

# Interest Rates and FX Weekly

## Cut expectations intensifies

26 September, 2011

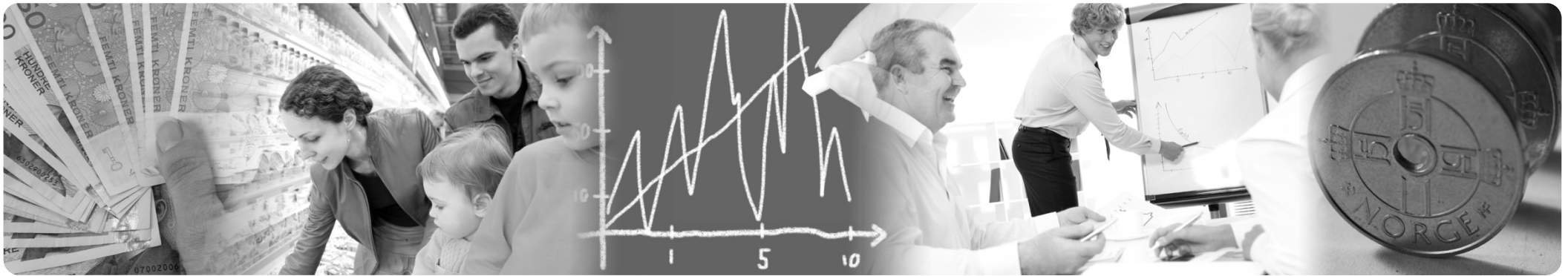


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Good morning,

Content in this week's edition of Interest Rate and FX Strategy:

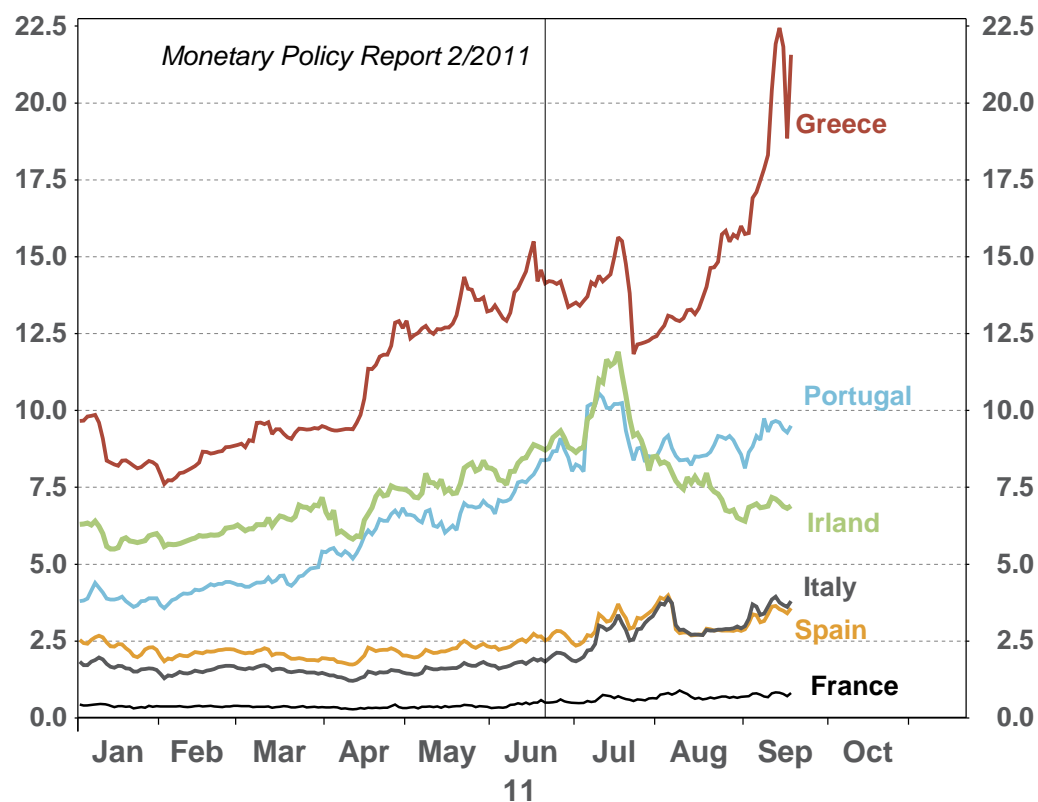
- Scared European politicians: Angela Merkel says euro area needs a firewall around Greece to avoid market attacks on other euro area countries. Leveraging the EFSF?
- Twist and doubt: The slope of the US yield curve flattened markedly after the twist, but it did not help to improve general market sentiment
- Norges Banks turned neutral: Key policy rate to be kept low for longer. Could cut if situation worsens
- Key events of the week: German parliament to vote over EFSF expansion (Thursday).
- Norway data will indicate to what extent Norway is slowing, if at all. We expect retail sales at 1.3% m/m in August after -0.7% in July. Consensus: +0.7%.
- We distributed a new fixed income trade idea last week: Receive NOK 5y5y fwd versus EUR at 120 bp for a target of 70 bp
- In currency space, the NOK is obviously not a safe haven in the event of a severe downturn. The NOK lacks the liquidity safe-haven investors prefer, there are few underlying government bonds to buy and the correlation between the NOK and the oil price is too high.
- EURNOK will probably be trading in the wide 7.70-7.95 range again until dust settles. If the crisis escalates to a severe downturn with large impacts on commodity prices, the NOK would suffer



- **Key events of the week: Germany to approve EFSF expansion, Retail sales in Norway,**
- **Fixed Income Strategy: Receive NOK vs. EUR in 5y5y fwd**
- **FX Strategy: Risk off**

