



Strategy Research Sweden: On the radar

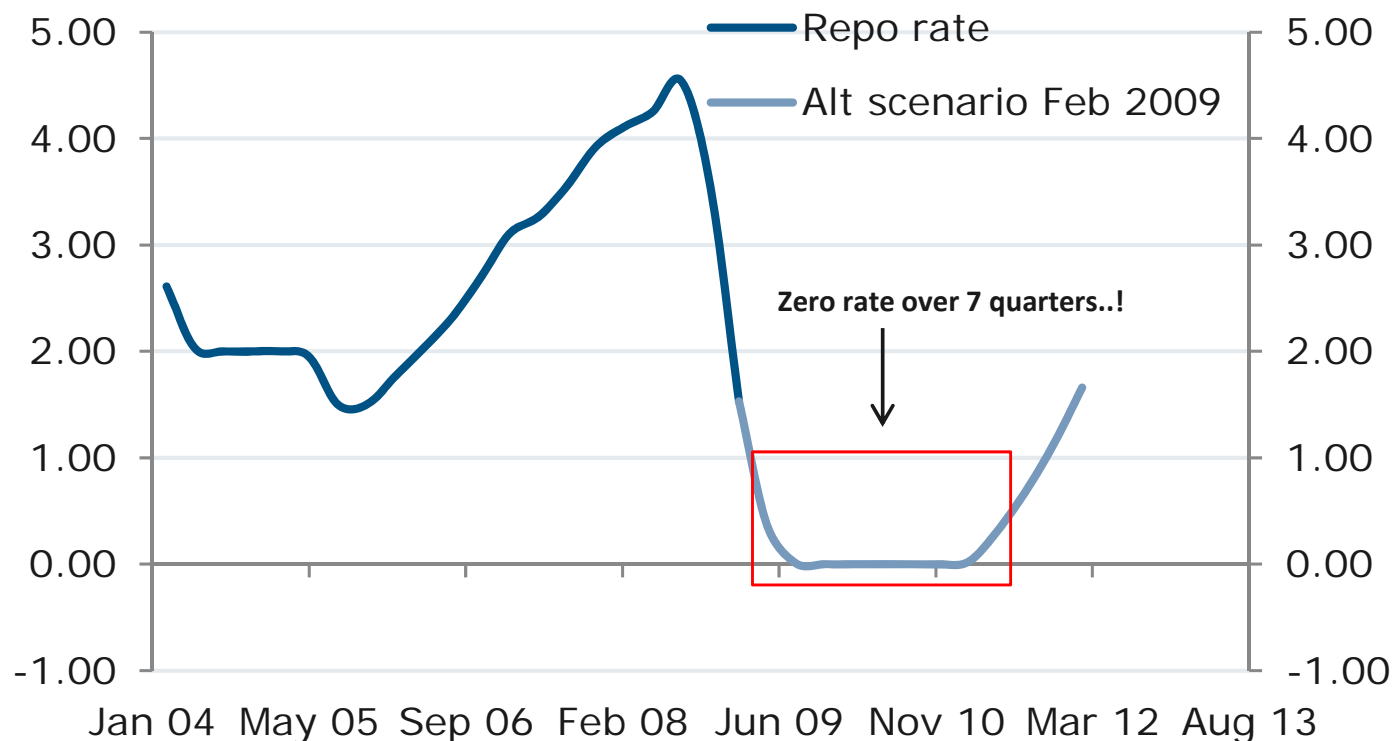
This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea...

Themes in this edition:

- ***Riksbank:*** time to re-gain credibility and control
- ***Riksbank:*** survey points to 15-20bps cut
- ***SEK rates:*** Sweden most out of sync with the economy
- ***Sweden macro:*** skewed probability distribution for government's debt
- ***EUR rates & FX:*** QE – perspectives on what's priced in
- ***AQR & stress tests:*** the golden mean

27 October 2014

Chart of the week: all eyes on the Riksbank



Source: Nordea, Riksbank

The Riksbank is now widely expected to cut rates and revise the rate path lower. But in addition to that, we believe the bank will outline more clearly how the next step could look like, i.e. what other tools are at its disposal with the policy rate at the zero bound (see more on page 3...)

