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SEK rates weekly: Surprises create doubts on Swedish inflation exceptionalism

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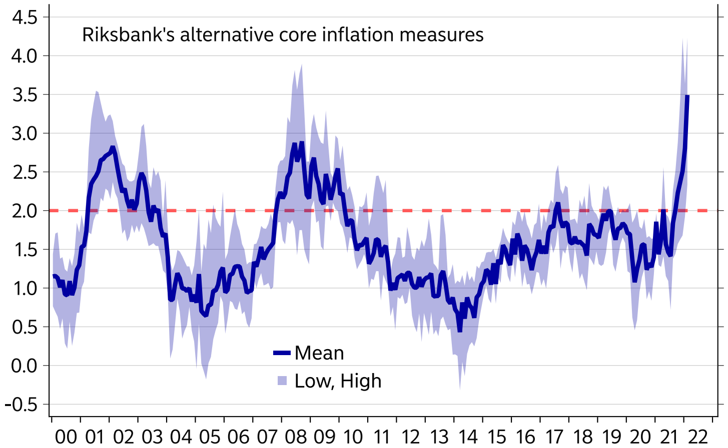
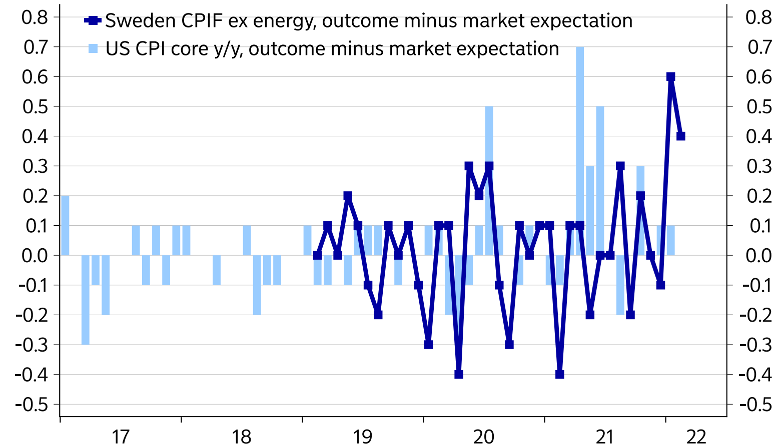
Riksbank: Surprises create doubts on Swedish inflation exceptionalism

1. Core inflation has surprised significantly on the upside. No matter how you slice and dice inflation, it is on record high levels.



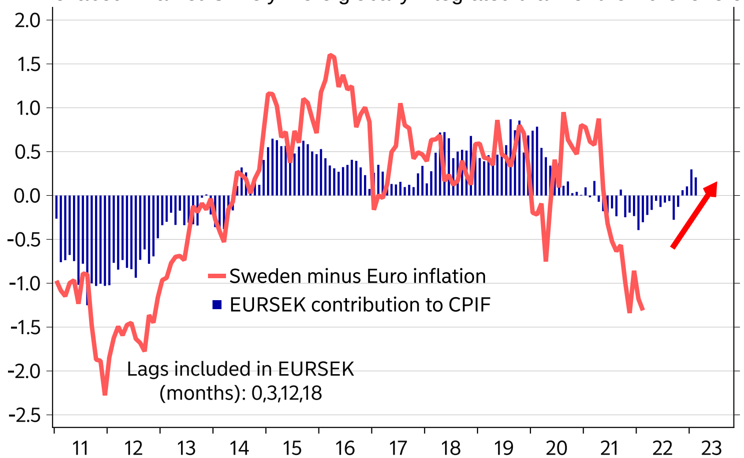
Source: Macrobond and Nordea

2. Comparing to the US, it seems that Sweden is going through a similar "surprise phase" that the US suffered in Q2 2021 and that eventually paved the way for a turning Fed around six months later.



