



# EUR Rates

- Schatz observations and SE vs DE bond remarks

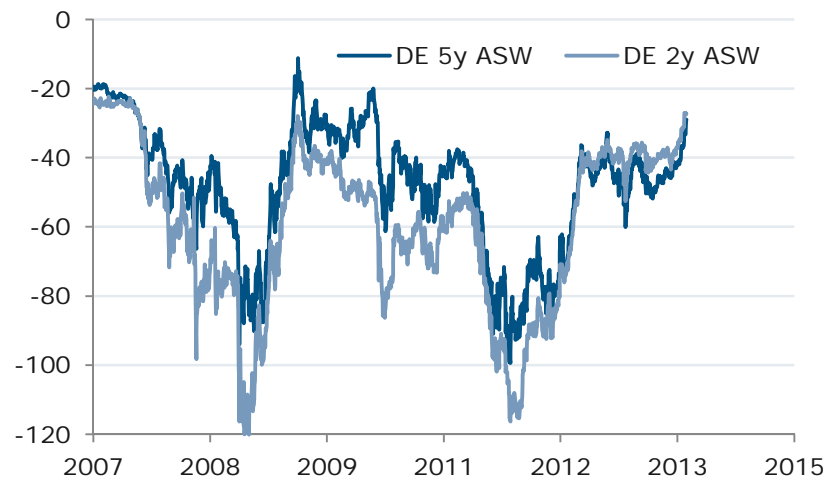
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# Summary

*The sell-off in Schatz will likely continue going into year-end and revert thereafter. The depth of the investor's pockets will decide if current levels are attractive for entry...*

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- Schatz have cheapened significantly during past month.
- We see this move mainly driven by the liquidity stress that has pushed the short end, and also repo rates, higher.
- This has helped tighten ASWs.
- We believe this is mainly year-end related.
- The following slides try to illustrate the drivers behind the move and some cross market observations vs SEK.
- Whether this is a good entry opportunity depends largely on the depth of the investor's pockets. The move will likely continue as we approach December 31, and revert thereafter.



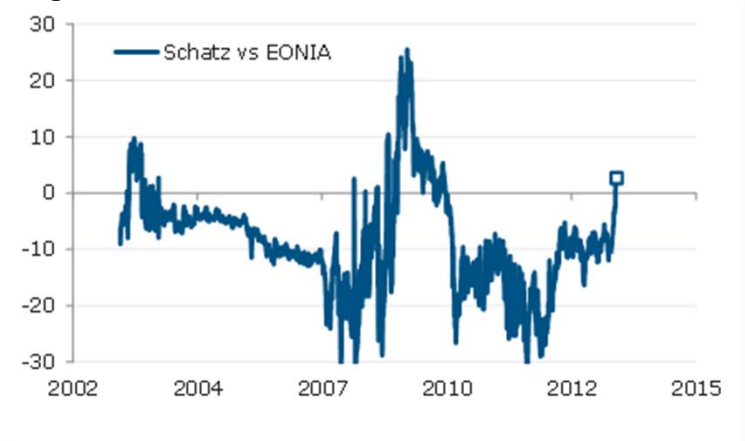
Source: Nordea

# Repo-driven sell-off

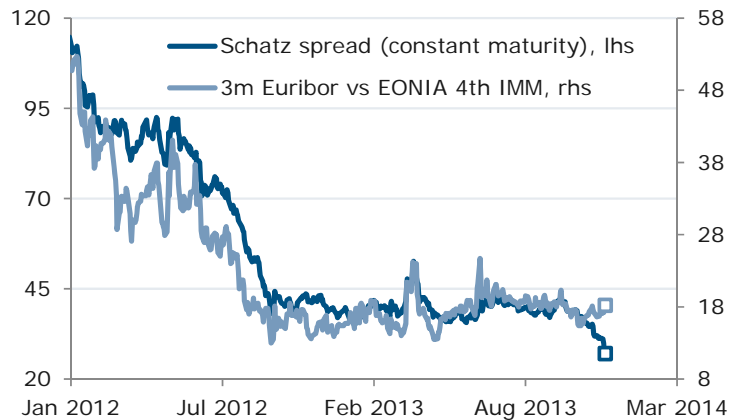
*Sell-off in EUR short end has pushed repo rates higher, and bonds have followed suit...*