# Week in Review: Angela Merkel calls for firewall around Greece

## 10 yr gov. bond yields, spread to Germany

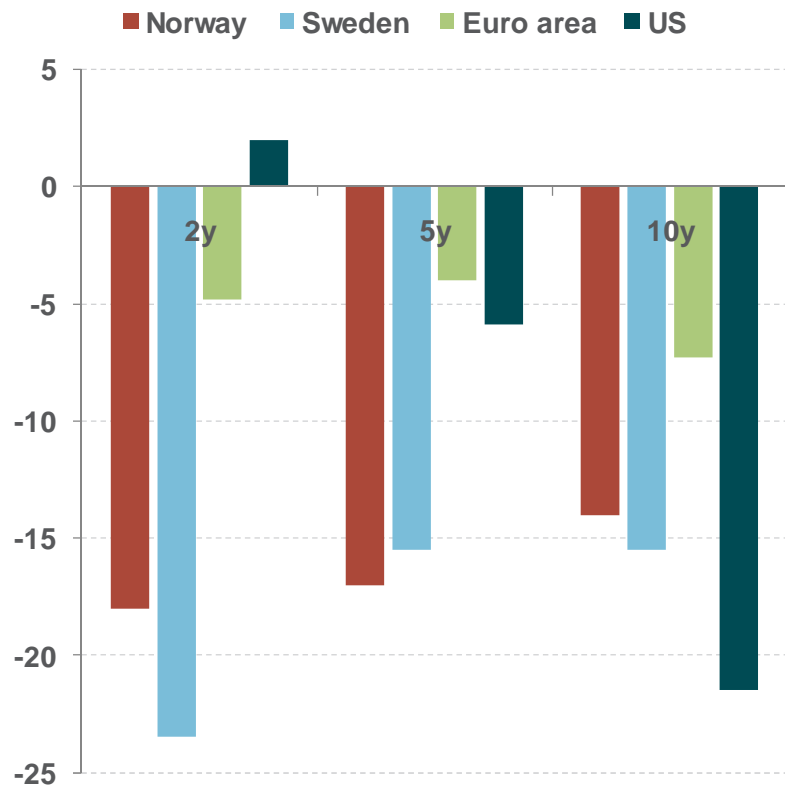


## Developments over the weekend

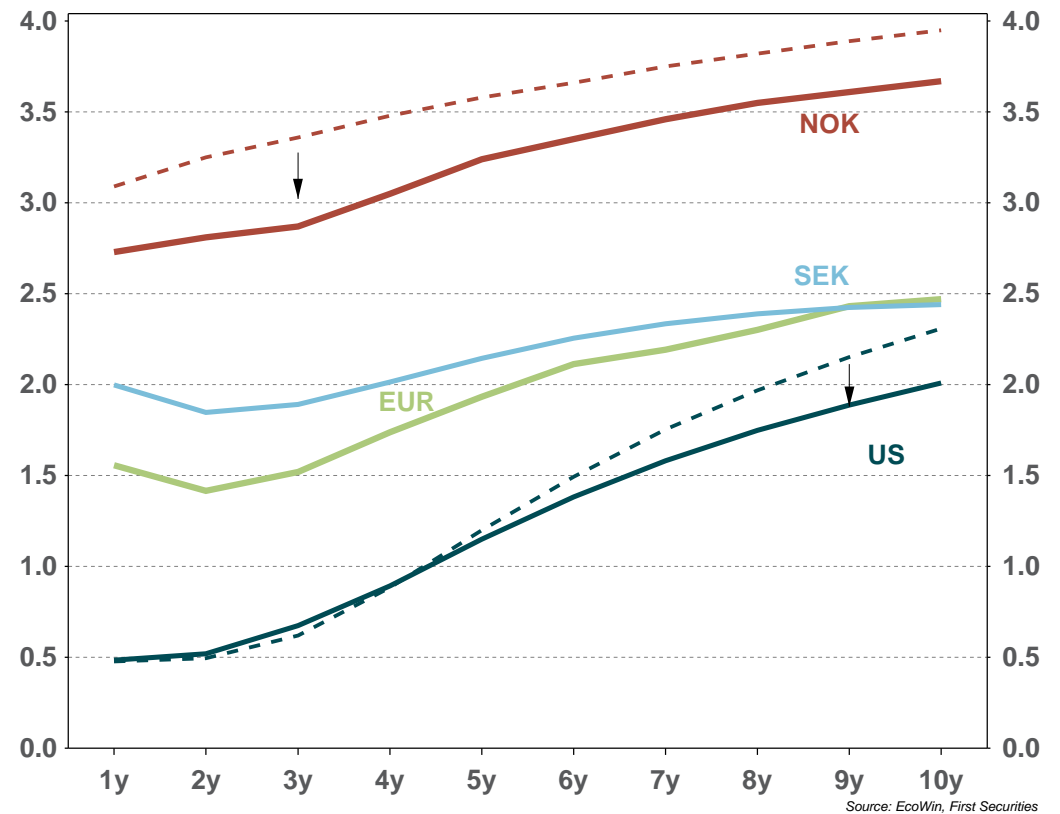
- Chancellor Angela Merkel said euro area needs a firewall around Greece to avoid contagion to other European states
- EFSF expansion agreed in July will be approved by German parliament 29. September.
- The EFSF could be even more “efficient” by leveraging it without involving the ECB (Finance Minister Wolfgang Schaeuble)

# Week in Review: The “twist” in the US, bull steepening in Scandinavia

Changes in rates (swaps) last week, bp



IRS curves, now and a week ago

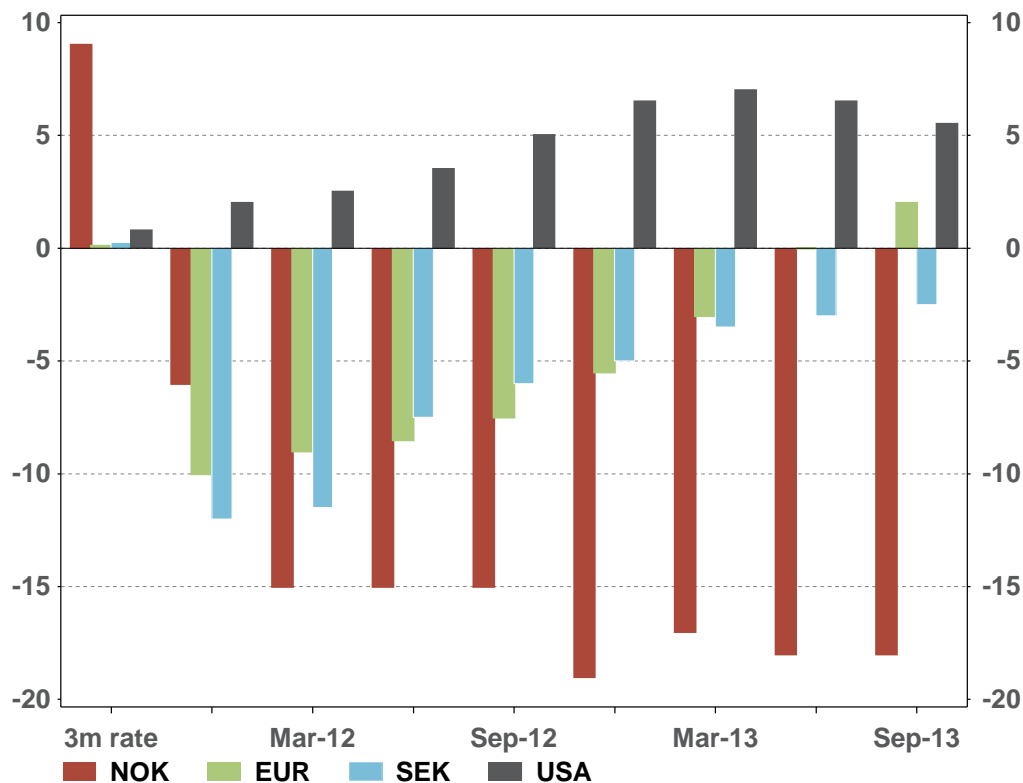


- Fed will buy USD 400 bn in long dated bonds (6 y t o 30y) and sell short term bonds (less than 3y) for the same amount. An Operation Twist to pull long bond yields further down – no impact on the size of the balance sheet.

# Week in Review: Norges Bank turned from “tightening bias” to “neutral”

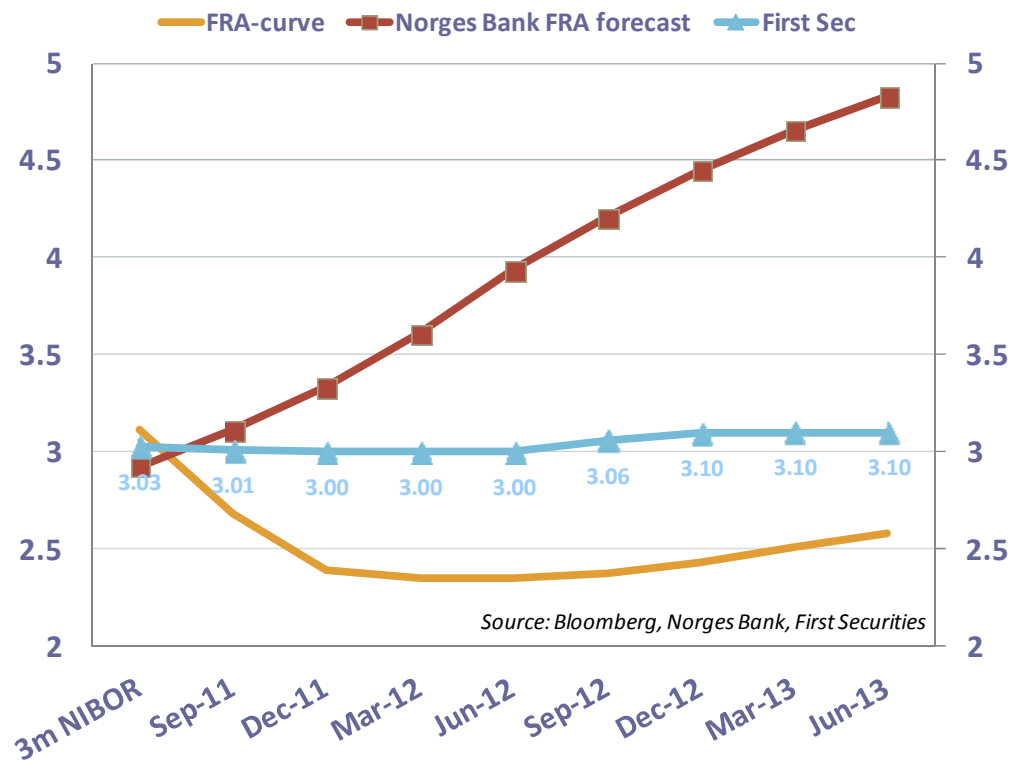
## Expectations of Norges Bank interest rate cuts intensified last week

