



Strategy Sweden: On the radar

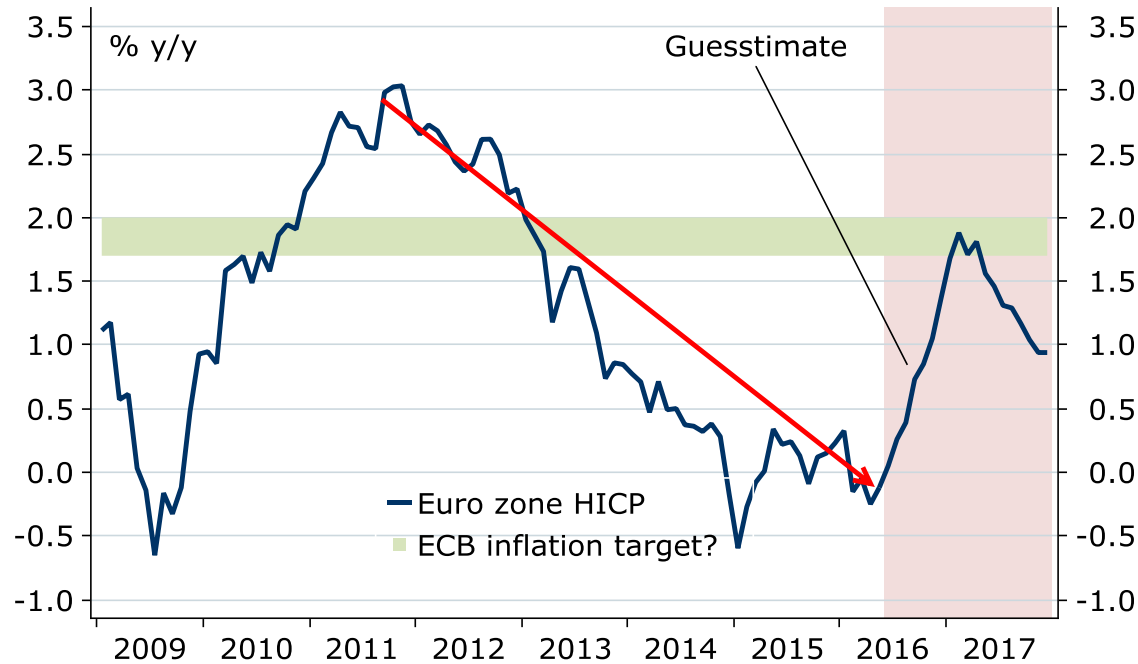
This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea...

Themes in this edition:

- ***EMU:*** it's all about the base (effect)
- ***SEK rates:*** diverging trend is ASW cannot go on forever
- ***SEK linkers:*** did new CPI method lead to richening or market failure

7 June 2016

Chart of the week: it's all about the base (effect)



Källa: Nordea Markets och Macrobond

It is quite easy to construct an inflation scenario where it touches 2% early 2017. An assumption that the oil price reaches 60 USD (anyone's guess), then base effects from energy prices is one important reason. Another reason is that it takes time for currency effects to influence the imported part of consumer prices. Non-energy goods inflation should thereby continue to rise between now and early 2017. A very slight up-tick in Service inflation on top of that and voilà, 2% is possible.