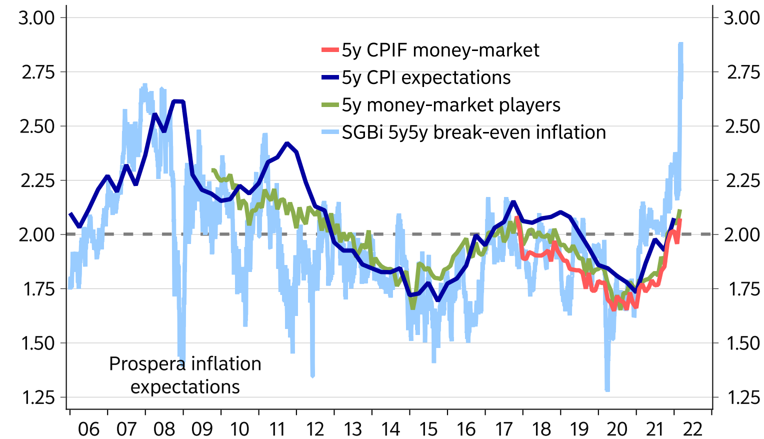
Source: Macrobond and Nordea

3. The Riksbank has argued that Sweden has less of an inflation problem that other economies. For example Sweden can be argued to have less lingering inflationary consequences of pandemic support measures. Also, it has less exposure to natural gas. Wage negotiations are centralized and wages show little sign of problematic increases. The labour market is likely more globally integrated than for the Eurozone on average.



Source: Macrobond and Nordea

4. The lagged impact of the SEK strength in 2020 may have hidden some goods inflation, and when the FX contribution starts to drive on the upside in prices instead, the outlook may look different. Also inflation expectations are of immense importance: sudden shifts to above target levels and persistence of expectations should be watched for, but no signs of this yet.



Source: Nordea Markets and Macrobond

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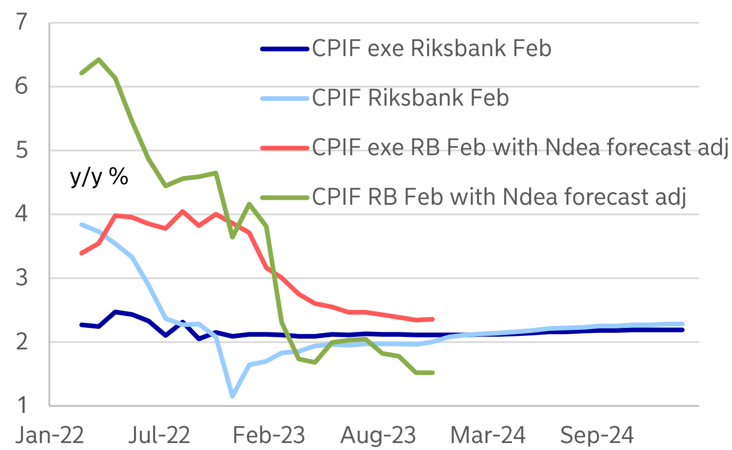
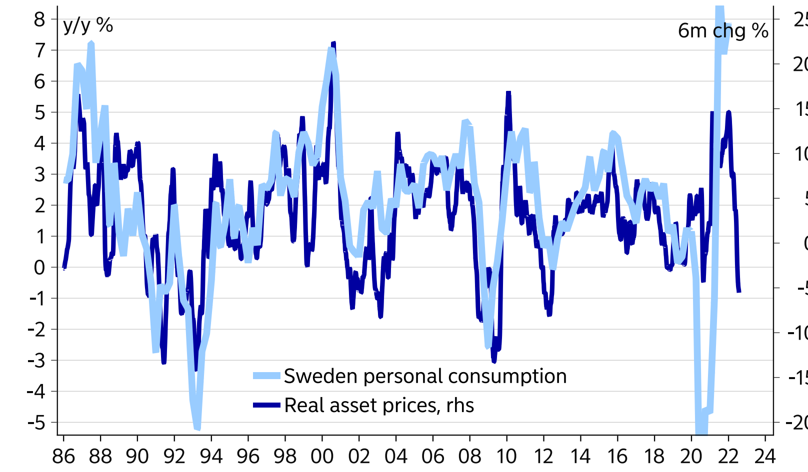
Macro Strategy: The economy is cooling, but maybe not fast enough

1. We have taken the Riksbank's inflation forecasts from the February policy report and adjusted them with the forecast revision that Nordea has made since then. Major revision by the Riksbank is in the pipeline for the April meeting!