FRA-rates, change in bp since a week ago



Source: EcoWin, First Securities

3m NIBOR and FRA curve vs. forecasts

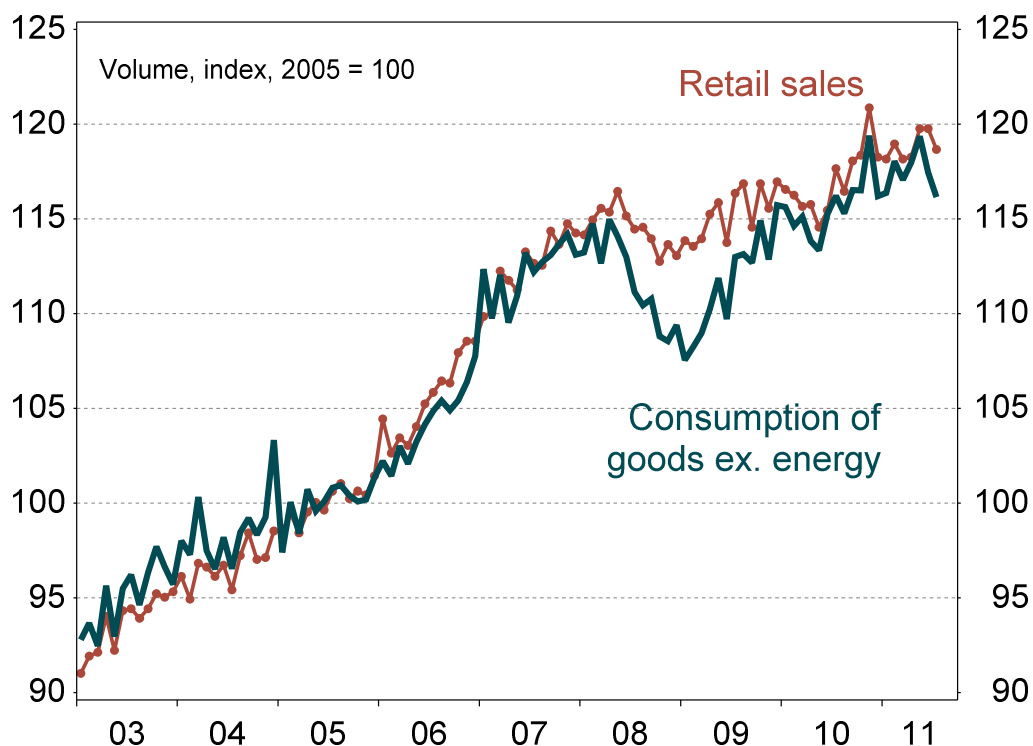


Source: Bloomberg, Norges Bank, First Securities

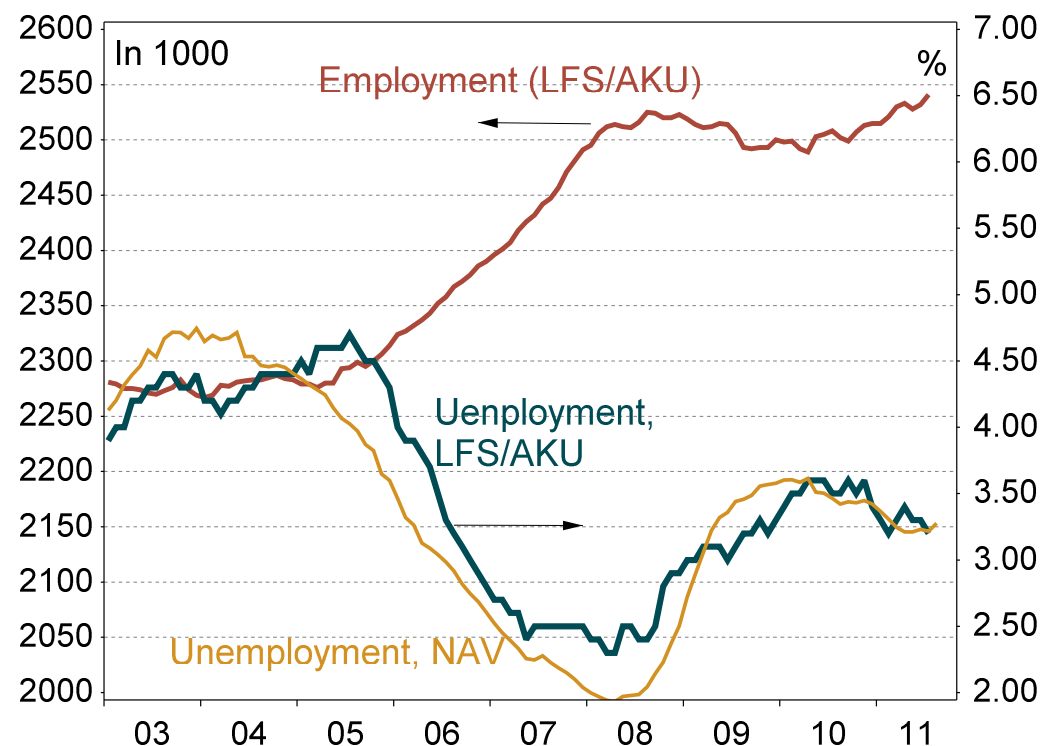
- **Press statement:** “The turbulence and uncertainty abroad, combined with lower inflation and weaker prospects at home, suggest that the key policy rate should be kept low for a longer period than expected in June”

# Week ahead: How much is Norway slowing, if at all?

## Norway Goods consumption



## Norway Employment & Unemployment



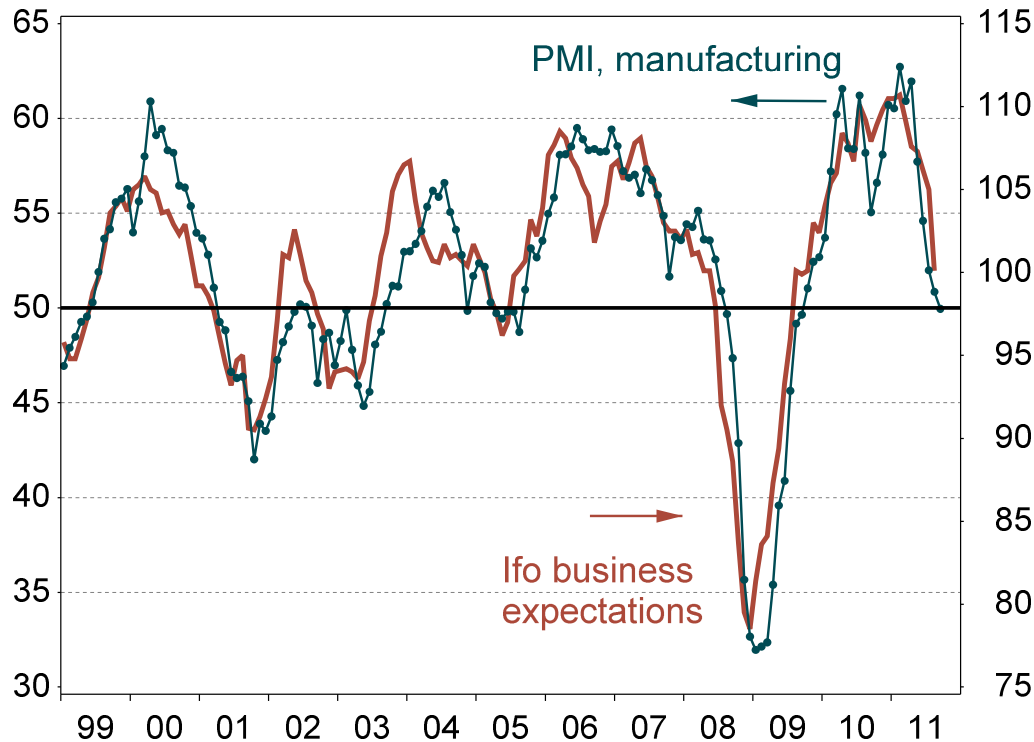
Source: EcoWin, First Securities

- **Retail sales (Thursday):** We expect +1.3% m/m after -0.7% in July. Consensus: +0.7%
- **NAV Unemployment (Friday):** We expect 2.6% (excluding job market programs). Consensus: 2.6%
- **Credit growth (Friday):** We expect 6.3%. Consensus: 6.3%

# What about the rest of the world?

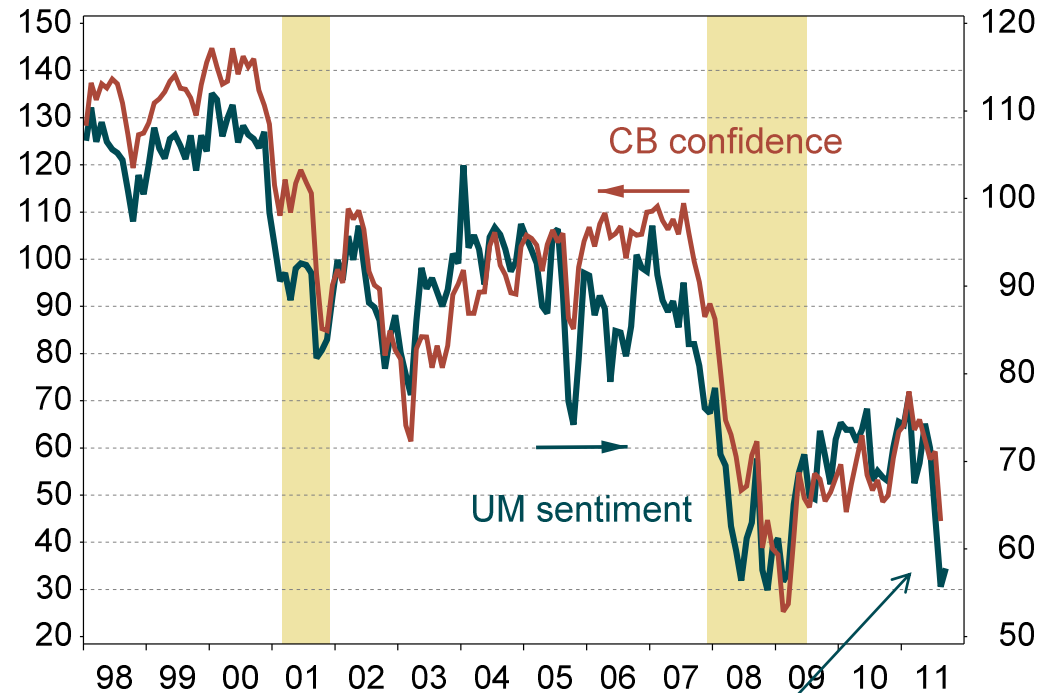
German Ifo (107 expected), US Consumer confidence (46.5 expected)

