Northern Lights

Goldilocks?

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Sweden – Riksbank to cut rates

Riksbanken indicated that the repo rate would rise slower than expected… and then the March inflation convinced a majority of the market that Riksbanken will actually cut next time.

Shorter duration bonds to benefit but SEK will be under pressure.

Norway – lower mortgage rates, higher NB rates?

Housing market data has surprised on the upside and close to 20 bp cut in mortgage rates could somewhat perversely trigger Norges Bank to become more hawkish.

Demand for Norwegian government bonds is picking up. This could further underpin a stronger NOK as we judge the weak period has run its course.

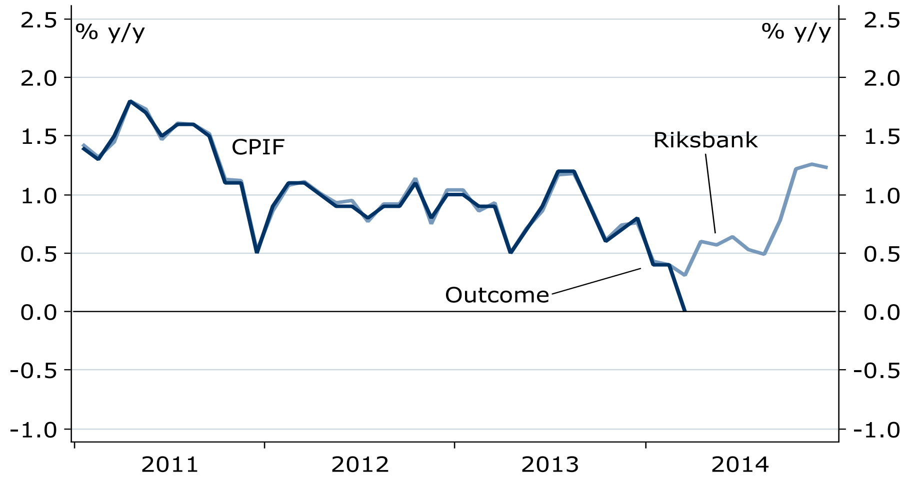
Denmark – central bank in hibernation

The DKK has weakened to the lowest level in eight years—but we are not worried (and yes, that is a full 0.07% above the central parity). 10 bp spread widening priced so this could be an interesting position.

Finland – Russia weighs on spreads

Finnish economy is suffering in the wake of the Ukrainian situation and can weigh on the spreads. Finnish PM is leaving but mostly a non-event.

Chart of the month – Swedish inflation far below forecast



Source: Nordea Markets and Macrobond

Contents

Nordic Overview: Divergence

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The past month has seen its dose of surprises in the Nordics. Swedish inflation surprised—yet again—on the downside, Norwegian house prices showed renewed upside, the Danish krone is trading at its weakest levels in years towards the EUR (which means you would need a very strong lens to see the changes) and Finland soon needs a new PM, as the present one is looking for a new career within the European Union.

A one-two to any rate hike expectations

Forecasters of the Swedish economy got hit by a quick one-two combination earlier this week. First, the Riksbank tried to be as dovish as possible without actually cutting rates, lowering the repo path by a whopping 40bps and the following day the March inflation figures showed an underlying inflation of exactly zero per cent, which is the lowest print since 1998. Accordingly, we had to change our forecasts now calling for a rate cut in July and a weaker SEK in the coming months. Current market pricing calls for a 15 bps rate cut or about a 60% chance of a cut at the next meeting.

Interestingly enough, the very dovish Riksbank coincided with the first failed 10-yr SGB auction since 2010, the reasoning behind being with a repo rate at 0.75% now, cutting it further would just imply the next rate change all the more likely to be a rate hike.

In Norway the picture was somewhat opposite. Mortgage rates were cut by approximately 20 bps and showed some very tentative signs of turning around. Couple that with signs that investor demand for NGBs is picking up, a EURNOK that has stopped weakening and the up move in NOKSEK we have seen over the past few weeks could have some more legs on it.

