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…

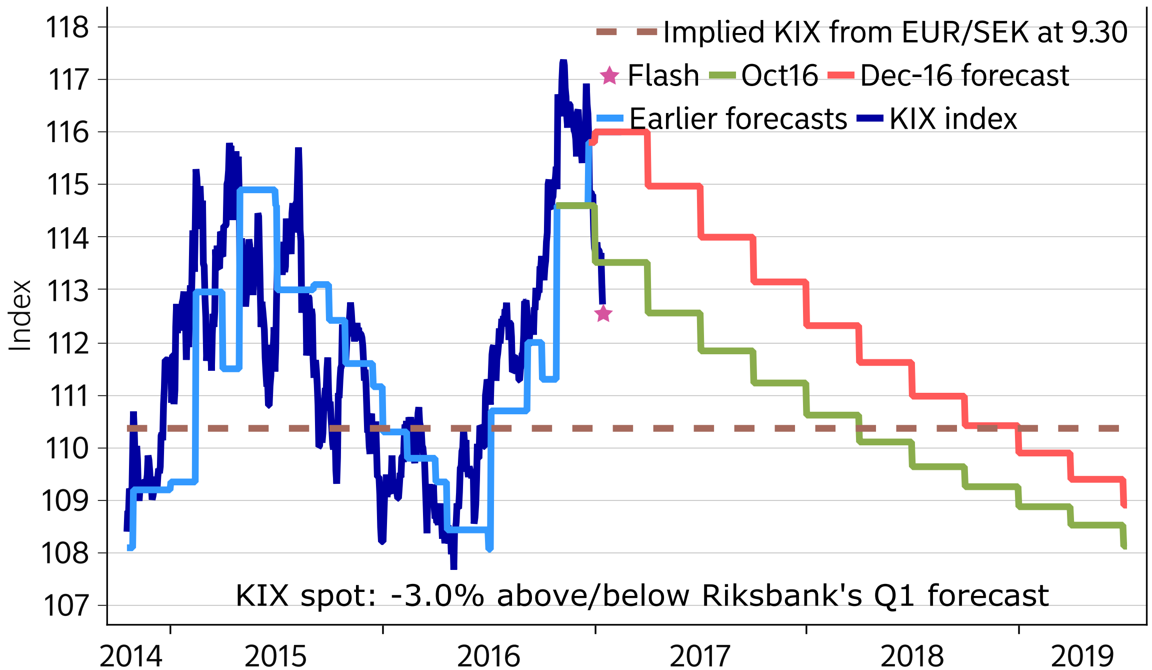
Themes in this edition:

- ***SEK:*** *"usually" loses momentum here, but Riksbank won't care yet*
- ***USD:*** *border-adjusted taxes (BAT) and/or American Abenomics?*
- ***Fed****: reinvesting all maturing bonds will not last forever…*
- ***Fed:*** *reinvesting policy could change already in 2017*
- ***Fed:*** *potential fiscal stimulus could speed up change in policy*

16 January 2017

Completion timestamp (local Stockholm time): 16Jan2017 12:30
Dissemination timestamp (local Stockholm time): 16Jan2017 13:30

Chart of the Week: Riksbank won’t care about SEK yet..



Source: Nordea Markets and Macrobond

SEK stronger than Riksbank’s (weak) December forecast, not so much vs its October forecast. If Riksbank won’t intervene until SEK is 2.7% stronger than it’s October forecast, EUR/SEK can drop to 9.30

Nordea

Trades on the radar

Strategy view on direction and curve: *Swedish bond yields should have potential to increase further in 2017, but the near-term outlook is less clear. Swedish 10y rates should have potential increase more or decrease less than other markets. Even if 5/10y curve steepens somewhat near-term, flattening should still be the major theme during 2017*

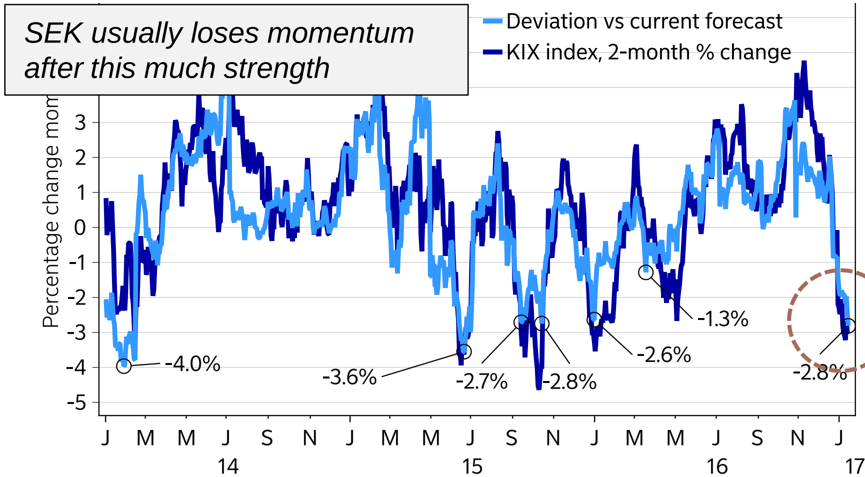
	Trade idea	Date	Comment
Active	Curve: flattening 2y1y/2y6y	22-Dec-2016	SEK rates: curve slope contemplations
Active	ASW: SGB 1052 swap spread widener	13-Dec-2016	SEK ASW: boring chart but multiple reasons to bet for widening
Active	Front-end: FRA/RIBA widener (Mar17/Jun17)	13-Dec-2016	Stibor spreads: time to play for re-widening
Active	Linkers: BEI steepener (SGBi 3108/3104)	30-Nov-2016	Linkers: our CPI forecast implies a steeper inflation curve
Active	Country spread: pay SEK 10y swap, receive 10y EUR	18-Nov-2016	SEK rates: higher long-end SEK rates relative other markets…

List of recommendation changes in past 12 months is found here.