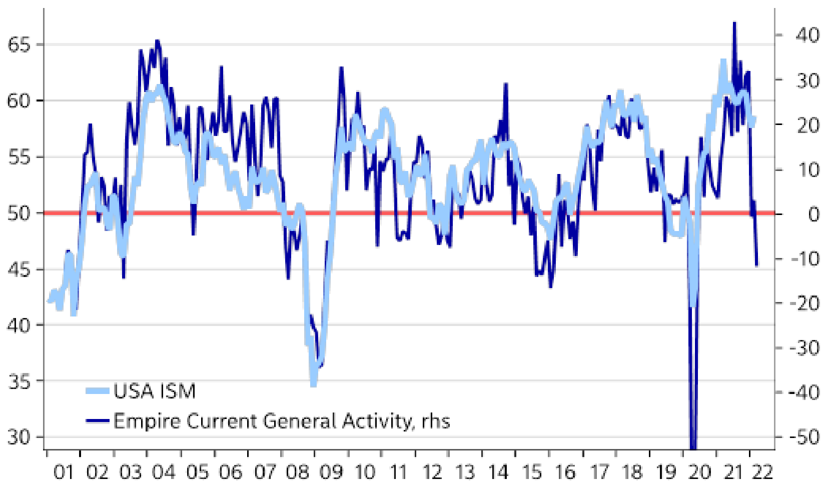
Source: Nordea

2. The extended and increased inflation hump must be put against indicators that point at a cooling economy: the stock markets are down by a lot year-to-date, inflation is running wild and the risk of a military conflict is likely chewing in many households subconsciousness.



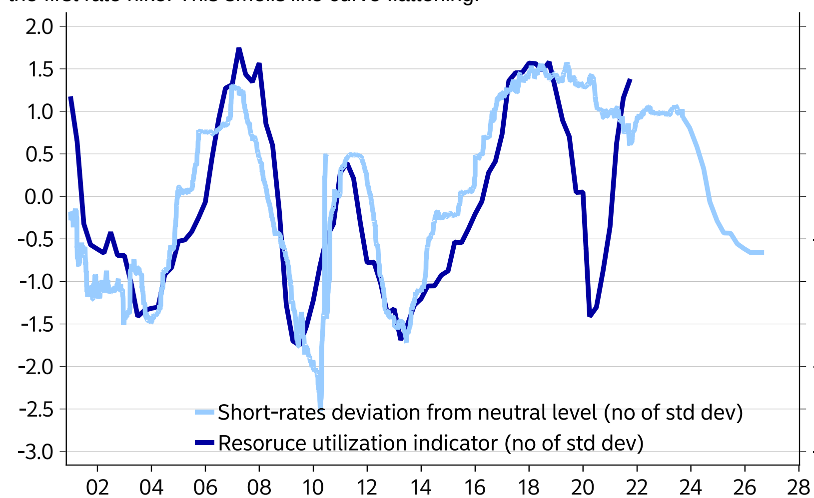
Source: Macrobond and Nordea

3. The drop in business confidence in March has been extreme and the business cycle is about to be squeezed by both household demand, the drop in manufacturing confidence, higher energy prices and higher rates.



Source: Macrobond and Nordea

4. But the dampening of the economy may take time. It is usually higher policy rates that finally breaks the business cycle and in Sweden the policy rate has yet not been raised even once. Many more quarters of high activity in the economy may be in the pipeline, even after the first rate hike. This smells like curve flattening.