Increasing demand for Norwegian bonds

As mentioned, short and medium-term Swedish bonds should continue to perform versus the Euro area but we think interests could be building for a bigger move in Norwegian rates. This is both in government bond and swap space. In Sweden, we favour 3-5y covered bonds.

Finnish bonds could be under pressure

The Finnish PM leaving is a non-event for markets. Longer-term we do believe the Finnish Aaa-rating will be under pressure and short-term any negative news on the Russian economy will work against Finnish bonds.

Chart 1. NOKSEK on the rise

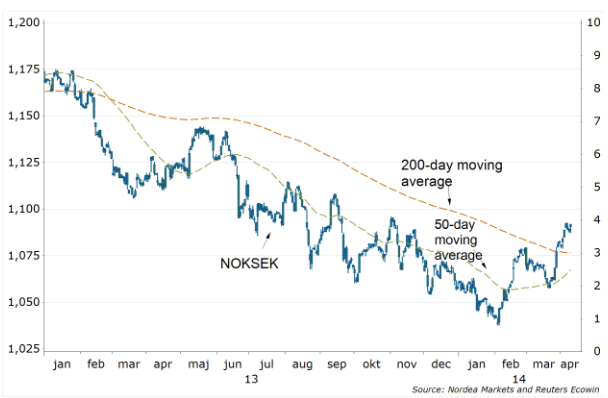
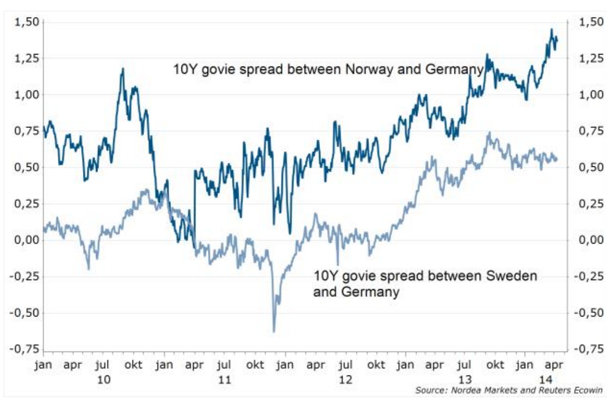


Chart 2. Spreads are high vs Germany



Sweden – Riksbank to cut rates

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Inflation at historical lows

In its Monetary Policy Update the 9 April, the Riksbank clearly signalled a rate cut at the next policy meeting in the beginning of July. Moreover, the surprisingly low inflation reading for March underlines that a rate cut is in the pipeline.

CPIF-inflation, the Riksbank's favourite measure, was unchanged over the year in March, 0.3% point below the Riksbank's new forecast and also the lowest print since 1998. March probably marks the bottom for CPIF-inflation in this cycle, but the low outcome will most likely lead to a downward revision of inflation forecasts.

Low cost pressures

Cost pressures are in general very low in the Swedish economy. This is for instance illustrated by a drop in unit labour cost in Q4 last year. In addition, the Riksbank lowered its forecast on unit labour cost for 2014 substantially. This adds to the picture of low inflation and suggests that the any rate hike is remote.

Rate cuts despite strong GDP growth.

The Riksbank's economic forecasts are in line with our view. Thus, the Riksbank also expects a healthy GDP growth going forward. The bank shares our view of a GDP growth of almost 3% for the full-year 2014. Thus, the Riksbank signals that it is open to cut rates despite the economic upturn, which underlines the Riksbank's strong focus on inflation and the credibility of the 2% target.

All eyes on inflation

Inflation is everything…

As for the key figures, we will pay close attention to the next inflation reading (due 13 May). We expect inflation to bottom out in March and that we'd see a gradual increase onwards. Labour market is expected to improve further (LFS is due 22 April). Other, more key figures, should confirm the improving momentum in the Swedish economy.