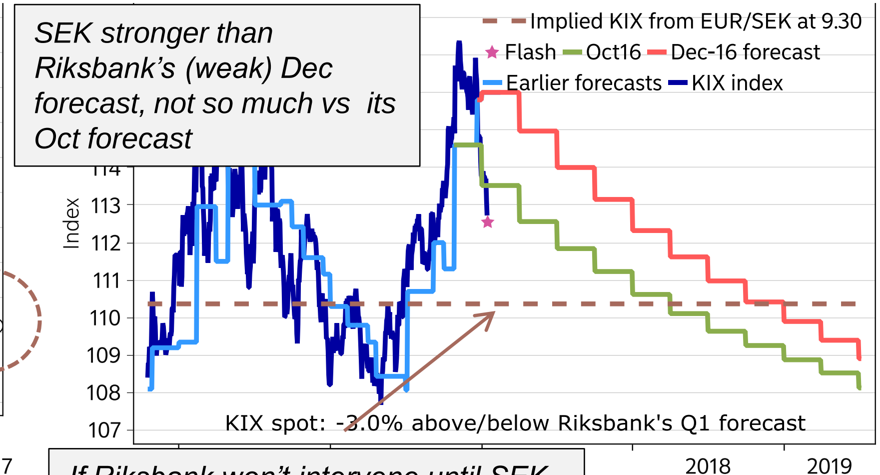
The list of trade ideas is up-to-date around the date of publication. The column "Date" shows the publication date in which the trade idea was initially listed. It does not necessarily reflect our view on the optimal entry date. When a trade is removed from the list, it will be marked accordingly. Obviously,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

SEK: "usually" loses momentum here, but Riksbank won't care yet

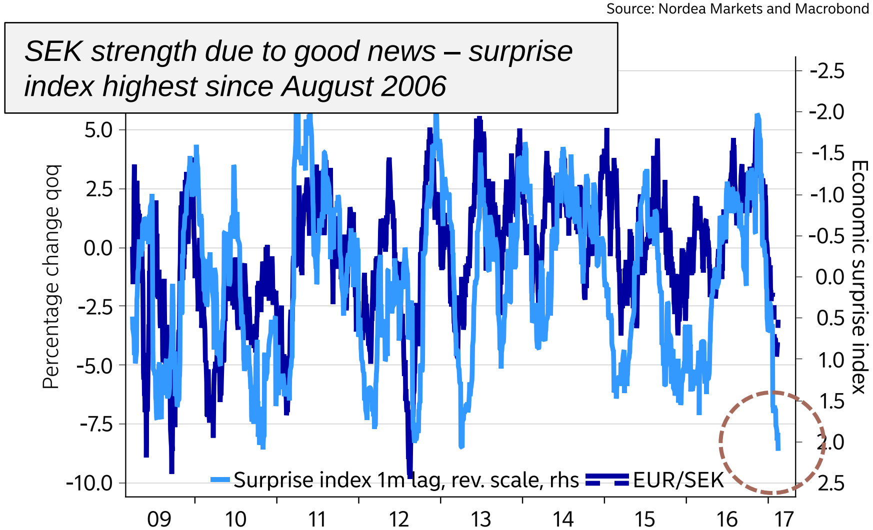
The SEK has gained more than 3% over the past two months. It is also almost 3% stronger than the Riksbank expected at its December meeting, a valuation deviation which usually spills over to a lack of momentum. However, the Riksbank is likely to tolerate a stronger SEK if the drivers are positive (which they are – the surprise index hasn't been this high since August 2006). Rhetoric from Riksbank's minutes and speeches from the EB suggests more tolerance than in the past. If the Riksbank won't react until the SEK is ~2.7% stronger than its October forecast, EUR/SEK could dip to 9.30 before it reacts strongly.



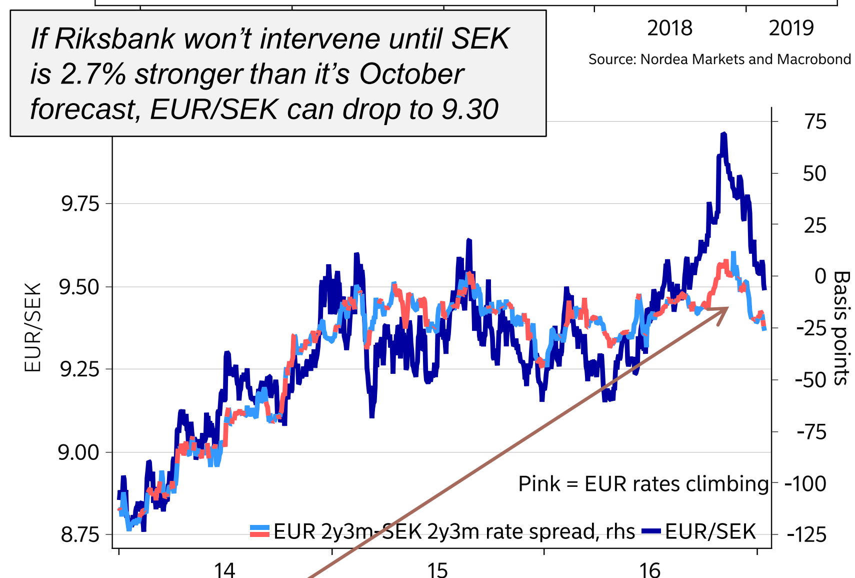
Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

