Danske Morning Mail: German fiscal package negotiations take centre stage

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In focus this week

- The main spotlight of the week will be on news regarding the negotiations of the German fiscal package. The package is scheduled to be passed in the Bundestag on Tuesday and then in the Bundesrat on Friday, with expectations for approval. Merz states that CDU/CSU unanimously support the proposal, although there are risks that some may not vote in favour and that Bavaria's 'Free Voters' might not support it in the Bundesrat on Friday.
- In the US, President Trump announced that he will be speaking with Russian President Putin about ending the war in Ukraine on Tuesday. On the data side, February retail sales data will be released this afternoon. Markets will closely follow if the recent weakness seen in consumer sentiment surveys has translated into more cautious spending behaviour.
- On Wednesday, the FOMC meeting is set to take place, with an unchanged rate decision anticipated. Attention will be on Powell's communication about future rate cuts and economic projections, as the Fed may signal further tapering or the end of QT soon. On Thursday, the Bank of England is expected to keep the Bank Rate at 4.50%, following its gradual approach to monetary policy. Meanwhile, the SNB is likely to cut the policy rate by 25bp to 0.25% due to subdued inflation pressures.

Economic calendar

Economic and market news

What happened over the weekend

In Germany, the incoming government has reached an agreement with The Greens on reforming the debt brake and establishing an infrastructure fund. Overall, the package is nearly identical to what was originally proposed. Concessions to The Green party include a commitment for the off-budget fund to focus on green initiatives, with EUR 100bn out of the EUR 500 billion dedicated to this cause. On defence, the agreement maintains the exemption of spending above 1% of GDP from the debt brake, with an expanded definition to include aid to Ukraine and intelligence services. The third aspect of relaxing regional governments' "black zero" policy is also agreed upon.

In the euro area, final inflation figures came in for Germany, France and Spain. While France and Spain reported levels consistent with their initial flash estimates, German final HICP inflation was revised down to 2.6% y/y from 2.8% y/y in the flash release. The lower final print will pull down the euro area HICP where German inflation has a weight of 28%.

In the US, the University of Michigan's consumer survey revealed a significant decline in sentiment as inflation fears grew. Preliminary March results indicate a 1-year inflation outlook of 4.9%, up from February's 4.3%. Consumers are less optimistic, with current situation assessments dropping to 63.5 from 65.7, and future expectations falling to 54.2 from 64.0. The impact on consumption will be closely watched when February retail sales data is released today.

In Sweden, the Labor Force Survey for February showed employment rising by 0.2%, while the unemployment rate fell to 8.9%, mainly due to a decrease in the activity rate and more discouraged workers. Although employment aligns with the Riksbank's December forecast, unemployment remains high. The decline in temporary workers suggests a weak labour market outlook for the next 6-9 months, with slow improvement expected later this year. The data highlights low resource utilization, indicating potential downside risks for Riksbank rate cuts, though high inflation remains the primary concern.

The Swedish Moderate Party announced that: 1) The government will add SEK 11.5bn of fiscal spending in the spring amendment budget bill, likely with parts of it being defence related. 2) The Moderate Party is open to more borrowing, which they label should be temporary in nature. How large the increase in defence spending eventually will be is likely to be decided at the upcoming NATO summit in June. For a discussion on defence spending, see *Reading the Markets Sweden*, 21 February.

Equities: In the absence of new tariff threats, equities engineered a nice rebound bounce on Friday. Nasdaq a full 2.6% higher, Russell 2000 2.5%, S&P 500 2.1% and Dow 1.7%. This was a classic rebound session where investors bought the dip in the most battered sectors, such as tech, energy, banks and consumer discretionary. All sectors were notably higher, though cyclicals were in clear favour. The return in risk appetite was visible outside US too, with Stoxx 600 up 1.1% with banks, tech and industrials in the lead. However, this still takes most US lower for the fourth straight week and Europe for its second. One day without tariff news was too little for investor to build upon, as US futures are nosediving again this morning.

FI&FX: SEK, NOK and EUR gained vis-à-vis USD and JPY on Friday as risk sentiment recovered to end the week. EUR/USD traded close to the 1.09 level and EUR/SEK fell towards the 11.00 level. Bond yields held steady with the 10Y US Treasury trading close to 4.30% and the 10Y German bond yield trading around the 2.90%

level.

See also our in-depth *FI & FX morning comment* *

Recommended reading

Research US - Fed preview: Aiming for stability, 14 March

Weekly Focus - Trade war escalation weighs on markets, 14 March

China Headlines - Deflation in February temporary, more upbeat tech news within AI and microchips, 13 March

Global Inflation Watch - Tariff uncertainty blurs the outlook, 13 March

Fixed income and FX markets

Majors FX: The big event this week for GBP FX is the Bank of England meeting on Thursday. We expect an unchanged decision, keeping the Bank Rate at 4.50%. We expect the market reaction to be rather muted but look out for any guidance on altering the gradual approach to cutting interest rates. Our bias is for a swifter cutting cycle than currently priced by markets, which could weigh on GBP FX. For now, German politics and global factors are the main driving forces for EUR/GBP. We stay bearish.