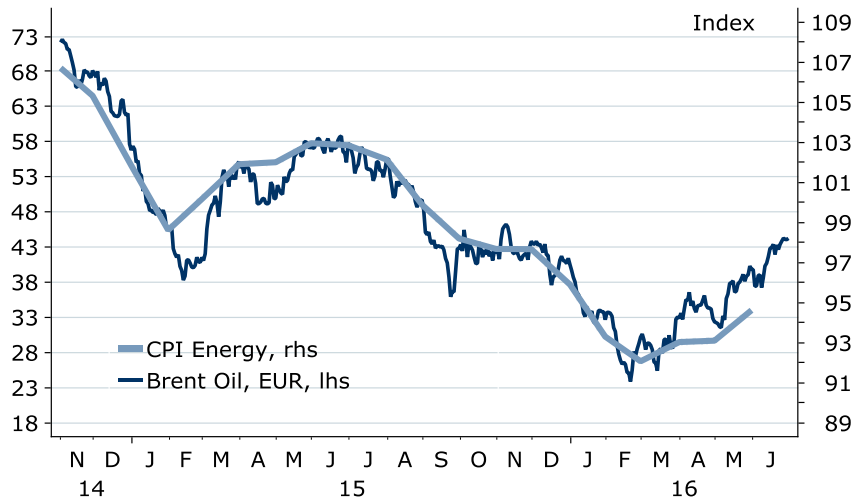
Trades on the radar

Strategy view on direction and curve: We are neutral on near-term direction of global bond yields. Swedish 10y government bonds stick out as cheap relative to core Eurozone. Swedish yield curve also sticks out as overly steep relative other markets. We have a bias to favour curve flatteners, but cost-of-carry make timing difficult.

	Trade idea	Date	Comment
Active	Govies: Short 1047 vs 1052/1051 & 1059 (b-fly)	25-May	SEK rates: switch in focus from near-term cuts to future hikes
Active	Kommuninvest: Long K2012, short Shyp 1584	25-May	SEK rates: supply in at a premium instead of a discount
Active	Govies: Long SGB 1059 vs OAT 10y benchmark	18-Apr	SEK rates: two trade ideas ahead of Riksbank meeting
Active	Linkers: Long SGB 1053 vs SGBi 3111, long US 20y BEI	18-Apr	SEK rates: two trade ideas ahead of Riksbank meeting
Active	Kommuninvest: buy KI 1708 vs swaps	9-Mar	SEK rates: front-end municipals cheap...
Active	Frond-end: receive SEK FRA Dec16, pay RIBA Mar17	12-Feb	SEK rates: have a look at receiving FRA Dec16, pay Mar17 RIBA
Active	Govies: SGB 1058/1053 flattener	3-Nov	SEK rates: steep 10y+ govie curve

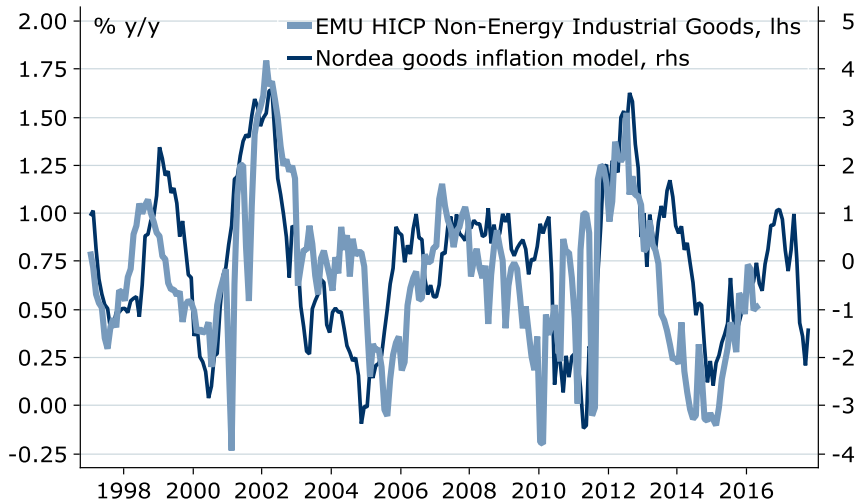
The list of trade ideas is up-to-date around the date of publication. The column "Date" shows the publication date in which the trade idea was initially listed. It does not necessarily reflect our view on the optimal entry date. When a trade is removed from the list, it will be marked accordingly. Obviously, the date of removal/publication does not necessarily reflect our view on the optimal exit date.

EMU: it's all about the base (effect)