Riksbank: time to re-gain credibility and control

Riksbank is now widely expected to cut rates and revise the rate path lower. Nordea's forecast is a cut to 0.05% and the end-point of the path being revised lower by 75bps, to 1.5%. But in addition to that, we believe the bank will outline more clearly how the next step could look like, i.e. **what other tools are at its disposal with the policy rate at the zero bound**. Below is a list of what they said in 2009, when the repo rate was 0.25%:

1. **The repo rate can be cut to 0.00%** (see chart)

2. If the real rate is deemed too high even with rates at the boundary, the following **tools are at the disposal**:

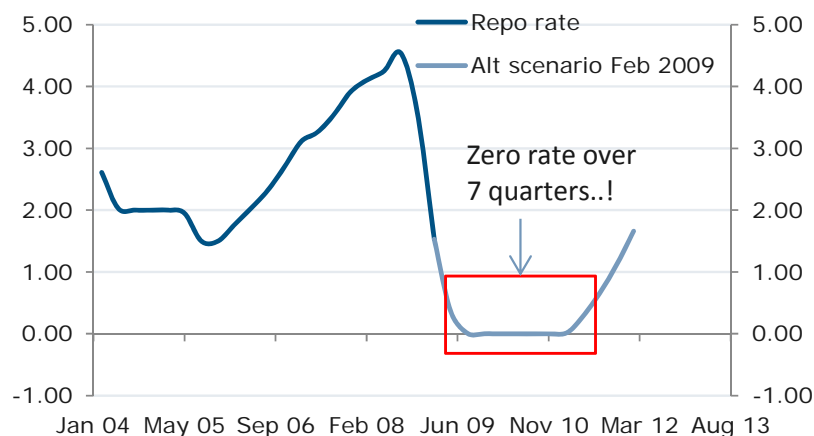
(2.1) *affecting expectations of inflation and future policy rates **by credible forecasts***

(2.2) ***keep the exchange rate fixed** at a low level until the inflation/price level target is met*

(2.3) ***bring down spreads** that are deemed excessive and that could boost aggregate demand*

(2.4) ***affect longer interest rates** by buying or selling government/other securities with longer maturities*

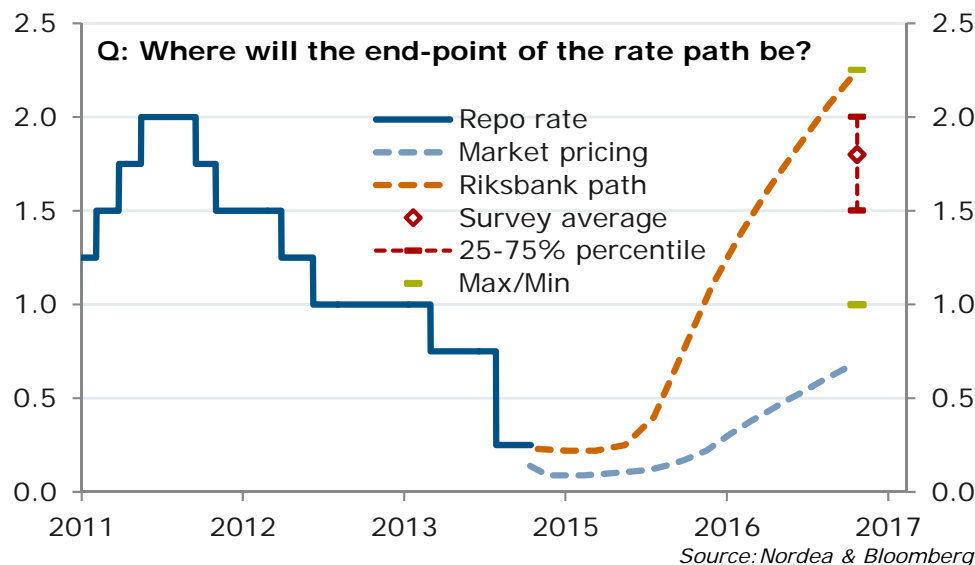
The bank will likely address all these tools again, although some are more realistic than others. At this point, we think it will be all about re-gaining control over the front-end and re-gaining credibility on the forecasting. That is, to deliver a rate path that people consider to be a realistic base-line scenario and a path that is symmetric in the sense that it also can be revised higher if the economy improves. One such solution could be to cut rates down towards the zero bound and also signal that rates will stay at these levels