Source: Macrobond and Nordea

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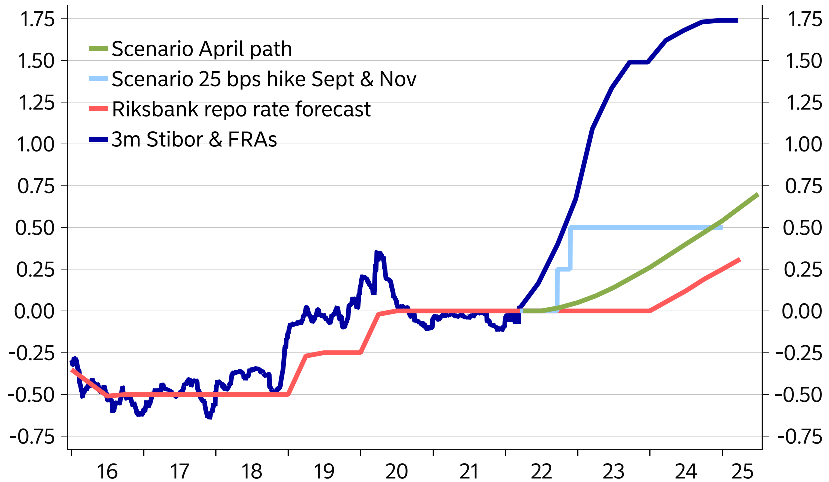
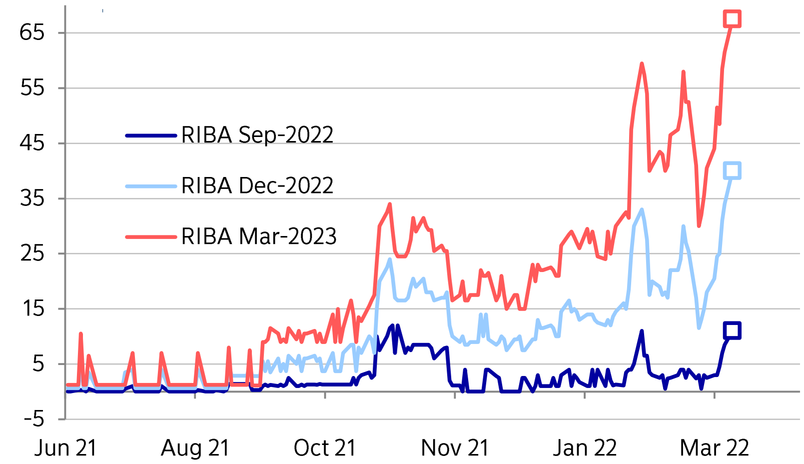
SEK rates: Listen, the yield curve speaks!

1. The message from the rate market is clear: one or two rate hikes will be delivered over the next three meetings. After that: one hike per meeting.

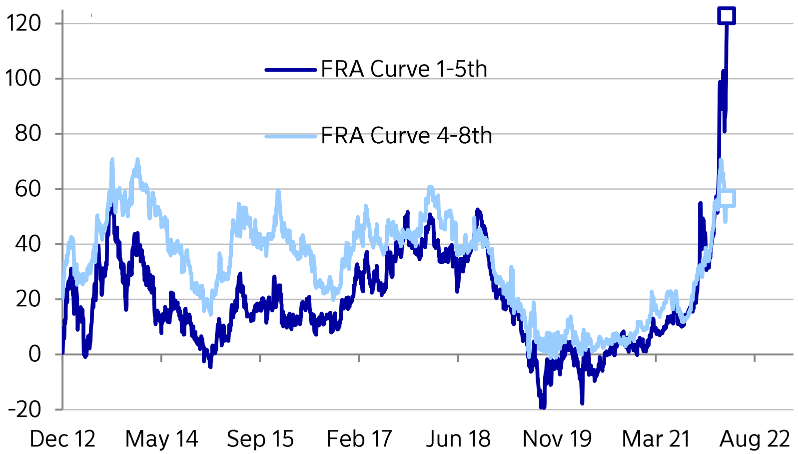


Source: Nordea Markets and Macrobond

2. More and more hawkishness has been baked into the front-end of the yield curve. The large inflation upside surprise made Nordea change its main scenario for the policy rate: going from zero to two hikes in 2022 (Sept & Nov).