- German ASWs have tightened markedly during the past month, with a particularly large move in the Schatz spread, which trades above zero vs EONIA (Fig 1).
- This move may at first glance look counter-intuitive, as the year-end liquidity stress usually is associated with wider Euribor vs EONIA spreads and ASWs (Fig 2).
- What instead has happened this year is that the short end of the EUR curve has sold off (see [EUR Rates: Liquidity pressure rising](#)), bringing the repo rates of most Euro zone markets along, including the German ones. This, in turn, has pushed bond yields higher.
- The German 1m GC rate has now moved higher than corresponding EONIA rate (Fig 3).

**Fig 1. Schatz vs EONIA above zero**

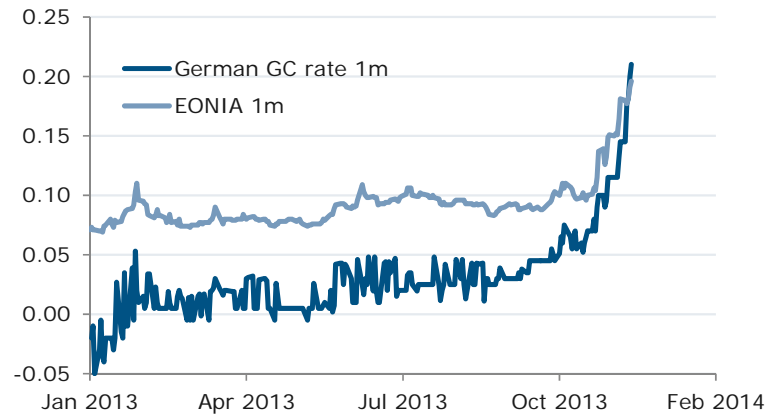


**Fig 2. ASWs decoupling from Euribor – EONIA**



Source: Nordea & Bloomberg

**Fig 3. EONIA above German GC rate**



Source: Nordea & Bloomberg

# Reversal unlikely before year-end

Liquidity is set to tighten further going into year-end, and that should keep Schatz trading cheap and ASWs tight until early next year...

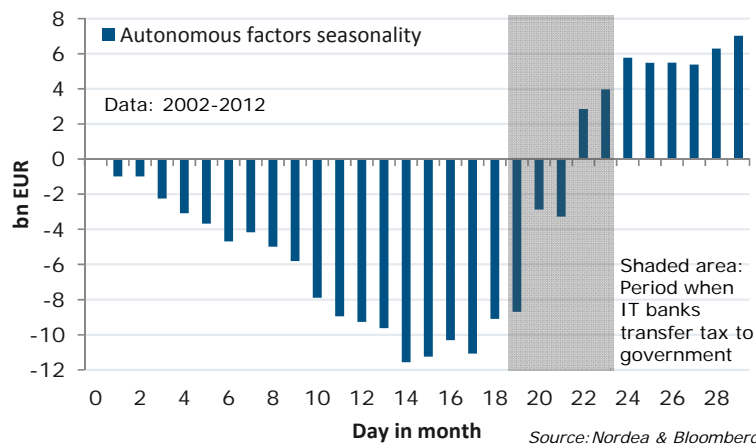
- This has made the carry for holding Schatz less attractive compared to the situations after previous sell-offs in 2013 (Fig 4).
- We expect Schatz to cheapen further going into year-end, as liquidity usually tightens around the 19-23 each month (Fig 5).
- This will occur at the same time as the last LTRO repayment of the year (announced on Friday, December 20).
- Last week's repayment of EUR 22.6bn was the largest since February. Notably, 19bn was repaid from the second LTRO. The uptake in this was skewed more towards peripheral banks, which suggests that they may be increasingly worried about the AQR and stress tests next year, thereby wanting to reduce certain sovereign bond holdings.

