



## Strategy Research Sweden: On the radar

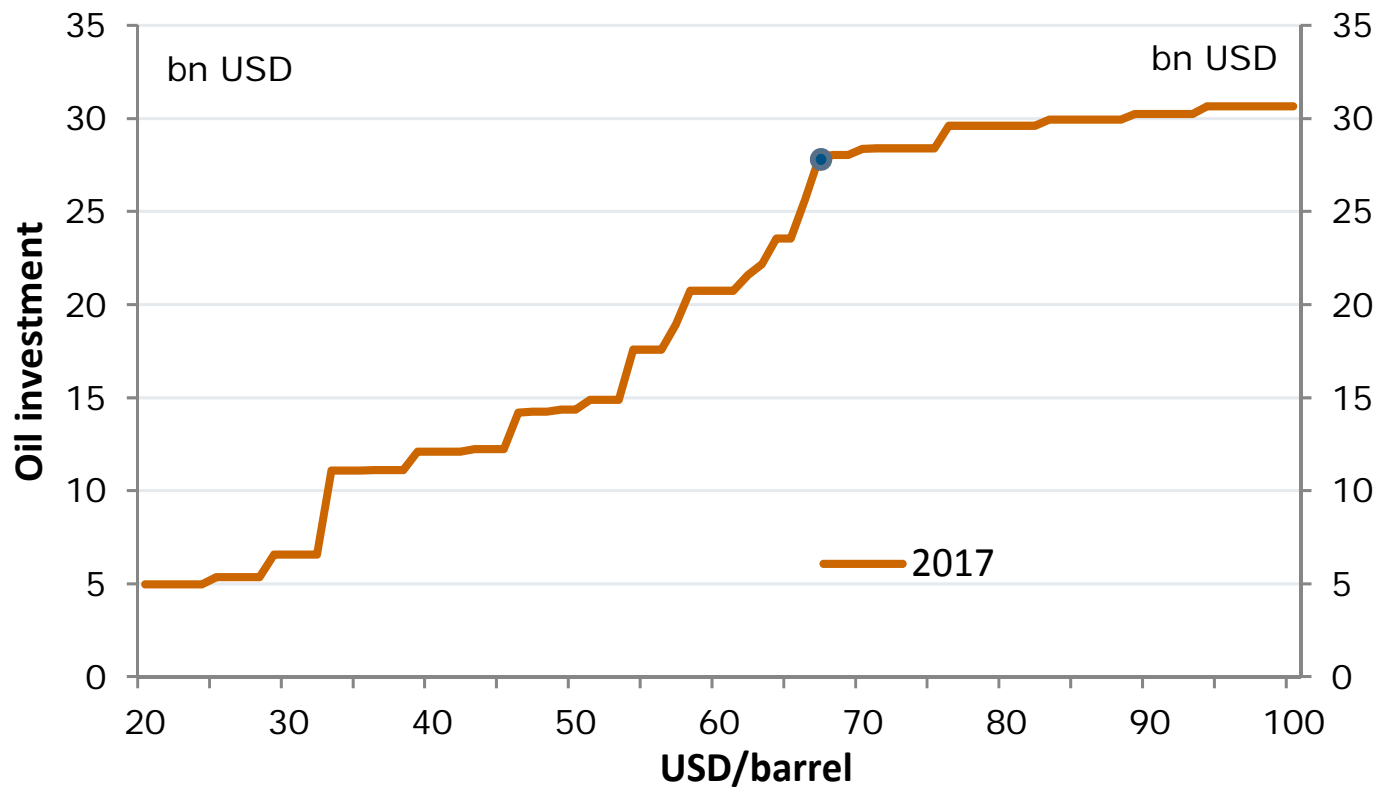
*This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea...*

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

- **Norway:** Oil below the critical 70\$/b level
- **SEK rates:** The switch, more curvature in the offering
- **Cross-market:** 5s/10s decoupling
- **ECB:** from if to when and how
- **Euro area:** not all rates are low...
- **FX:** PPM, an unreliable source to SEK weakness

