SEK FI & FX Strategy

Scenario Analysis - ahead of the 9th of April Riksbank rate announcement

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Markets

Scenario analysis: Riksbank rate announcement on 9th April

- The rate decision on 9th April is an important one, with the **capability of shaping the trading pattern for quite a while**. The development since the previous decision in Feb is mixed, with inflation and unit labour cost statistics having surprised on the downside, while Q4-13 GDP was strong and several business indicators having improved further. In addition, the story about financial stability (linked to ever rising house and apartment prices and a pick-up in household credit demand) is looming in the background and for the first time in a very long while some central banks are actually envisaging rate hikes further down the road (i.e. BoE and Fed).
- **Our base-line scenario** is that the Riksbank will strike a dovish tone. We would also assign a larger probability than markets for a rate cut. If the repo rate is cut to 0.50%, we hold out the prospects that its **relatively easy to foresee the market reaction, while its indeed more difficult in other scenarios**. In this analysis we discuss three different scenarios and the likely market implication thereof:

  – **Scenario 1:** repo rate cut by 25bps, to 0.50%, on the back of subdued cost pressure. The bank acknowledge the improvements in activity data and continue to project a first tightening move in the beginning of 2015 (in accordance with the current path). No further, or a very marginal, easing bias signalled in the rate path…

  – **Scenario 2:** repo rate left unchanged at 0.75%, but the rate path is revised meaningfully lower (following a downward adjustment of the inflation forecast). First tightening move not seen until H2-15. The near-term easing-bias maintained, or even increased slightly…

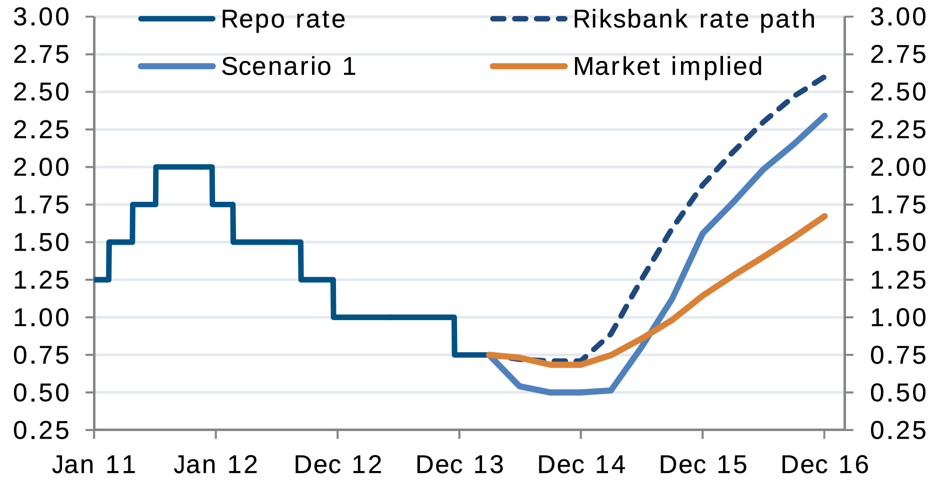
  – **Scenario 3**: repo rate left unchanged at 0.75%, with quarterly rate path averages in 20015-16 revised lower by 15-25bps, or less. Thus, fairly small changes compared with the February message…

Scenario 1

Repo rate cut by 25bps, to 0.50%, on the back of subdued cost pressure. The bank acknowledge the improvements in activity data and continue to project a first tightening move in the beginning of 2015 (in accordance with the current path). No further, or a very marginal, easing bias signalled in the rate path…

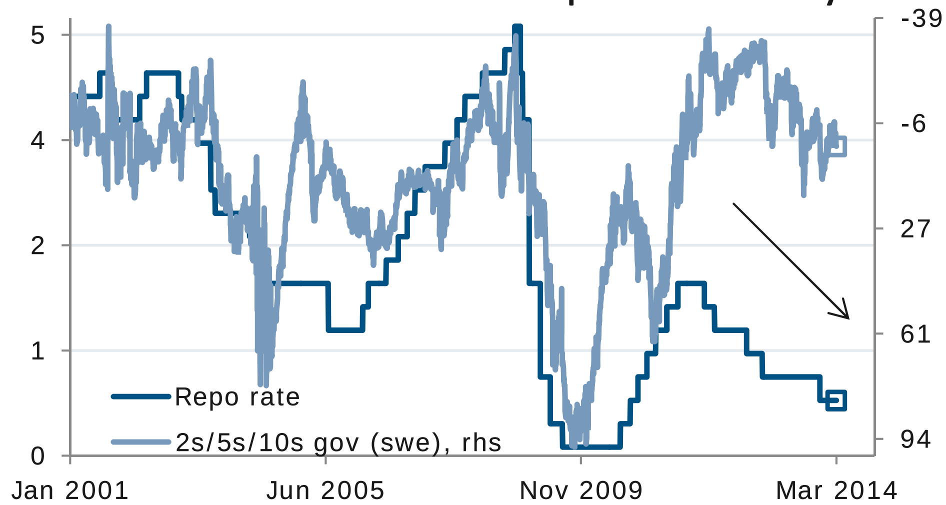
- Very front-end down by **around 15bps**, while the "greens" should move notably less. SGB 1050 down by 7-10bps…
- Market to end up with the conclusion that this was **the final cut** and it will be more credible to speculate on a first tightening move (along the lines of BoE and Fed speculation), especially if activity data continue to improve, which we expect…
- Thus, easier to motivate curve steepeners, such as **2s/5s**, and to **sell the belly on the 2s/5s/10s fly**, as a catch up with the USD and GBP markets…
- **Good news for covered bonds** and particularly 2-3yr ones (e.g. Shyp 1577 & 1578)…
- **Break-even** inflation lower, around 6-8 bps in SGBi 3107, 2-3 bps in SGBi 3109…
- **Performance against EUR rates** across the board, but particularly in the front-end, with the **relative curve to steepen further**…
- **EUR/SEK** above 9.00-05, at least temporarily, and **NOK/SEK** towards 1.10…

