

Flash Comment Denmark

DN to cut by 10bp if ECB cuts by 20bp

- **Our base case is now for ECB to cut by 20bp in September – we look for Danmarks Nationalbank (DN) to cut by 10bp to minus 0.75%.**
- **EUR/DKK in the high end of the trading range and FX intervention in the beginning of the year means that DN will cut less than ECB. This should lead to a tightening of the spread between short-term DKK and EUR swap rates and higher FX forwards. It should also move the EUR/DKK spot lower.**
- **Short-end of the DGB curve could underperform marginally to Germany. Little impact expected on the long-end of the DGB and mortgage bond curves.**

In *DKK Edge What would DN do if ECB opens up for further easing?*, 6 June we laid out some initial thoughts on how Danmarks Nationalbank (DN) would respond to a rate cut from ECB. After the remarks from ECB President Mario Draghi at the annual Sintra conference today, such a scenario has become all the more relevant.

Our base case now is that ECB cuts its deposit rate and main refinancing rate by 20bp to minus 0.60% and minus 0.20% respectively in September (along with other measures including QE and forward guidance) – see *ECB Research New ECB call – rate cut and restart of QE*, 18 June. In this scenario, we think DN is more likely to cut its certificates of deposit rate to minus 0.75%. DN will cite a EUR/DKK in the weak end of the historic trading range and FX intervention earlier this year as the key reasons for not matching an ECB rate cut. As we have written before, we do not expect DN to do QE.

If there is full pass-through to market rates from both rate moves this should trigger a tightening of the spread between short-term DKK and EUR swap rates and higher FX forwards. That in turn should lead to a drop in EUR/DKK spot – likely below 7.4600 from the current level of around 7.4670-80. The tricky part here is that we also expect ECB to change its tiering system allowing banks to place 40% of its excess liquidity at minus 0.20% and 60% at minus 0.60%. If this somehow hampers the pass through to market rates then the effect on the DKK-EUR swap spread and FX forwards would be less and the impact on EUR/DKK reduced correspondingly. We do not expect DN will change its current account limits, i.e. how much Danish banks can deposit at the current account rate currently at 0.00%.

If DN does not fully follow the ECB lower, the short-end of the DGB curve could suffer relative to the German curve. Both due to the outright level and the move in the EUR/DKK FX forwards, that everything equal make DKK short-end papers less attractive for EUR based investors. That said, an expected drop in EUR/DKK could fuel independent Danish rate cut expectations minimizing any underperformance. We see very little impact on the long-end of the DGB curve and 30y callable bonds. The struggle to avoid negative yields will intensify internationally and the foreign demand for example Danish 30Y mortgage bonds could strengthen. The drop in duration in the mortgage market will furthermore dominate in the FI market keeping 10y and 20y government bonds well supported.

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