1 December 2014

## Chart of the week: Oil below the critical 70\$/b level



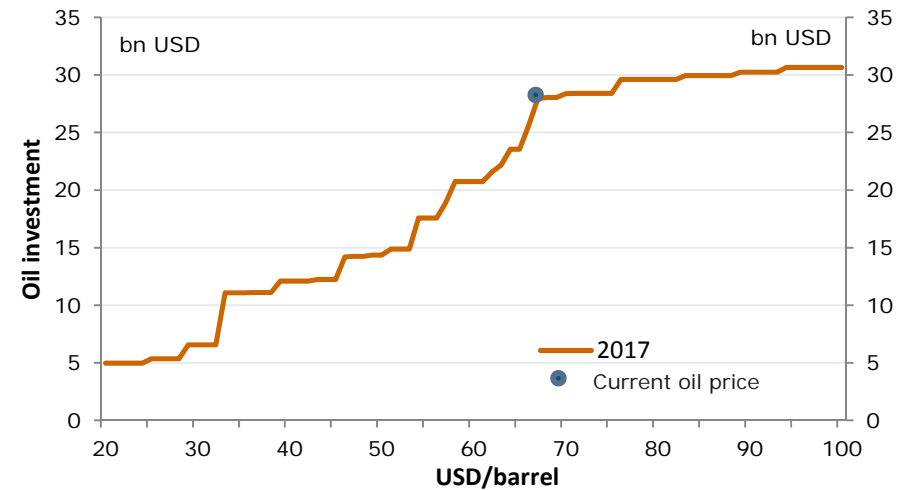
Source: Rystad Energy

***Oil below 70\$/b, a level where investments could level off in a rather quick pace (more on page 3) ...***

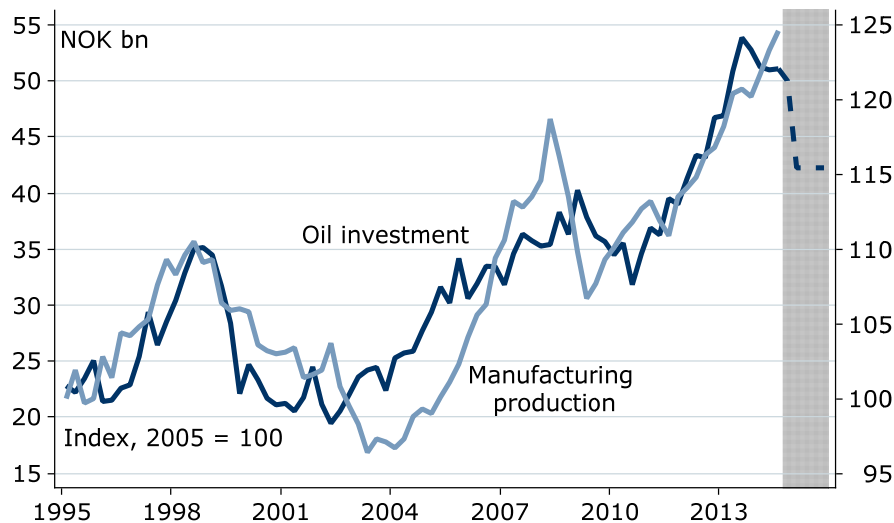
# Norway: oil below the critical 70\$/b level

Our colleague and Norway economist Joachim Bernhardsen has looked at oil investments and prices with regards to the Norwegian economy (see *"Robust oil investments – Pessimistic market"* for more)

- The OPEC meeting didn't result in an agreement to cut production and as a result oil prices took another hit
- Data from Rystad Energy, collected by our Norwegian colleagues show that an oil price around 70\$/b, close to where it's trading now, is a sensitive level. Below that, oil investments could be levelling off in a rather quick pace...
- ... and this when Norges Bank is already expecting oil investments to decline next year, which will likely have a large impact on the economy
- Oil companies are likely having a view on oil prices in the future being higher than today, but a pro-longed period of prices around current levels could impact the industry going forward



Source: Rystad Energy



Kilde: Nordea Markets and Macrobond



Source: Nordea & Bloomberg

# SEK rates: "The switch", more curvature in the offing

*EUR curvature is trending upwards and SEK rates approach levels where the correlation between curve and rates might switch sign. Thus, the downside in paying the belly in butterflies looks more limited...*

With lower rates and a flatter yield curve, it's reasonable that curvature becomes negative, and as the policy rate reaches zero and future rate hikes are pushed out, it stretches even further. This is exactly what we have seen in most zero-policy-rate yield curves

