

Market Pulse SEK

Conflicting forces in long-end bonds and swaps

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3. Sweden: Low-rate-addiction possible driver of real estate outperformance
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SEK rates: Swap restructuring may add steepening pressure

1. By 1 Jan-2019, new rules for deductions of interest rate costs in corporations will apply.

Change of interest-deduction rules:

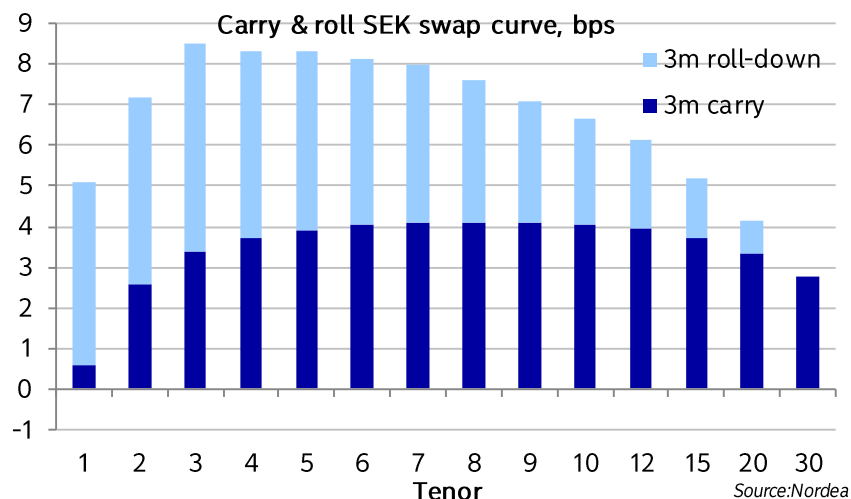
- Rules for deduction of interest cost was changed by decision made by the Riksdag 14 June 2018. The change is an adaptation to EU rules and will be effective as of 1 January 2019.
- Read more [here](#) (only in Swedish)
- Bottom line: Deductions for interest costs will be capped (compensated by lower corporate tax rate) to 30% of EBITDA and in some case not allowed at all. The aim for the legislator is to reduce tax evasion.
- The obvious consequence of the new rule is that the incentive to reduce interest costs in debt portfolios increases as well as the risk to earnings of borrowing at all-time low floating/short-term rates

2. At least one Swedish real estate company has publicly, through a press release, announced that it has restructured its derivatives portfolio as consequence of the new rules.

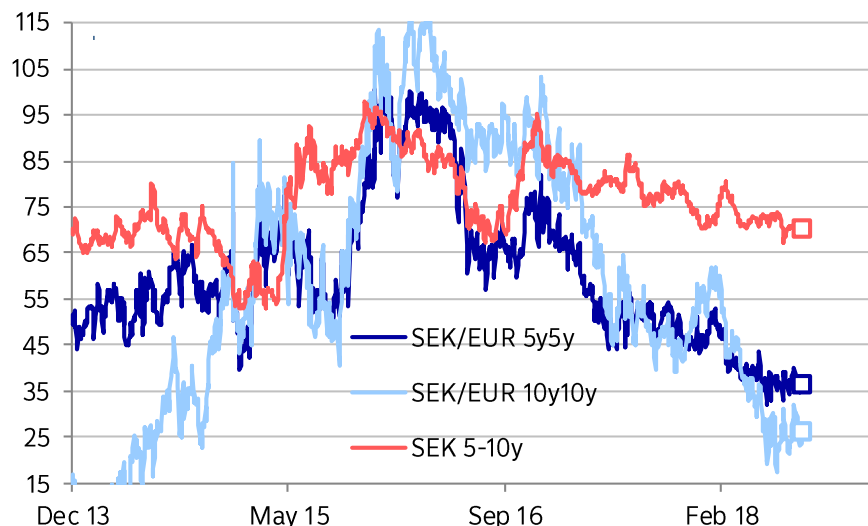
Potential consequence for liability portfolios (especially real estate companies):

- It will make economic sense to re-strike payer swaps with negative NPV (fixed rate higher than market rate) since this will reduce the interest rate cost.
- Such restructuring will not by itself have any market impact, but since the level of swap rates has decreased over recent years, some liability managers may choose to extend the duration in their derivative portfolios as well as restrike swaps at lower rates.
- The total derivatives portfolio in the sector is significant and restructuring of some of these portfolios may create steepening pressure on the SEK swap curve 5y+

