



## Strategy Sweden: On the radar

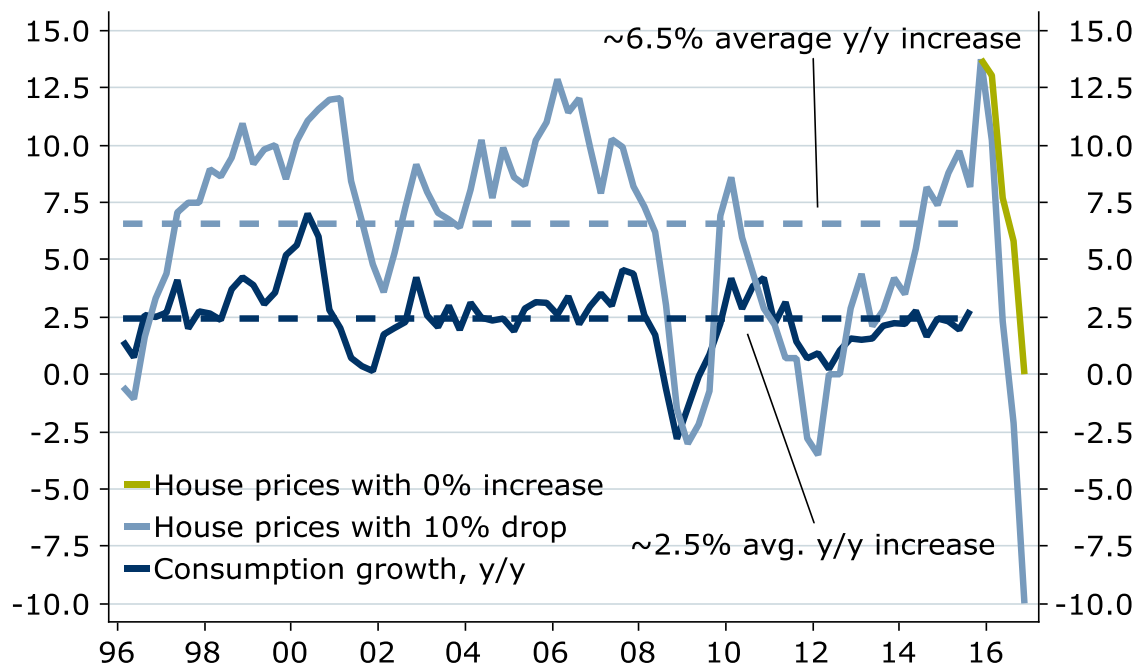
*This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea...*

### **Themes in this edition:**

- **xCCY basis:** SEK and DKK cross-currency basis swaps
- **SEK rates:** supply reflected in covereds
- **SEK rates:** no plateau in housing with out a downside scenario
- **SEK rates:** foreign demand for SGB's should be negative
- **SEK Linkers:** new 10y bond in an inflation negative environment
- **SEK Linkers:** SGBi 3107 is very cheap on a hold-to-maturity basis

21 January 2015

## Chart of the week: what a 10% drop in house prices could bring...



Source: Nordea Markets and Macrobond

***House prices have increased by 6.5% on average for the last 20 years, with very few dips below zero. A 10% drop in house prices 2016, or even just a levelling out, is likely to make markets start toying with a downside scenario for the economy as a whole...***

# Trades on the radar

**Strategy view on direction and curve:** Riksbank's easing bias remains. Despite major set-back in stock market, it is too early for us to give up on our main macro scenario of decent global growth and higher bond yields.

