



Strategy Research Sweden: On the radar

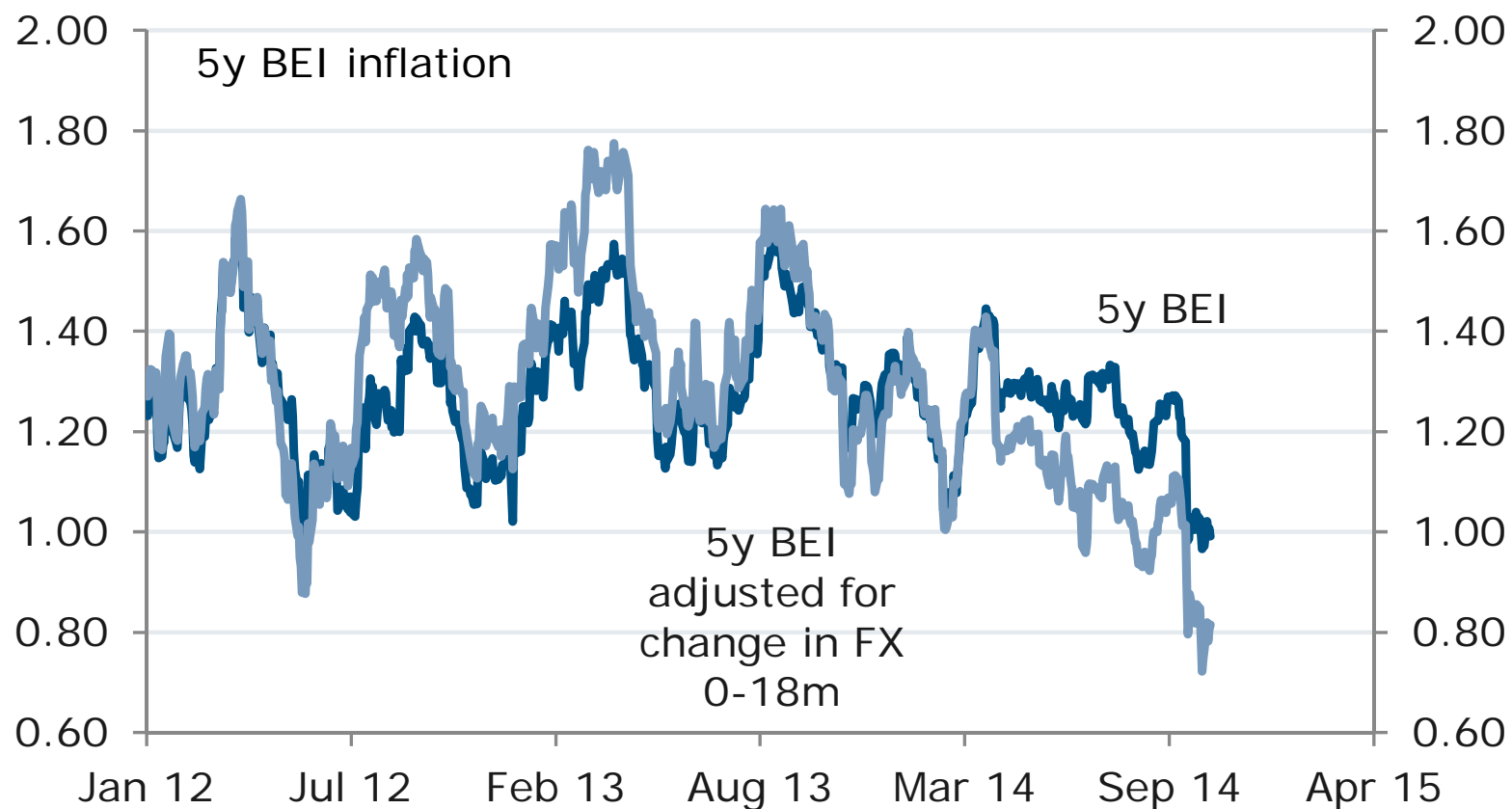
This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea...

Themes in this edition:

- **Sweden:** amortization requirements, as we know it
- **SEK rate vol:** end of year is not end of history
- **SEK linkers:** break-even inflation low in relation to SEK
- **EUR rates:** peculiar patterns in the repo market
- **EUR rates:** 10s dipping a toe below 1%
- **FX vol:** EURCHF for the gutsy

17 November 2014

Chart of the week: break-even inflation low in relation to SEK



Source: Nordea Markets

SEK weakness to continue to feed through into CPI and support BEIs (more on page 5) ...