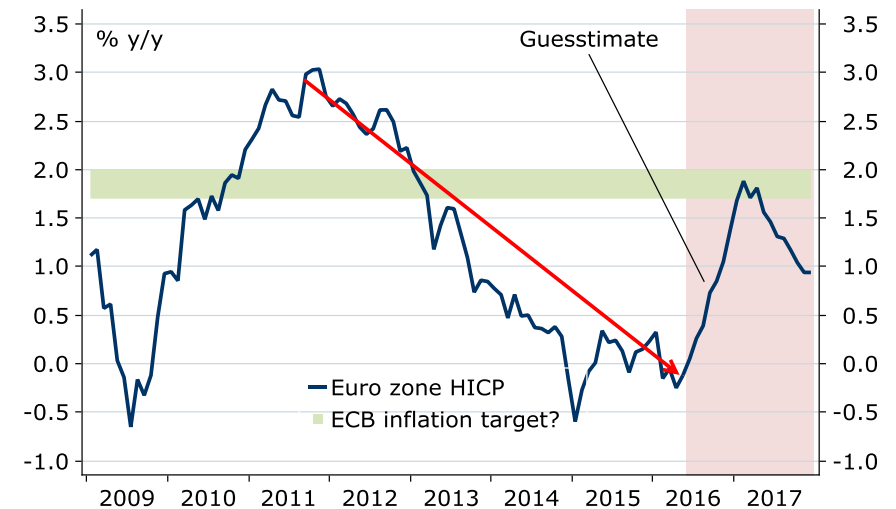


Source: Nordea Markets and Macrobond

The current market wisdom is that ECB won't increase stimulus over the summer, but that the September meeting should include an extension of the QE program and possibly a 10 bps deposit rate cut. That might turn out to be true. More interesting, however, is that we **should face a totally different inflation trend this autumn than what we have been used to since 2011**. It's actually so that it is quite **easy to construct an inflation scenario where it touches 2% early 2017**. An assumption that the oil price reaches 60 USD (anyone's guess), then base effects from energy prices is one important reason. Another reason is that the lesson from Sweden is that it takes time for currency effects to influence the imported part of consumer prices. Non-energy goods inflation should thereby continue to rise between now and early 2017. A very slight up-tick in Service inflation on top of that and voilà, 2% is possible. **How does a bund yield of 0.13% feel in this scenario?**