Scenario 1 - rate cut + rate path with a similar shape as the current one, although some 20-45bps lower...



Source:Riksbank, Nordea, Bloomberg

A more active central bank to re-shape curve convexity...



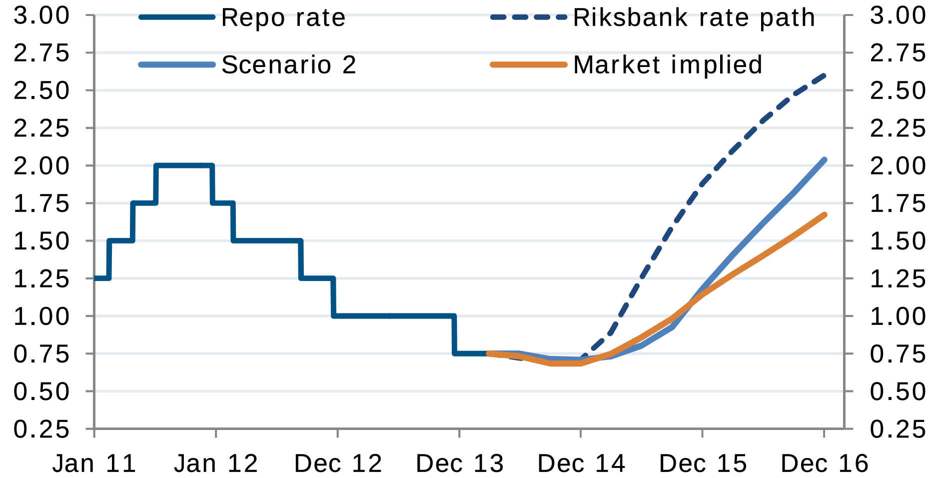
Source: Nordea

Scenario 2

Repo rate left unchanged at 0.75%, but the rate path is revised meaningfully lower (following a downward adjustment of the inflation forecast). First tightening move not seen until H2-15. The near-term easing-bias maintained, or even increased slightly…

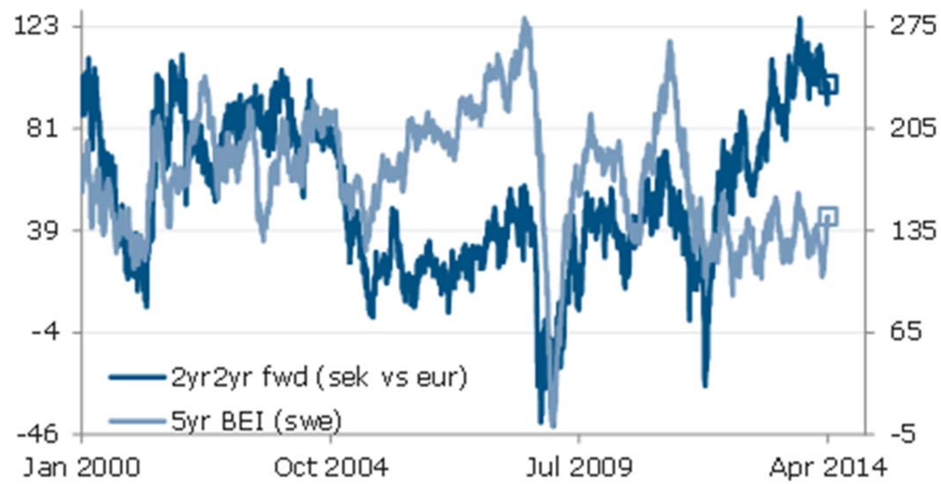
- Very front-end up a few bps, but it will be **viewed as a rate bullish message**, so later contracts, out to the 5yr sector, will rally (not least with back-end "reds" and greens at +100bp spread levels vs. EUR)…
- Market may continue to price in a small chance for a cut (July-Sep), but that will not be the focus…
- **Good news for covered bonds** and particularly the 3-5yr sector…
- Difficult for 2s/5s to steepen, rather **some steepening potential in 3s/10s & 5s/10s**…
- Neutral for **index-linked**…
- **Performance against EUR rates** across the board, and particularly in back-end "reds" and greens out to the 5yr point (against Bobl), which are trading at high spreads given the inflation outlook…
- **EUR/SEK** to be established above 9.00 (towards 9.10) and **NOK/SEK** towards the 1.10-12 area…

No rate cut, but rate path notably lower, by some 20-60bps across the curve. First hike in Q3-15...