Source: Nordea, Riksbank

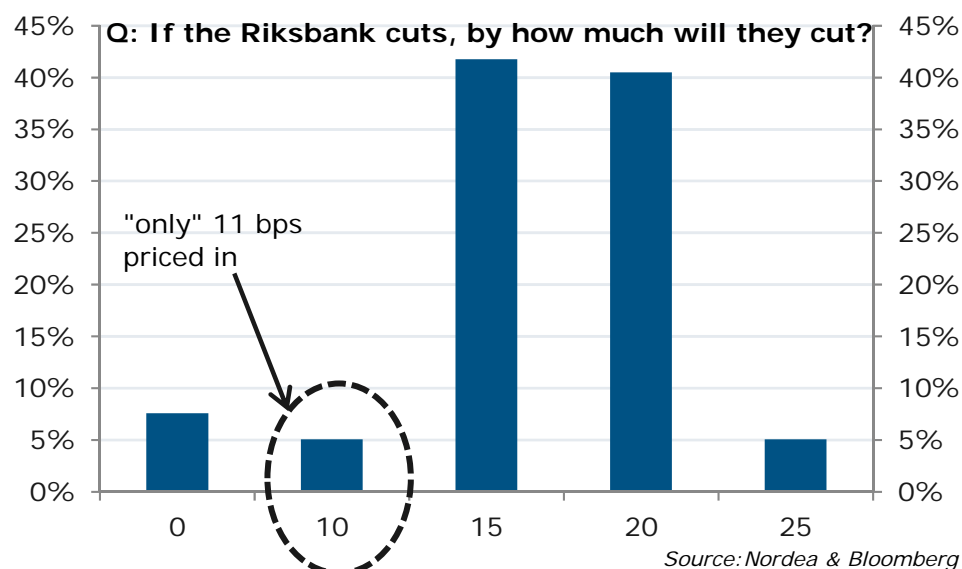
for a considerable period of time and that the bank is not prepared to change stance unless inflation is above a certain level (such as Governor Jansson's 1.50% threshold). Since there are hardly any economist out there that expect CPIF to print higher than 1.50% over the coming two years, such a signal would likely cement the front-end around the zero-bound throughout the best part of 2016 and the bank has re-gained control over front-end rate expectations. Tactically, it would probably also **be a wise move for the bank to highlight that currency interventions could prove necessary** if the currency appreciates too much, since such a statement likely would prevent it from any excessive appreciation in the scenario where, for instance, ECB announce large scale sovereign QE

Riksbank: survey points to 15-20bps cut

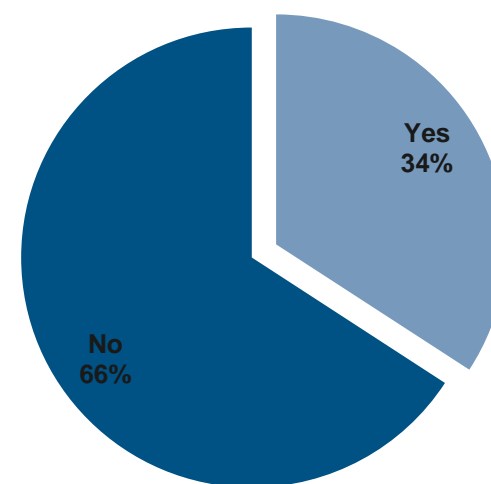


Our colleagues within sales on Friday presented a survey ahead of tomorrow's Riksbank decision (covering roughly 100 internal and external respondents). While it's not a professional survey, there are a couple of observations worth highlighting.

- The end-point of the rate path is expected to be revised down from 2.25% (Q3 2017) to 1.8%
- A cut of 15-20bps is expected by most, while only 11bps is priced in
- About a third of respondents expected the Riksbank to eventually have to get involved in alternative measures (QE, FX intervention, negative rates etc.)