SEK has experienced tailwinds in the form of relatively higher Swedish rates

Nordea

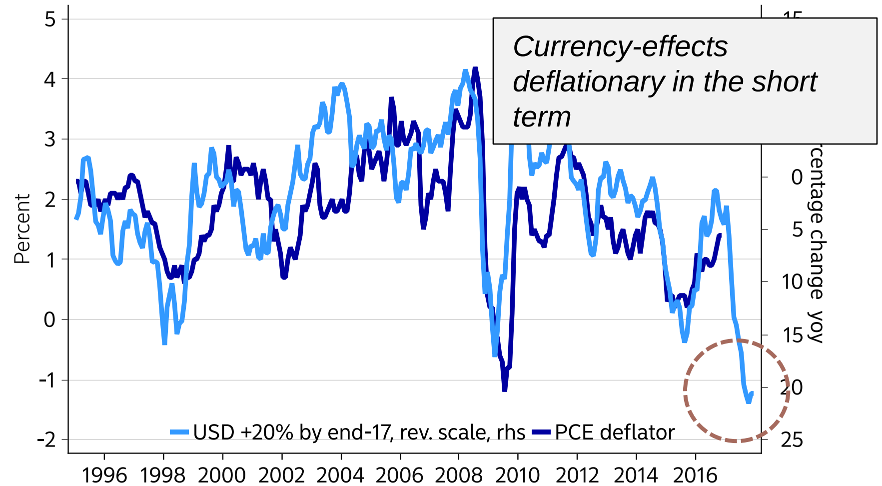
USD: border-adjusted taxes (BAT) and/or American Abenomics?

Border-adjusted taxes is a tail-risk scenario (25%-33%?), but a US administration implementing BATs could trigger a FX move akin to Abenomics did with the JPY - but with the opposite sign. It would also wreak havoc with FX/rates correlations. The problem with this USD-bullish risk is that too much dollar could go against the wishes of the "greatest jobs producer that God ever created". How about some American Abenomics?

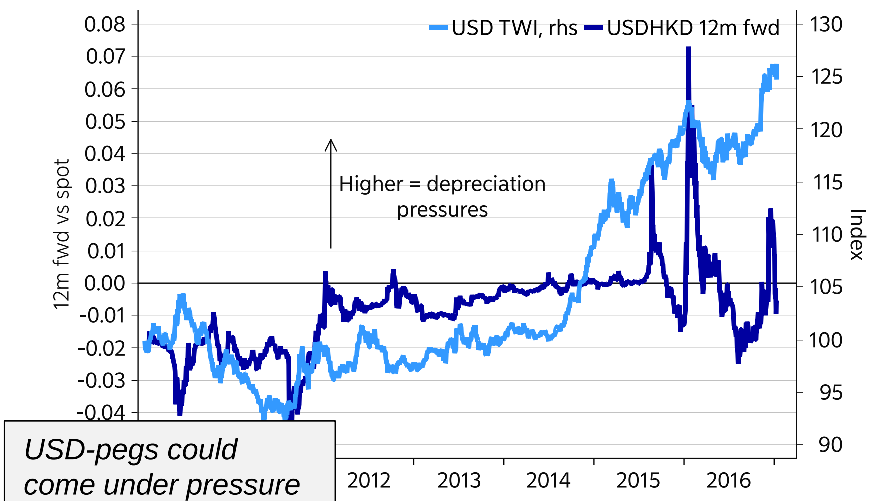
	No border adjustment	Border adjustment	Border and currency adjustment
Exchange rate (foreign currency per USD)	1.00	1.00	1.25
Foreign sales in foreign currency	100	100	100
Total sales in USD	100	100	80
Total costs in USD	60	60	60
Taxable income	40	-60	-60
Tax burden/rebate at 20%	8	-12	-12
After-tax profit	32	52	32

BAT could push USD TWI 25% higher

Source: Nordea Markets



Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

- A strong USD would go against the Trump administration's wishes of a smaller current account deficit. How about some out-of-the-box attempts to contain the USD?
  i. night-time tweets about the too-strong USD
  ii. ending the US' "strong dollar policy"
  iii. convince the Fed to stay dovish
  iv. hinder capital flows (akin to JFK in 1963)
  v. get the Fed to accumulate foreign currency
  vi. ???

Nordea

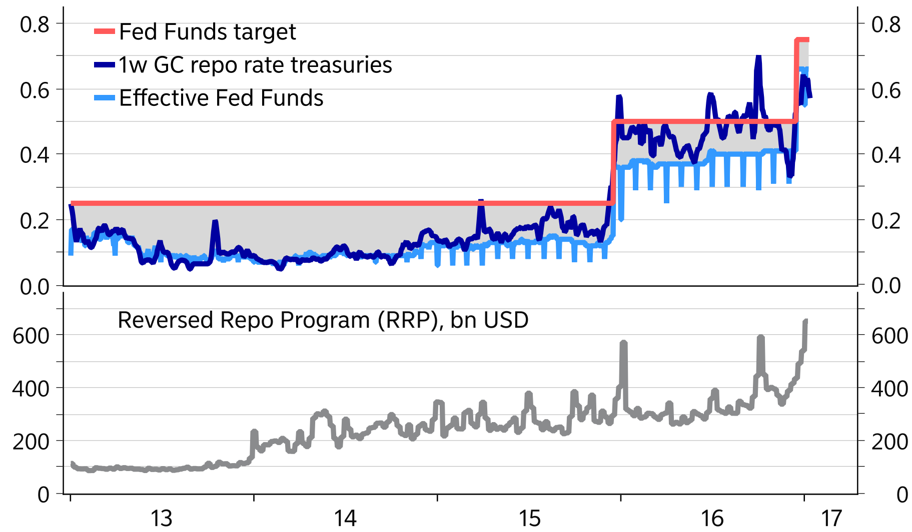
Fed: reinvesting all maturing bonds will not last forever…

