riksbank to raise rates before year-end 2014.

Riksbank's rate decision next key event

Inflation is currently the focal point for the Riksbank. In February, CPIF-inflation stood at 0.4% y/y, 0.1% point below the Riksbank's forecast. Notably, CPIF excluding energy was spot on the Riksbank's call at 0.8% y/y.

Riksbank will keep near term easing bias.

There are no additional inflation readings ahead of the Riksbank's monetary policy meeting April 8 (announcement April 9). The Riksbank will most likely stay on hold, but. may revise down the near term inflation forecast as electricity prices have fallen. This should in turn mean that they will keep the near term easing bias in the rate path.

As for key figures, the current recovery should be reflected in the data releases in the coming weeks. Sentiment for households as well as companies should remain relatively positive (figures out March 26). We will also monitor closely the trade balance (March 26), household credit growth (March 27) and retail sales (March 28), all for February.

Chart 11. Inflation to rise later this year

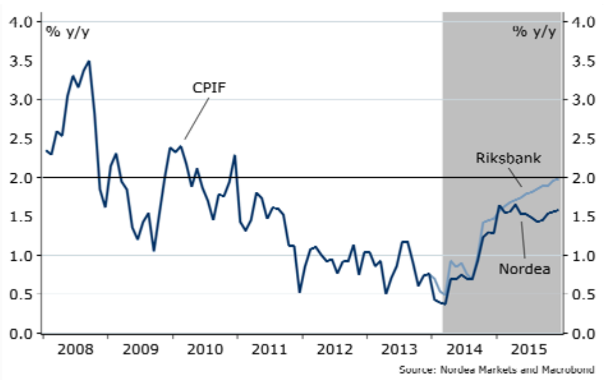
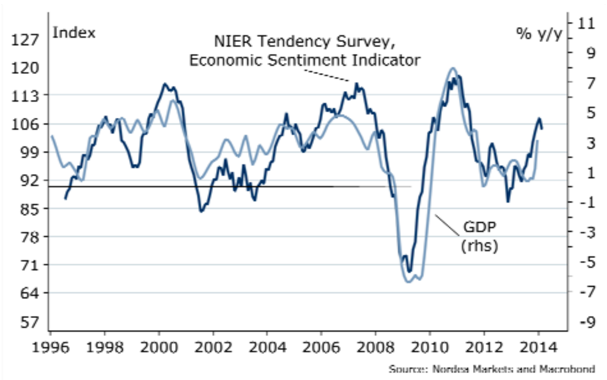


Chart 12. Improved sentiment point to higher growth



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EURSEK – Scania to support the SEK?

Short-term we see a range-bound EURSEK, 8.80 – 9.00. We find arguments supportive of a slightly stronger SEK and see no obvious reason why the spot should cross 9.00 again. The macro momentum is still in favor of the krona and the surprise index has not reached its cycle high just yet. Although therein lies a small problem: It seems as if the FX market currently is more sensitive to favorable Swedish data than the interest rate market. An appreciation of the SEK would be more reliable if the macro momentum set its mark on short rates. Buyers of USDSEK at present low levels could also serve as a trigger for a slightly higher EURSEK short term.

The potential sale of the national champion Scania is an option worth considering

But the potential sale of the national champion Scania is an option worth considering. Volkswagen's offer to buy the remaining stake in Scania at 200 SEK/share, or 6.7 billion EUR in total, opens next week and will expire April 25. The question is how much will go through the market. According to Volkswagen, around five billion euro will be raised through issuance of preferred shares and hybrid capital and two billion euro will be drawn from Volkswagen's ample cash reserves. Even if the latter consists of some SEK, the issuance of new securities suggests that exchanges are to be made. As for Scania's approximately one billion euro cash reserve, these are likely to contain some SEK as well. Unless Volkswagen gets 90% of the shares, the deal will not be finalised. However, with the share trading above SEK 195, a high probability is given for the deal to go through, even if some minority share owners have declared that they will not participate. All in all, news of the Volkswagen/Scania deal going through will likely support SEK in the coming month.

