Sell the SEK

- Neutral on risk sentiment
- We turn bullish on EUR/SEK
- We remain bearish on EUR/USD

**Market view**

Risky assets have experienced mostly headwinds over the past two weeks, with price action in the commodity space especially worrisome. Recent risk headwinds are not centred in Europe, and peripheral spreads and iTraxx Senior Financials have indeed narrowed.

Rather, the headwinds to risk sentiment are emanating from macro data (mostly the US but also China). While core bond markets seem to be pricing in a lot of recent macro weakness (see the lack of yield reaction to the worse-than-expected ZEW reading), equity markets (still) do not (Figure 2).

We noted in the previous FX Pilot that we might see a repeat of 2010-12, when macro momentum softens notably during spring, eventually prompting further Fed stimulus by autumn. Recent macro outcomes boost this risk.

**FX view**

We switch our stance on EUR/SEK to bullish from bearish based on rising risks stemming from the potential for weaker Swedish macro numbers, mostly due to lagged effects from recent krona strength. We remain bearish on EUR/USD, but with less conviction than earlier given the potential for further macro disappointments in the US.

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**Figure 1: EUR/SEK and Swedish surprise index**

![Figure 1: EUR/SEK and Swedish surprise index](image)

**Sources:** Handelsbanken Capital Markets, Macrobond, Riksbank

**Figure 2: Stocks shrugging off weak macro**

![Figure 2: Stocks shrugging off weak macro](image)

**Sources:** Handelsbanken Capital Markets, Macrobond, Riksbank
FX view

EUR/USD – sell on rallies

- The EUR/USD has climbed recently, boosted higher by surprising US macro weakness at a time of too-negative positioning. In addition, the cross was arguably “too low” given rates ahead of the ECB in April (Figure 3).
- What is more, after the Cyprus hubbub and ensuing bail-in fears which depressed European bank shares and coincided with a lower cross, euro financials have rebounded, helping the cross higher. (Figure 4).
- There are still good reasons to expect that the EUR’s strength since last summer will start to hit eurozone growth in coming months (in June and onward according to historical lags).
- Delayed effects from the stronger EUR will also tend to increase intra-eurozone growth divergences, as Germany can more easily cope with a stronger euro than many other eurozone countries.
- European economic underperformance and increased divergences may provide a trigger for softening the ECB’s monetary stance (we expect a refinancing rate cut in the coming months, and an SME-focused lending programme/LTRO), and/or prompt an escalation of the European debt crisis.
- In short, we remain bearish on EUR/USD.

EUR/SEK – buy on dips on Swedish macro risks

- The Riksbank is widely expected to keep rates unchanged in April, and is also expected to keep its rate path unchanged, still indicating about a 20% probability of a rate cut later this year.
- The ECB, on the other hand, is likely to ease further in coming months, a negative for the cross. Should the ECB soften in May, we see a buying opportunity due to rising FX headwinds for Swedish macro.
- We believe the recent krona strength will make itself heard in coming months, in sentiment indicators such as the NIER manufacturing gauge (April 25). However, normally the PMI would be expected to lead the NIER survey. The next number is due on May 1.
- In terms of economic surprise indices, the only way appears to be down (Figure 1, page 1). In recent years, this has tended to coincide with a weaker SEK both in EUR/SEK and trade-weighted (KIX) terms. Swedish macro weakness should tend to boost the priced-in probability of rate cutting this year.
- There is also a rising probability that the government will implement fees on Swedish banks funding in foreign currencies, to pay for the recently...
expanded FX reserve. This could boost SEK FRAs by ~8bp (in itself SEK-positive) but also boost the probability of mitigating rate cuts (lower RIBA rates).

- Any moves toward mitigating household lending would also tend to be SEK-negative (in the style of Norges Bank).

- We should mention some potential SEK positives, such as the ongoing bullish mood in Swedish house prices, which should tend to make the Riksbank worrisome and dampen any rate-cutting speculation.

- There is also the potential for an escalated debt crisis fuelling SEK-positive flows.

- The rumblings concerning the eurozone financial transactions tax (FTT) is another factor with SEK-positive potential.

- Despite event risks (the ECB meeting and Riksbank meeting), we switch our stance from bearish to bullish, and recommend buying EUR/SEK on larger dips.

**Table 1: Riksbank market pricing**

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Sources: Bloomberg, Handelsbanken Capital Markets, Macrobond.

**Handelsbanken Capital Markets’ forecasts**

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Source: Handelsbanken Capital Markets
The Big Picture

- QE-fuelled stock markets managed to goose US growth in Q1, despite tax hikes
- Recent data disappointments may be a sign that the positive impulse from QE on growth may be ending
- Problem child Europe will suffer from a stronger euro by summer

The US economy has seen some sudden negative surprises (ISM, payrolls). The household sector has also surprised negatively (retail sales, sentiment). It could be that we are seeing the first hard effects from this year’s austerity including January tax hikes and fiscal austerity from March onward. These data outcomes nonetheless boost the perceived risks that we may be in for a spring/summer swoon in macro momentum, similar to the ones seen in 2010-12.

In retrospect it was probably a good thing that the Fed launched QE3+ in December. This helped goose stock markets, an effect which at least initially overshadowed tax hikes and other fiscal headwinds affecting the US economy. However, the recent slump in consumer sentiment (Conference Board and University of Michigan surveys) is a warning that households might boost their savings ahead, after all.

Further fiscal negotiations loom. The new deal on the debt ceiling buys time formally until May 19. After this date, the US Treasury could again use budget trickery to keep things afloat for six to eight more weeks, making the ultimate deadline mid-July.

Chinese data is slightly worrying, with activity numbers on the whole weaker than expected.

As it is so often, Europe is the problem child, with sentiment indicators still pointing to a recession, albeit a less intense one than a few months ago.

The rise in the EUR’s value since last summer will probably start to harm growth by mid-year 2013, which could result in disappointing growth, which in turn increases intra-eurozone growth divergences and provides ammo for the doves at the ECB.
FX behaviour

G10 policy rates

G10 three-month interbank rates

G10 REER valuation

G10 budget balance

G10 asset correlation matrix

Legend

Positive correlation

Negative correlation

Explanation
The USD remain fairly strongly correlated to risk sentiment as proxied by MSCI World. The risk/FX correlations have continued to decline somewhat over recent weeks. The EUR has become less correlated with risk recently, as have the CAD.

Source: Handelsbanken Capital Markets
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