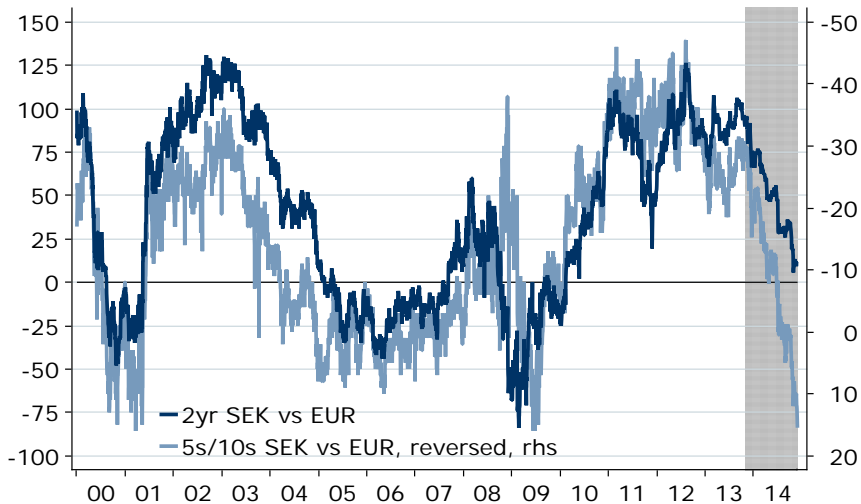
...but only up to a certain stage - when the future economic recovery becomes too distant, the curve (in specific segments) reaches zero. This is evident on EUR 1s/3s/5s and 2s/5s/10s.

In the case of SEK curvature, the levels of intermediate rates are around the levels of EUR rates when the correlation between curvature and rates switched sign. With a marginally lower policy rate and EUR curvature trending upward, the downside for Swedish curvature is starting to look limited, even on lower rates

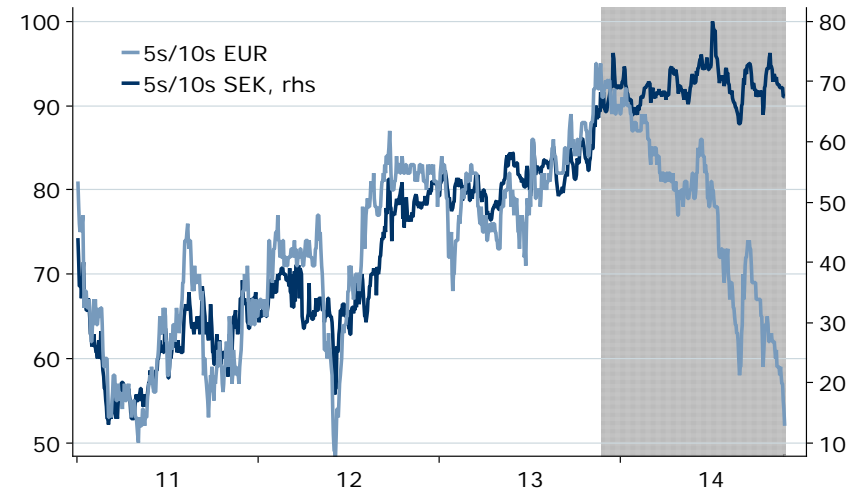


# Cross market: 5s/10s decoupling

On a relative basis, the SEK 5s/10s curve has steepened a lot in 2014, which comes from a Riksbank led front-end performance (2yr spreads have compressed by 90bps), which has kept the SEK curve isolated from the massive EUR curve bull flattening...