3. The carry & roll is decently positive SEK swap steepeners, 5/10y for example



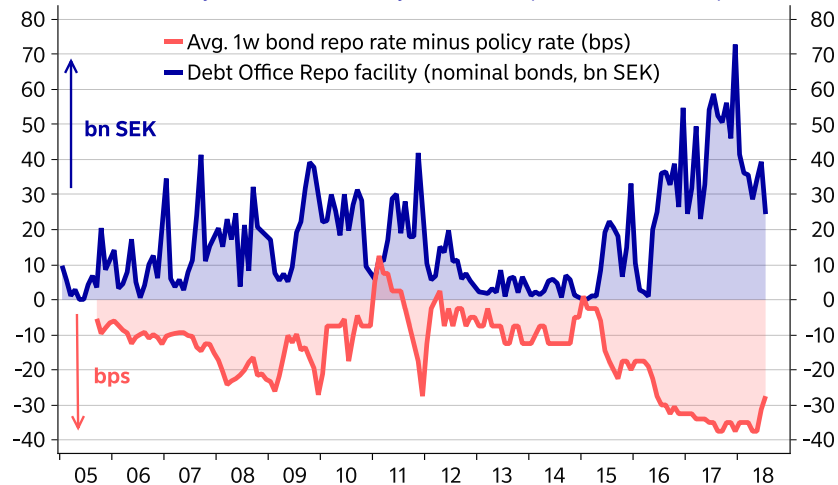
4. The long-term forward spreads to EUR are on the low side as well



Source: Nordea Markets

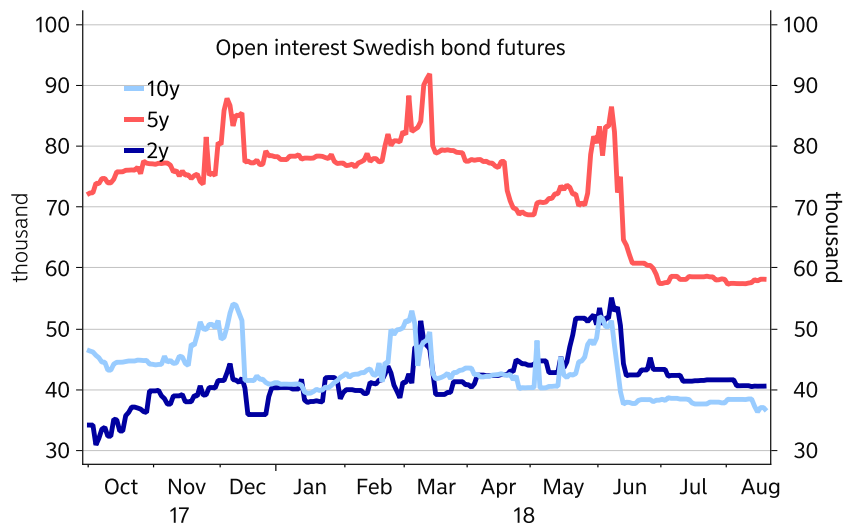
SEK rates: Some cleaning up in the SGB repo market

1. There were many indications during H1 that the functionality of the SGB market was hurt by QE and scarcity of bonds (read more [here](#)).

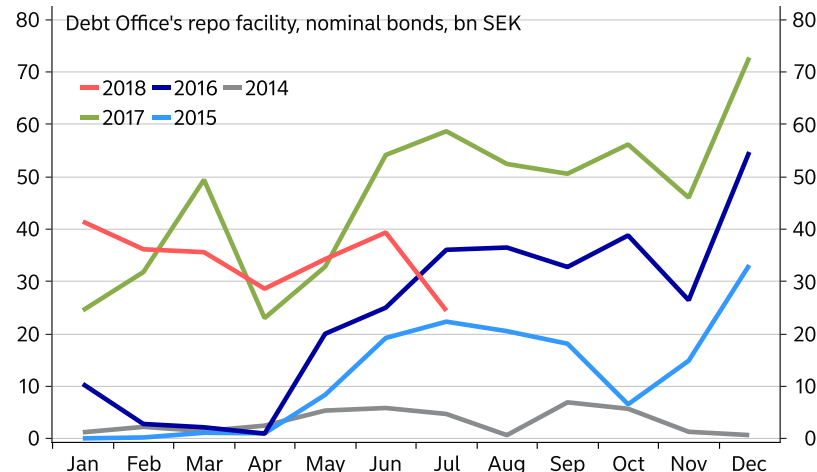


Source: Nordea Markets and Macrobond

3. The re-emergence of Eurozone debt worries may have washed some short bond future positions out and indeed the outstanding amount in the SGB bond futures has decreased by roughly 23 bn since April