## Germany Business surveys



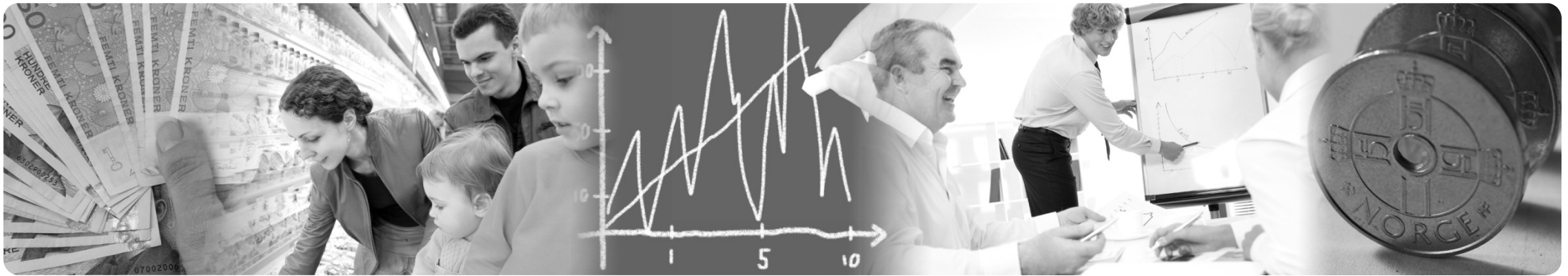
Source: EcoWin, First Securities

## USA consumer sentiment/confidence University of Michigan vs. Conference Board



Source: EcoWin, First Securities

- Ifo (Monday): Consensus: 107 (total), 98.5 (expectations), 116 (current assessment)
- US Consumer confidence (CB) (Tuesday): Consensus 46.5(!). Looks too optimistic



- **Key events of the week: Germany to approve EFSF expansion, Retail sales in Norway,**

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- **Fixed Income Strategy: Receive NOK vs. EUR in 5y5y fwd**

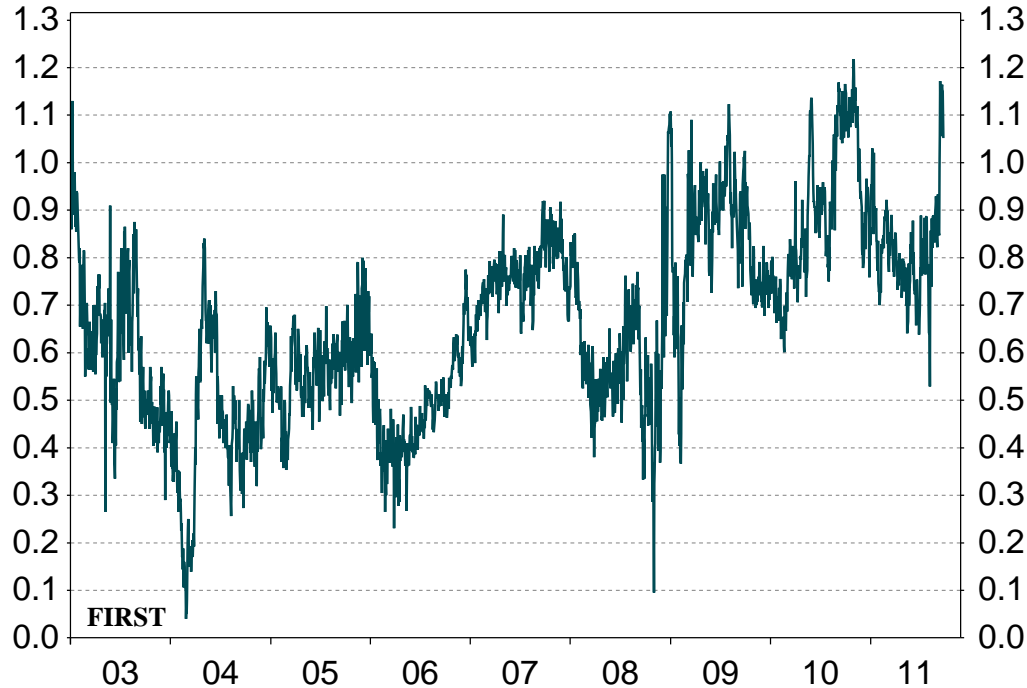
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- **FX Strategy: Risk off**

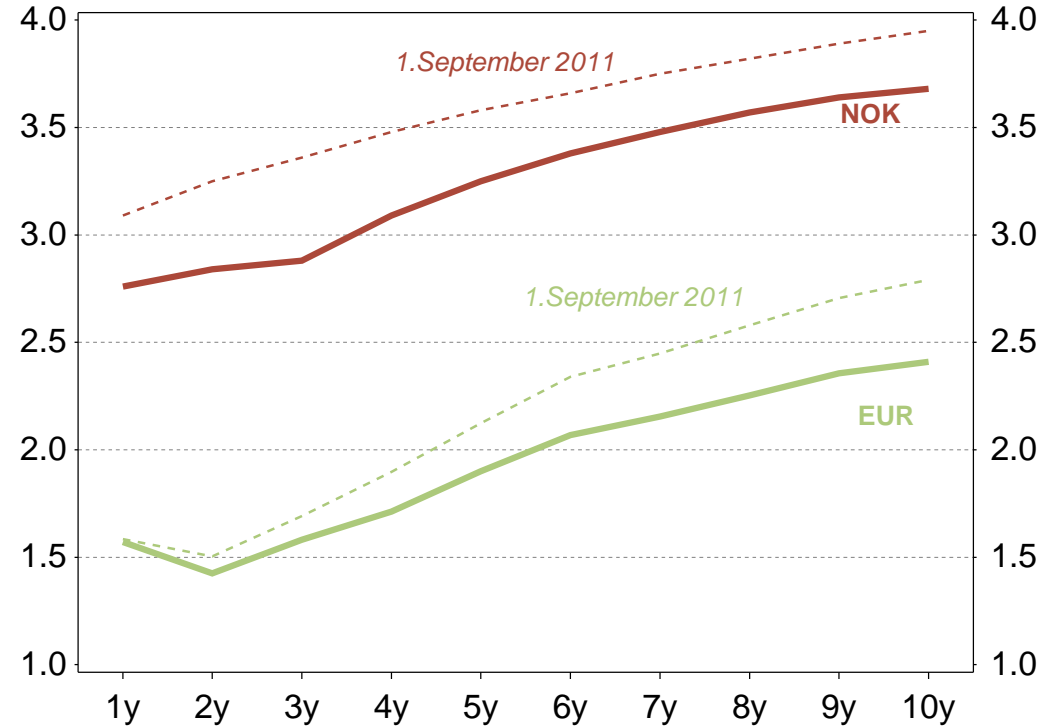
# New trade idea: Receive NOK vs. EUR in 5y5y fwd

