

FX Watch

DKK: Watching the Peg

Key takeaways

- As market exposes fault-lines, attention is back on EUR/DKK which is at levels last seen in 2020. We have been here before...
- .. and not unduly concerned. No significant pressure on forwards and DNB has tools at its disposal to counter DKK weakness...
- .. such as hikes & interventions. But keep covered mortgage market on radar given size of foreign participation/higher rates

A wobble

As the markets continue to expose fault-lines in the global economy, fixed exchange rate regimes have unsurprisingly come back onto the radar for no other reason than investors wanting to test the resolve of the authorities. Rightly or wrongly, EUR/DKK is once again in the spotlight as DKK weakens to levels not seen since 2020 (Exhibit 1). As the chart highlights, the spikes in EUR/DKK tend to correlate well with periods of market tumult – DKK has been a victim rather than the instigator of these high vol periods.

But no need to panic

We are not unduly concerned by the recent pressure on DKK. The Danish Central Bank will by now be well versed in rolling out the playbook to counter any unwarranted pressure on the currency. In a recent note (see: [Liquid Insight: The FX/Risk Disconnect 27 March 2023](#)), we described the indiscriminate nature in how markets have exploited perceived vulnerabilities (be that position etc). EUR/DKK is not one of them: 12mth forward points have remained well behaved (Exhibit 2) supporting the argument that recent DKK weakness lacks a fundamental driver.

The policy tools available to the central bank are formal intervention to sell EUR and buy DKK or to hike rates proportionately more than the ECB. DKK remains on the stronger side of the central rate and prior to the March move and the central bank was an active intervener, selling DKK and buying EUR. Denmark's FX reserves are sizeable, amounting to 25% GDP. Defending the peg, should the need arise, is manageable.

It is worth reinforcing the point that the peg is the main policy objective for Denmark. Rate setting is completely subservient to exchange rate stability and follows the ECB to achieve this. Denmark therefore has the option of narrowing the policy spread to the ECB (currently 40bps between the deposit rates, Exhibit 4). This can happen at any time as the Danes do not schedule rate meetings.

(Continued on next page)

30 March 2023

G10 FX Strategy
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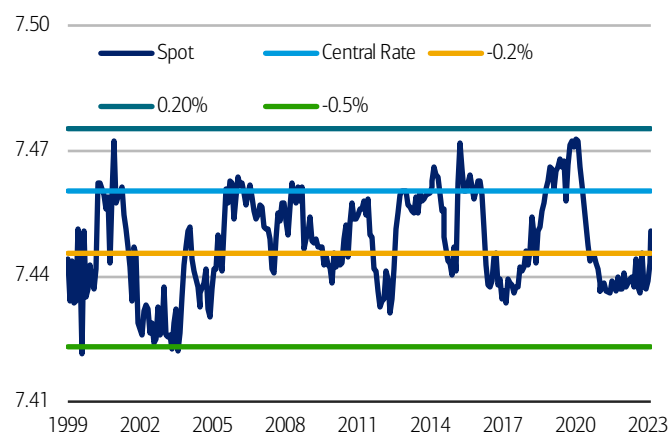
One eye on the Danish Covered Bond Market

Overall, therefore, we think recent pressure on DKK is unjustified, reflecting a skittish market keen to expose perceived fault-lines. However, with markets still on alert for further fallout from a higher global rate environment, we have one eye on developments on the Danish covered bond market – the largest of its kind in the world (~\$450bn or 110% GDP). Exhibit 5 plots the y/y performance in the Danish mortgage bond index. The dip through the March tumult has not been as significant as the risk sell-off during the GBP crisis in September. Prima facie, there appears little of concern. One potential thing to keep on the radar is foreign ownership in this market. Exhibit 6 shows foreign ownership of Danish mortgage bonds. Having peaked in 2020 at 36%, the current reading as January was 31%. The composition has not been revealed but Bloomberg in a recent report suggest strong Japanese participation in this market which could be an important dynamic once the Bank of Japan exits from Yield Curve Control.

To reiterate: with markets stalking around for more fault-lines and with housing and commercial real estate the focal point against the backdrop of rising rates, strong foreign ownership of the Danish covered bond market is worth keeping one eye on.

Exhibit 1: EUR/DKK spot versus central rate and fluctuation bands

DKK has weakened to its lowest levels since 2020



Source: BofA Global Research, Bloomberg

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Exhibit 2: EUR/DKK 12mth Forward Points

Forward points well behaved; DKK selling has been indiscriminate

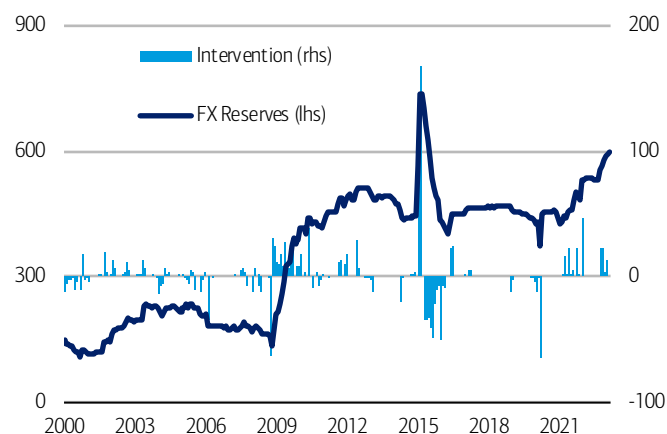


Source: BofA Global Research, Bloomberg

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Exhibit 3: Denmark FX Reserves and Interventions (DKK bn)

Denmark has ample reserves to defend the peg

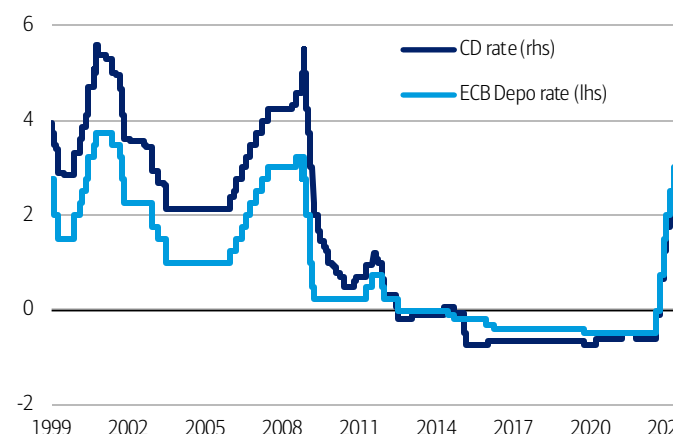


Source: BofA Global Research, Bloomberg

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Exhibit 4: Denmark vs ECB policy rates

Denmark has option to outpace ECB to protect the peg



Source: BofA Global Research, Bloomberg

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Exhibit 5: Danish Mortgage Bond Index, %y/y

Some recovery but posting negative y/y returns.



Source: BofA Global Research, Bloomberg

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Exhibit 6: Foreign Ownership of Danish Mortgage Market, %

Foreign ownership of mortgage market has peaked.



Source: BofA Global Research, Danish Central Bank

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