Majors FI: The fiscal expansion could drive yields even higher in the near term despite the dramatic move we have already seen in February and early March. Last week, we closed our long position in Bunds that we took on earlier this month. We took the trade on at 2.82%, and closed it at 2.87%, as we see some risk of the level breaking through 3% as supply worries could worsen in the near-term. Our bias, though, remains for lower yields over the next 12M as German term premia have reached elevated levels and markets are still to discount additional ECB cuts. This week, there will be a vote in the Bundestag (18 March) and Bundesrat (21 March) on the fiscal package that the CDU/CSU, SPD and Greens settled on last week. Furthermore, there is plenty of supply this week as Finland, Ireland, Germany, France and Spain are coming to the market. The net cash flow is negative given the supply and limited redemptions and coupons. This could add renewed pressure on Bunds. In the US, the 10Y UST yield continues to hover around our 12M target of 4.20%. We do not expect the FOMC to provide any clear direction for yields this week, although the door will remain open for a May cut. Any changes to QT, which could be unveiled at the meeting, will most likely have a modest impact, as a near-term tapering announcement already seems discounted by markets.

Scandies FX: The previous positive SEK momentum has abated, and it increasingly looks like EUR/SEK troughed (for now) around 10.90. Last week was mostly spend consolidating around 11 and we expect more of the same in the coming week. We retain our tactically neutral near-term view on broad SEK, but as our short-term fair value models are currently indicating that the SEK looks a tad overbought across crosses, we see scope for a slight SEK depreciation over the coming weeks. As for this week's domestic calendar, Thursday's Riksbank decision will be key. We expect an unchanged decision and a flat rate path but are keen to listen in to the board's assessment of the developments since their last meeting, including the inflation topside surprises.

In terms of FX, a dovish surprise with the Riksbank opening for another cut should push EUR/SEK higher given current market expectations. If that door is firmly closed, the SEK will probably be supported, though the aforementioned fair value model suggests that the downside potential is relatively muted. See, *Reading the Markets Sweden*, 14 March for more on the Riksbank and the SEK.

In Norway, we will pay attention to any news with respect to the central wage negotiations although it is not clear we will get a deal before the rate decision. For more information please see *Reading the Markets Norway*, 14 March, where we also recommend buying a 6M USD/NOK bullish seagull (cost neutral). The intuition behind this FX trade is simple. We think the long-term headwinds for NOK are set to return and we see the latest NOK rally offers an attractive opportunity to add some strategic short exposure. US recession risks have been priced considerably into the USD, and we think the energy complex will continue to struggle. In addition, we think the balance of risk for NOK-USD rates spreads is skewed to downside - but we stress that this trade is not a position on Norges Bank cutting in March. Finally, purely from our cross-asset regression model - based on relative rates, curve slopes, relative equity sector performances, oil and natural gas prices - USD/NOK seems oversold with our fair-value estimate of 11.13. The timing of the trade is very difficult and for that reason we opt for an option structure as an alternative to the spot-outright position.

Danish Banks have tapped the central bank 1W repo facility for DKK15bn - the first time since June 2022 the facility has been used. The move comes amid tightening of liquidity conditions in the Danish money market and a recent surge in money market rates, e.g. the 3M EUR/DKK FX forward climbed to -15bp on Friday - well above the -40bp policy rate spread. The net position is set to drop below DKK200bn this week for the first time since 2022 due to large corporate tax payments and fall further next week. Banks will likely continue to use the repo facility as long as liquidity conditions stay at these tight levels.

Scandies FI: We are up for a key week when it comes to short-term Norwegian rate outlook. Following last week's big inflation topside surprise markets have gone from pricing a 25bp Norges Bank 27 March rate cut as a certainty to now pricing it at a less than 50/50 likelihood. The ultimate decider is likely to be Thursday's Regional Network Survey where we will especially pay attention to the capacity utilization metric. Should this fall we think the short end of the NOK curve offers a very appealing receive case. We therefore stand ready to receive NOK 1Y1Y vs EUR

1Y1Y should the Regional Network Survey confirm our base line case that rates are far too high for the rate sensitive parts of the economy.

Tactical views

FX

EUR/USD - tactical upside potential - we seek strategic selling opportunities
EUR/NOK - look to fade CPI-induced drop, buy strategic topside exposure
EUR/SEK - room for near-term bounce higher in SEK-crosses
EUR/GBP - strategic downside
USD/JPY - we favour the downside
EUR/DKK - to trade just below the central rate on strong DKK fundamentals
USD/CNY - tactical view neutral, strategic view bullish on trade war 2.0 in 2025

Fixed Income

Europe - We have taken profit on our Bund ASW-spread as we have reached our target, but the spread can go wider (Bunds underperform)
US - Long-end US rates have reached our 12M target. We see near-term risks as being tilted to the upside
Sweden - We expect steeper curves primarily driven by the long end
Norway - Look for opportunities to re-enter steepeners and receiver strategies, possibly on the Regional Network Survey released on Thursday
Denmark - We expect further performance in DGBs versus matching German government bonds

Commodities/Energy

Oil - low and steady on benign supply conditions and trade war woes.

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