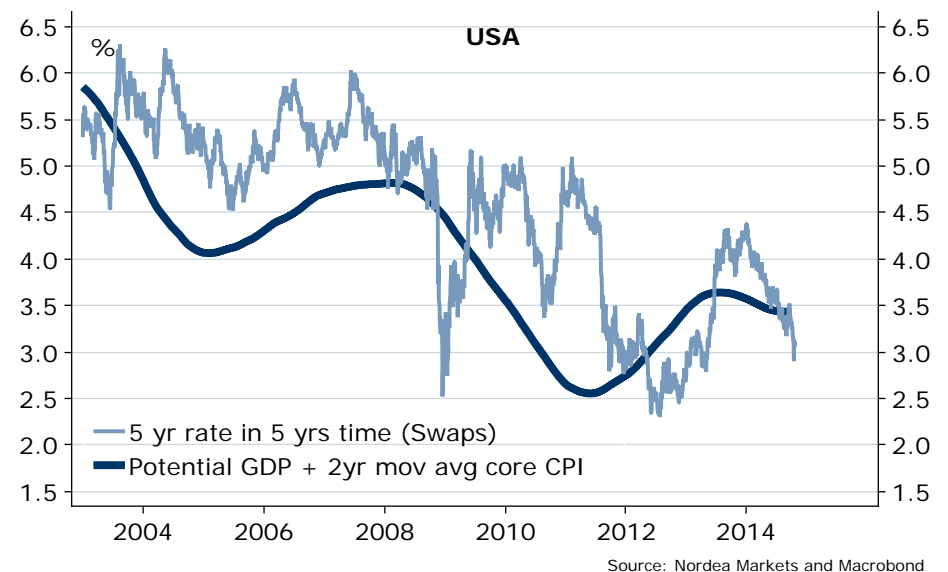
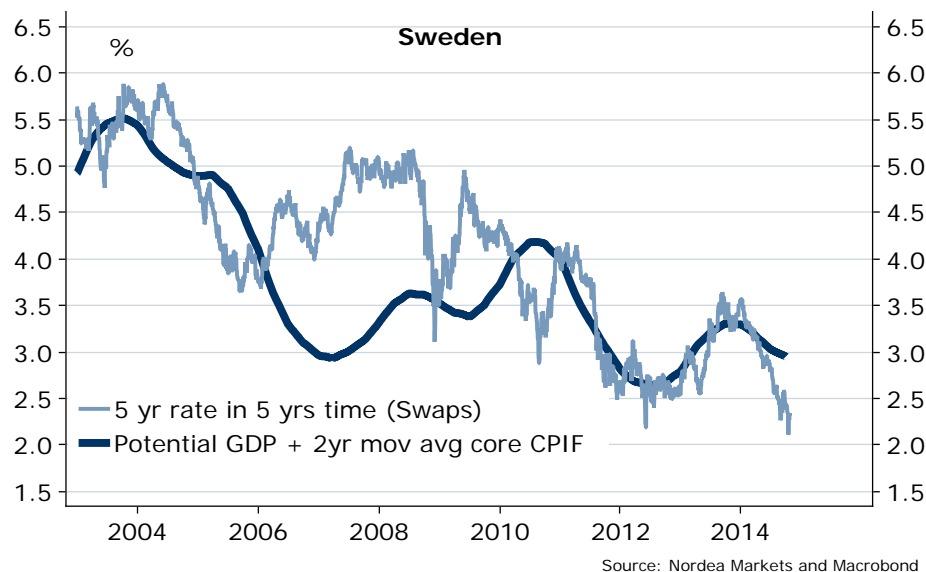
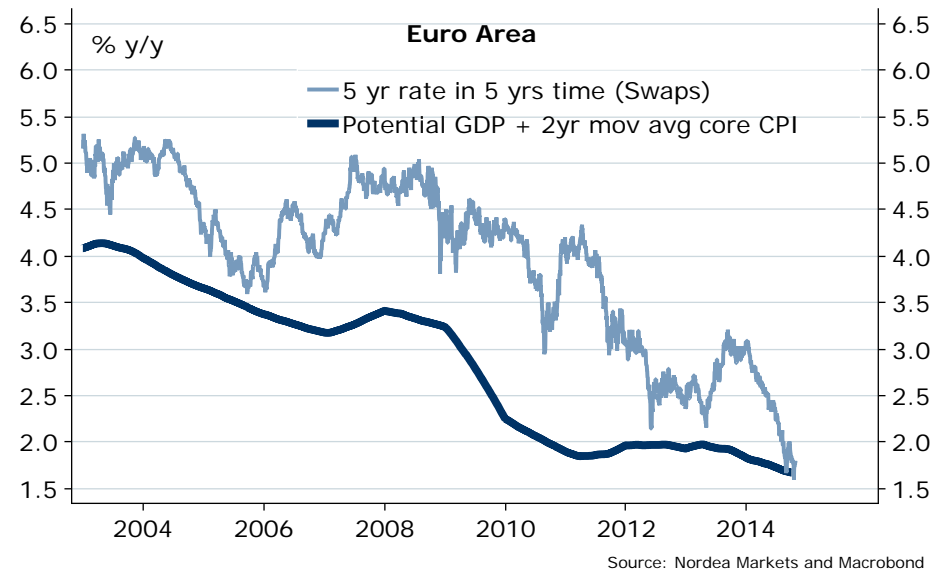
Q: Will the Riksbank eventually be forced down the road of extraordinary measures?