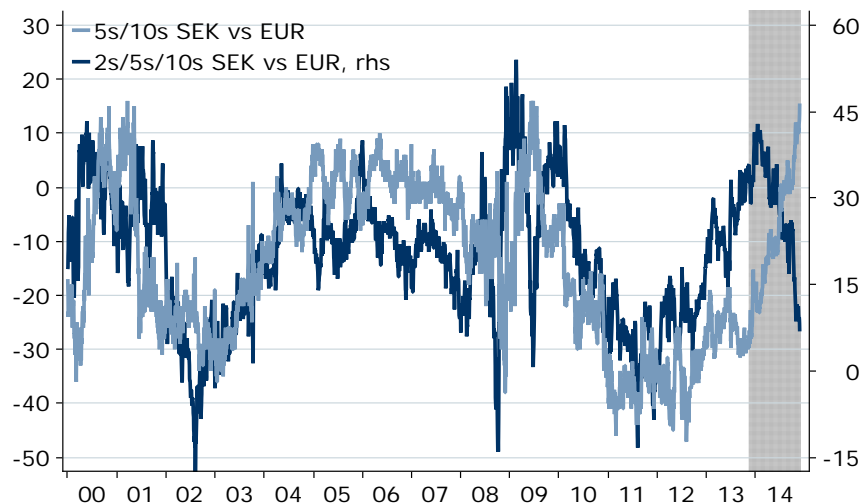


Source: Nordea Markets and Macrobond

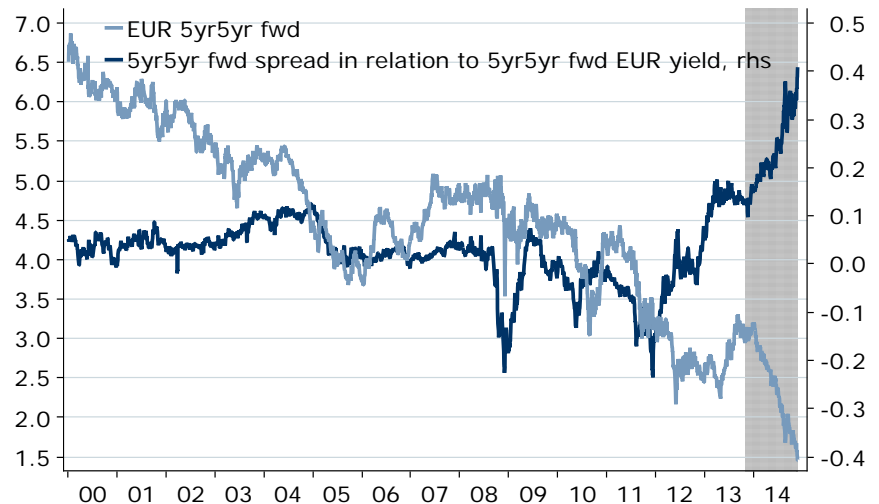


Source: Nordea Markets and Macrobond

Indeed, one can argue that since the potential growth rate is higher in Sweden, the 10yr sector should trade higher on yield. But at the same time, in the scenario where data does not confirm this, the SEK long-end offer value in a low yield environment. One way of showing this is to relate the SEK vs EUR 5yr5yr fwd spread with the level of the EUR 5yr5yr fwd (bottom right chart)...