...at 120 bp with a target at 70 and a stop at 145

## NOK- EUR 5y 5y fwd



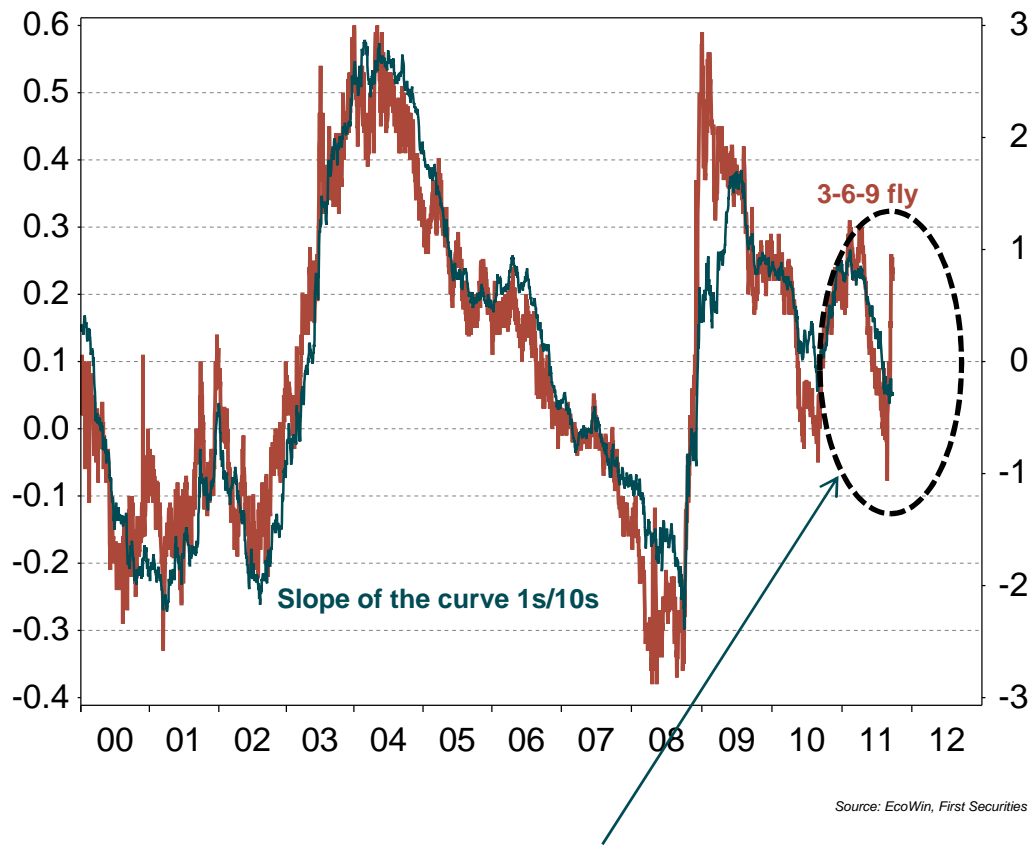
## Interest rate swaps, yield curves



- The spread is trading in the upper end of a wide historical range...
- ...which is likely to attract investors in search for yields

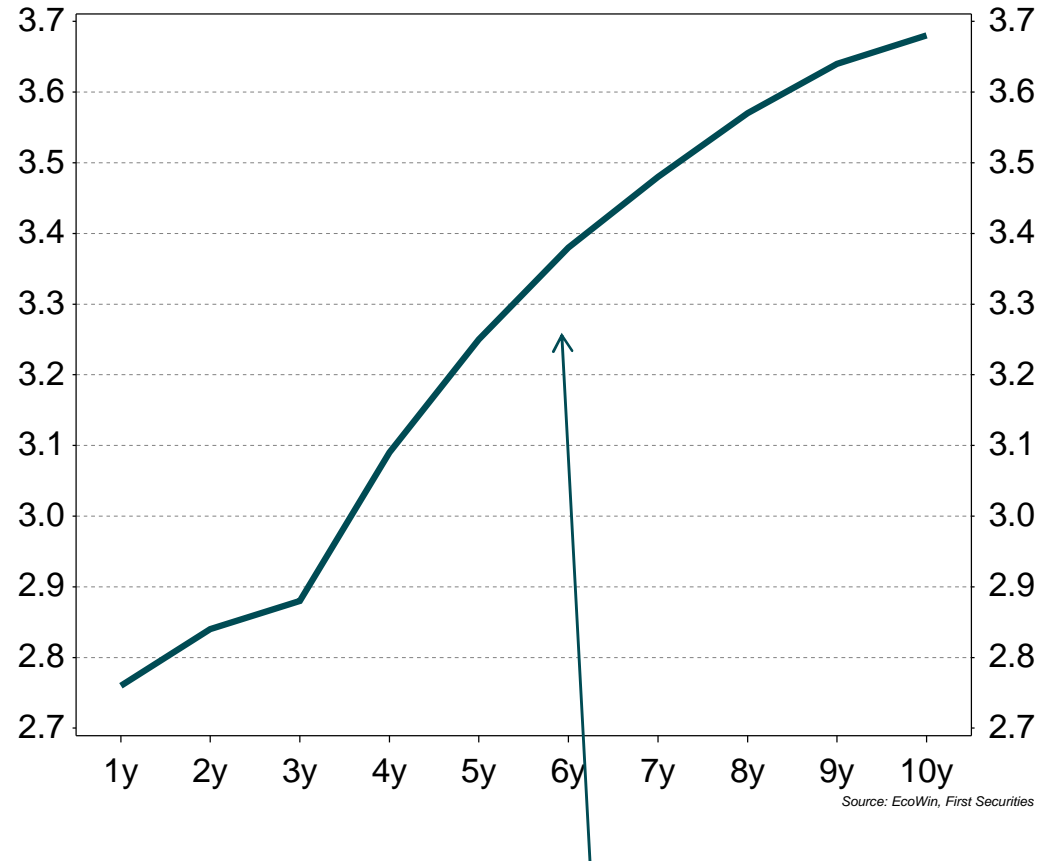
# Trade on watch list: Receive NOK 6y, pay 3y and 9yr

NOK fly 3-6-9 vs. slope of the yield curve 1s/10s



The 3-6-9 fly normally correlates strongly with the spread between the 10y and 1y rate, but it's currently detached from this model

NOK IRS yield curve



6y segment too cheap vs. 3y and long-end

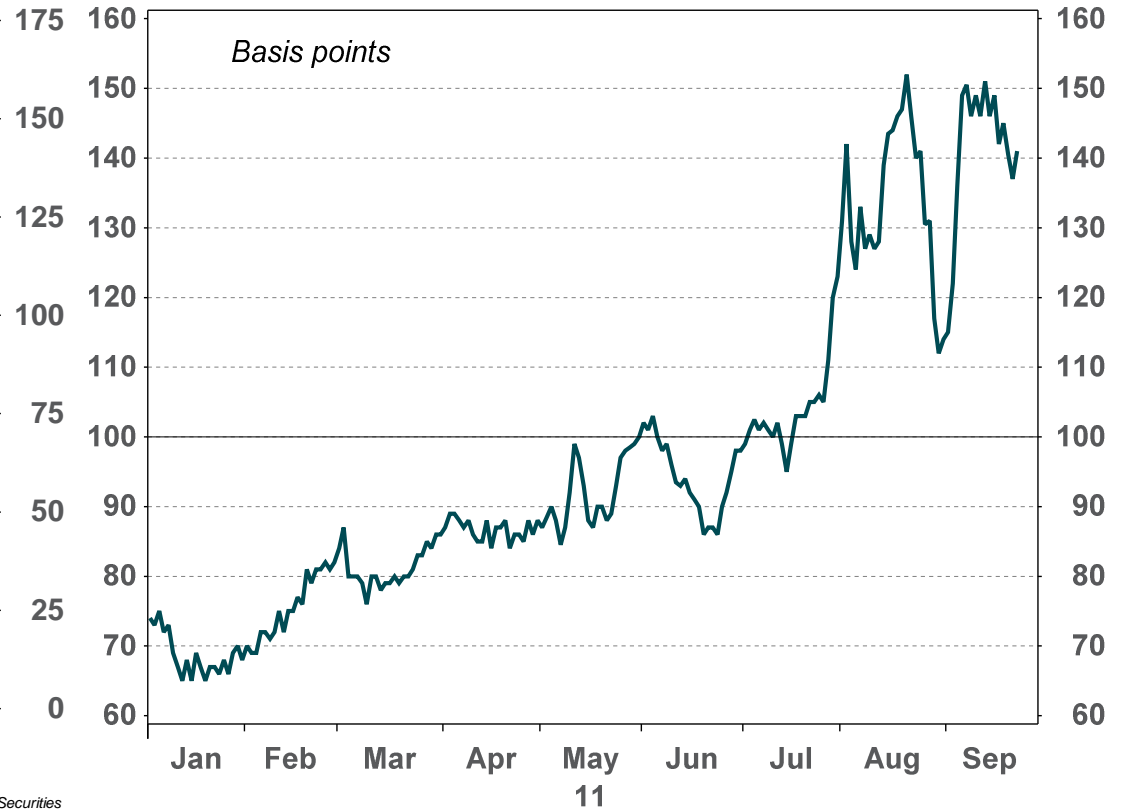
# Swap spread: Very wide, but narrowed last week