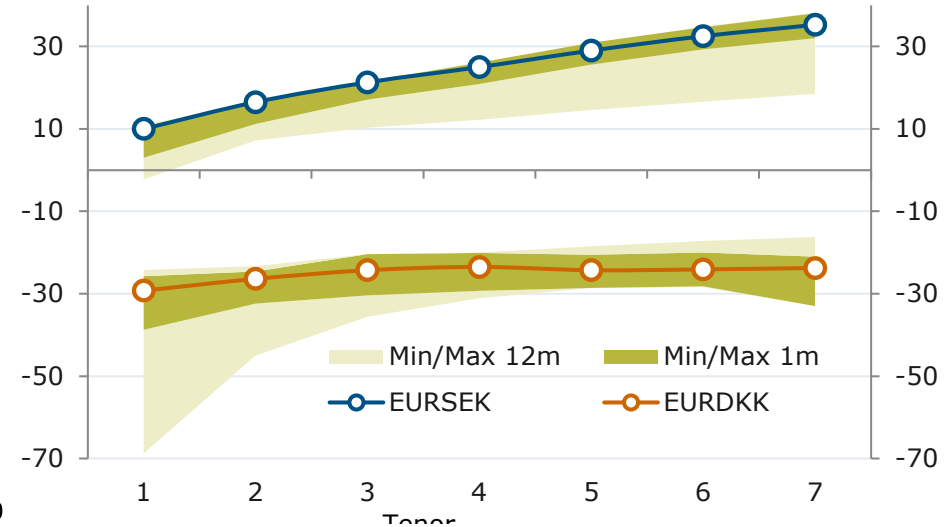
	Trade idea	Date	Comment
Active	Curvature: Spio 186/SGB 1047/SGB 1059 (short belly)	12-Nov	<a href="#">SEK rates: A way to exploit a rich belly</a>
Active	Govies: SGB 1058/1053 flattener	3-Nov	<a href="#">SEK rates: steep 10y+ govie curve</a>
Active	ASW: sell SGB 1058, receive in swap	16-Oct	<a href="#">SEK rates: have a look at ASW tighteners</a>
Active	Covereds: long 5y covered vs govie	16-Oct	<a href="#">SEK rates: no cover for covereds, but widening is overdone</a>

*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.*

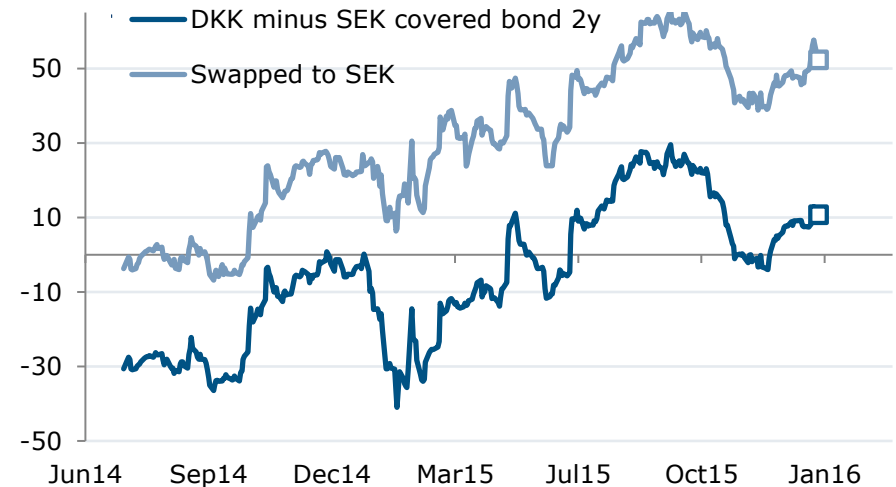
# xCCY basis: SEK and DKK cross-currency basis swaps

*Preferences for the depth and liquidity of the EUR market among Swedish bond issuers and Danish asset managers creates an opportunity for SEK denominated asset managers to gain yield pick-up and for DKK issuers to reduce funding costs.*

**Fact box:** Swedish issuers use the Euro-market to exploit depth and broaden the investor base. Danish real-money investors use the Euro-market to exploit depth and liquidity for their asset portfolios (this adds no currency risk due to the DKKEUR peg). The activities described above are structural to their nature and exposure is continuously being swapped back to the domestic currency. Thus, both EURSEK cross-currency basis swaps (CCBS) and DKKSEK CCBS average at levels some distance from zero, but with opposite signs. A Danish issuer that issue in SEK and swap cash-flows back to DKK will gain cheap funding. A Swedish investor that buy DKK bonds and swap cash-flows back to SEK will gain a yield-pick up.