Sweden: amortization requirements, as we know it

FSA regulation proposal on amortization:

- Mortgage loans to be repaid down to 50% LTV
 - 2% per year, down to 70%
 - 1% per year, down to 50%
- Only for new loans (definition of “new” not yet clear)
- Temporary exceptions due to sickness, unemployed, ma-/paternity leave etc. (definition not yet clear)
- People over 65 not included (definition not yet clear)
- Regulation proposal submitted for comment, to be implemented 1 July 2015, at the earliest

Comments:

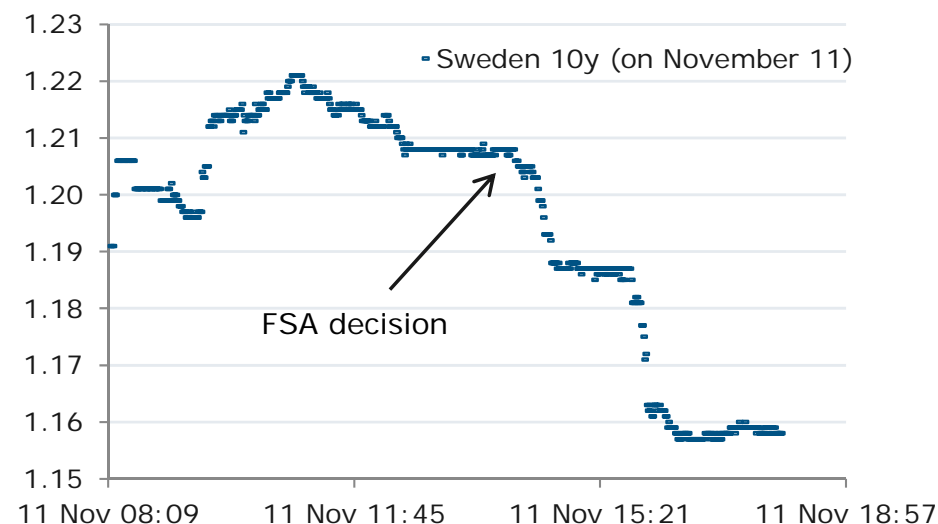
- Risks leading to lock-in effects and lower activity in the housing market
- Debt on a new loan to be amortized down to 70% LTV over 9yrs, which is rather fast, and down to 50% over 32yrs (see table)
- All-else-equal, contribute to a larger potential downside for the Swedish economy, which is highly dependent on private consumption. Particularly in a scenario where house prices/equity prices correct and /or unemployment rate is rising
- Market reaction was negative, with a 4bps correction in 10yr yields following the decision, which we suspect was largely linked to the FSA decision (see chart)

Example on FSA regulation, assuming constant house/apartment prices (in SEK)

House/apartment price		1176471	2352941	3529412	4705882	5882353
Loan (85% LTV)		1000000	2000000	3000000	4000000	5000000
Phase 1 (85%)	per year	20000	40000	60000	80000	100000
	per month	1667	3333	5000	6667	8333
	years, from 85% to 70%	8.8	8.8	8.8	8.8	8.8
Phase 2 (85 to 70%)	per year	10000	20000	30000	40000	50000
	per month	833	1667	2500	3333	4167
	years, from 70% to 50%	23.5	23.5	23.5	23.5	23.5
Total	years, from 85% to 50%	32.4	32.4	32.4	32.4	32.4