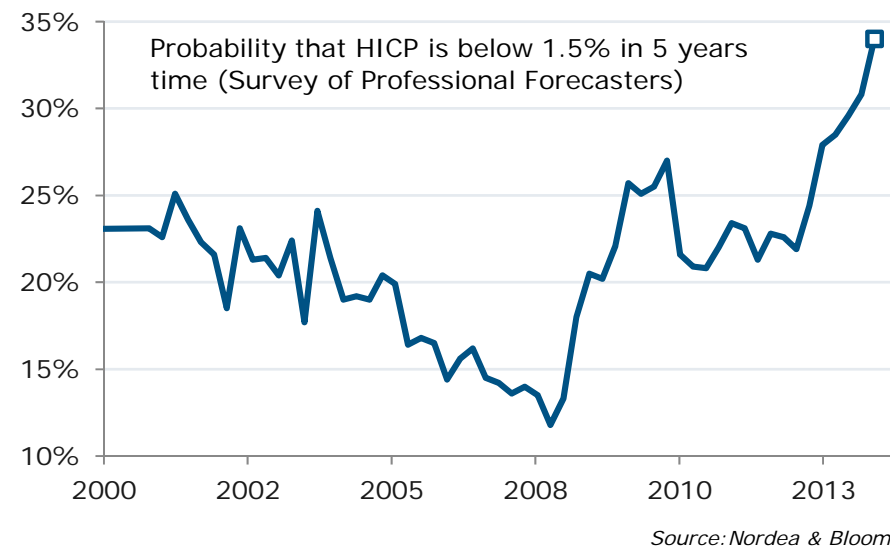
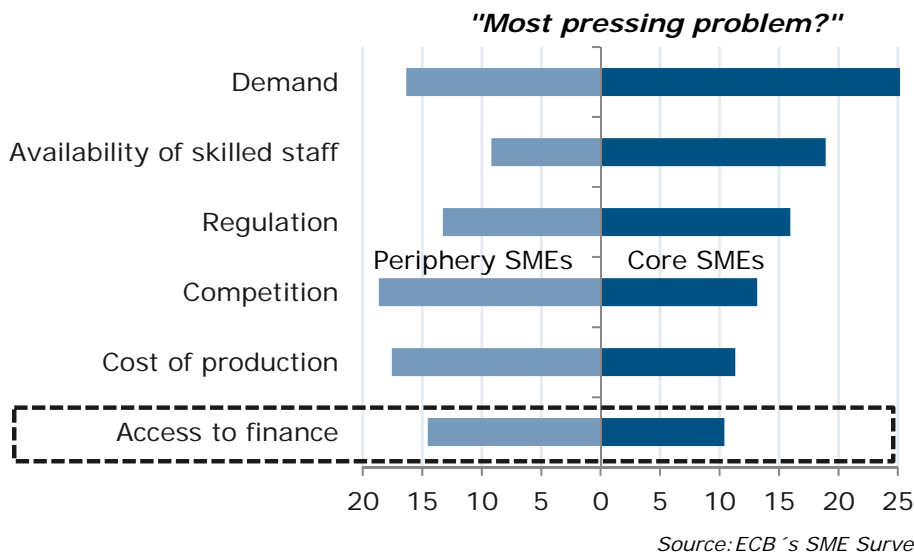
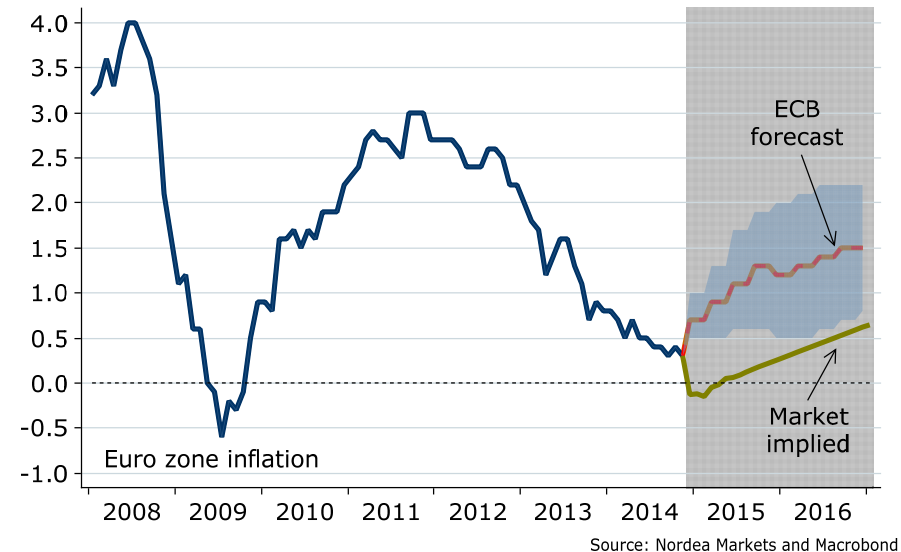
Source: Nordea Markets and Macrobond



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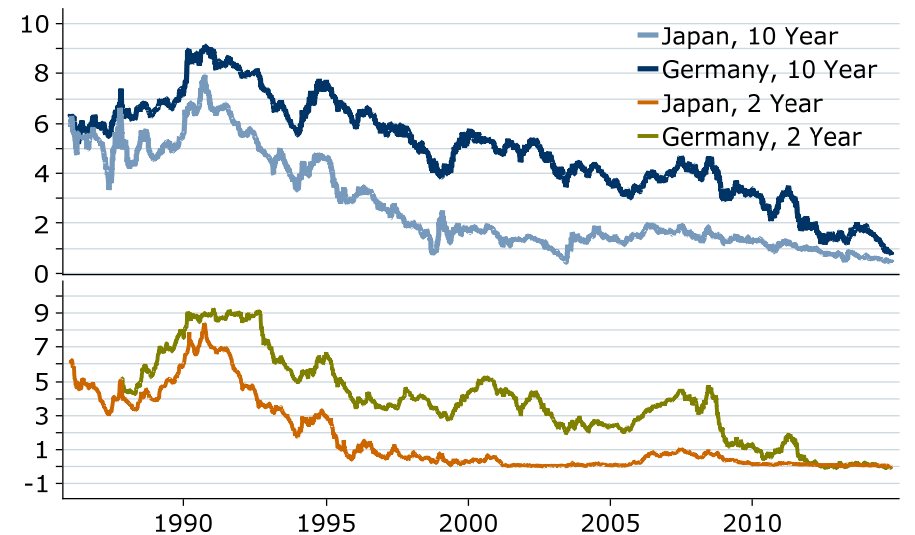
# ECB: from if to how and when