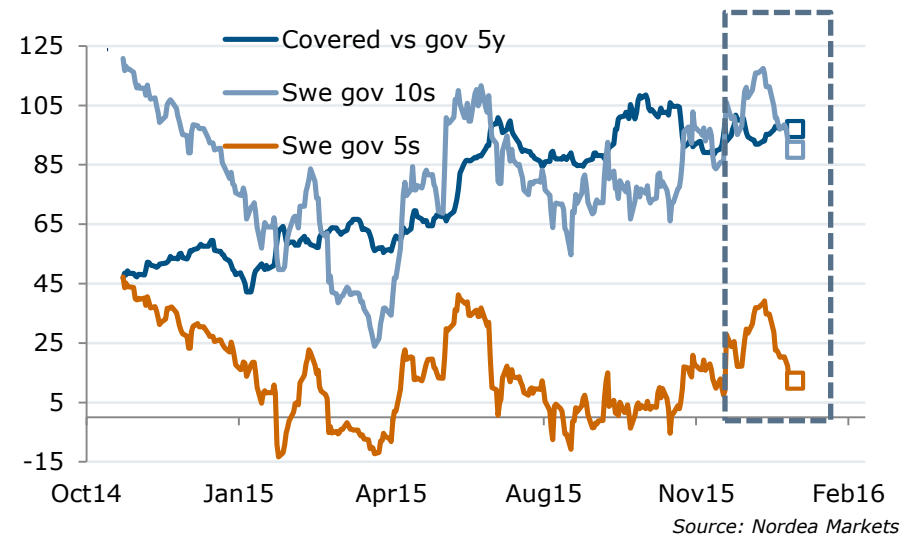
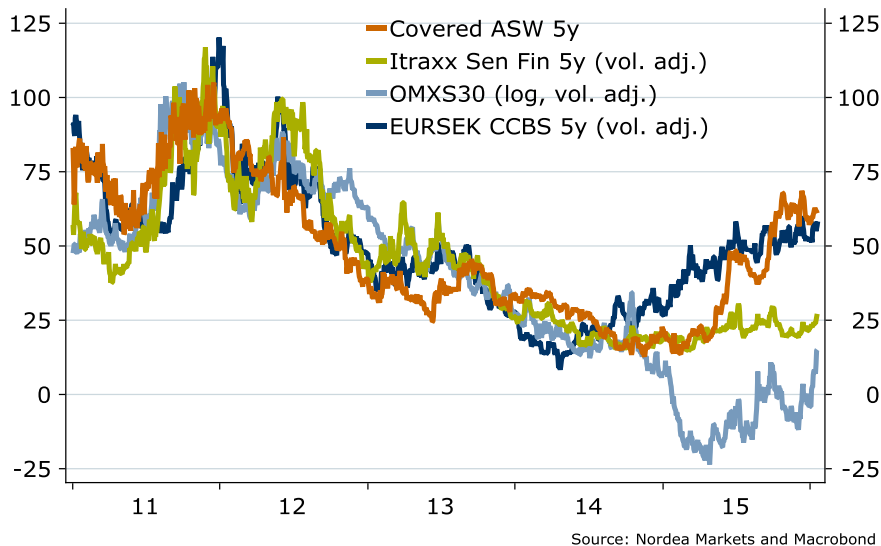
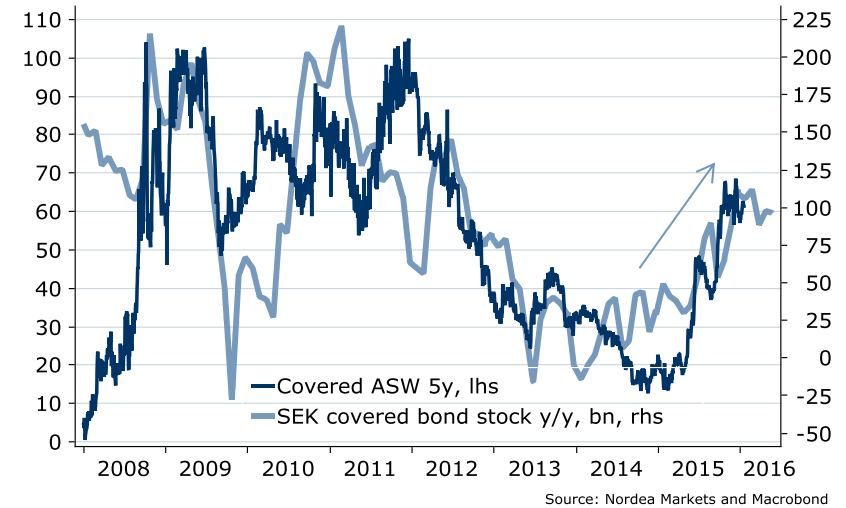
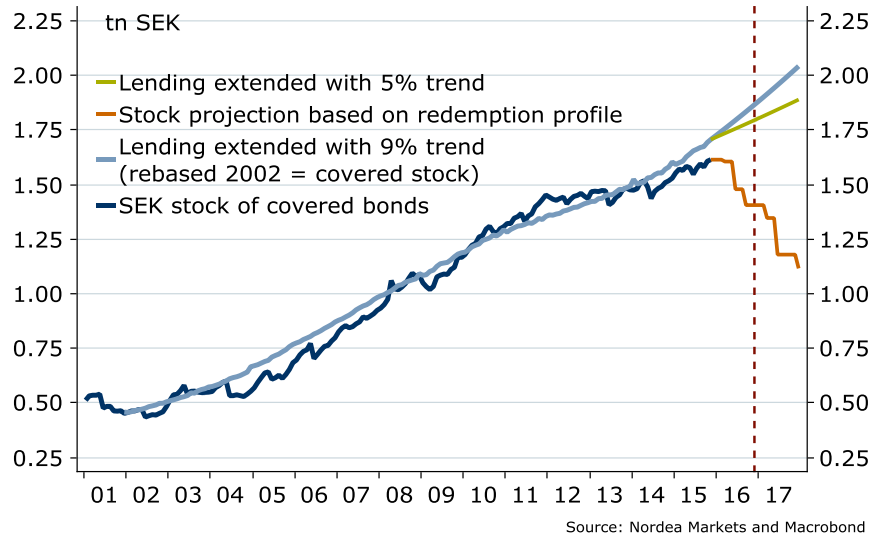
Source: Nordea Markets and Macrobond



