

21 January 2016

Flash Comment Denmark

Denmark to mirror ECB cut in March - but it's a close call

- We expect Danmarks Nationalbank (DN) to mirror a 10bp ECB rate cut in March and lower the rate of interest on certificates of deposit to minus 0.75%.
- The 7 January 10bp DN rate hike should be sufficient to stabilise EUR/DKK close to the central rate and we expect EUR/DKK to trade at 7.4550 in 1M-12M.
- It is a close call and DKK10-20bn of FX intervention outflow would trigger an independent rate hike or a decision not to follow an ECB rate cut in March.

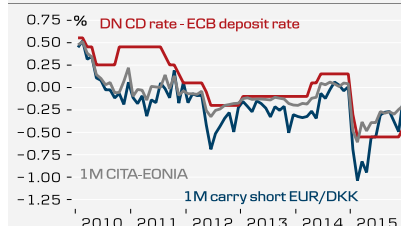
Following the meeting in the European Central Bank today, we now expect the ECB to cut its deposit rate by 10bp to minus 0.40% at the upcoming March meeting – see *ECB comment: Draghi never gives up – we expect 10bp cut in March*. We expect Danmarks Nationalbank (DN) to mirror the rate cut and lower the rate of interest on certificates of deposit to minus 0.75%. In our view, the 7 January 10bp rate hike normalising the DKK-EUR money market interest rate spread to around the level last seen in 2013 should be sufficient to stabilise EUR/DKK close to the central rate of 7.46038 and we expect EUR/DKK to trade at 7.4550 in 1M-12M.

However, given EUR/DKK currently trades above the central rate of 7.46038, we stress that it is a close call. As we have noted earlier, we look for DN to follow its normal reaction function, which means DKK10-20bn of FX intervention outflow will trigger an independent rate hike or a decision not to follow an ECB rate cut in March, thereby narrowing the spread between DN and ECB policy rates.

DN may also act if there has been an outflow below this level, while the experience from 2014 may lead DN not to react too swiftly. In June 2014, DN opted not to follow the 10bp ECB rate cut due to the DKK0.8bn of FX outflow in May. This decision initiated the trend lower in EUR/DKK, the pair traded close to 7.44 three months later, which ended in the strong rally into DKK January and February last year.

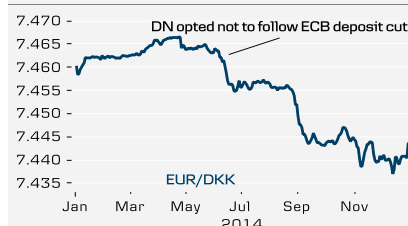
We do not expect DN to raise banks' current account limit again when the rate of interest on certificates of deposit is cut to minus 0.75% again. The reason for this is the lower net position, which has already reduced the amount of excess DKK liquidity banks will have to deposit at a negative interest rate.

Market rate spread back to normal



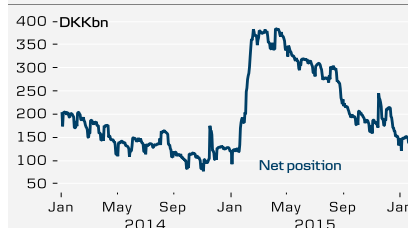
Source: Macrobond Financial

June-2014 experience may scare



Source: Macrobond Financial

Lower net position limits need for higher current account limit



Source: Macrobond Financial

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This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The author of the research report is Jens Nærvig Pedersen, Senior Analyst.

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