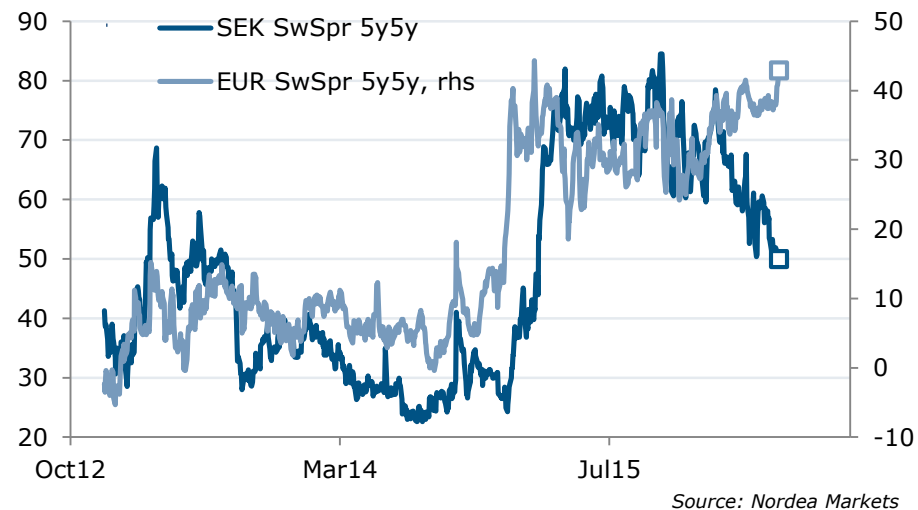
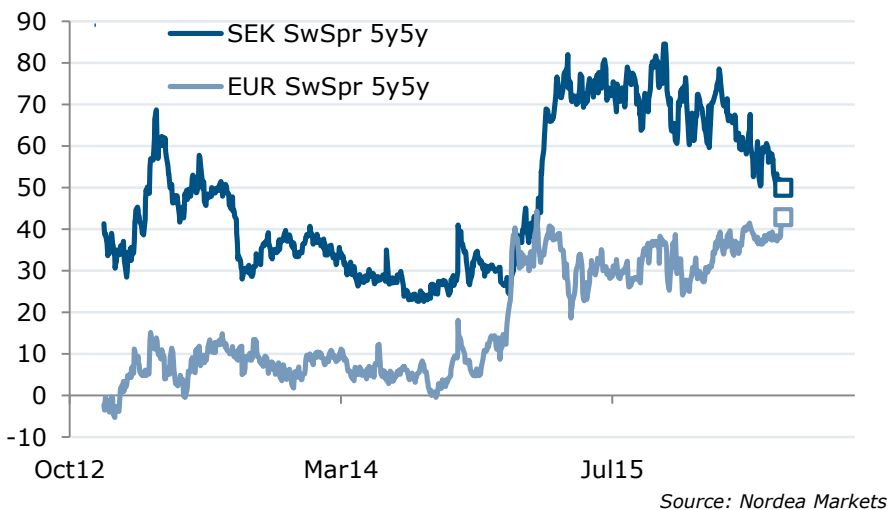
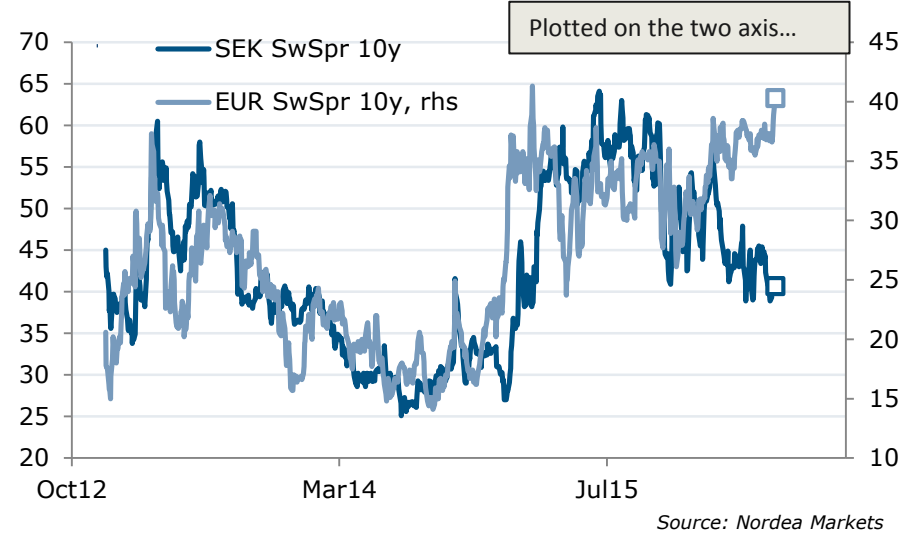
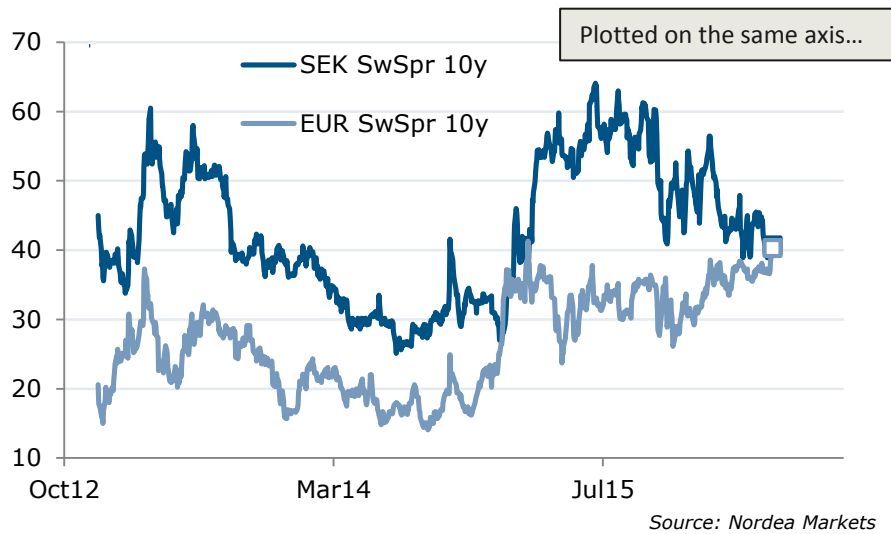
Source: Nordea Markets and Macrobond