Source: Nordea Markets

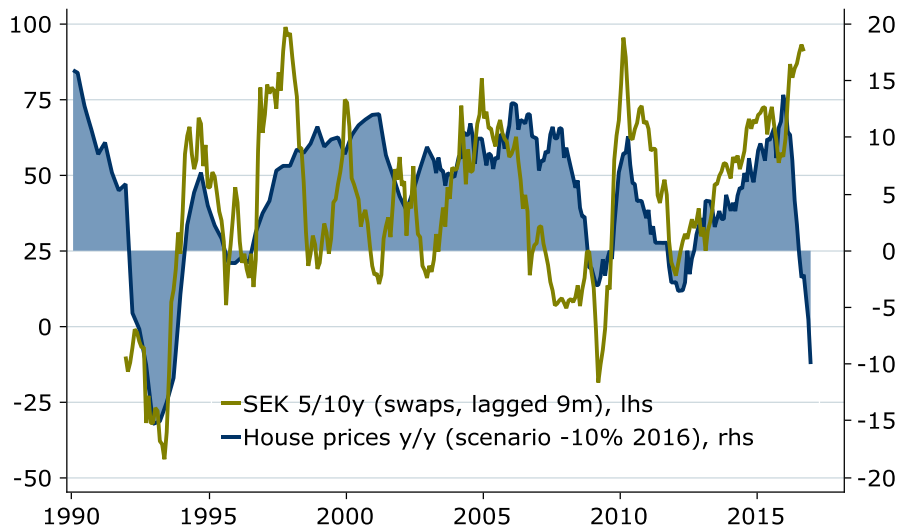
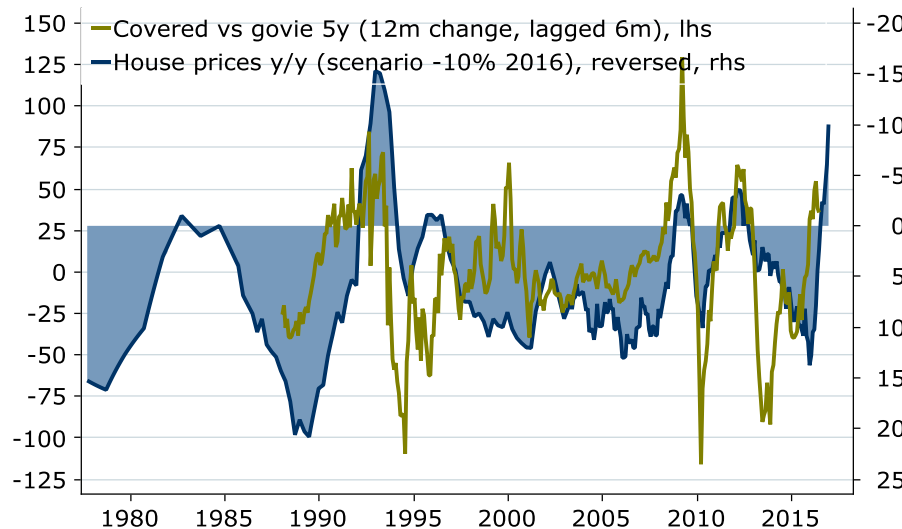
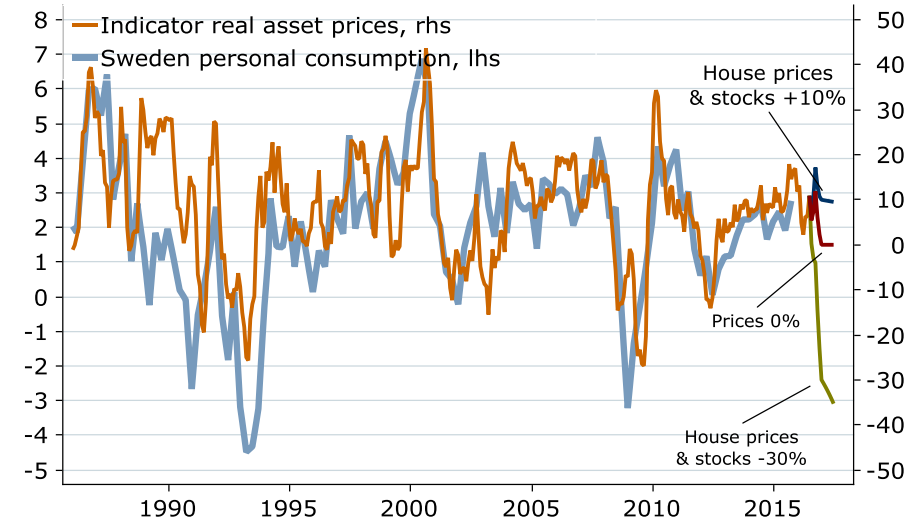
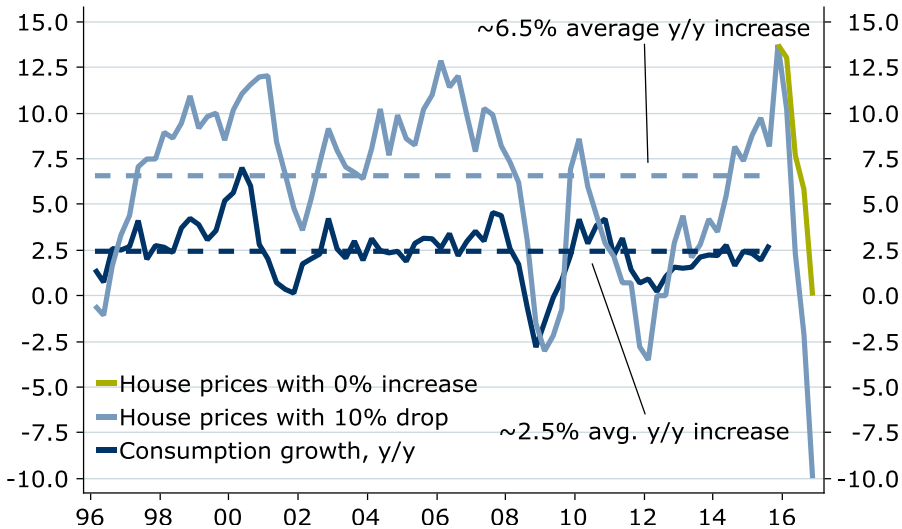
# SEK rates: supply reflected in covered

*We expect gross issuance 2016 in range 350-425bn (387bn 2015). Wide spreads reflect expectations of supply and higher bond yields. Covered should contain cushion against equity and corp credit turbulence. Long covered position preferably hedged with outright shorts, (short duration to be hedged with over-weight in covered)*



# SEK rates: no plateau in housing with out a downside scenario

*Link between personal consumption and asset prices strong as ever, and stock market weakness increase sensitivity to house prices. A levelling out in prices together with amortizations, tax hikes etc is a stage set for speculating on the downside. Market conclusions dubious: covered spread widening consistent with lower house prices, but steep 5/10y curve not... front-end the missing link.*