* average house price in the country around 2.3m SEK and in Stockholm 4.8m SEK

Intra-day chart, 10yr SEK govie

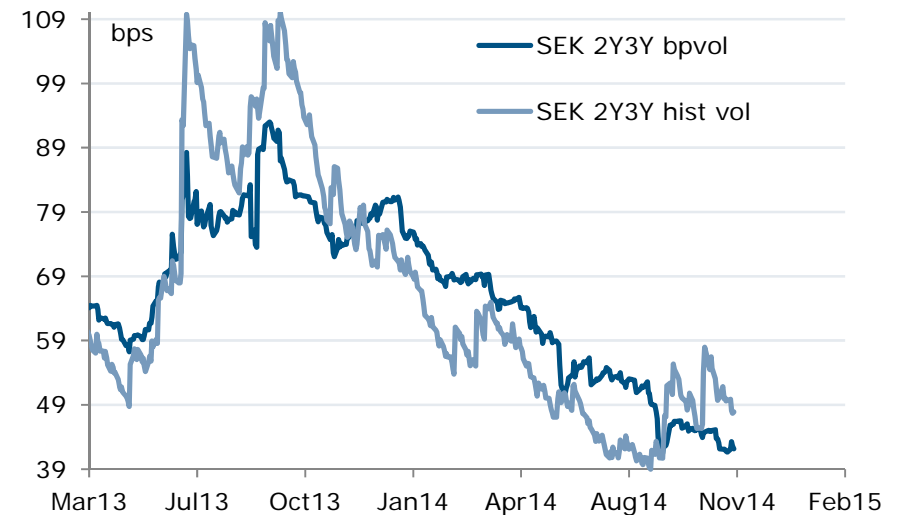


Source: Nordea & Bloomberg

SEK rate vol: end of year is not end of history

Thin year-end market, additional Stibor uncertainty and upward sloping yield curve contribute to value in SEK receiver swaption volatility...

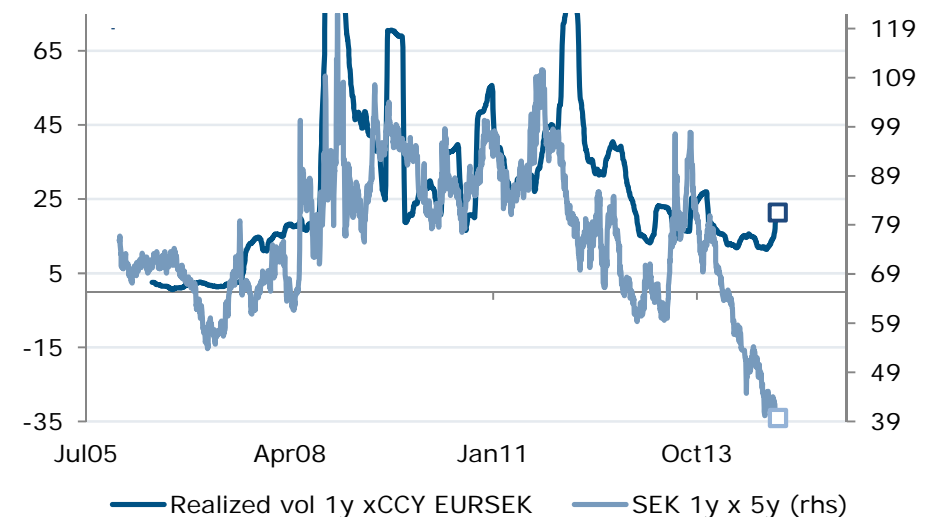
- Calling for higher rate vol has been as futile as any call for higher bond yields the last year or so
- Thin year-end bond markets with a lot of holidays over Christmas and new year might however enhance volatility somewhat
- Also, some friction in the SEK money-market has been evident as of lately with somewhat higher Stibor as a consequence (read more: ["What's behind the move in Stibor"](#)). This could continue or reverse, but marginal contribution to vol should be on the upside
- The upward sloping yield curve makes long vol positions in receivers even cheaper to carry (for example: a SEK 2y3y receiver lose about 12 bps in roll on vol surface the first year while the underlying 3y rolls positively with about 34 bps)
- **Have a look at buying a 2y3y SEK amt receiver and trade the delta in 5y or 10y govies to profit from realized yield vol over year-end and into next year**