Fig 4. This time it's different



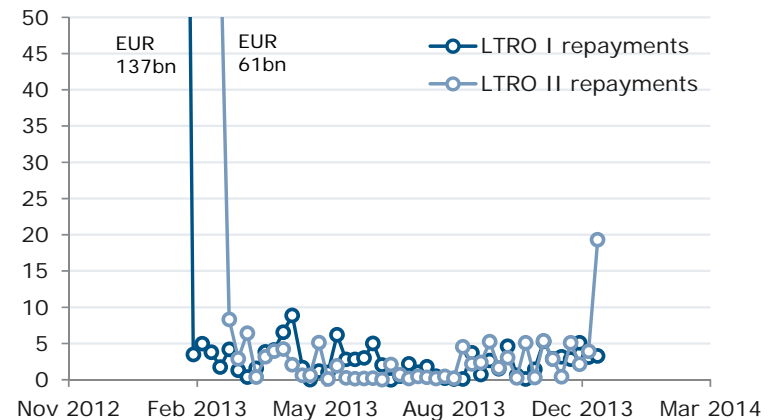
Source: Nordea & Bloomberg

Fig 5. Liquidity to tighten further



Source: Nordea & Bloomberg

Fig 6. One last LTRO repayment remaining



Source: Nordea & Bloomberg

# Observations on Sweden vs. Germany bond spreads

*In the scenario we foresee, spread levels begin to offer value again...*

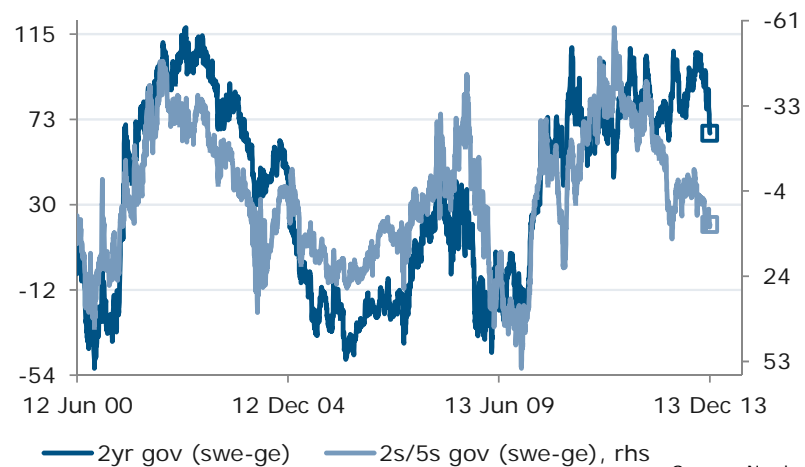
- The underperformance in German bonds and repos have coincided with a significant dovish re-pricing of Swedish monetary policy - alongside the economic soft patch and softening of inflation.
- The mix of these factors have pulled spreads a lot tighter: e.g. 2y bond spreads have moved 45bps since September and now trade in the low end of the past 3 year range (Fig 7).
- Near-term, we fail to see the triggers for a reversal, but levels begin to look interesting and especially in the scenario we foresee, with a marked improvement of Swedish macro data in H1-14 (see [SEK FX & Rates: Swedish Strategy Outlook 2014](#)). Such episodes typically lead to spread widening, a steeper SEK curve and stronger krona (see [Market viewpoint: Swedish schizophrenia](#)).

**Fig 7. 2y SE vs DE has narrowed...**



Source: Nordea

**Fig 8. ... recoupling with the curve move**



Source: Nordea

**Fig 9. 2y govie is the odd one out**



Source: Nordea

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