Source: Nordea

SEK rates: Sweden most out of sync with the economy?

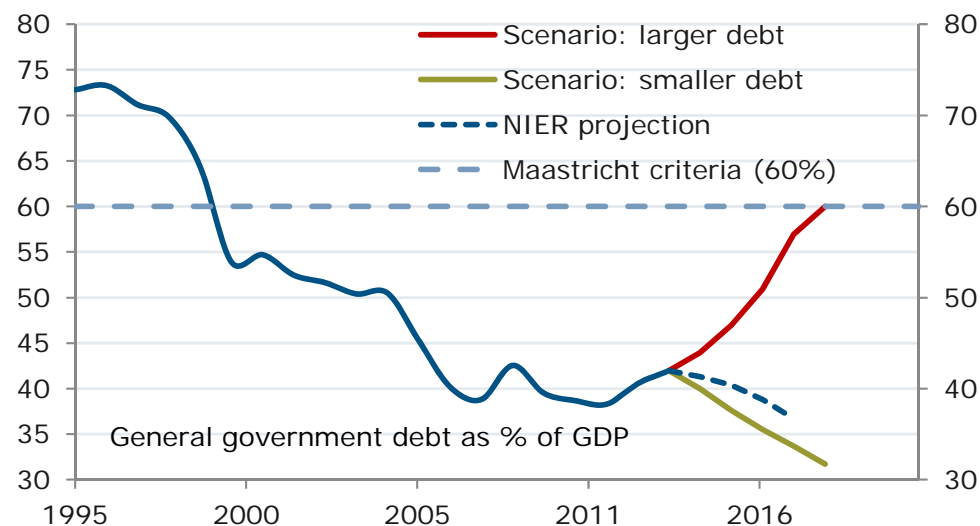
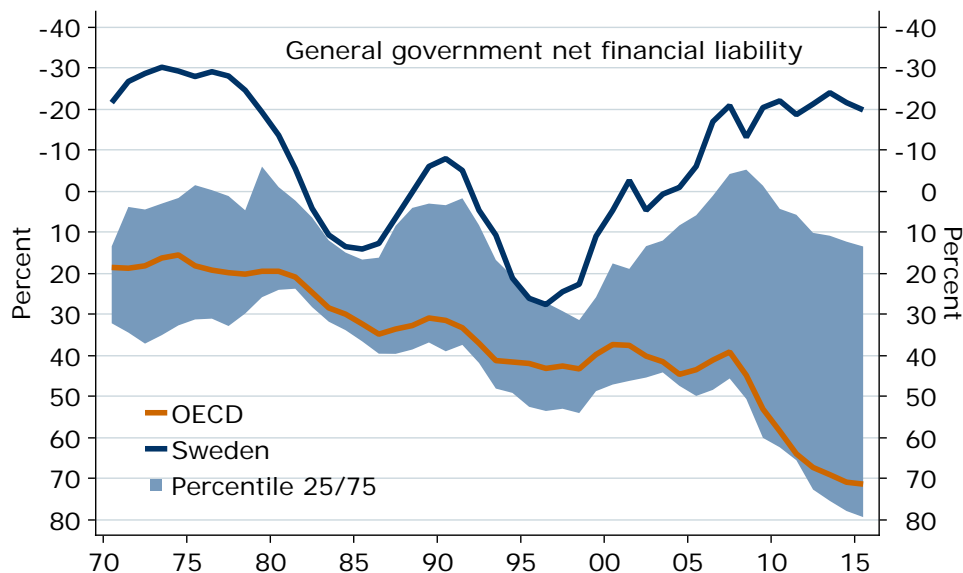
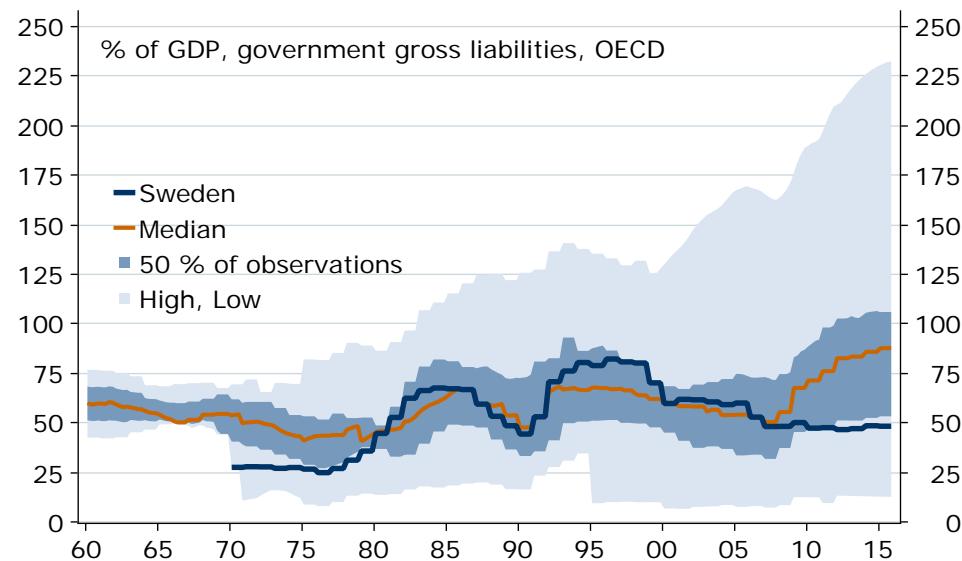
We have used “nominal anchors” (potential growth + inflation trend) previously in [On the Radar](#). We noted that medium term pricing of policy rates had moved markedly below the anchors (particularly in EMU and Sweden). Our take was that these central banks “only” care about the inflation part and not the real part of the policy rate. Thus, as long as inflation stays too low, so will bond yields. If we stretch this analysis further out the curve after the recent bond rally, also 5yr5yr forward rates look historically low compared to the nominal anchors. Another conclusion is that EMU has struggled with too high interest rates a long time. And Sweden is currently most out of sync with economic reality...