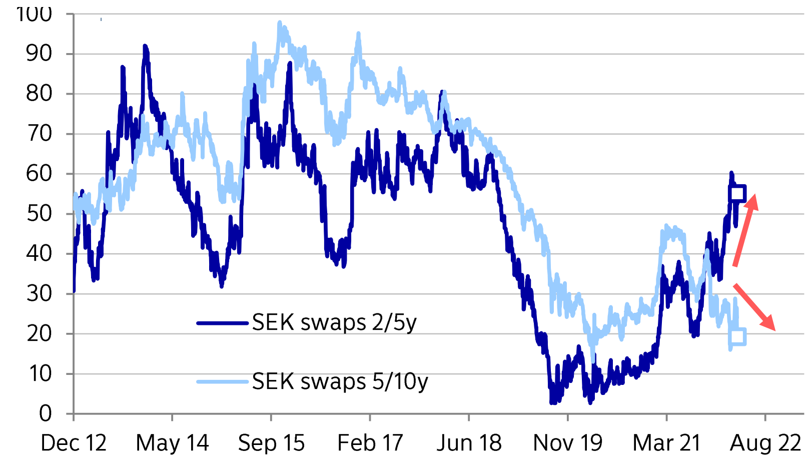


3. The consensus has shifted and the governor Ingves has commented publicly that rate hikes will come earlier. It is unusual for the Riksbank to comment on policy between meetings. The FRA curve reflects the current policy revision train: very steep in the 0-1y and less steep 1-2y (same theme as on most segments of the yield curve).



Source: Nordea

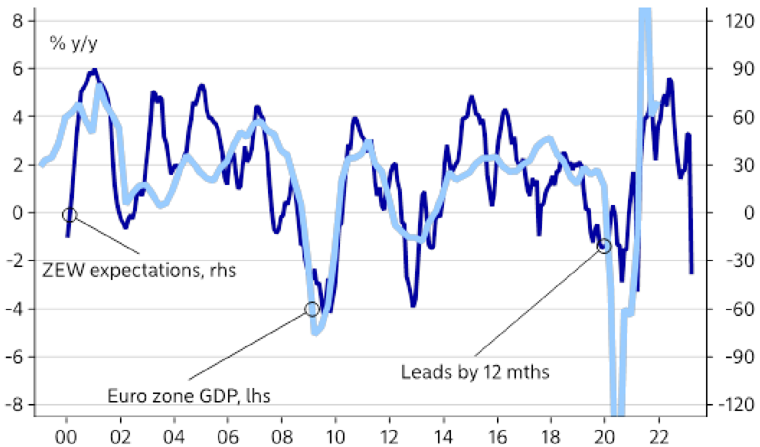
4. We have prematurely argued for value in receiving Sep and Dec-22 FRAs. It is yet not clear if the Riksbank is in "panic mood" regarding inflation. Most likely not, and neither a July nor a Sept hike is set in stone. Still, the yield curve has spoken also on longer tenors. Early rate hikes that will sap the business cycle, motivating a flatter curve longer out. Although we have argued for the front-end to say steep and the flattening trend 5y+ to continue, we are surprised by the magnitude of re-pricing.



Source: Nordea

Duration: Struggling with the bond vs equity regime

1. The economic outlook has become less shiny for quite some time. High energy prices, rising bond yields and falling equity market all contribute. More near-term business cycle indicators are also turning more negative and the net contribution of our macro models may start to contribute to a long duration bias in the coming weeks.



Source: Macrobond and Nordea

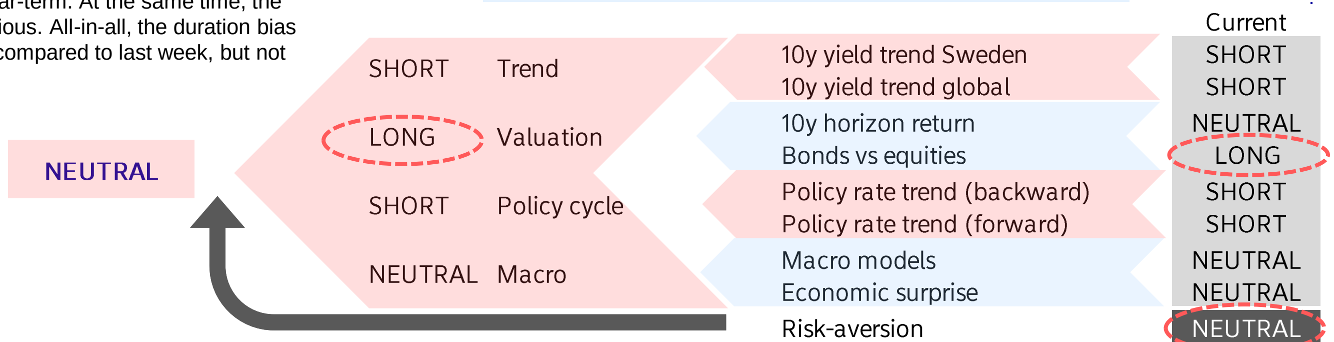
2. The set-back in the equity market, widening TED spreads and rising volatility have turned the "bond vs equity" indicator to a long bias for the first time in a very long time. The high inflation numbers that have materialized over the recent months complicate the picture. In an high inflationary environment, inflation expectations may de-anchor and inflation risk-premium start to drive bond yields. In such regime, decreasing equity prices may not coincide with lower bond yields. Our assessment is that we are in a twilight zone regarding the inflationary regime. Despite the high inflation outcomes it is not obvious that inflation risk-premium will start to drive the bond market since central banks are recalibrating their policies and re-committing to price stability.