## 10 yr Norway asset swap spread and crisis

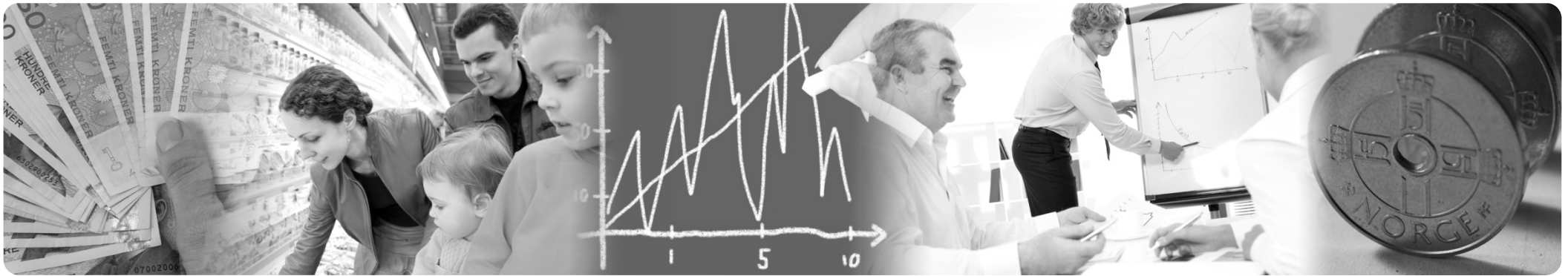


Source: EcoWin, First Securities

## 10 yr Norway asset swap spread



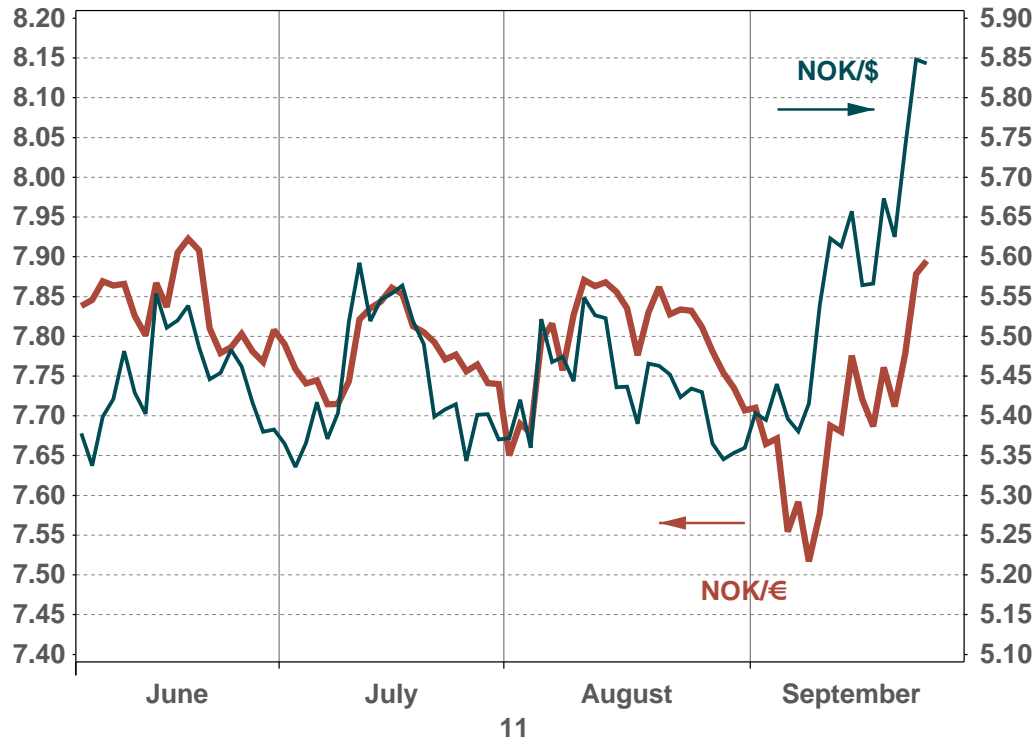
Source: EcoWin, First Securities



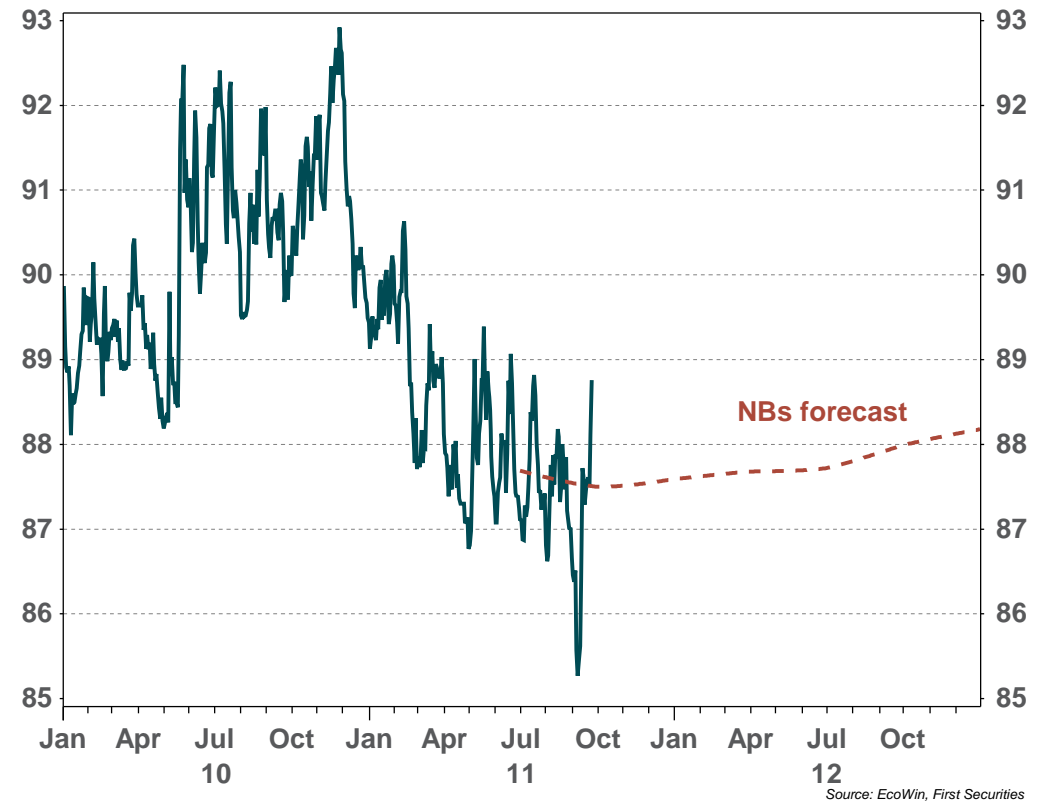
- **Key events of the week: Germany to approve EFSF expansion, Retail sales in Norway,**
  - **Fixed Income Strategy: Receive NOK vs. EUR in 5y5y fwd**
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- **FX Strategy: Risk off**
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# NOK not so popular anymore