- Fed's current SOMA (System Open Market Account) holdings of bonds amounts to ~4200 bn USD (~23% of GDP).
- A consequence of the large SOMA portfolio is a large amount of excess liquidity (EL). In the presence of this EL, and in order to maintain the federal funds rate in the target range, Fed conducts reverse repurchase operations (RRPs). As the fed funds target rate has increased, is seems as the size of the RRPs has increased as well. In practice this means that treasury bonds are being lended to the market as liquidity is absorbed by the Fed. Consequently, the market GC repo rates for treasuries seems to have increased and is likely contributing to the higher bond yields seen over the last year.
- The decision to increase policy rate before reducing the balance sheet has been thoroughly studied and communicated by the Fed. The increase in RRPs is quite natural and not considered problematic in general. However, at some point, it would surely be more practical to start reducing the balance sheet by for example reinvest less than all redemptions.
- The current policy is to reinvest all maturing treasuries and payments from MBS's. Fed "***anticipates doing so until normalization of the level of the federal funds rate is well under way***" (quote from the Monetary Policy Statement).
- Fed's dot-plot indicates an estimate of the long-term fed funds rate (the "normal" level?) around 3%, and ***it is hard to phantom that the level of the fed funds rate when reinvesting policy changes is higher than 1.5%. Indeed, even to reach 1% in the process of normalizing a rate to 3% could be considered to be "well under way".***
- In Feds ***Primary Dealer Surve***y (published in connection each policy meeting) one question, among many other, is: "What is your estimate for the most likely level of the target federal funds rate or range if and when the Committee first changes its reinvestment policy?". The answers are in the table below (median, Primary Dealers):

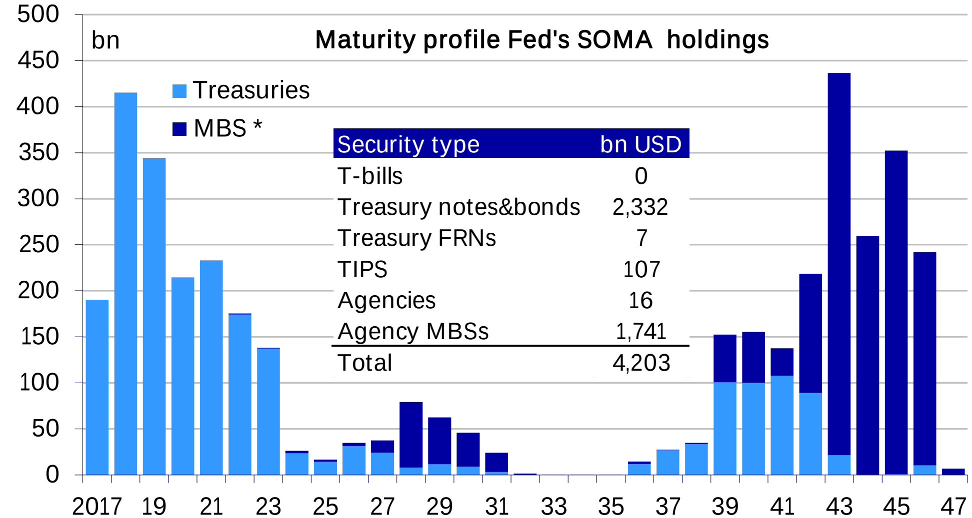
Meeting	Median
Dec-2016	1.38%
Nov-2016	1.19%
Sep-2016	1.19%

Meeting	Median
Jul-2016	1.19%
Jun-2016	1.25%
Apr-2016	1.38%

Meeting	Median
Mar-2016	1.38%
Jan-2016	1.31%



Source: Nordea Markets and Macrobond



*) Max maturity of MBS, loans may be prepaid

Source: Nordea Markets, New

Nordea

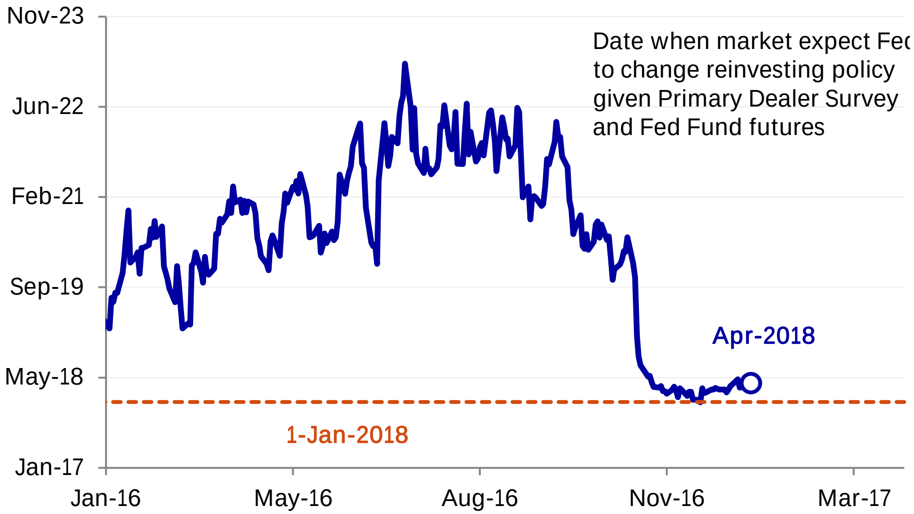
Fed: reinvesting policy could change already in 2017

- Given the market's estimate of the level of fed funds when reinvesting policy change and the pricing of fed funds futures, one can easily calculate the date when the change of reinvesting policy is expected.
- Indeed, the calculation can be made for each trading day. The resulting time series of dates is shown below.
- To take the analysis one step further, one can use the volatility of this series of dates to plot a probability density function (for simplicity we use a log-normal distribution). We can use the estimated probability functions to get a feeling for when a possible change in reinvesting policy could be expected.
- We make the following observations regarding the timing of the change in reinvesting policy:

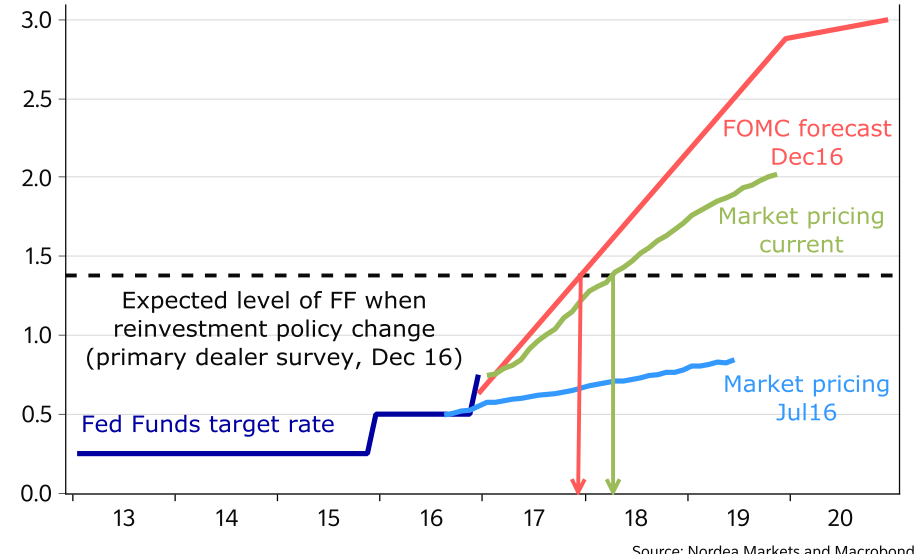
(i) Using 1.38% (latest Primary Dealer Survey) as the critical fed fund level and the current fed fund futures curve, the mean of ***the expected date of policy change is Q2 2018 (~Apr-2018), but Q4 2017 is just 1 standard deviation away***

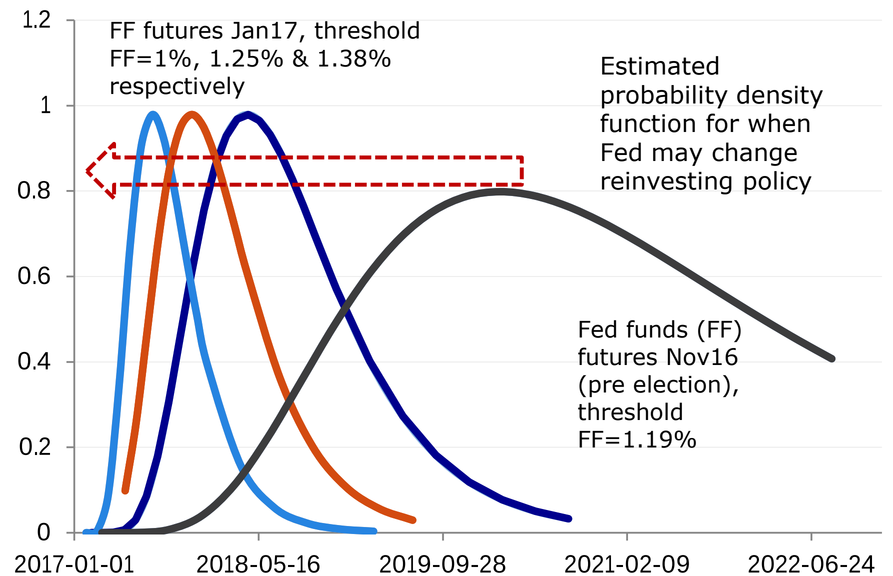
(ii) If we instead use 1 % as the critical fed fund level, ***the mean for expected date of policy change is ~Aug-2017***

(iii) If we use 1.38% as critical fed funds level and Fed's dot-plot, ***the date of policy change is in Q4 2017 and Q2 2017 is just 1 standard deviation away.***