Källa: Nordea Markets och Macrobond

SEK rates: diverging trend is ASW cannot go on forever

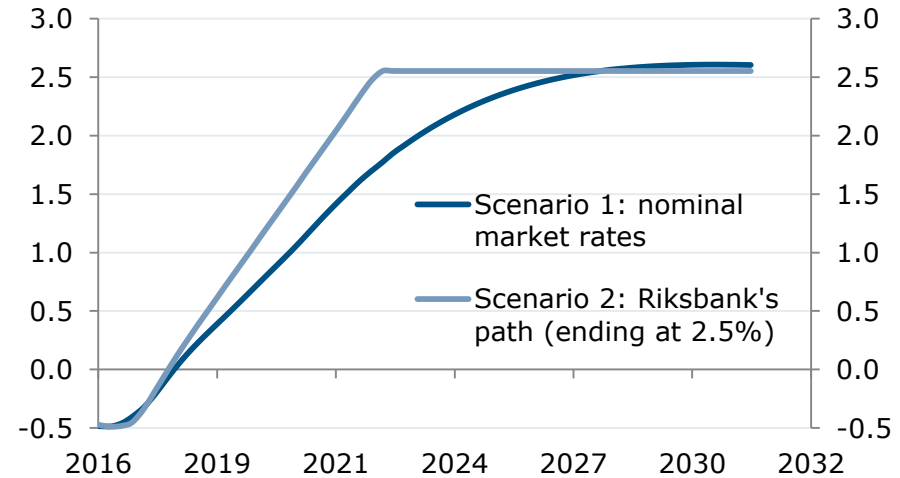
The SEK swap spread curve has started to flatten from very steep levels. A consequence of this is that 10 SEK ASW has trended in the opposite direction of German ASWs as forward starting ASWs (5y5y in charts below). Concerns regarding Brexit and other "risk-off" factors are likely contributing to the widening move in German ASWs but surely SEK ASWs are not immune to these same factors?



SEK linkers: did new CPI method lead to richening or market failure

The new calculation method for CPI reduced value in index-linked. For example, the value in SGBi 3109 was reduced by up to 11 bps. No reaction in the market is either a sign of a sudden increase in the appetite for linkers (richening in the market) or a sign of market dysfunction (failure of market prices to incorporate all available information)...

- On 23 May, Statistics Sweden (SCB) decided to reduce the mortgage weight in CPI by adjusting for interest tax deductions ([read more here](#)).
- The changed calculation method for CPI means that **the impact of higher interest rates in the future will be less** (i.e. less increase in CPI when interest rates increase)
- Since the nominal yield curve is upward sloping, expectations of positive contribution from increasing rates should be discounted in break-even inflation (BEI).
- The new information from SCB what not expected and thus BEIs should be adjusted downward
- The table to the right shows the contribution from rates to BEI in two different scenarios. Taking 30% off these contributions give a **proxy for the impact of the changed CPI calculations to BEIs if discounted at face value: 10-12 bps in the intermediate part of the curve**



Source: Nordea Markets

Bond	Maturity	BEI	Fair-value		Contribution from rates	
			Sc1	Sc2	Sc1	Sc2
SE IL 3107	2017-06-01	0.82	1.56	1.55	-0.25	-0.27
SE IL 3110	2019-06-01	1.30	2.21	2.34	0.21	0.34
SE IL 3102	2020-12-01	1.45	2.29	2.46	0.32	0.48
SE IL 3108	2022-06-01	1.55	2.34	2.49	0.39	0.54
SE IL 3109	2025-06-01	1.67	2.34	2.40	0.37	0.43
SE IL 3112	2026-06-01	1.67	2.31	2.34	0.35	0.39
SE IL 3104	2028-12-01	1.73	2.35	2.38	0.30	0.33
SE IL 3111	2032-06-01	1.73	2.15	2.16	0.24	0.25

- BEI:** break-even inflation using a generic nominal government bond yield with maturity matched to the index-linked bond
- Fair-value:** break-even inflation using Riksbank's CPIF forecast and 2% trend CPIF-inflation. To calculate the interest rate component, two different scenarios for the repo rate is used (see below)
- Contribution from rates:** the contribution from the interest rate component given a repo rate scenario
- Sc1:** scenario 1 uses the repo rate path implied by the nominal market (FRAs and swaps)
- Sc2:** scenario 2 uses Riksbank's repo rate path extended with increases in the repo rate by 25 bps/6 months until the repo rate reached 2.5%

Thank You!

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Martin Enlund
martin.enlund@nordea.com

Mats Hydén
mats.hyden@nordea.com

Jerk Matero
jerk.matero@nordea.com

Mikael Sarwe
mikael.sarwe@nordea.com

Henrik Unell
henrik.unell@nordea.com