Weight	Equity vs bonds z-indicators	Mar	Feb	Jan	Dec	Nov	Oct
20%	Expected info ratio	-2.0	-1.5	-0.7	-0.8	-0.2	-0.3
10%	CB liquidity	-0.1	0.0	0.0	0.0	0.1	0.0
5%	Fwd PE	-1.3	-1.6	-2.2	-2.3	-2.3	-2.4
15%	TED spread	-1.2	1.0	0.8	0.5	0.9	1.1
15%	Orders & Employment	0.0	0.0	0.4	0.5	1.0	1.6
35%	Trend	-1.0	0.1	0.8	0.8	0.8	1.0

Red dot means contrubtion to long duration bias *Source: Nordea*

3. Bias on duration We remain with a neutral duration bias but the underlying dynamics has changed quite a bit. Risk-aversion has subsided both in the equity market but also in implied volatility in general. Although the situation can change abruptly, we put no restriction to a short duration bias from the perspective of risk-aversion. Downside risk to the equity market adds a long duration contribution and macro activity indicators have taken a turn for the worse. Also, higher bond yields and a steep 0-5y yield curve is starting to make rolldown and carry attractive again, potentially adding to a long duration bias in the near-term. At the same time, the policy hiking cycle is intact and the yield trend obvious. All-in-all, the duration bias process has pushed us closer to a short duration compared to last week, but not all the way.

		Change this week
Duration (short/long)	★★★☆☆	UNCH
Covereds (sentiment: weak/strong)	★★★★☆	UNCH



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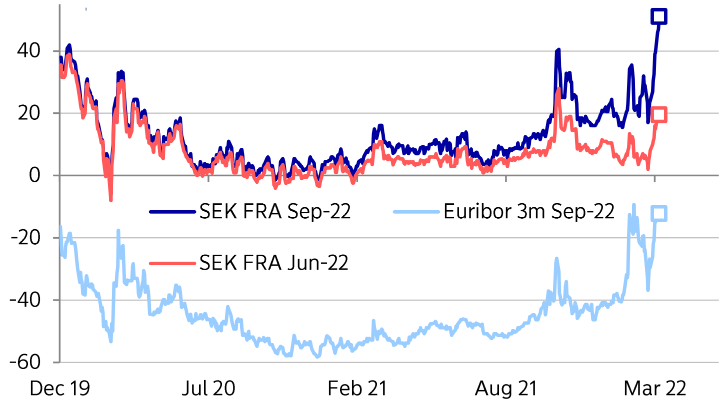
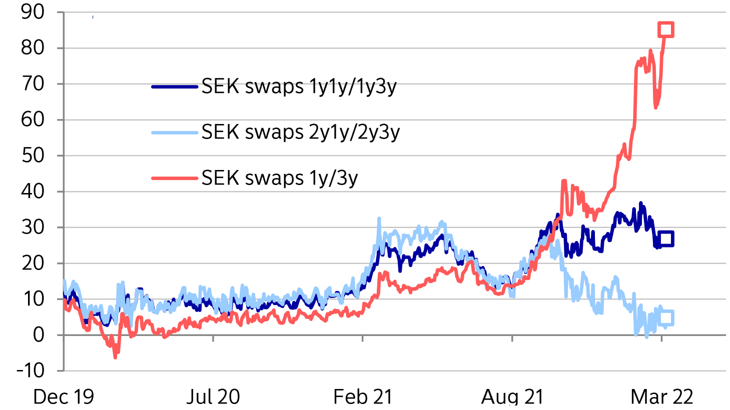
Trade Ideas: Whiplash! Back to somewhere in between the Fed and ECB…