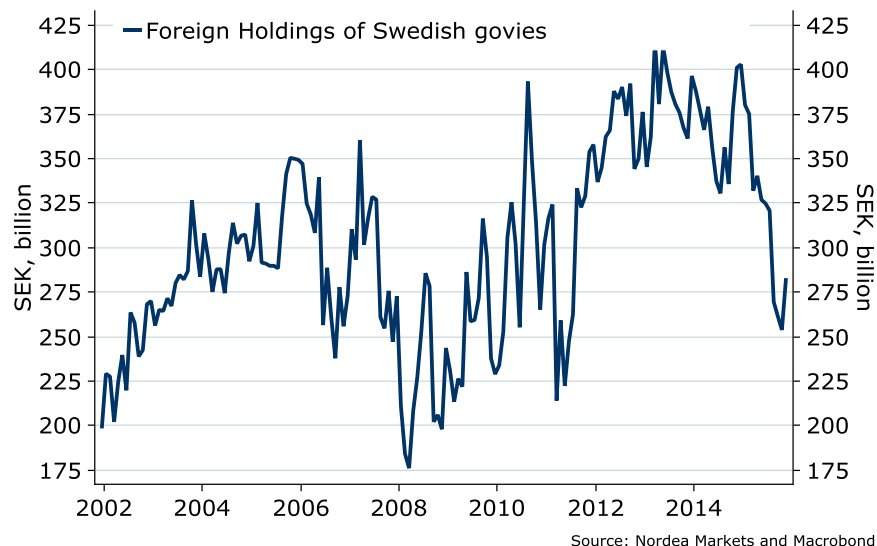


Source: Nordea Markets and Macrobond

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# SEK rates: Foreign demand for SGB's should be negative

Foreign holdings of SGB's declined significantly last year ahead of the FED hike in December. The remaining reason for foreign investors to hold Swedish bonds without much of a pick-up vs DBR's where the Federal Reserve keeps hiking, the ECB is not as soft as anticipated and Swedish inflation picks up is diversification through SEK exposure. The very explicit threat of FX intervention removes the currency diversification argument. The Riksbank's message to foreign investors is loud and clear: Stay away!

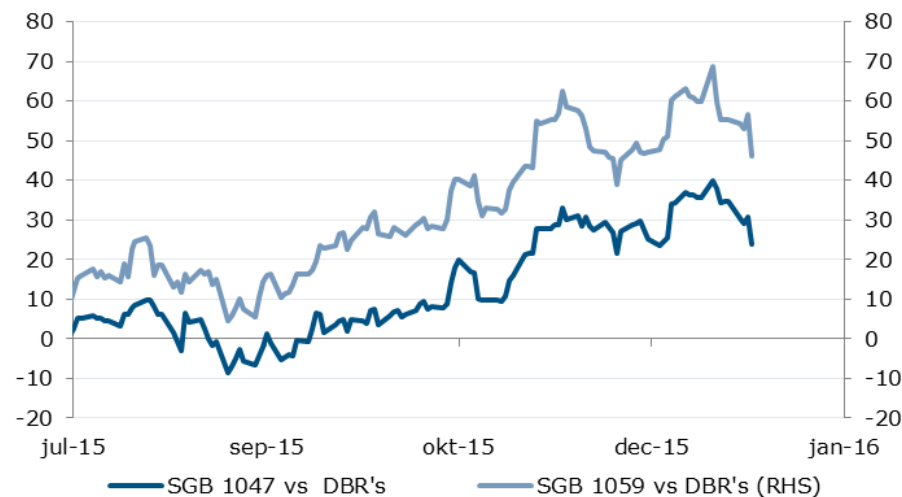


## Riksbank Q4 2016 forecasts and Taylor style repo model

RB meeting	Unempl. sa	CPIF yy	Repo	Repo, model
Dec-15	6,73	2,05	-0,41	2,9
Oct-27	7,05	1,97	-0,41	2,5
Difference [bps]			0	40