Source: Nordea Markets



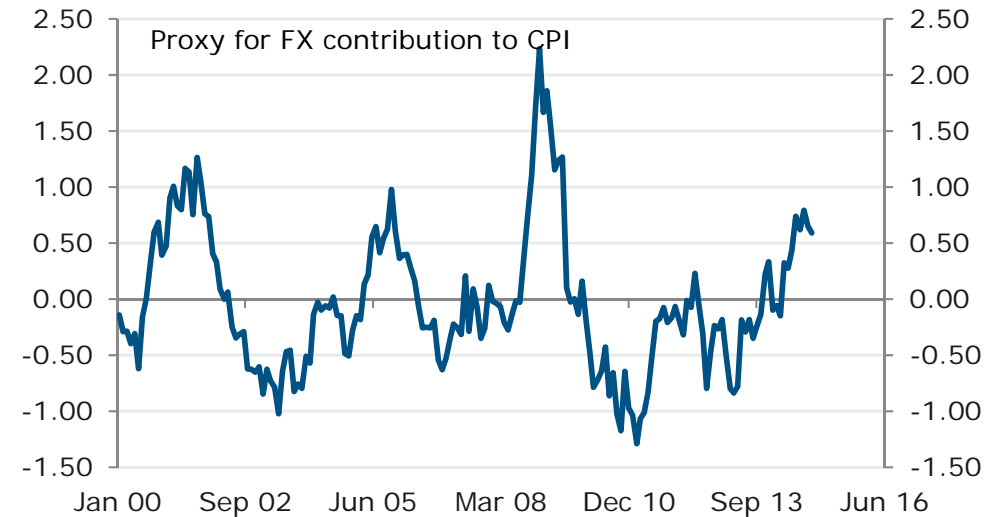
Source: Nordea Markets



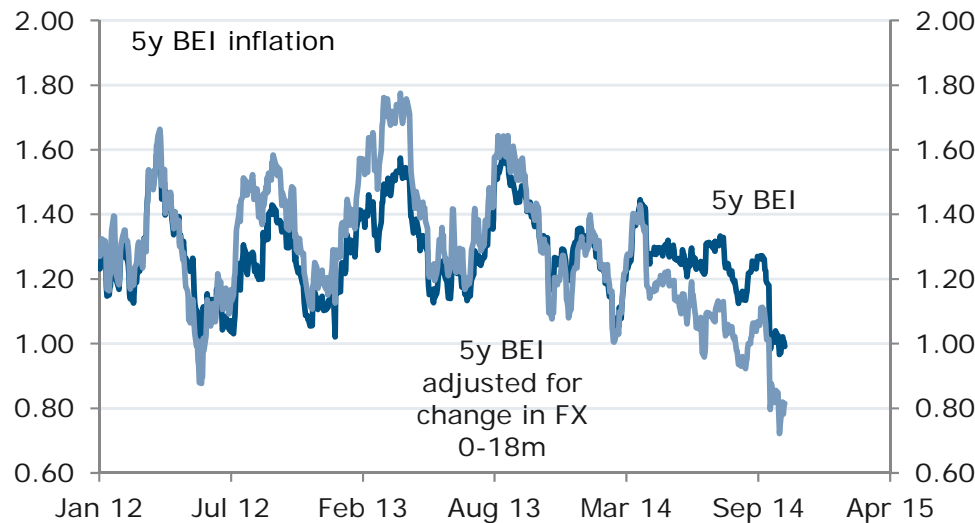
SEK linkers: break-even inflation low in relation to SEK

SEK weakness to continue to feed-through into CPI and support BEIs...

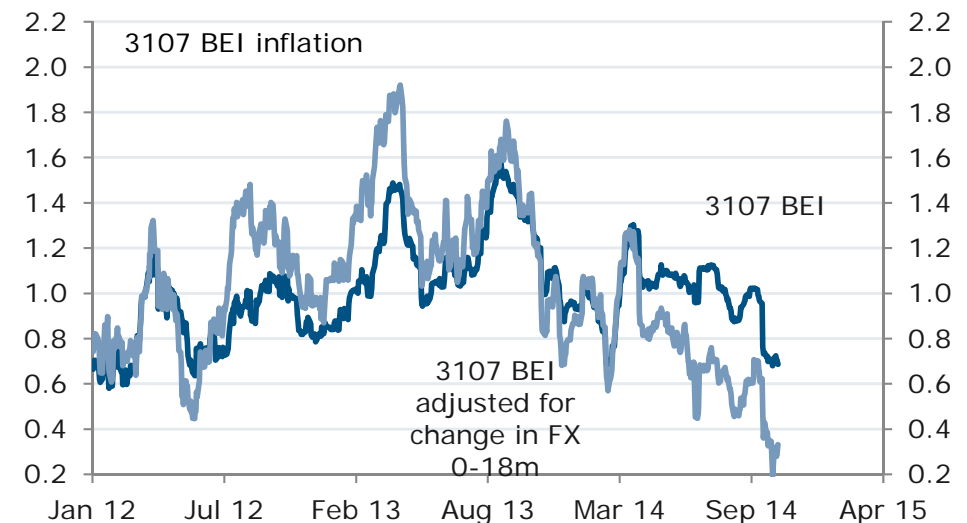
- About one third of the CPI basket stems from imported goods and services. It is more or less impossible to derive exactly how a change in the currency feeds through into CPI, but a commonly used rule-of-thumb is to assume that about 15% of the change in a trade-weighted currency index feeds through over 18 months
- If one uses this simplified rule, and assume that the feed-through is uniform over 18 months, then one can calculate a proxy of how the last 18 months currency development will impact CPI
- In SGBi 3107 (maturity June 2017), a currency weakening worth about 40 bps should be priced in, meaning that more than half of the break-even inflation is actually originating from currency weakness. **All in all, break-even inflation seems to be low relative the level of EURSEK**