Sweden macro: skewed probability distribution for government's debt

Record-high net wealth and low debt will put fiscal policy under pressure as policy rates reach zero

- Swedish government's finances are at record strong levels, both when looking at debt levels and net wealth. Compared to other OECD countries, Sweden stands out even more and the only comparable countries are Norway and Switzerland.
- With the repo rate close to zero, the monetary policy options are getting fewer. As both support to the covered bond market and currency interventions appear to be poor choices, the torchlight should eventually fall on fiscal policy. With lower growth abroad, more fiscal stimulus will most likely be deemed appropriate.
- Thus, the probability distribution for the future size of the government bond stock is getting more and more skewed to the upside. The new government's soft withdrawal from the surplus target adds to the above.

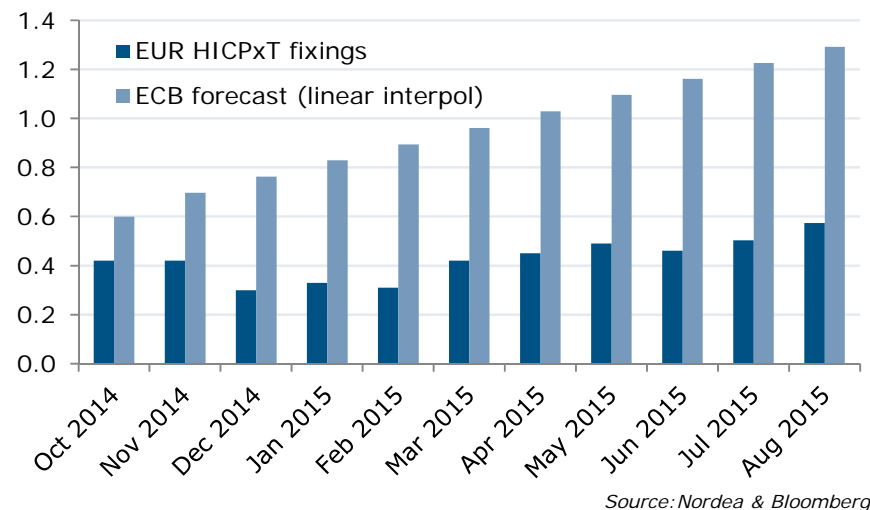
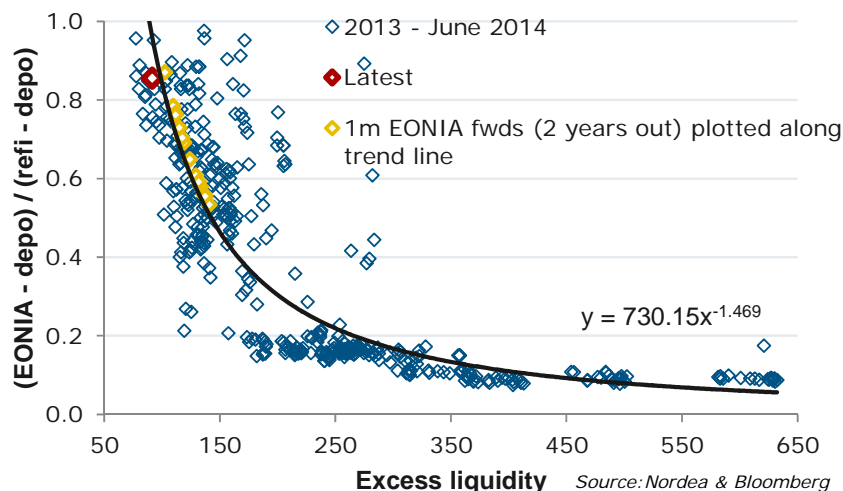