Source:Riksbank, Nordea, Bloomberg

Bullish message for spreads further out on the curve...



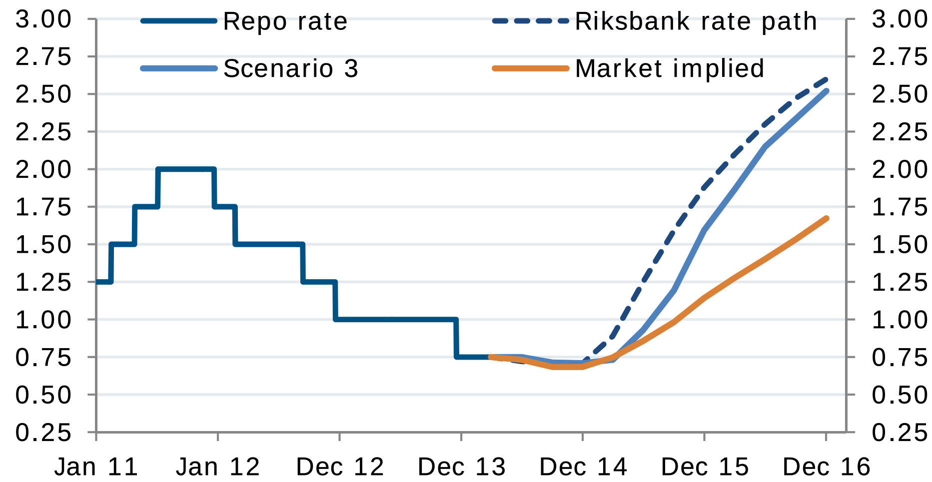
Source: Nordea

Scenario 3

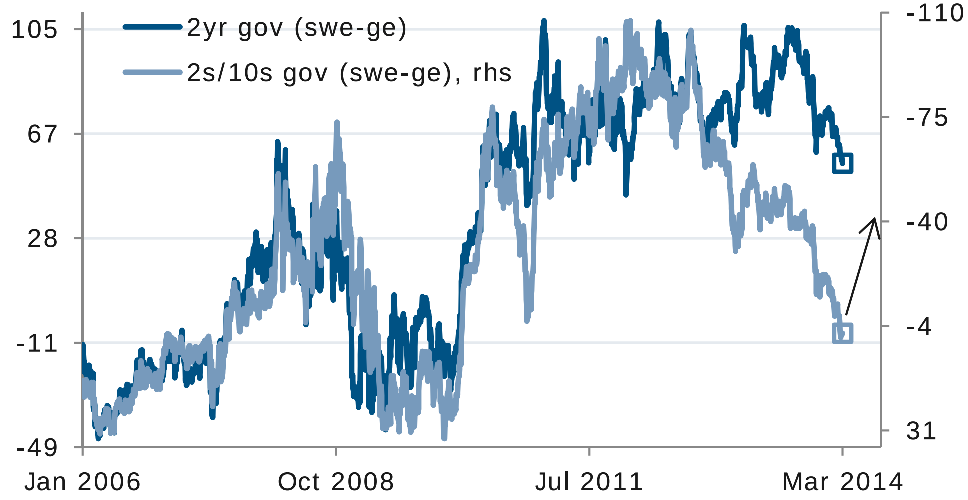
Repo rate left unchanged at 0.75%, with quarterly rate path averages in 20015-16 revised lower by 15-25bps, or less. Thus, fairly small changes compared with the February message…

- **A message that could be viewed as hawkish** and give the impression that the board care as much, or more, about improving growth prospects (and financial stability) as low inflation. Front-end to back up somewhat (2-6bps) and likely in a flattening fashion.
- **Initial profit taking in longs against EUR, but** there is likely a limit how much this can go, with spreads already discounting an additional 50bp decoupling (it will be easier for markets to think in terms of future tightening if they cut). **Reversal of the relative steepening trend a likely path**…
- Difficult to motivate curve steepeners, such as 2s/5s, and to sell the belly on the 2s/5s/10s fly, as a catch up with the USD and GBP market…
- **Front-end covered bonds will remain relatively bid**…
- **Break-even inflation marginally wider** in SGBi 3107 and 3102, neutral for longer maturities…
- Currency slightly stronger: **EUR/SEK** towards 8.85, and **NOK/SEK** towards 1.07 ,but temporarily…

No rate cut, rate path somewhat lower (by some 10-25bps) and first hike postponed a few months to April 2015…



Source:Riksbank, Nordea, Bloomberg



Source: Nordea

Thank You!

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