- Speculation has turned to when rather than if...
- But recent comments have made the timing question difficult...
- Draghi's *"as soon as possible"* vs Constancio's *"during the first quarter of next year we will be able to gauge better"*
- In terms of the two contingencies for further measures, the first one, a worsening of the inflation expectations outlook, should be close to met by now.
- In terms of the second, if current measures are enough, this is more difficult to gauge. Draghi has highlighted easier credit conditions for loans shown in the recent Bank Lending Survey as an improvement. At the same time, access to finance is not even among top three most pressing problems for SMEs in the periphery, according to the latest SME survey...
- Read our economist take here, [\*"ECB preview"\*](#)

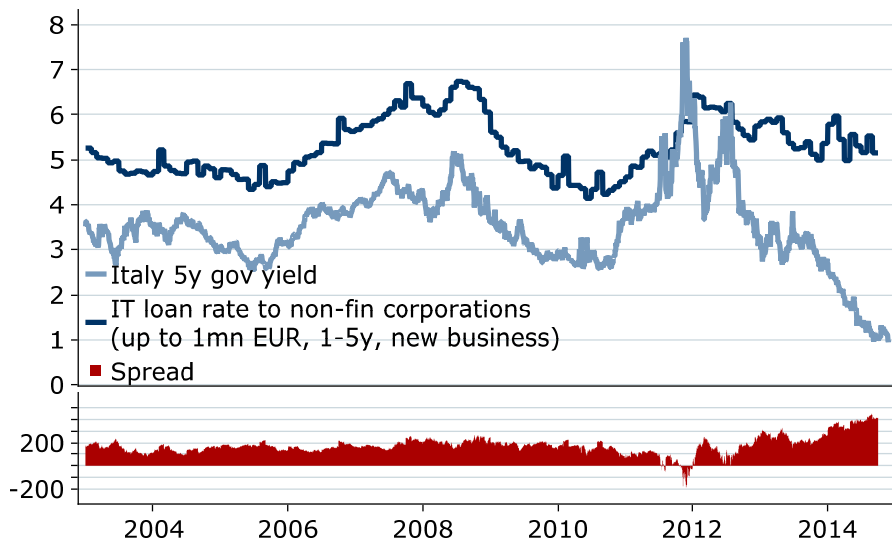


# Euro area: not all rates are low...

- No doubt rates are low but not all rates...
- As we have highlighted many times in the past (e.g. last week in *Arguments mounting for wider BTPs vs Bonos*), lending rates in Italy have remained flattish during the past year's government bond rally
- Deflated with current inflation rate, the Italian lending rates are trading close to the highest level on record...
- Draghi clearly highlighted the issue with the falling inflation expectations recently as de facto monetary tightening *"...if inflation expectations fall, real interest rates rise, which is the interest rate that matters most for investment decisions. /.../ In other words, any de-anchoring of (inflation) expectations would cause an effective monetary tightening – the exact opposite of what we want to see"* - Draghi, Nov 21