Source: Nordea Markets



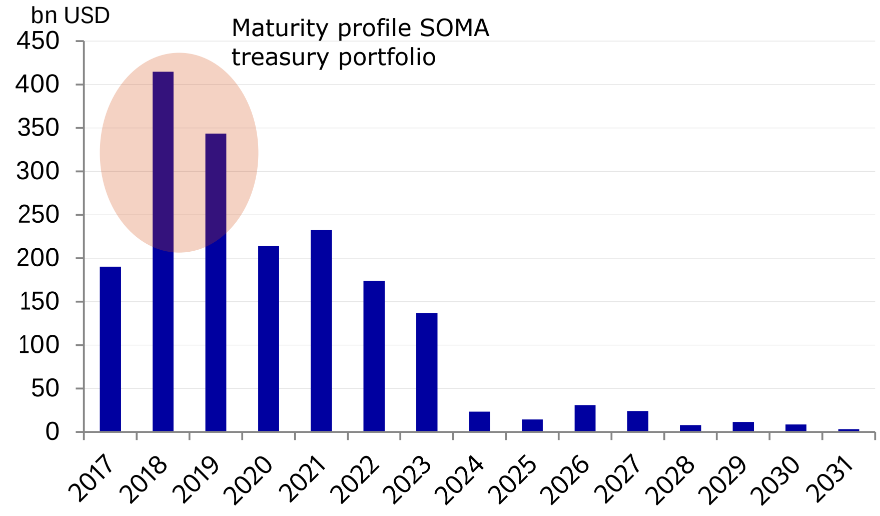


Source: Nordea Markets

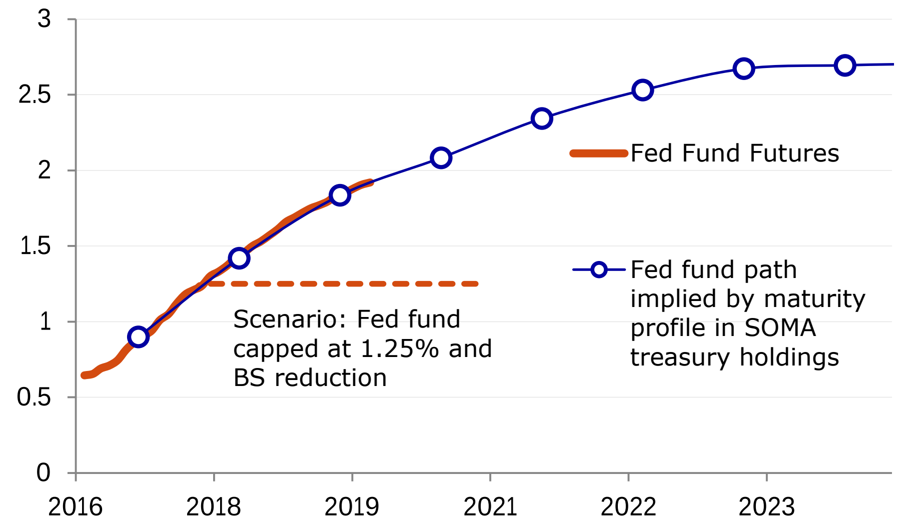
Nordea

Fed: potential fiscal stimulus could speed up change in policy

- The redemptions in the treasury portfolio in 2018 & 2019 is about twice those for 2017.
- ***If the reinvesting policy is left unchanged, Fed would thus have to double its purchases of treasuries in next year***.
- Increasing the policy rate while increasing downward pressure on bond yields must sure be viewed as counterproductive.
- If higher rates are deemed appropriate in 2018, surely is makes sense to tightening financial conditions by not reinvesting some of the redemptions instead of continuing increasing the policy rate.
- A rule-of-thumb relationship between QE / long-term yields/ fed fund rate is: ***1% of GDP in QE ⇔~25 bps change in fed fund rate*** (we wrote about this in a Swedish context back in 2015, see "On the radar", 30-Mar-2015).
- Using this rule-of-thumb ***we can translate the maturity profile of the SOMA portfolio to a "balance sheet implied fed funds curve".***
- Indeed, the current slope of the fed fund futures curve is very similar to the slope implied by the maturity profile of the treasury portfolio. ***To stop increasing the policy rate between 1% and 1.5%, and start reduce the investments sometime between Q4 2017 and Q2 2018 seems very reasonable.*** Such a change in policy should start being massaged into the market roughly 6 months in advance and ***Fed-speak containing more frequent discussions around the balance sheet could then gain momentum already in Q2 2017.***
- In the aftermath of the US election, the probability of fiscal stimulus has no doubt increased. Fiscal stimulus at this stage in the business cycle must surely be considered pro-cyclical and would surely motivate a tighter monetary policy. At the same time, it seems reasonable to believe that Fed would consider a optimal mix of monetary policy "normalization" over the coming years to include both rate hikes but also balance sheet reduction. Fiscal stimulus would mean more bond issuance and that would make it harder to change the reinvestment policy by the Fed. Thus, at the margin, ***the increased probability of fiscal stimulus may influence the Fed to start preparing for a change in reinvestment policy sooner rather than later.***



Source: Nordea Markets



Nordea

Disclaimer and legal disclosures for investment recommendations

Origin of the publication or report

This publication or report originates from: Nordea Bank AB (publ), including its branches Nordea Danmark, filial af Nordea Bank AB (publ), Sverige, Nordea Bank AB (publ), filial i Finland and Nordea Bank AB (publ), filial i Norge (together "Nordea") acting through their unit Nordea Markets.
Nordea Bank AB (publ) is supervised by the Swedish Financial Supervisory Authority and the branches are supervised by the Swedish Financial Supervisory Authority and the Financial Supervisory Authorities in their respective countries.

Content of the publication or report

This recommendation has been prepared solely by Nordea Markets.
Opinions or investment recommendations from Nordea Markets may deviate from one another or from recommendations or opinions presented by other departments in Nordea. This may typically be the result of differing time horizons, methodologies, contexts or other factors.
Investment opinions, ratings, recommendations and target prices are based on one or more methods of valuation, for instance cash flow analysis, use of multiples, behavioural technical analyses of underlying market movements in combination with considerations of the market situation and the time horizon. Key assumptions of forecasts, ratings, recommendations, target prices and projections in research cited or reproduced appear in the research material from the named sources. The date of publication appears from the material cited or reproduced. Opinions and estimates may be updated in subsequent versions of the publication or report, provided that the relevant company/issuer is treated anew in such later versions of the publication or report.

Validity of the publication or report

All opinions and estimates in this recommendation are, regardless of source, given in good faith, and may only be valid at the stated date and time of this recommendation and are subject to change without notice. This recommendation has not been disclosed to the issuer directly or indirectly.

No individual investment or tax advice

The recommendation is intended only to provide general and preliminary information to investors and shall not be construed as the basis for any investment decision or strategy. This recommendation has been prepared by Nordea Markets as general information for private use of the investor to whom the recommendation has been distributed, but it is not intended as a personal recommendation of particular financial instruments or strategies and thus it does not provide individually tailored investment advice, and does not take into account the individual investor's particular financial situation, existing holdings or liabilities, investment knowledge and experience, investment objective and horizon or risk profile and preferences. The investor must particularly ensure the suitability of an investment as regards his/her financial and fiscal situation and investment objectives. The investor bears the risk of losses in connection with an investment.
Before acting on any information in this publication or report, it is recommendable to consult one's financial advisor.
The information contained in the recommendation does not constitute advice on the tax consequences of making any particular investment decision or strategy. Each investor shall make his/her own appraisal of the tax and other financial merits of his/her investment.