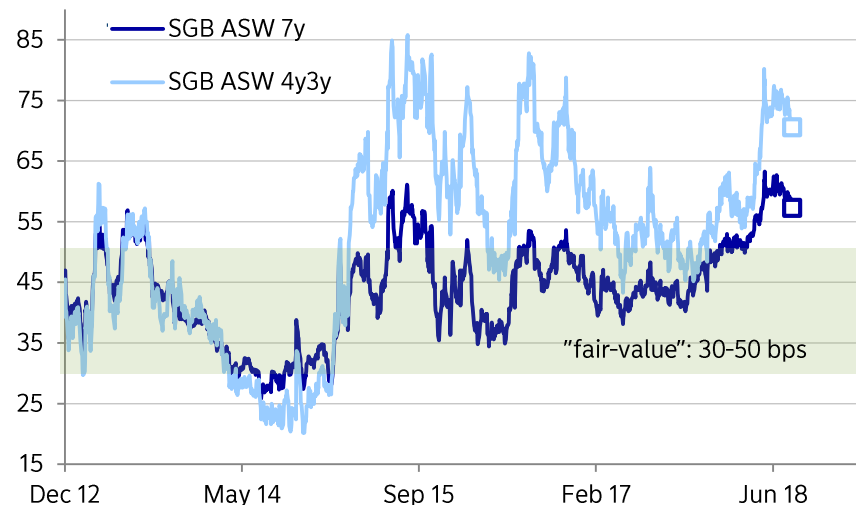


2. In July, a easing of the repo squeeze became apparent as the volumes in the Debt Office's repo facility decreased to seasonally low levels.



Source: Nordea Markets and Macrobond

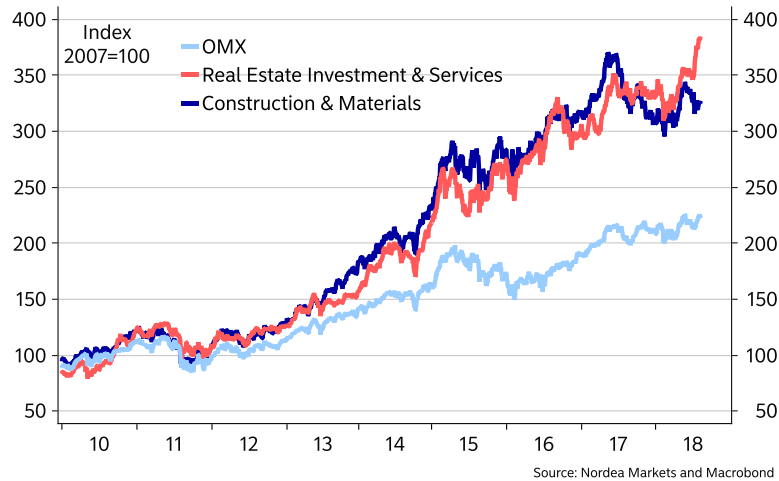
4. With SGB swap spreads still well above their "fair-value" level, continued spread contraction should be on the cards.