## NOK vs. EUR & USD



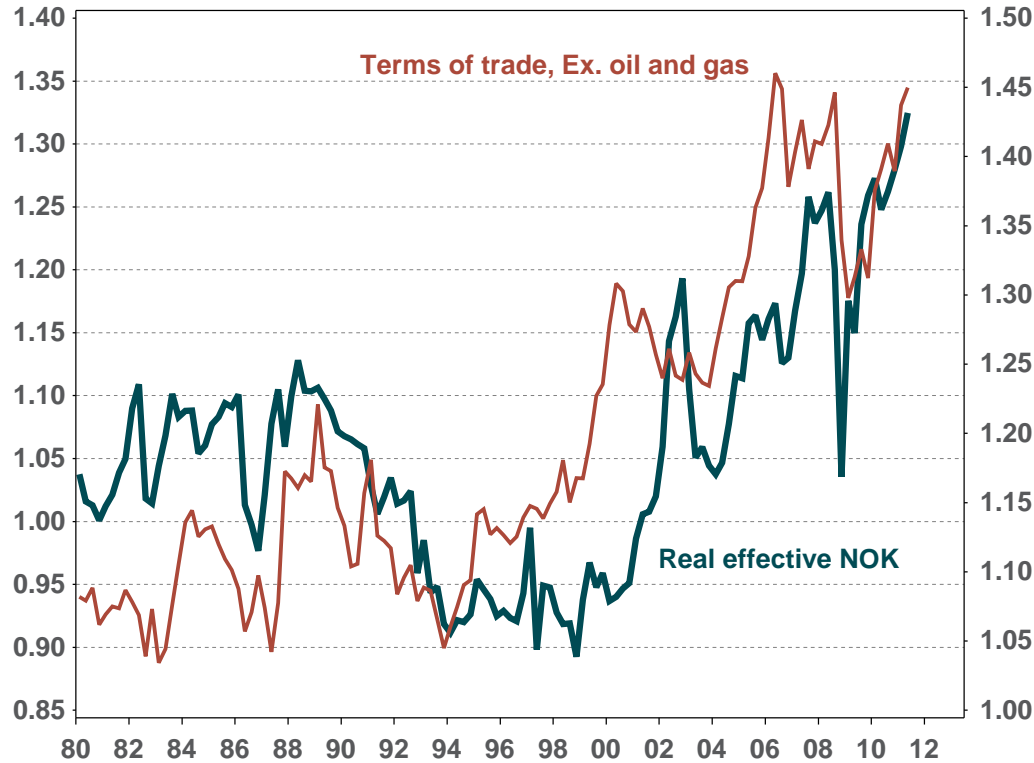
## Import-weighted NOK vs. Norges Bank



# Why the real effective NOK is so strong...

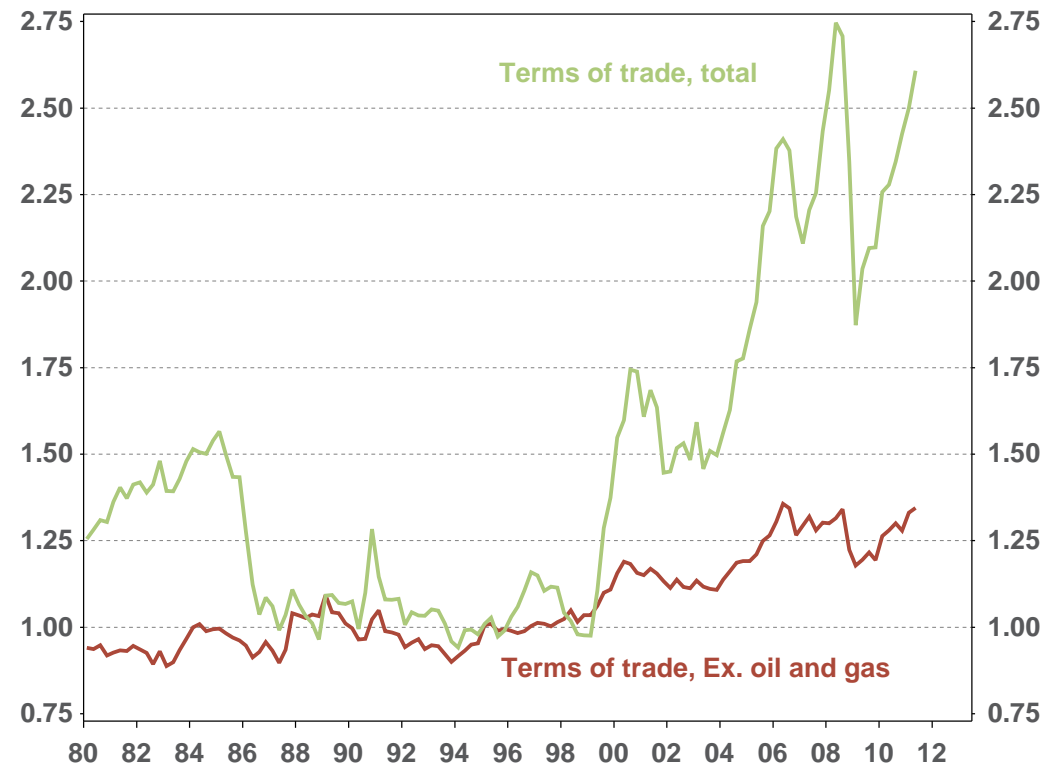
...and why it is vulnerable to a collapse in demand for commodities

### Real effective NOK vs. Terms of Trade



Source: EcoWin, First Securities

### Terms of trade (prices on exports/imports)

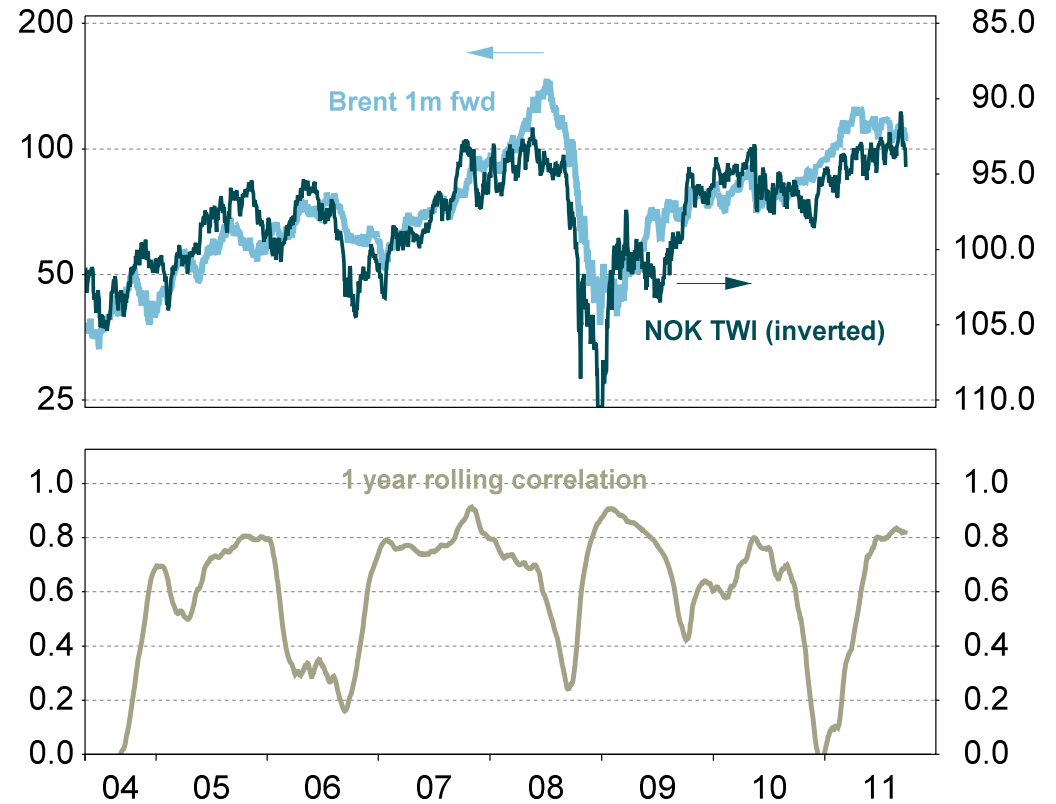
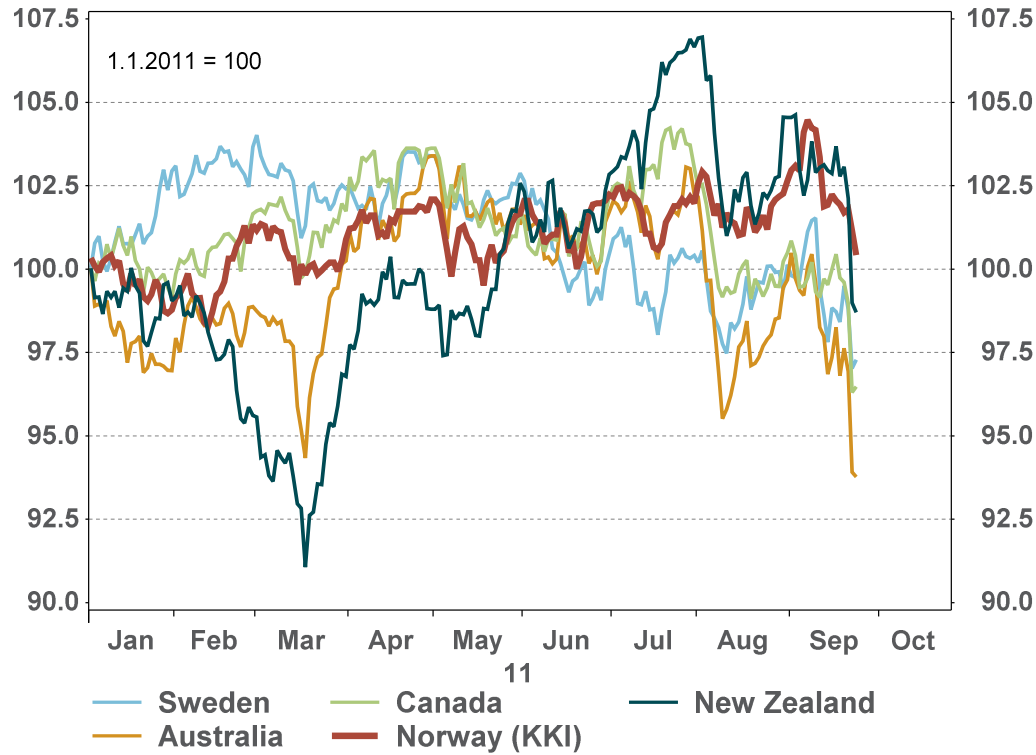