EUR rates & FX: QE – perspectives on what's priced in

While most analysts seem to agree that the probability for QE has increased, parts of the rates & FX market has not been going in that direction. For more, see *“QE – perspectives on what's priced in”...*

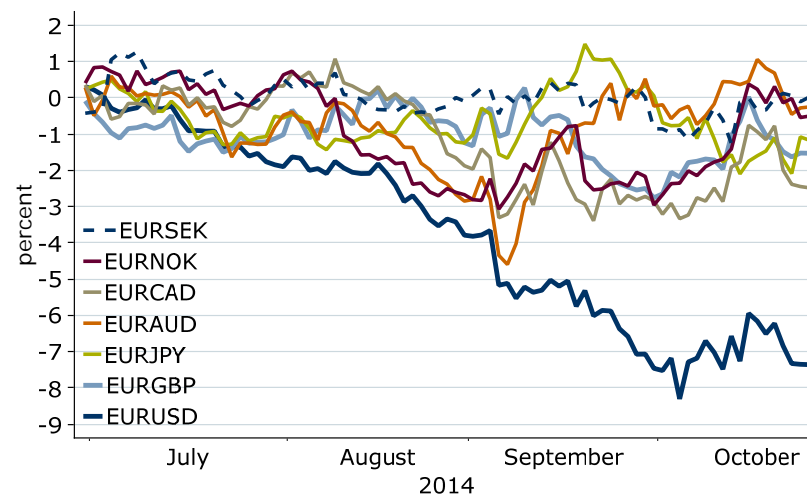
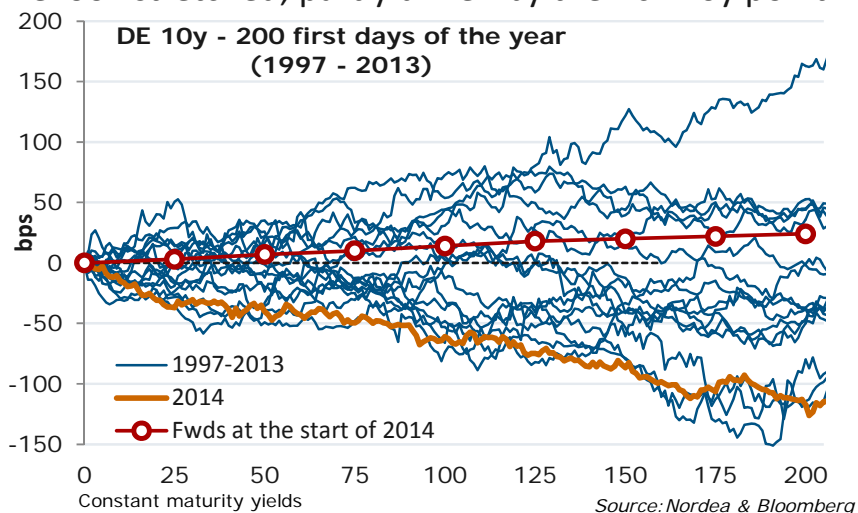
EONIA fixing above zero looks ok given liquidity levels but the short-end appears elevated (exc. liq. expectations too low)...

If the HICP_T fixings were to be realized, QE should be close to a done deal. Still, long term inflation expectations remain low...