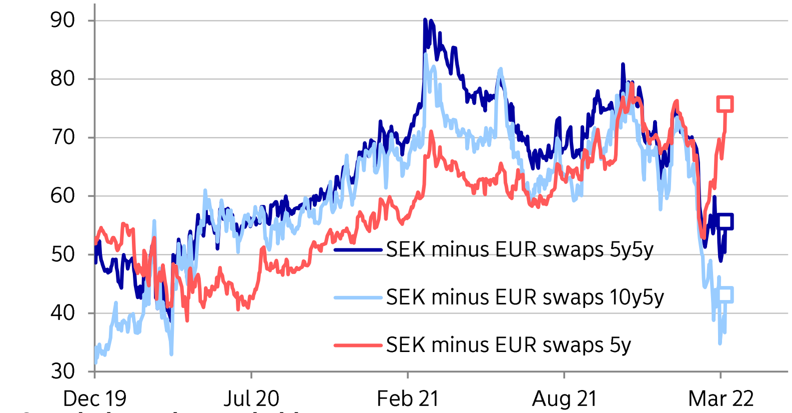
1. Front-end Pricing a June-22 hike with 70% probability and 2-3 hikes until year-end. We argued too early for value in receiving Sept-22 FRA. Now even more value. Not good.



2. Front-end Even the 1y/3y curve is close to being inverted in fwd space. But remember, this curve is already inverted in the US, soon more flattening to come in SEK?

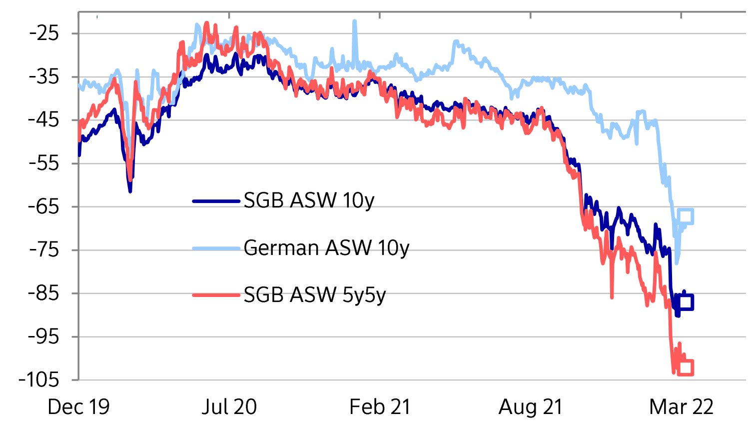


3. Country spread SEK swaps back at or higher than previous highs in spread to EUR on tenors <= 5y. The SEK curve 5y+ has flattened relative EUR, but not unreasonable if front-end is right. The market may be too hawkish on the Riksbank currently but may take time before pricing is adjusted. Eventually, steepening SEK 5y+ relative EUR may be the trade.



Source: Nordea

3. ASW Swap spreads have little to do with policy rates. The wild repricing of rates is mainly driven by the view on policy, so ASWs may be a safer bet. Unfortunately, market liquidity risks remain and SGBs are still mega-squeezed. ASWs may need turn in business cycle data (pointing at turn in gov. budget balance) to start compressing. Worth waiting for?



