ANDBANK RESEARCH

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Switzerland, Denmark ... The first steps in the final unravelling of the euro?

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ANDBANK Private Bankers

Following the last month SNB's shocking decision of de-pegging the Swiss franc, investors are now targeting the Danish Krone (buying it), challenging Copenhagen's long held fixed exchange rate policy.

Factset Research Systems, Andbank.

Which acrobatics the Danish Nationalbank is doing in order to defend its peg with the EUR and neutralize the buying pressure from investors?

1. In the last three weeks, the Nationalbank has cut its main policy rate four times! (to a record global low of -0.75%)

2. Denmark has stopped issuing government debt, bringing (with this new supplies cut off) the yield of the five-year government bond to an astonishing -0.4% with the aim of stopping foreign demand for DKK denominated assets.

3. In January, the central bank has sold some DKK106bn (US$16.2bn) in order to depreciate its currency. These Krones had to be created and by doing it, the central bank's balance sheet was inflated by a 25%.

What do we think of all this madness resulting from the blatant manipulation of the entire global monetary system?

1. In my view, investors are right when buying the DKK! I also think that the Krone is deeply undervalued following the euro's steep decline and the maintenance of the DKK-EUR peg. Why?

2. When the euro declines against the USD, I see now sound reasons for such a move (Draghi's decision to implement the QE with the aim to monetize debt of countries with large funding needs). However, for a country that can afford to cut the debt issuance (Denmark has surplus) and decides to defend its peg with the euro (by artificially devaluing the Krone), we see this move as a forceful action, not being supported by any foundation.

3. Indeed, both central banks are expanding monetary base but the reasons are quite different. The euro devaluation is a consequence of the miseries of the region (among these the own fiscal, and now, the monetary policy), being the euro fall, therefore, fair. Instead, the DKK's devaluation is not a consequence of any misery.

4. As we see it, the market will inevitably continue to put a lot of pressure to an artificial and forced exchange rate, forcing the Danish central bank to eventually give up and stop expanding balance sheet, selling Krones and buying euro denominated bonds.

5. Against this, we have the possibility of a 20% gain if the peg breaks today.

When can this happen?

1. Following recent statements from Mr. Lars Rohde (Danish central bank governor), not in the short term. Thus, I would not bet for an imminent de-pegging of the Krone. *Mr. Rhode: "We can place all of our excess currency reserves –roughly 30% of GDP- in the euro bond market at a negative rate of -0.1% or -0.2% since we are finding ourselves at a negative rate of -0.75%". "We can go on forever".* (Remember that Switzerland's Fx reserves ballooned to 80% of GDP before they broke the peg. So they still have room to maneuver).

2. Well. Nobody in their right mind believes Mr. Rohde's suggestion of keeping the DKK devalued is credible. In no way it is the same to borrow money through a Denmark bond (a certain liability for the Danes) than lend money through an Italian bond (uncertain asset for the Danes).

3. Mr. Rhode's point of "We can go forever", will soon blow up, being the second currency "departing" from the Euro (the first one was the Swiss Franc) and appreciating significantly.

4. And now the million dollar question: Which currency will be the third currency departing from the Euro? Knowing that the GBP jumped (long ago) the fixed exchanged system (courtesy of Mr. Soros), I am inclined to think that will be a currency within the euro.

5. Which One? Seeing that are precisely the "good" currencies that decide to leave the euro (CHF, and the DKK in short), rather than Greece, one could easily think that will be the Germans that will decide to depart.

6. Obviously, all this dynamic will materialize only if we continue doing the same things that caused all this madness. (Remember that all the fuss in the exchange rates was initiated the day that Draghi announced its QE).

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