Source: Nordea Markets and Macrobond



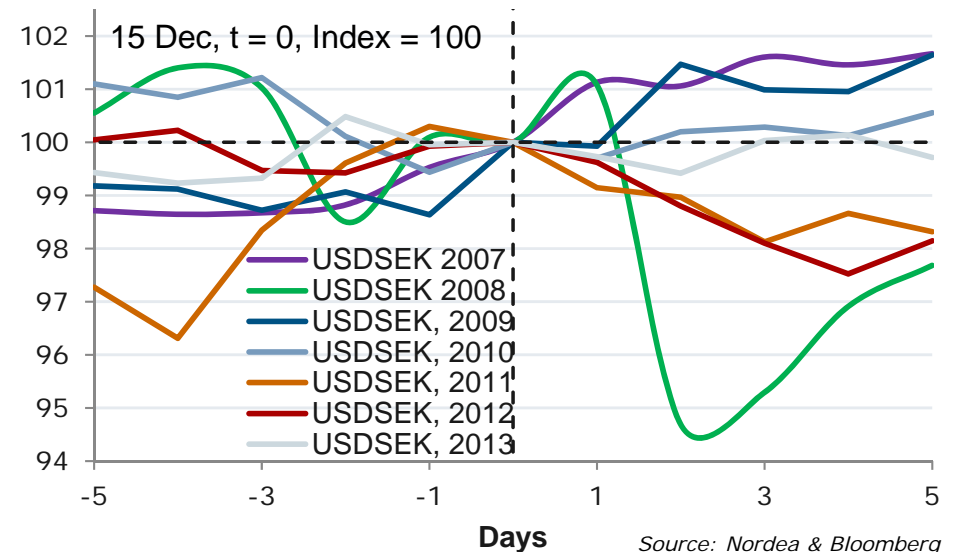
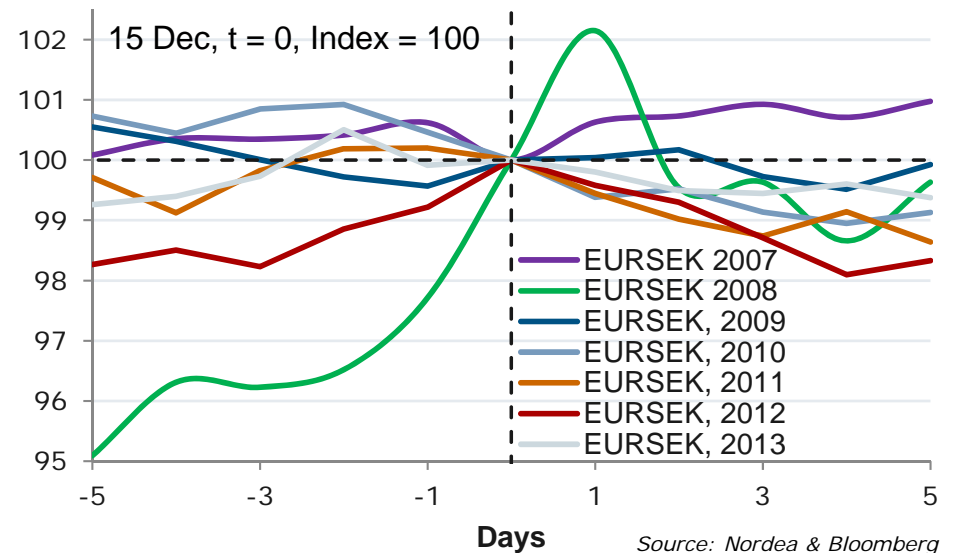
Source: Nordea Markets and Macrobond



Source: Nordea Markets and Macrobond

# FX: PPM, an unreliable source to SEK weakness

- The annual investment of pensions in the PPM system is due on December 15. Roughly SEK 35bn will then be invested for the income earned in 2013. The investment will be allocated according to the current distribution of the individual choices made. We estimate, using distribution data from the Pensions Agency, that 65-70 % will be allocated to foreign investments.
- Since May 2010, the default choice for inactive individuals – “Premiesparfonden” – was replaced by “AP7 Såfa”, a fund-in-fund solution based on global equities and Swedish bonds. “Premiesparfonden” used to hedge 50% of its currency exposure, which the underlying global equity fund in “AP7 Såfa” doesn’t. Hence, without any knowledge of the currency hedging in other fund choices, up to SEK 24.5bn (70% of 35bn) could be seen in capital outflow from Sweden with respect to the PPM-allocation.
- Experiences from the last seven years do not however reveal any clear-cut weakening influence on the trade-weighted SEK covering the days around the PPM-transfer. Nor are there any appreciation patterns in EURSEK and USDSEK.



# Thank You!

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