Source: Nordea Markets



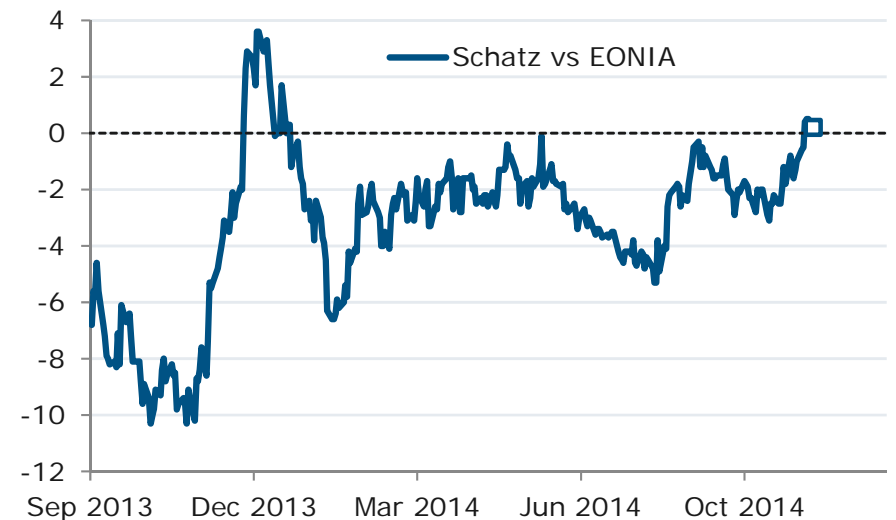
Source: Nordea Markets



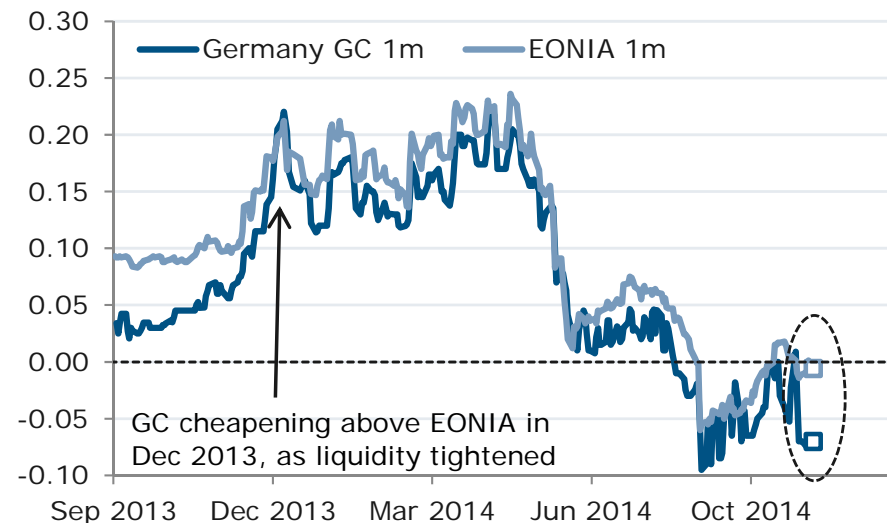
Source: Nordea Markets

EUR rates: peculiar patterns in the repo market

- Schatz is currently trading around the same levels as a maturity matched EONIA
- During the last years' low yield environment, that has only happened a handful of times
- A similar move was seen ahead of year-end in 2013, partly driven by the fact that German repo rates picked up and pulled bond yields along. For a brief period, 1m GC rates traded above 1m EONIA
- Now, however, the move in the repo market is in the other direction
- If liquidity tightens somewhat going into year-end (see *"Liquidity, balance sheet and market opportunities"*), we may see a similar pattern in the repo market, which could also impact how Schatz is trading
- The TLTRO on December 11 could make this less pronounced, as liquidity is likely to improve, but it's worthwhile to keep an eye on the development of German repo rates and the Schatz vs EONIA spread over the coming month...