Source: EcoWin, First Securities

- Real effective NOK is calculated using relative wage growth

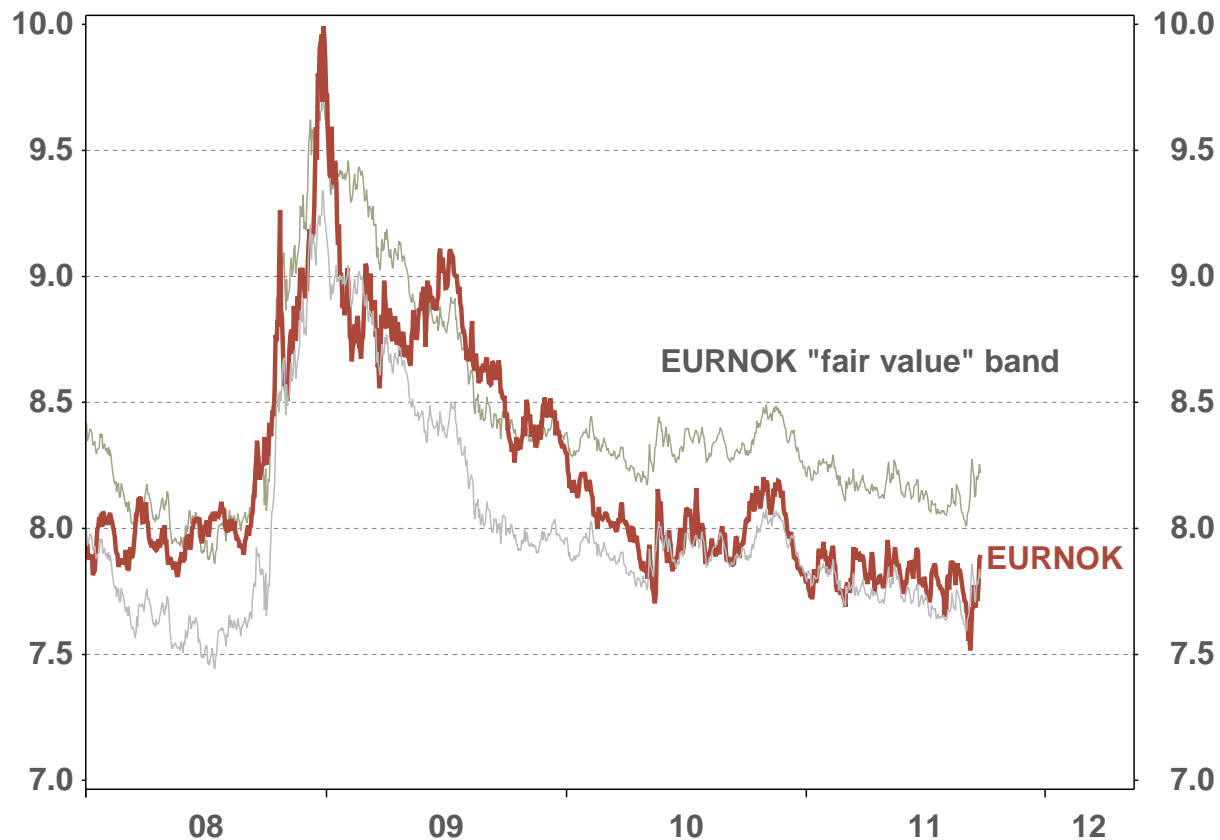
# NOK vulnerable for a further decline in commodity prices

Commodity exporters exchange rates  
Effective exchange rates (BoE)



# We repeat, NOK isn't a safe haven in the event of a severe downturn

EURNOK Model: Oil price & rate difference



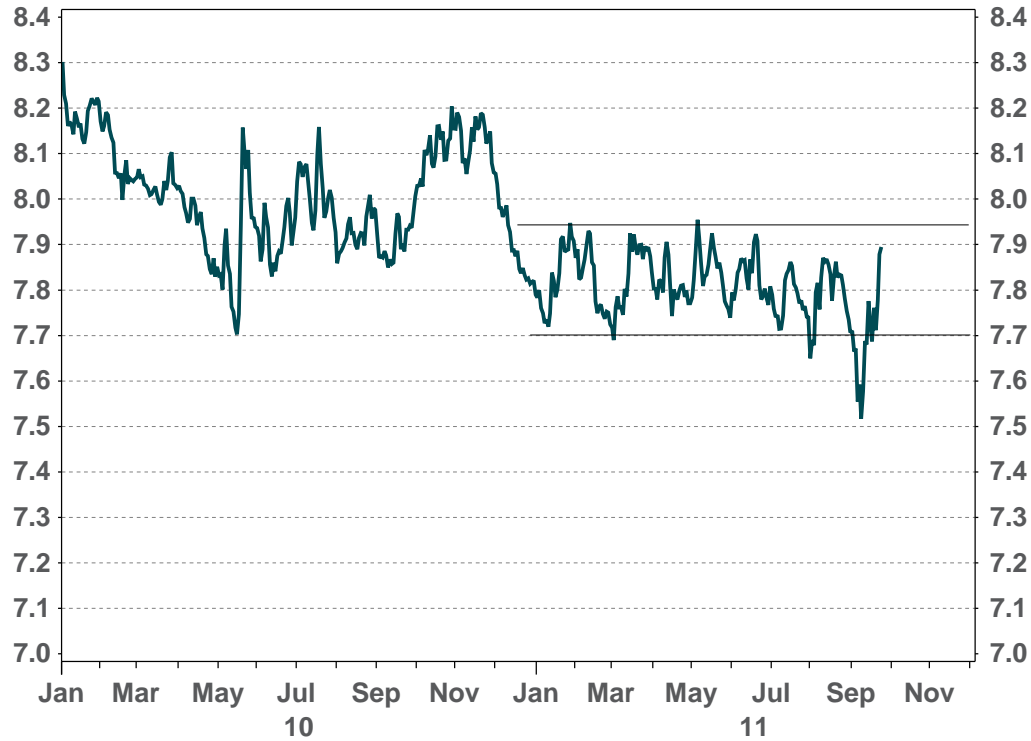
Source: EcoWin, First Securities



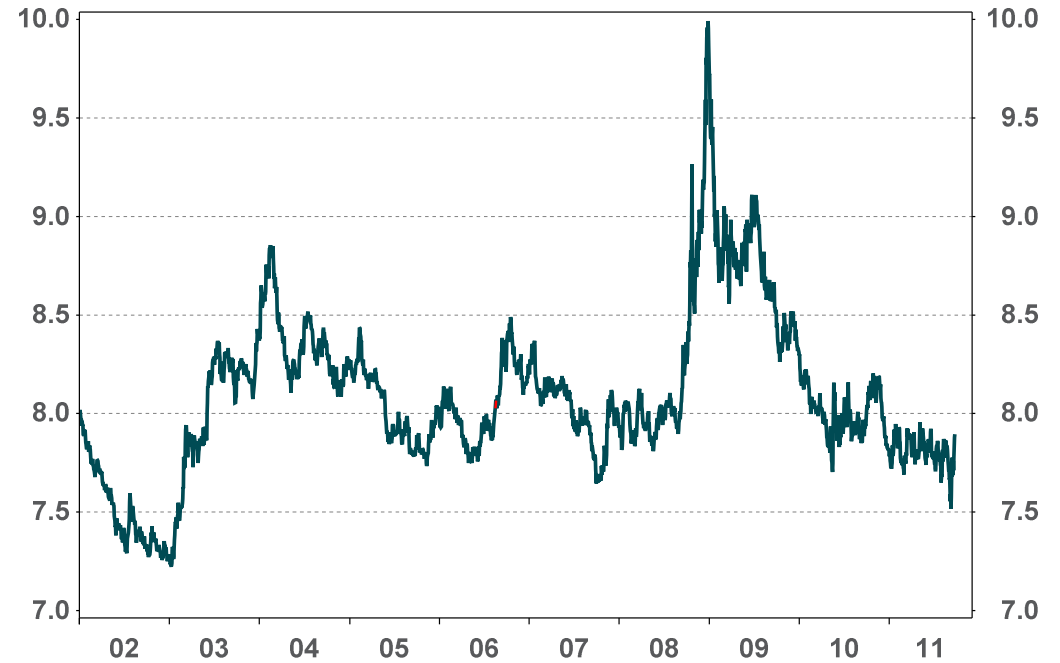
- Why NOK isn't a safe haven:
  - Lacks liquidity
  - Few government bonds to buy
  - High correlation to the oil price

# EURNOK likely to remain in the old range, until dust settles

## NOK EUR



## NOK EUR



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