A sharp move lower in stocks would naturally be pushing the krona away from our forecasts

The last couple of weeks have also been overshadowed by another theme, the tension in Ukraine. This has raised the question; what would happen to the SEK in case of sudden bursts of risk aversion and sharp equity sell-offs? Historically, these periods have been associated with a weaker krona. However, in calmer periods the currency correlates only weakly with equities. Thus, a sharp move lower in stocks would naturally be pushing the krona away from our forecasts. But a more gradual softness would not necessarily mean EURSEK should move higher. During the past year EURSEK has in fact been surprisingly weak, considering the strong equity rally.

Chart 13. EURSEK and stock market correlation

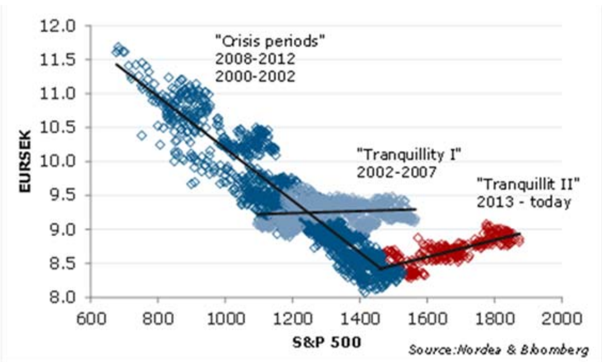
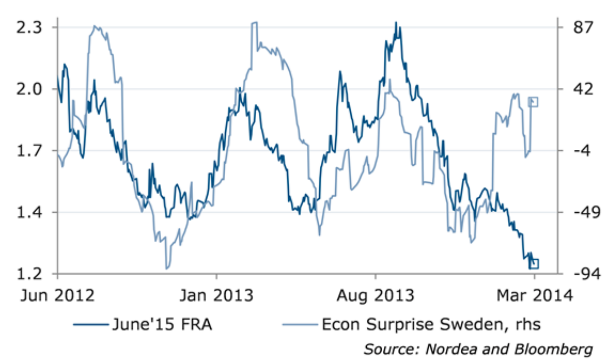


Chart 14. Macro data leaves no print in interest rates



Norway – Rates firmly on hold

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Norges Bank publishes their new interest rate forecast on March 27. Developments since the December report do not point to any major revisions.

Registered unemployment has moved sideways the last two months, thus being somewhat on the strong side to Norges Bank's forecast. In addition the Q4 GDP figures were stronger than expected and together the figures point to somewhat stronger capacity utilization than Norges Bank forecasted in the December Monetary Policy Report.

Demand seems to be weaker than Norges Bank expected in the December report. The big question is how it will affect the new rate path.

The big question this time will be how Norges Bank weighs this against signs of weakness in demand and the latest Regional network report. Consumption of goods covers about 50% of private consumption and year on year growth now points to lower growth in private consumption than Norges Bank expects (Chart 9). In contrast to registered unemployment and the Q4 GDP figures, the Regional network report indicates lower capacity utilization and lower GDP growth in Q1 compared to Norges Bank's forecast.

House prices have moved sideways the last three months, but recent housing market data could still cause worries for Norges Bank. Housing starts fell almost 40% in January (SA). The figures are in line with other figures and the stories we hear from builders – the sales of new houses have plummeted.

Other factors are about neutral to the rate path. The NOK has strengthened and is now in line with Norges Bank's forecast. The same holds for rates abroad and Norwegian market rates. Inflation was below Norges Bank's forecast in December while it was above in January. With the February figure being more or less in line with forecast we think Norges Bank in sum will judge inflation as expected.

The new rate path probably much the same as the December path.

All in all we think Norges Bank will judge the development since December more or less as expected. The Network report does however increase risks on the downside, but still no major revision. The interest rate path presented at the end of March will therefore indicate rates firmly on hold well into 2015.

We stick to our view of weaker growth than Norges Bank forecasts due to weakness in housing market and oil investments. This will however need time to materialize, but when it does we think Norges Bank will have to keep rates on hold beyond 2015.