Source: Nordea & Bloomberg



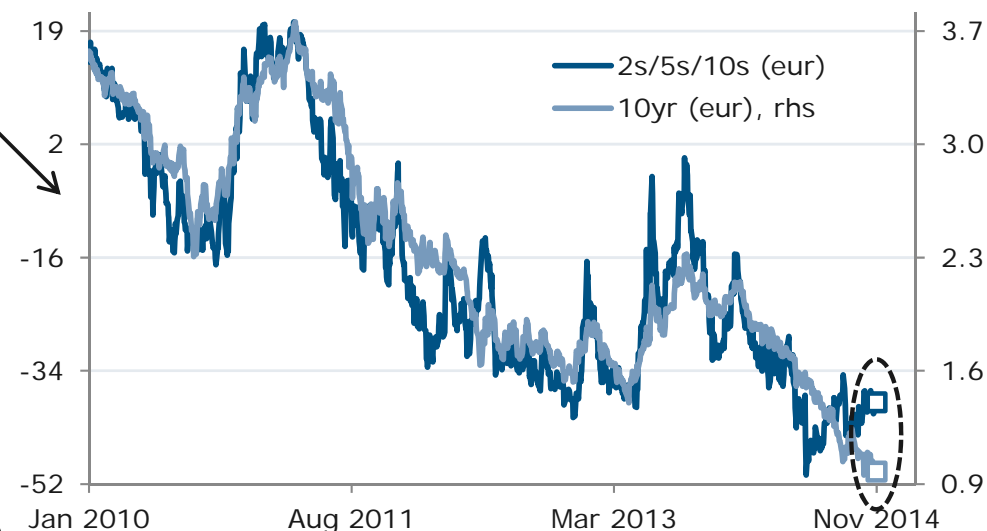
Source: Nordea & Bloomberg

EUR rates: 10s dipping a toe below 1%

The 10y EUR swap has seen a ~10bps performance over the past month and is now trading around 1%. The level, in turn, has decoupled somewhat from 2s5s10s, a result of 5s10s flattening more than 2s5s.

In essence, this is not strange in a low-rate environment, but still stands out to the historical relation between 5s10s and the level of yields that was broken in the beginning of this year.

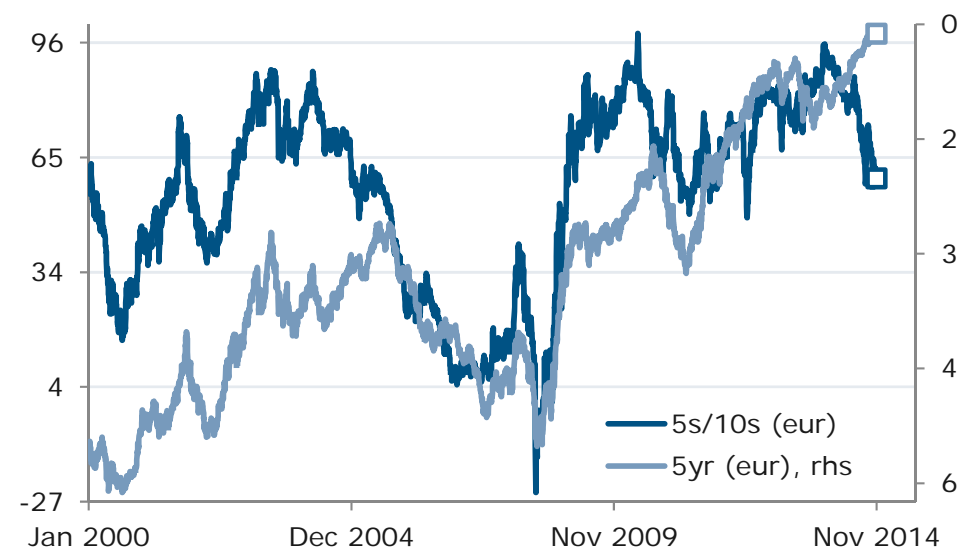
However, the flattening that has occurred in 5s10s has not been mirrored by a move of similar size in fwd space. As a consequence, positions like 5s10s, 1y fwd, rolls flat, for the first time in many years.