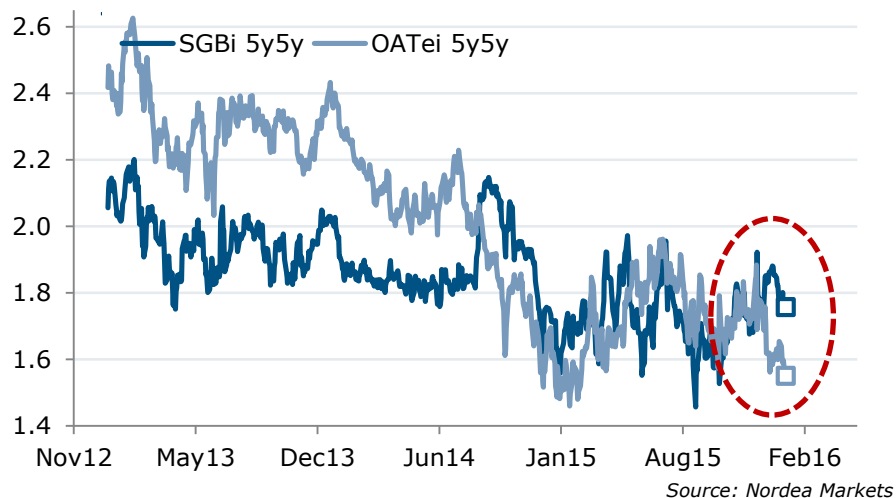
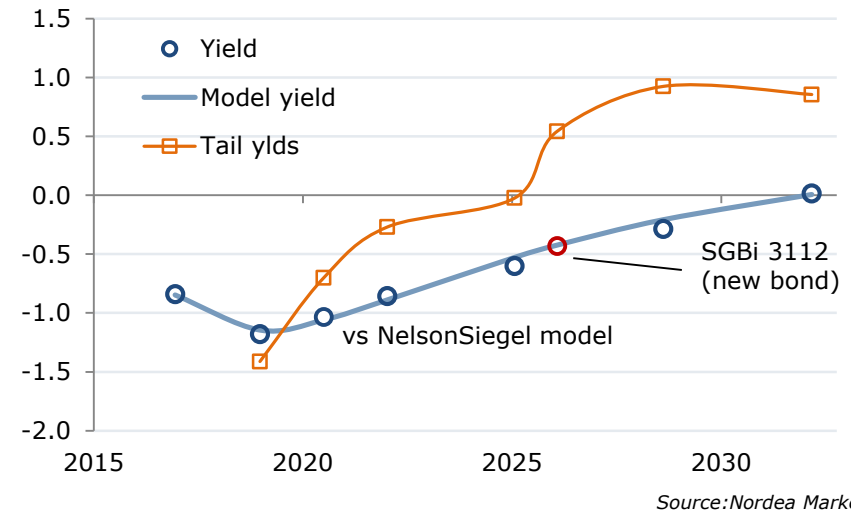
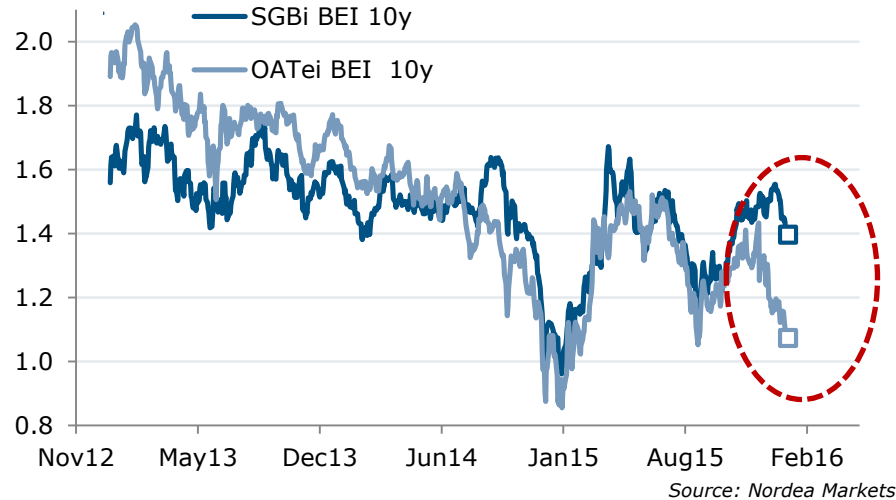
Note that a true Taylor rule puts the repo rate even higher; our model is designed to match the actual repo rate time series Jan 2001 - Jun 2014

A simple Taylor rule-style repo rate model based on unemployment and (CPIF-) inflation the last 15 years gives a good fit until the Riksbank gave up their economy-based approach to monetary policy in the summer of 2014. Using current data in the 'old' model illustrates the huge difference between the Riksbank's policy and conventional monetary policy



# Linkers: new 10y bond in an inflation negative environment

*A new 10y index-linked bond (SGBi 3112, 1 June 2026) will be launched on 11<sup>th</sup> February, followed by 13bn issuance through bond switches. Swedish BEIs have lagged the down-turn in Eurozone on back of falling oil and stock prices, which is bad news for the auction. Some comfort may be found in the fact that real yields also have lagged the down-turn in nominal yields...*