Sources

This recommendation may be based on or contain information, such as opinions, recommendations, estimates, price targets and valuations which emanate from: Nordea Markets' analysts or representatives, publicly available information, information from other units of Nordea, or other named sources.
To the extent this publication or recommendation is based on or contain information emanating from other sources ("Other Sources") than Nordea Markets ("External Information"), Nordea Markets has deemed the Other Sources to be reliable but neither Nordea, others associated or affiliated with Nordea nor any other person, do guarantee the accuracy, adequacy or completeness of the External Information.
The perception of opinions or recommendations such as Buy or Sell or similar expressions may vary and the definition is therefore shown in the link at the bottom of the page or on the website of each named source.

Limitation of liability

Nordea or other associated and affiliated companies assume no liability as regards to any investment, divestment or retention decision taken by the investor on the basis of this recommendation. In no event will Nordea or other associated and affiliated companies be liable for direct, indirect or incidental, special or consequential damages resulting from the information in this publication or report.

Risk information

The risk of investing in certain financial instruments, including those mentioned in this document, is generally high, as their market value is exposed to a lot of different factors such as the operational and financial conditions of the relevant company, growth prospects, change in interest rates, the economic and political environment, foreign exchange rates, shifts in market sentiments etc. Where an investment or security is denominated in a different currency to the investor's currency of reference, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment to the investor. Past performance is not a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. When investing in financial instruments, the investor may lose all or part of the investments.

Conflicts of interest

Nordea, affiliates or staff in Nordea, may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives) of any company mentioned in the publication or report.
To limit possible conflicts of interest and counter the abuse of inside knowledge, the author of Nordea Markets are subject to internal rules on sound ethical conduct, the management of inside information, handling of unpublished research material, contact with other units of Nordea and personal account dealing. The internal rules have been prepared in accordance with applicable legislation and relevant industry standards. The object of the internal rules is for example to ensure that no author will abuse or cause others to abuse confidential information. It is the policy of Nordea Markets that no link exists between revenues from capital markets activities and individual analyst remuneration. Nordea and the branches are members of national securities dealers associations in each of the countries in which Nordea has head offices. Internal rules have been developed in accordance with recommendations issued by the stockbrokers associations. This material has been prepared following the Nordea Conflict of Interest Policy, which may be viewed at www.nordea.com/mifid.

Distribution restriction

The securities referred to in this publication or report may not be eligible for sale in some jurisdictions. This research report is not intended for, and must not be distributed to US persons or within the US.
With respect to Singapore, this research report is intended only for, and may be distributed only to, accredited investors, expert investors or institutional investors in Singapore who may contact Nordea Bank, Singapore Branch of 3 Anson Road, #22-01, Springleaf Tower, Singapore 079909. This publication or report may be distributed by Nordea Bank, Singapore Branch, which is subject to the supervision of the Monetary Authority of Singapore.
With respect to Luxembourg, this publication or report may be distributed by Nordea Bank Luxembourg S.A., 562 rue de Neudorf, L-2015 Luxembourg which is subject to the supervision of the Commission de Surveillance du Secteur Financier.
With respect to UK, this publication or report may be distributed in the UK to institutional investors by Nordea Bank AB, London Branch of 6th Floor, 5 Aldermanbury Square, London, EC2V 7AZ, which is authorised by Finansinspektionen (Financial Supervisory Authority) in Sweden and subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request.

Distribution of recommendations (last quarter)

Recommendation	Distribution	Definition
Buy	12.3%	Recommendation to buy
Sell	8.2%	Recommendation to sell
Hold	0.0%	Recommendation to hold
Other	79.5%	Recommendations that include buying and/or selling more than one financial instrument

Recommendation changes in the past 12 months

Author(s)	Date issued	Recommendation	Valid until
Jerk Matero, Mats Hydén	3/9/2016	Buy KI 1708 (ISIN: SE0003787985) Pay fixed in SEK swap maturity 12Aug2017	9/9/2016
Jerk Matero, Mats Hydén	4/18/2016	Break-even inflation tightener Buy SGB 1053 (ISIN: SE0002829192) Sell SGBi 3111(ISIN: SE0007045745)	8/18/2016
Jerk Matero, Mats Hydén	5/25/2016	Short belly in 2/5/10y barbell Buy SGB 1051 (ISIN: SE0001811399)	9/25/2016
Jerk Matero, Mats Hydén	5/25/2016	Buy KI 2012 (ISIN: SE0005705621) Sell Shyp 1584 (ISIN: SE0003174838)	9/25/2016
Jerk Matero, Mats Hydén	6/21/2016	Buy Swed 186 (ISIN: SE0004270007), pay SEK FRA Mar18 (ISIN:SE0006734547)	9/21/2016
Jerk Matero, Mats Hydén	8/16/2016	Sell KI 2012 (ISIN: SE0005705621) Buy Shyp 1584 (ISIN: SE0003174838)	
Jerk Matero, Mats Hydén	8/16/2016	*** close *** Break-even inflation tightener Sell SGB 1053 (ISIN: SE0002829192) Buy SGBi 3111(ISIN: SE0007045745)	
Jerk Matero, Mats Hydén	8/23/2016	Short Swedish 10y bond (ISIN: SE0008290845)	12/31/2016