Chart 3. CPIF-inflation far below forecasts

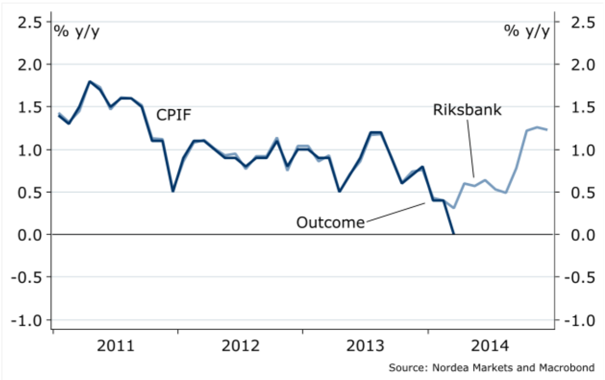
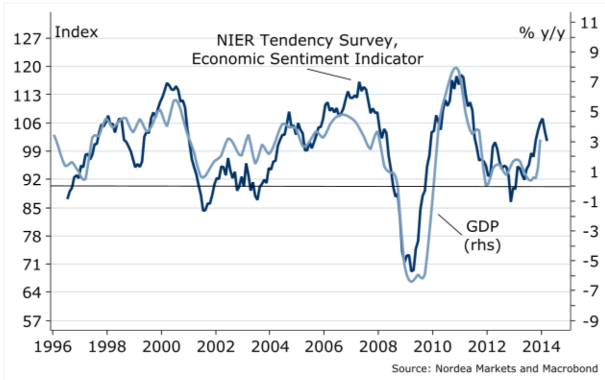


Chart 4. Improved sentiment points to higher growth



Swedish rates

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The message from the Riksbank's policy meeting this week was dovish, with a lower repo rate path (down 40bps in late 2015) and an almost doubled probability (to just shy of 40 %) of a rate cut in July. This was softer than the market expected and consequently, front-end rates were down and the currency weakened. Like we have been arguing, it was lower inflation aggregates that pushed the Riksbank into this territory and SEK receiver positions against EUR have been favourable into the announcement. Despite the spread re-pricing, we continue to see value in red and green SEK receivers vs EUR, with the attractive roll-down along the spread curve being an additional factor.

Interesting to note is also that on the same day as the Riksbank delivered its rate decision, a 10y SEK government auctions failed for the first time since 2010. The more likely a near-term rate cut becomes, the more credible a future rate hike is. So in a way, the soft stance from the Riksbank might very well be negative for longer dated bonds in a relative sense and an environment that nurtures a steep curve is more in place now.

As for index-linked bonds, the negative carry month of March has passed, with linkers actually outperforming the negative carry contributions. The next big theme is the relative play between the high March Eurozone HICPxt and a low Swedish March CPI. Swedish short-end linkers need to outperform by as much as 32 bps (SGBi 3107) compared to their German peers to break even during the month of May. We are therefore no longer bullish on Swedish linkers for this tactical reason.

The SEK covered bond market is still dominated by the ebbs and floods of index-extensions, buy-backs and new issuance. Right now, the June index-extension should start to leave its imprints on June 2015 bonds as they should stay cheap or chepen up even more against swaps. At the same time, duration extensions are supportive of 5y covereds and there are currently few signs that issuers are about to increase the SEK market as a funding source, since appetite among foreigners for unsecured debt is high and liquidity continues to be abundant in the Eurozone. We think that 3-5y SEK covered bonds will continue to perform decently relative to swaps.