Source: Nordea

3. Relative value trade ideas

Action	Date	Trade	Comment
	4-Mar-2022	Buy SHYP 1592, sell SGB 1059	The spread reflects liquidity premium sufficiently and offers value
	25-Feb-2022	Receive Sep-2022 FRA	Will take time for Riksbank to turn, downside risk to Stibor
	14-Jan-2022	Receive SEK 1y2y, pay 1y5y	Catch up with the front-end steepening trend

References: Publications year-to-date

Swedish interest strategy publications year-to-date:

11-Mar-2022	SEK rates weekly: New world disorder… case for inverted yield curve
4-Mar-2022	SEK rates weekly: Through the fog of risk, towards higher rates
2-Mar-2022	SEK covereds: Supply update February
25-Feb-2022	SEK rates weekly: Flare in risk-aversion, uncertain outcome for bonds
18-Feb-2022	SEK rates weekly: Stibor is dead, long live Stibor
11-Feb-2022	SEK rates weekly: Policy pivot postponed
4-Feb-2022	SEK rates weekly: A shift in Riksbank's forward guidance
3-Feb-2022	SEK covereds: Supply update January
28-Jan-2022	SEK rates weekly: The balance… equity volatility and bond duration
21-Jan-2022	SEK rates weekly: Highway to the Divergence Zone
14-Jan-2022	SEK rates weekly: Short duration and another front steepener
5-Jan-2022	SEK covereds: Suppy update December
16-Dec-2021	THURSDAY1500: Please insert risk-premium
9-Dec-2021	THURSDAY1500: All I want for Christmas is a steeper yield curve
3-Dec-2021	SEK covereds: Supply update November
2-Dec-2021	THURSDAY1500: A lower bound on rate hike discounting
1-Dec-2021	SEK covereds: EU harmonized law updated, soft-bullets are BACK
25-Nov-2021	THURSDAY1500: A monetary policy plumber uses two tools
22-Nov-2021	SEK linkers: Inflation x-factor cannot be checked yet
18-Nov-2021	THURSDAY1500: Riksbank's not turning yet
11-Nov-2021	THURSDAY1500: Lower Swedish inflation-risks than in other markets
4-Nov-2021	THURSDAY1500: The business cycle never sleeps
3-Nov-2021	SEK covereds: Supply update October
28-Oct-2021	THURSDAY1500: The Riksbank's SEKret weapon
21-Oct-2021	THURSDAY1500: Borrowing report preview
14-Oct-2021	THURSDAY1500: Policy information deficit
7-Oct-2021	THURSDAY1500: SGB ASWs are satellites without a planet
6-Oct-2021	SEK covereds: A deep dive into medium term drivers
6-Oct-2021	SEK covereds: Supply update September *** special edition ***
30-Sep-2021	THURSDAY1500: The symphony of slope, covereds and volatility
23-Sep-2021	THURSDAY1500: Asleep in Neverland
16-Sep-2021	THURSDAY1500: Riksbank preview
9-Sep-2021	THURSDAY1500: Tapering morphs seamlessly into reinvestments
2-Sep-2021	SEK covereds: Supply update August
2-Sep-2021	THURSDAY1500: The Long March of inflation pressure
26-Aug-2021	THURSDAY1500: Positive carry & roll that should work on higher rates
19-Aug-2021	THURSDAY1500: Speed limits and roll games
16-Aug-2021	SEK linkers: Supportive environment for BEI as new 18y bond…
12-Aug-2021	THURSDAY1500: Policy slow-motion
9-Aug-2021	SEK covereds: Supply update July
5-Aug-2021	THURSDAY1500: Washed out

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…

6-Jul-2021	SEK covereds: Supply update June
23-Jun-2021	SEK rates: Riksbank preview
17-Jun-2021	THURSDAY: The sphinx-like curve slope
10-Jun-2021	THURSDAY1500: No news is good news for bonds
4-Jun-2021	SEK covereds: Supply update May
3-Jun-2021	THURSDAY1500: 5 bps widening may be the new 50 bps
1-Jun-2021	SEK rates: Calculations on the new 50y SGB bond
27-May-2021	THURSDAY1500: Despite less issuance, 50y SGB adds duration
20-May-2021	THURSDAY1500: Borrowing report preview
20-May-2021	SEK rates: Extensions ahead of extension
6-May-2021	THURSDAY1500: Low inflation supports relative receiving
5-May-2021	SEK covereds: Supply update April
22-Apr-2021	THURSDAY1500: Riksbank preview
15-Apr-2021	THURSDAY1500: Fiscal spending vs business cycle
8-Apr-2021	THURSDAY1500: Government index-extension at the gate
8-Apr-2021	SEK covereds: Supply update March

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