Chart 15. Consumption of goods point to weakness…

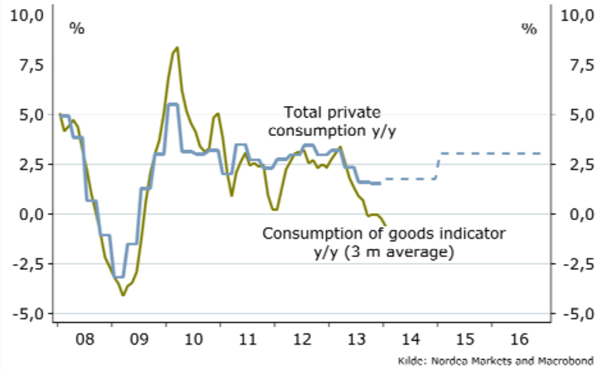
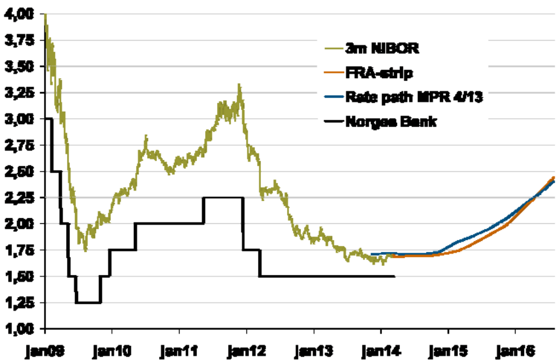


Chart 16. The market does not expect major changes



Source: Nordea Markets and Bloomberg

NOK: Investments leaving the (not so) safe haven

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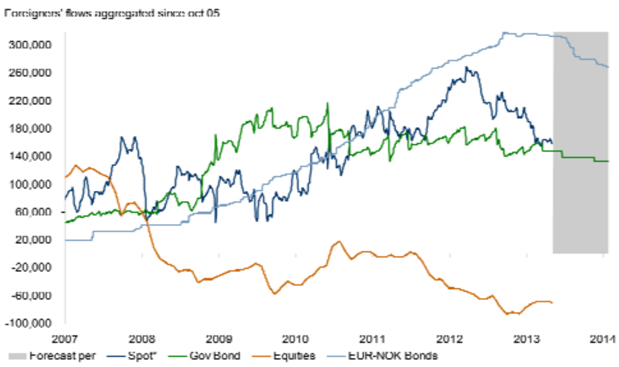
NOK weakened along with Emerging Markets in the beginning of the year. With improved risk sentiment and key figures on the strong side EURNOK came down from the 4.5 year high around 8.54. In addition to low liquidity, the picture of decreasing oil investments makes the case for a comparison with countries like Russia, South Africa and Brazil. Like stated earlier, our main reason for believing in a weak NOK is our forecast for a weaker Norwegian economy than Norges Bank.

The flow picture in NOK for the coming months could also become a negative contribution. The perception of NOK as the safe haven made EURNOK-bonds quite attractive during the European debt crisis. These are bonds issued by foreign companies with high credit rating in NOK, mostly attracting investors with a positive NOK-view. The issuance activity came to a halt in the second half of last year and this spring we will see a rush of maturities. The combined volume is around NOK 30bn during April and May. In addition to this we will see redemption of Norwegian T-bills on March 22 of which foreigners own NOK 9bn. Add the dividend payments in May of around NOK 13bn and we might look at more than NOK 50bn on its way out of the country.

The amount maturing might of course be reinvested, but with our take on the Norwegian economy such an outcome is not obvious, and we find it hard to believe in a stronger NOK for the coming months.

Going into the Norges Bank's meeting on March 27; buying volatility for the upside seems interesting. In general, we have been realizing more volatility than implied through these meetings, in particular the last year. Add the flow picture to this and it seems like the drop of more than two percentage points in implied volatility the last couple of weeks make for a decent buying opportunity.

Chart 17. Foreigners on their way out of NOK



Source: Norges Bank, VPS, Bloomberg and Nordea

Chart 18. NOK; implied volatility coming back down