Chart 5. Relative govie curve with failed auction marked

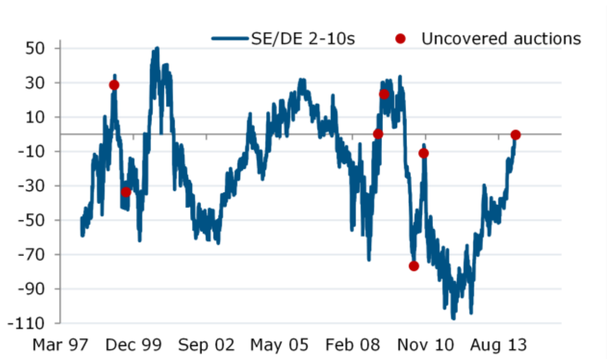

Chart 6. SEK covereds lagging credit spread tightening

EURSEK: ECB fires blanks while the Riksbank uses real ammunition

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We almost made it. In the latest Northern Lights we suggested a range bound EURSEK trading between 8.80 and 9.00 and we thought that nine would hold firm. However, after Wednesday´s Riksbank meeting and the shockingly low CPI print for March, our new proposition is for the EURSEK to climb somewhat higher. EURSEK has for the past few years mostly been a function of relative monetary policy and we now forecast a 25 bps cut from the Riksbank at the meeting in July. Such a move is not yet fully discounted in rates, but we are getting close, and we see room for further depreciation of the SEK towards 9.10 vs EUR. The asymmetric attitude between the ECB and the Riksbank towards the inflation target and the "cosmetic" Riksbank worry of financial stability gives us a less aggressive SEK forecast further out on the forecast horizon as well. In total, our end 2014 repo rate forecast has been lowered by 50 bps, which should mean a markedly weaker SEK than previously thought.

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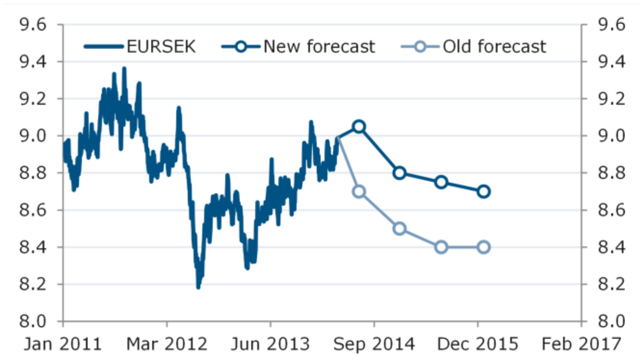
Even though the market should prepare itself for more monetary stimulus it will be difficult for it to understand why. The mix of strong growth and broadly improved macro data and shockingly low inflation does make the Riksbank puzzle hard to solve. For quite some time the EURSEK has lost some of its sensitivity to rate differentials and have instead reacted more to the overall macro development. Therefore, we feel confident that monetary policy alone will not push EUR/SEK up towards much higher altitudes and back to historical ranges.

The potential sale of the national champion Scania is an option worth considering

The expected cut in July will coincide with GDP growth above 3% y/y with a steady improvement in the labor market. In such an environment property prices should continue to climb as well as credit growth and the export sector will have more EURSEK to sell than they have had for a long time. As Sweden continues to be well positioned for further fundamental improvements the presumed cut should have limited implications.

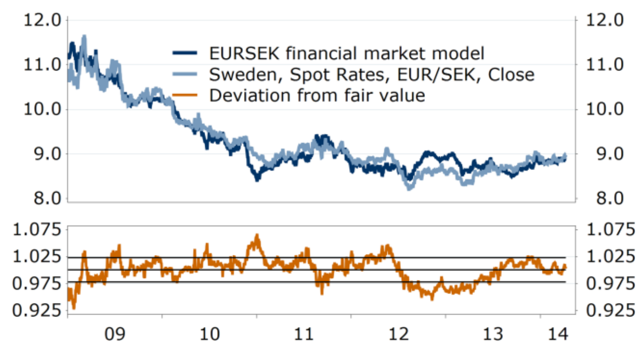
The Scania/VW deal which we discussed last month and its flow implications is still alive and kicking, judging from its stock price. Admittedly, it has not been detectable in spot moves, but we still consider it an important factor to consider looking ahead. Also, it is still our economists' view that the Riksbank will hike the repo rate in Q1 2015, i.e. much earlier than is discounted by the money market. Therefore we stick to a forecast where EURSEK weakens again later in 2014.

Chart 7. EURSEK – Old and new forecast



Source:Nordea

Chart 8. Our financial model suggests a "fair" EURSEK



Source: Nordea Markets and Reuters Ecowin

Norway - Better housing market?

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The main news since the last Northern Lights is the strong March house price figures and that most Norwegian Banks have cut their mortgage rates by about 20 bps on average. Seasonally adjusted house prices rose by 0.7% in March and y/y growth is now slightly positive again. There are however still signs of weakness in the housing markets. The stock of unsold houses in March was up 30% y/y and the highest March level since 2009, even though transactions are, as earlier, keeping up fairly well, time on the market before a sale is up and the longest since 2010.