Recommendation changes in the past 12 months

Author(s)	Date issued	Recommendation	Valid until
Jerk Matero, Mats Hydén	8/25/2016	View on w hen to roll bond future positions. Sept2016 & Dec2016 bond futures on SGBs w ith tenors 2y,5y and 10y (6 contracts involved). ISINs: SE0007975552, SE0007975578,SE0007975594,SE0008290829,SE0008290837,SE0008290845	9/16/2016
Jerk Matero, Mats Hydén	9/6/2016	Sell SGB 5y future Dec16 (ISIN: SE0008290837), buy Bobl 5y future Dec16 (ISIN: DE0001135440)	10/6/2010
Jerk Matero, Mats Hydén	9/6/2016	SEK sw ap flattener 5y5y/10y5y: pay fixed 5y5y, receive fixed 10y5y	12/31/2016
Jerk Matero, Mats Hydén	9/15/2016	*** close *** Buy KI 1708 (ISIN: SE0003787985) Pay fixed in SEK sw ap maturity 12Aug2017	
Jerk Matero, Mats Hydén	9/15/2016	*** close *** Short belly in 2/5/10y barbell Buy SGB 1051 (ISIN: SE0001811399) Buy SGB 1052 (ISIN: SE0002241083) Sell SGB 1047 (ISIN: SE0001149311) Buy SGB 1059 (ISIN: SE0007125927)	
Jerk Matero, Mats Hydén	9/15/2016	*** close *** Sell SGB 5y future Dec16 (ISIN: SE0008290837), buy Bobl 5y future Dec16 (ISIN: DE0001135440)	
Jerk Matero, Mats Hydén	9/23/2016	SEK 5/10y flattener (paying fixed rate in SEK 5y benchmarksw ap, receiving fixed rate in SEK 10y benchmarksw ap)	3/31/2017
Jerk Matero, Mats Hydén	9/23/2016	Receiving fixed rate in SEK 5y5y forw ard starting sw ap, paying fixed rate in USD 5y5y forw ard starting sw ap	1/31/2017
Jerk Matero, Mats Hydén	9/23/2016	Bond sw itch: value in selling K2002 (ISIN: SE0008040786) and buying K2012 (ISIN: SE0005705621)	10/30/2016

Recommendation changes in the past 12 months

Author(s)	Date issued	Recommendation	Valid until
Jerk Matero, Mats Hydén	10/10/2016	"We see more value in": SGBi 3110 (ISIN:SE0006758736) SGBi 3102 (ISIN:SE0000317943) SGBi 3108 (ISIN: SE0004211084)] SGBi 3104 (ISIN:SE0000556599) "Than in": SGBi 3109 (ISIN:SE0005703550) SGBi 3112 (ISIN:SE0008014062)	11/10/2016
Jerk Matero, Mats Hydén	10/18/2016	Receive SEK FRA March 2017 (ISIN: SE0007587175)	11/8/2016
Henrik Unell, Jerk Matero	10/27/2016	A bought payer swaption 5 year starting in 3 years	
Jerk Matero, Mats Hydén	11/1/2016	*** close *** Sell Swed 186 (ISIN: SE0004270007), ReceiveSEK FRA Mar18 (ISIN:SE0006734547)	
Alexander Wojt, Jerk Matero, Mats Hydén	11/2/2016	Pay 1y1y SEK vs EUR	
Alexander Wojt, Jerk Matero, Mats Hydén	11/2/2016	Receive EUR 1y1y vs 1y vs pay 2y2y vs 2y (vol weighted, i.e. roughly 2:1 dv01)	
Jerk Matero, Mats Hydén	11/18/2016	*** close *** "We see more value in": SGBi 3110 (ISIN:SE0006758736) SGBi 3102 (ISIN:SE0000317943) SGBi 3108 (ISIN: SE0004211084)] SGBi 3104 (ISIN:SE0000556599) "Than in": SGBi 3109 (ISIN:SE0005703550) SGBi 3112 (ISIN:SE0008014062)	
Jerk Matero, Mats Hydén	11/18/2016	Pay fixed rate in SEK 10y swap, receive fixed in EUR 10y swap	1/10/2017
Jerk Matero, Mats Hydén	11/30/2016	Go long BEI SGBi 3104 (ISIN:SE0000556599), go short BEI SGBi 3108 (ISIN: SE0004211084)	2/28/2017
Jerk Matero, Mats Hydén	11/30/2016	*** close *** SEK swap flattener 5y5y/10y5y: receive fixed 5y5y, pay fixed 10y5y	

Recommendation changes in the past 12 months

Author(s)	Date issued	Recommendation	Valid until
Jerk Matero, Mats Hydén	12/13/2016	*** close *** Buy Sw edish 10y bond (ISIN: SE0008290845)	
Jerk Matero, Mats Hydén	12/13/2016	Buy SGB 1052 (ISIN:SE0002241083), Pay fixed in maturity-matched SEK sw ap	6/1/2017
Jerk Matero, Mats Hydén	12/13/2016	Pay Mar17 SEK FRA (ISIN:SE0007587175), Receive Jun17 RIBA (ISIN:SE0007051388)	3/15/2017
Jerk Matero, Mats Hydén	12/22/2016	Pay fixed rate in SEK sw ao 2y1y Receive fixed rate in SEK sw ap 2y6y	5/30/2017
Jerk Matero, Mats Hydén	12/22/2016	*** close *** PaySEK FRA March 2017 (ISIN: SE0007587175)	

Thank you!

Strategy Sweden

Martin Enlund
Chief Analyst
martin.enlund@nordea.com

Mats Hydén
Chief Analyst
mats.hyden@nordea.com

Jerk Matero
Chief Analyst
jerk.matero@nordea.com

Mikael Sarwe
Head of Research
mikael.sarwe@nordea.com

Henrik Unell
Chief Analyst
henrik.unell@nordea.com