		SGBi 3112	Switch bond
Auction	11 Feb	1bn	-
Switch	12 Feb	5bn	4.9bn 3108, Cash neutral
Switch	15 Feb	5bn	5.3bn 3109, Risk neutral
Switch	16 Feb	3bn	1.7bn 3104, Cash neutral



# Linkers: SGBi 3107 is very cheap on a hold-to-maturity basis

In the short-term the inflation outlook is grim for the shortest-dated Swedish index-linked bond SGBi 3107 (0.5% Jun 1, 2017). Our forecast of January CPI inflation is -0.66% m/m, which means that (comparator) b/e inflation carry equals minus 55 bps, assuming a 10 bps repo spread vs its nominal comparator SGB 1051 (3.75% Aug 12, 2017). The next two months though CPI prints are expected to more than compensate the negative start of the year, with anticipated net bei carry until Jun 1 being plus 17 bps. Using the SGB 1051 fwd yield as of Jun 1 to compute the required settlement amount on maturity of the SGBi 3107, the implied fwd CPI inflation rate Mar-16/Mar-17 is less than 0.35%. Nordea's forecast is 120 bps higher. Thus, applying a hold-to-maturity approach, the current pricing of the SGBi 3107 leaves plenty of room for negative surprises in future CPI prints.

Carry	SGBi3107	SGB1051	B/E
Jan 20, 2016	-0,84	-0,52	32
Apr 1, 2016	-1,39	-0,52	88
Carry	-55	0	-56
	Repo spread		-10

Source: Nordea

Carry	SGBi3107	SGB1051	B/E
Jan 20, 2016	-0,84	-0,52	32
Jun 1, 2016	-0,67	-0,52	15
Carry	17	0	17
	Repo spread		-10

Source: Nordea

## Inflation forecast

Month	CPI	m/m	y/y
Dec	314,21	0,15	0,1
Jan	312,12	-0,66	0,4
Feb	313,48	0,44	0,2
Mar	314,92	0,46	0,6
Mar 2017	319,83	0,37	1,56

Source: Nordea

Based on our forecast of Q1 inflation at 0.24% and a 10 bps repo spread between SGBi 3107 and SGB1051, the forward bei on Jun 1 is 15 bps.

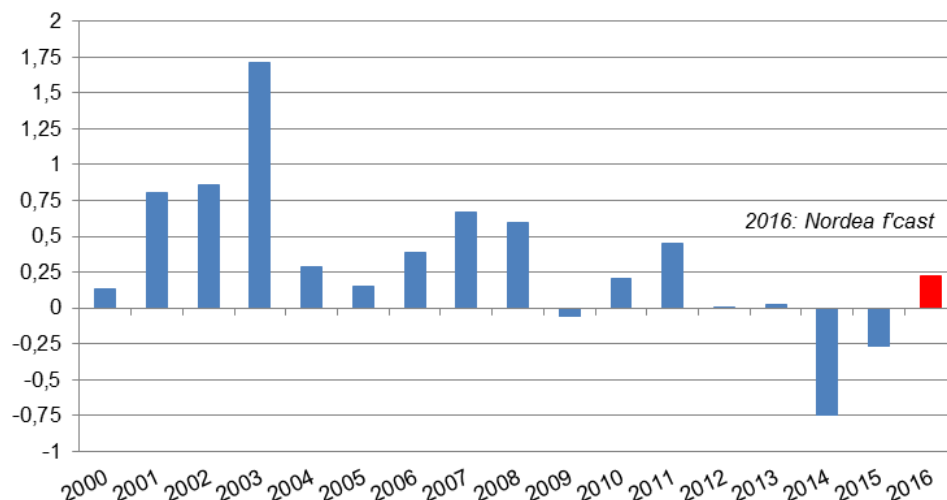
The corresponding settlement amount of SEK100m SGBi 3107 is required to generate the same nominal return to maturity as the SGB 1051.

This will be the case if inflation in March 2017 is 0.33%.

SGBi 3107 hold-to-maturity	Jan 22, 2016	Jun 1, 2016
Real yield	-0,84	-0,670
Settlement amount	105,849	105,349
Nominal yield	-0,52	-0,52
Break-even inflation	32	15
At maturity	Jun 1, 2017	
Required settl. amount	104,803	
Real amount	100,5	
Implied index factor	1,042818	
Index factor on Jun 1, 2016	1,039	
Implied Mar -17 CPI inflation	0,33	
Nordea forecast	1,56	

Source: Nordea

## First quarter CPI inflation



# Thank You!

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