Source: Nordea Markets

Sweden: Low-rate-addiction possible driver of real estate outperformance

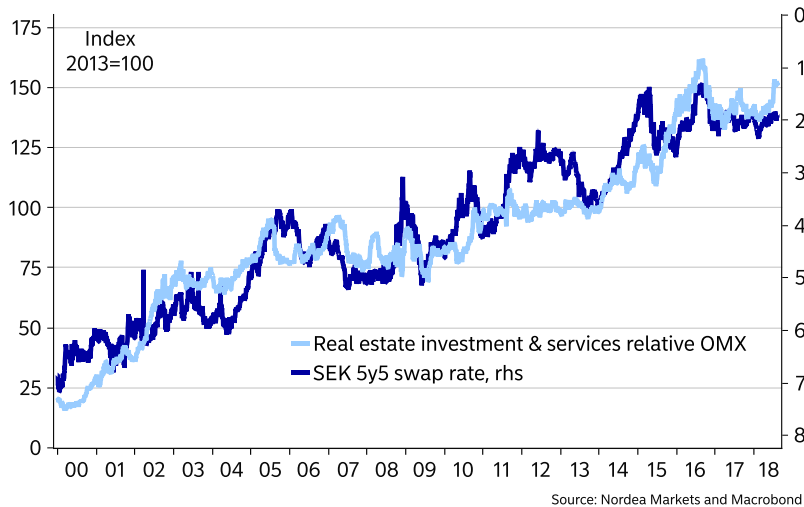
1. Construction sector continues to struggle, while real estate sector surge



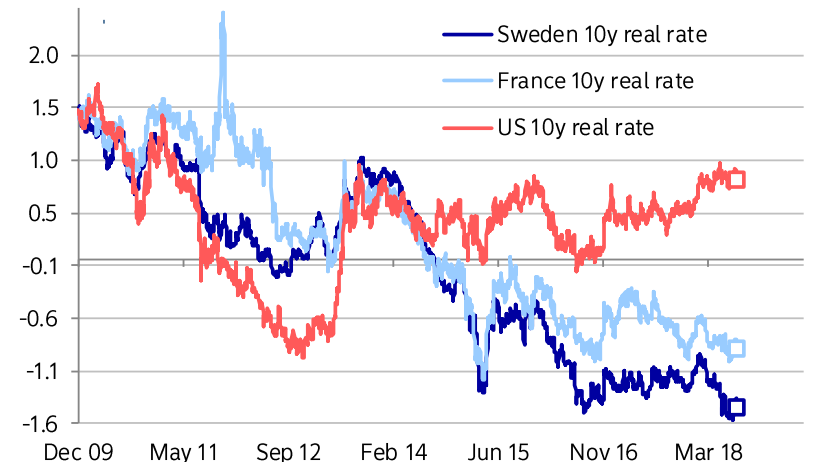
2. Continued decrease in housing start discounted in construction sector. Less supply of real estate objects → better outlook for running yield in real estate companies.



3. But level of long-term rates also important for real estate sector. It can not be ruled out that low Swedish inflation has created expectation on a dovish Riksbank, reflected in rallying real estate companies

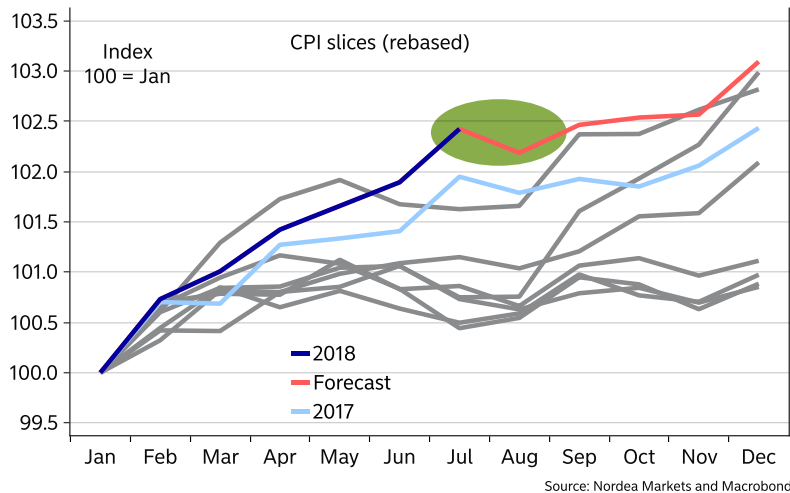


4. Swedish Long-term market based real rates seem stuck at negative and all-time-lows. Swedish real rates are also lower than in most other developed economies. And if Riksbank is happy with that, then why should not real estate sector boom?