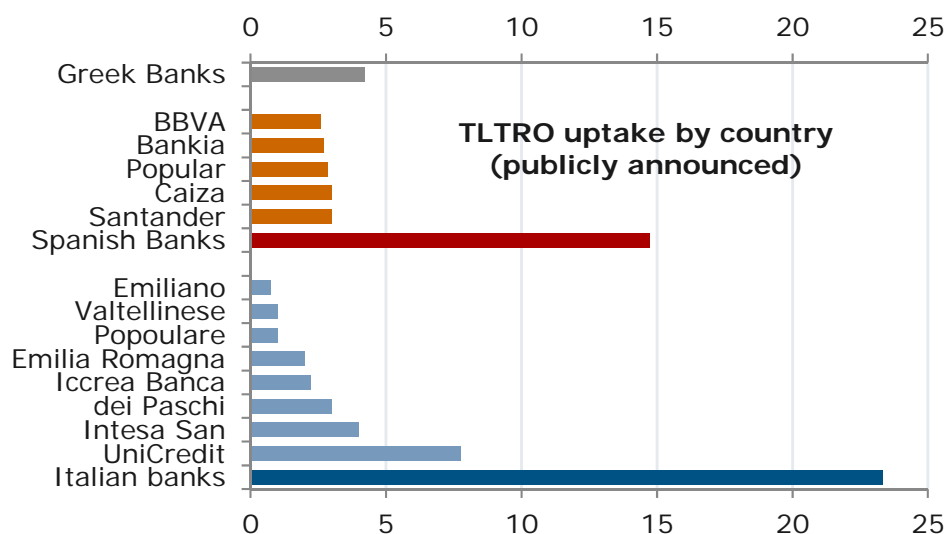
If a US-like sell-off is the result of €-QE, several segments of the curve look stretched, partly driven by the rich 10y point...

Gauging by the performance of various EUR crosses, there are no clear signs of a QE premium in the FX market...

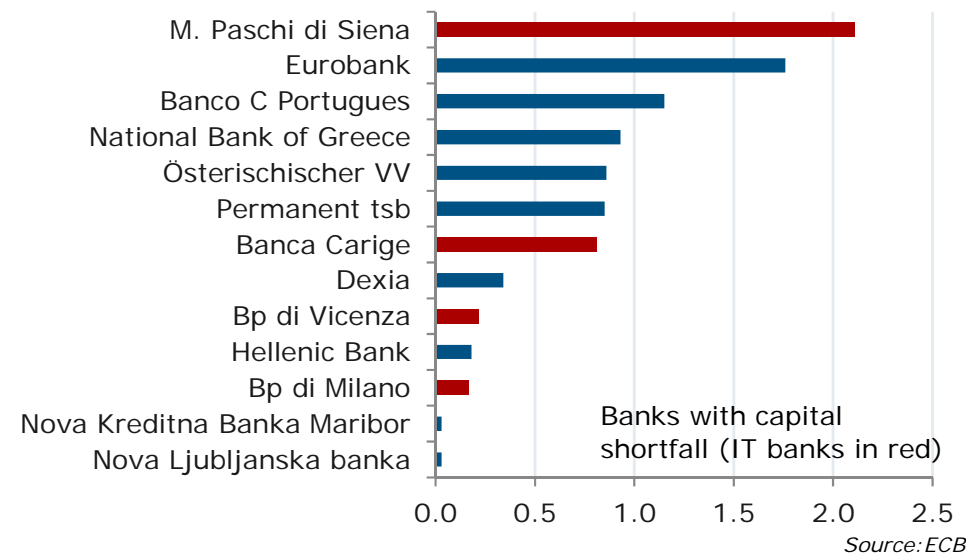


AQR & stress tests: the golden mean

The ECB could probably not have hoped for a better outcome of the AQR/stress tests. The number of banks failing was probably enough for the tests to be considered tough but low enough in order not to cause concern about the health of the Euro area banking system. While the results were close to market expectations, Italian banks were a touch on the weak side vs the rest (4 out of the 13 banks with capital needs were Italian). With Italian banks being the largest takers of the Sep TLTRO and lending rates to non-financial corporations remaining on the high side vs e.g. Spain, Italian banks may be watched carefully going forward. For more on this topic, see *“Stress tests behind – not the stress”*.



Source: Nordea & Bloomberg



Source: ECB



Source: Nordea Markets and Macrobond

Thank You!

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Kristofer Eriksson
kristofer.eriksson@nordea.com

Fredrik Floric
fredrik.floric@nordea.com

Mats Hydén
mats.hyden@nordea.com

Mikael Sarwe
mikael.sarwe@nordea.com

Henrik Unell
henrik.unell@nordea.com

Alexander Wojt
alexander.wojt@nordea.com