Source: Nordea



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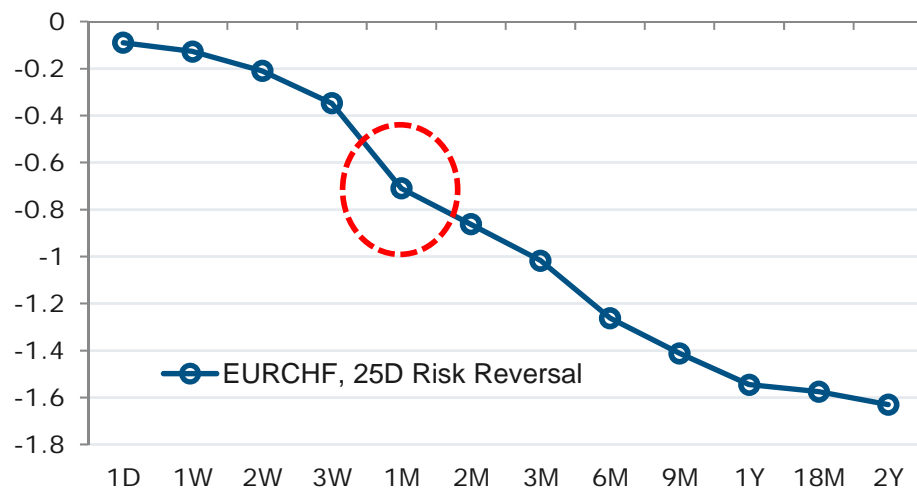


Source: Nordea

FX vol: EURCHF for the gutsy

ECB's increasingly dovish stance is affecting other central banks, most notably the SNB but also the Danish central bank (see *"Danish rate cut before the end of the year"*)...

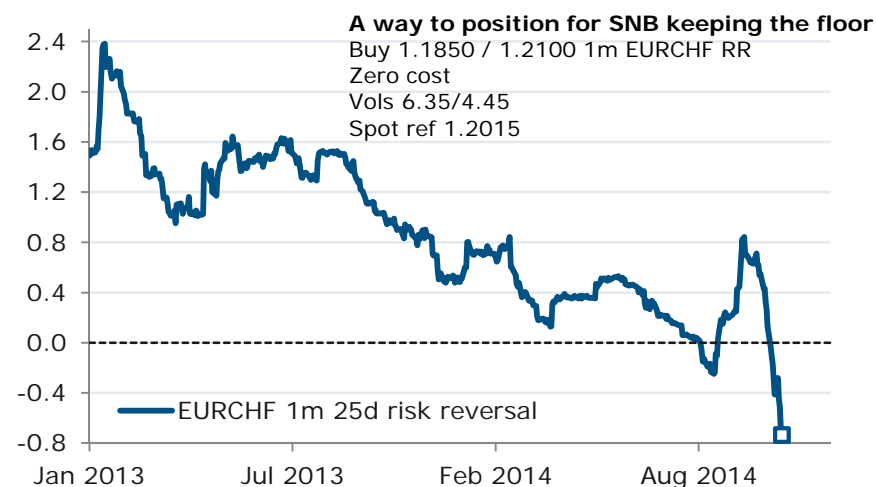
€-QE speculation and the upcoming gold referendum has pushed EURCHF close to the 1.20 floor, likely not far from levels where the SNB previously has intervened. As hedges are building on the downside, it's becoming more attractive to "trust the SNB" and sell downside protection. In particular, it seems as if protection over November 30, the date of the gold referendum, has turned increasingly expensive. A yes-vote, which recent polls are not pointing to, would mean 20% of SNB's balance sheet assets would need to be physical gold, stored in Switzerland, and not allowed to be sold. That would make FX interventions increasingly complicated. The SNB, which rarely make political statements, have clearly outlined their discontent with the yes-side. Thus, for investors trusting the SNB will keep the floor, the option market presents an interesting way to play it. For more on this topic, see *"When words are not enough"*



Source: Nordea & Bloomberg



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Thank You!

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