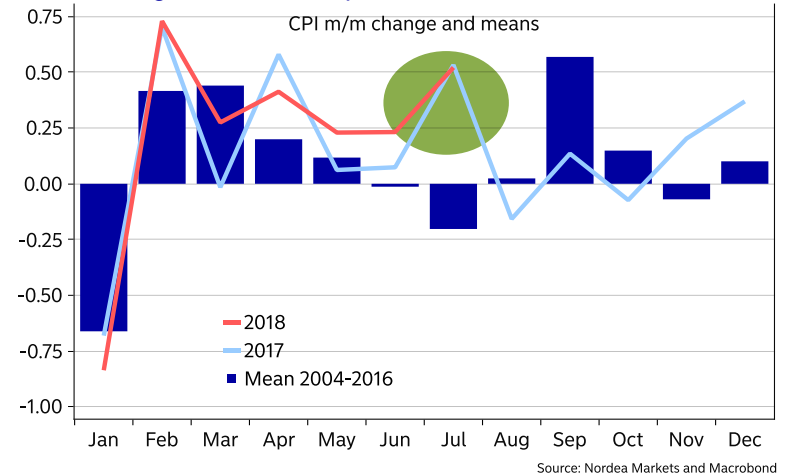


SEK linkers: July outcome points to new seasonal pattern

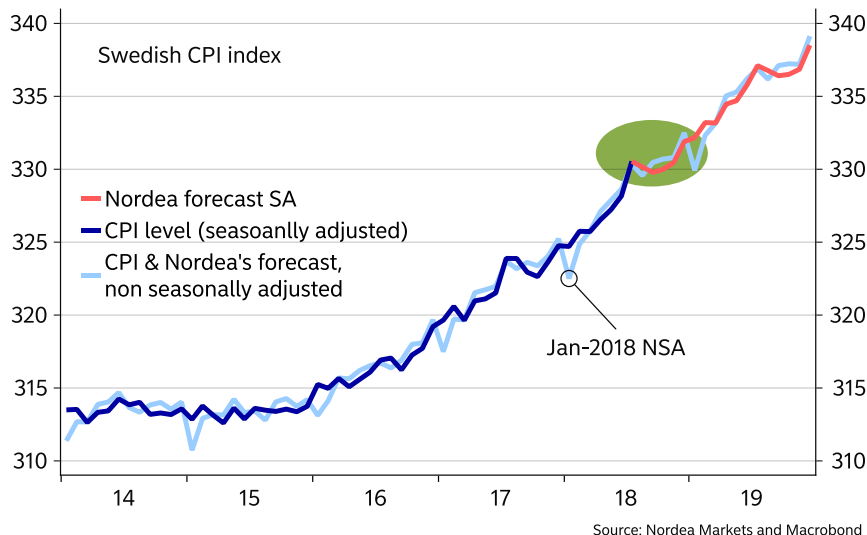
1. Headline CPI jumped in July this year, as it did in 2017 as well.



2. The change in the method to calculate price changes in foreign travels should change the seasonal pattern in CPI*. Recent outcomes confirm this.



3. Despite that we have the month of September coming up soon, CPI does not increase overly much coming months.



4. Indeed, the “carry season” for index-linked is two months early, compared to historical patterns. Carry-wise linkers look ok currently, but far from exciting.

<u>CARRY</u>	Yield	Yld on:			Carry to:		
Bond	Aug 20	Sep 1	Oct 1	Nov 1	Sep 1	Oct 1	Nov 1
SGBi 3110	-2.34	-2.30	-1.74	-2.28	4.4	60.3	6.0
SGBi 3102	-2.53	-2.52	-2.35	-2.53	1.3	18.3	-0.1
SGBi 3108	-2.29	-2.28	-2.18	-2.28	0.9	11.1	1.3
SGBi 3109	-1.86	-1.85	-1.78	-1.83	0.7	7.1	2.1
SGBi 3112	-1.70	-1.69	-1.64	-1.68	0.7	6.2	2.1
SGBi 3113	-1.51	-1.50	-1.45	-1.48	0.6	5.5	2.2
SGBi 3104	-1.44	-1.43	-1.38	-1.41	0.7	5.7	2.4
SGBi 3111	-1.02	-1.01	-0.98	-1.00	0.5	4.1	2.2
Inflation	Month	Jun	Jul	Aug	Jun	Jul	Aug
path	CPI m/m	0.23	0.52	-0.23	0.23	0.52	-0.23

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*) In Jan-2017 the method of calculating the price index for foreign travels was changed. The previous method used an average of summer & winter travels for all seasons. The new method only uses summer travels during summer, and likewise for winter travels. This has almost doubled the volatility for the foreign travel component something that is most visible in the month of July.

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