Mixed signals from the housing market

Still, the price development is much stronger than expected and we no longer believe in a sharp downward correction. Of course lower mortgages rates and possibly a more lenient credit policy in the banks also argues for stronger price development than we had expected.

Stronger housing market boost consumption

Higher house prices could have positive effects on growth through construction and private consumption. As for construction there is no need to be significantly more optimistic for 2014. The information we have received points to weak sales of new housing projects. And the official figures for housing starts confirm what builders are reporting, housing starts are on its way down.

But still consumption growth is to be subdued

The main uncertainty is how stronger housing market figures will affect private consumption. It is tempting to view the weak consumption growth last year as driven by some common factors such as tighter credit conditions and decreasing optimism. The turnaround in the housing market could be a sign that optimism is turning back. That could mean consumption growth will rebound contrary to our forecast but we have however no clear signs of stronger consumption growth albeit retail sales increased 0.6% m/m in February, but the trend is still sideways.

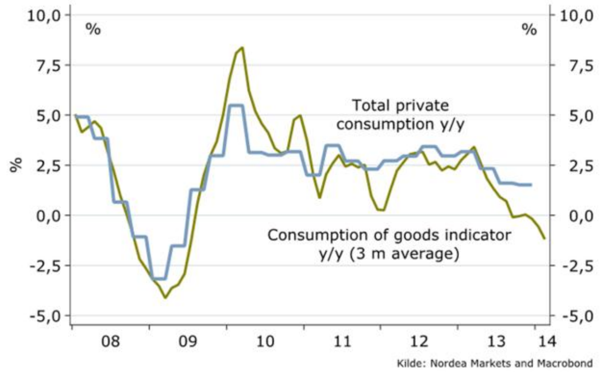
In addition to weak developments in residential investments and consumption, our below-consensus-forecast is also based on a drop in oil investments next year. There are clear signs of a slowdown in oil related industries, most evidently in manufacturing but early June we will get the official oil investment survey for 2015.

But on the whole, numbers have been coming in stronger than we expected.

All in all developments the last month have been stronger than expected. The risk to our below consensus forecast has increased.

Chart 9. Housing prices are on the rise again

Chart 10. Consumption growth though remains weak



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Norwegian rates—increasing demand

Norges Bank confirmed its on hold stance at the last meeting. There were only small adjustments to the rate path and the message is unchanged: you will have to wait until well into 2015 for the next hike.

We see a couple of recent developments that pose near term upside risks to this outlook. House price developments have turned out stronger than expected. After falling towards the end of the year, they levelled out early this year and showed a 0.7% rise in March. The last rise is close to 10% on an annual basis and would give reason to worry should the pace continue.

Banks cutting lending rates might trigger opposite move by Norges Bank.

Add to this that Norwegian banks have cut mortgage rates by approx 20bps over the last weeks. Falling lending rates is a factor that has the potential to affect Norges Bank's rate setting in the near term (see Norges Bank will take lower mortgages rates into consideration). The cuts so far are not large enough to trigger a hike on their own, but more could be in the pipeline as margins on mortgages are still high by historical standards.

Buying one of the front FRA contracts seems like a cheap option on a one-off hike should these developments continue. Risk reward is good since the FRA strip is flat out to December and a cut seems a remote possibility.

We have seen a lot of interest in government bonds lately and we think the trend of underperformance has come to an end. Demand for the new NGB2024 (#476) has been very strong.

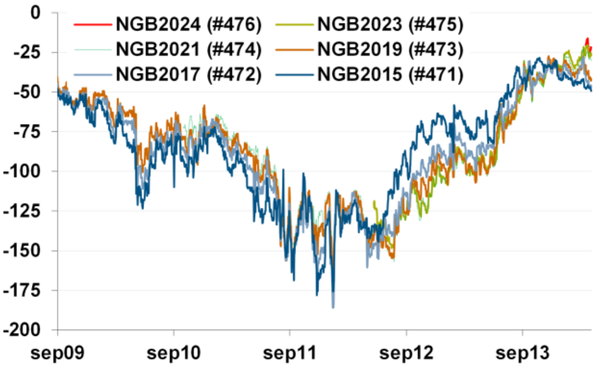
Interest in NGBs is picking up

Domestic investors were on on the sideline over the past two years as they considered NGBs too expensive, but this is definitely not the case anymore. Ownership data shows that they have been net buyers of 18bn since the start of the year. This is a substantial amount given that only 23bn has been auctioned in period.

