

FX Alpha

Buy GBPSEK

The trade

We recommend positioning for GBPSEK higher via a 3-month 1x1.5 call spread, with strike levels 13.1008 and 13.4217 (trade expires 12 April). The trade costs 0.66% GBP (spot ref: 13.1008, vol refs: 7.95% and 7.47%). Carry combined with our outlooks for the BoE and the Riksbank vs markets is a key reason. GBPSEK could also benefit should risk sentiment worsen.

Key risks to our trade are a more dovish BoE and/or a more hawkish Riksbank vs. our expectations and negative headlines around the UK budget. The long GBPSEK positioning also poses *some* risks (we do not find it stretched, [LCBF 8 Jan 24](#)).

For a list of our open/recently closed trades over the past year please see [Global FX Weekly12 Jan 24](#).

Turning constructive GBP

We are turning cyclically constructive on the outlook for GBP. Our base case scenario for a global soft landing, bull steepening of the US yield curve, yield compression and a weaker USD suggests a benign environment for volatility and risk. This enhances GBP status on a vol adjusted carry basis (Exhibit 1). We think the market is overly optimistic on the quantum of policy easing expected from the BoE (Exhibit 2). While we have brought forward the timing of the first UK rate cut to August 2024 (see [UK Watch 12 Jan 24](#)), we look for quarterly cuts thereafter. This still leaves our Base Rate projection higher than the current market pricing. Should the market move towards our forecasts, this will add further carry support for GBP. Additionally, while cyclical headwinds for the pound remain, the UK is not the outlier it once was and more significantly, investors still remain downbeat on the outlook for this year ([FXRS 12 Jan 24](#)). The risks are therefore skewed asymmetrically: stronger data prints will be a positive surprise for GBP; weak data will be in line with current thinking. We are keen to stress that our constructive views based on cyclical grounds given the current market set-up. Medium fragility remains in the form of a large current account and fiscal deficits. For now, markets are prepared to look through these factors allowing GBP free reign to the upside.

Tactically cautious on SEK

After a stellar Q4 we think markets have run a little ahead of themselves on SEK. So, while we expect 2024 to be a good year for SEK, near term we are tactically cautious.

First, markets may have run a little ahead of themselves on the Fed. Second, we think there is some room for markets to reprice the Riksbank lower vs. the ECB & the BoE. We expect the Swedish CPIF ex energy below 2% y/y in July, much earlier than the Riksbank forecasts (see [Nordics YA 24 8 Dec 23](#)). This suggests it is a matter of time for its stance on FX to turn symmetric, and we think Per Jansson's recent comments are in this direction. Third, the Riksbank's current FX hedging operation will likely end soon.

But, beyond the near term, we are constructive on SEK, counting on a softer USD,

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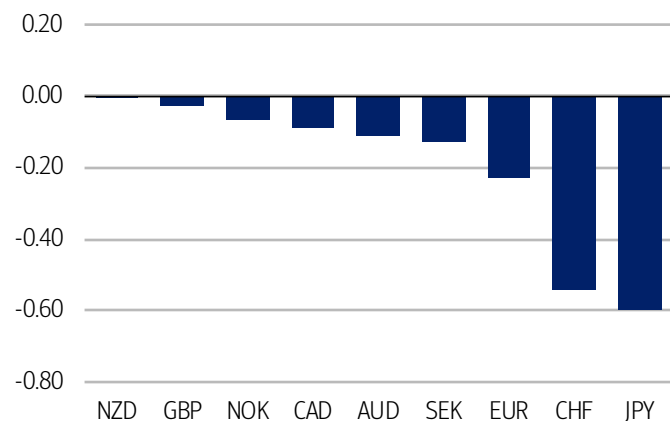
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reduced Swedish hard landing risks, light SEK positioning, and valuation.

Exhibit 1: 3-month vol-adjusted annualized carry vs USD

Carry supports GBP vs SEK...

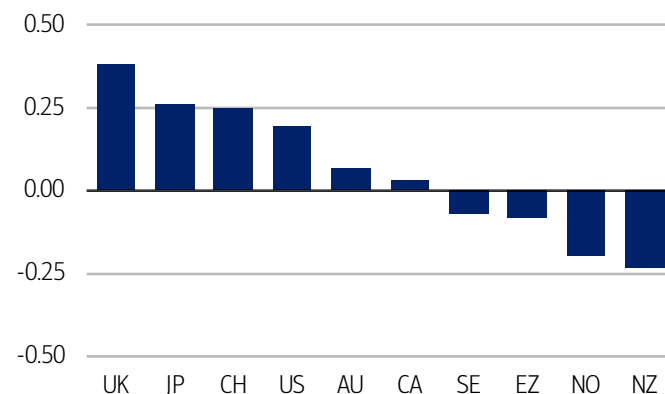


Source: BofA Global Research, Bloomberg

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Exhibit 2: BofA vs market pricing by YE 2025 (percent)

...and its support could slightly strengthen down the road



Source: BofA Global Research, Bloomberg. Positive values mean we expect a higher YE 2025 vs markets.

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