We see this as a response to cheap levels vs swaps and a swap spread curve that finally shows a pick up to investors along the entire term structure. Given the response we are seeing from investors we think the trend of underperformance is likely to stop here. Add to this that the currency is showing signs that the unwind of the safe haven trade is nearing completion and that we are likely to see lighter issuance in the second half of this year and the stage may actually be set for some NGB outperformance soon. Being long NGBs is also an attractive risk-off trade.

Chart 11. The FRA strip and Norges Bank's NIBOR-path

Chart 12. NGB asset swaps



NOK: Important test for the "stronger NOK idea" coming up

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Even if the adjustment of the rate path from Norges Bank was small it had quite some impact on EURNOK. With a reaction of more than 10bf it seems fair to assume that the market was not that long NOK before the meeting. The last couple of weeks have also been a nice run for emerging markets and risk appetite in general. Both factors supporting NOK and traders have been buying NOK lately.

The coming weeks will be an important test for both positioning and interests in NOK. During illiquid days of Easter and the weeks thereafter we will see redemptions of bonds in quite substantial size.

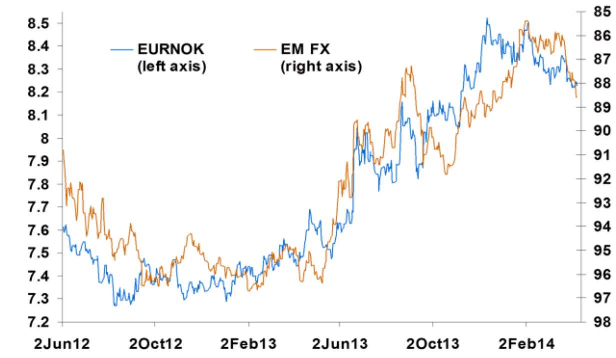
Redemptions coming up

The perception of NOK as the safe haven made EURNOK-bonds quite attractive during the European debt crisis. These are bonds issued by foreign companies with high credit rating in NOK mostly attracting investors with a positive NOK-view. The issuance activity came to a halt in second half of last year, and now we are starting to see a rush of maturities. The combined volume is around NOK 30bn during April and May. It seemed like the redemption of the Norwegian T-bills on the 22nd of March of which foreigners owned NOK 9bn had an effect. Investors in the bonds maturing now are most likely quite different and will have access to more alternatives than investors in Norwegian government bonds/bills.

The worst behind us for NOK?

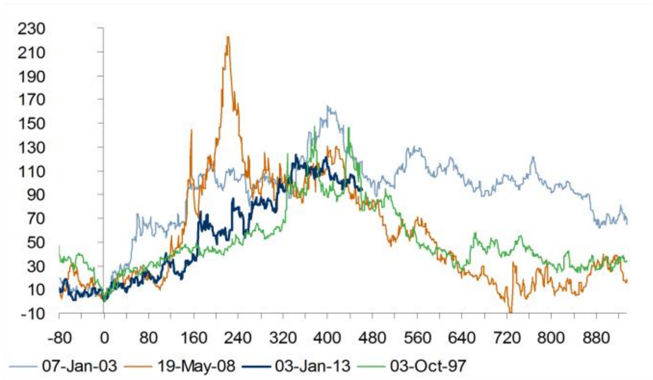
The bigger question it might make sense to address is if the big trend for the upside is behind us. Judging from history it might seem that way. The three examples we have of large EURNOK rallies have normally stopped approximately 140bf from the bottom and lasted for approximately 400 days. That is more or less the case for the run between 7.25 and 8.54 that we had this time around. In other words; there should be some upside left in EURNOK, but from there we should slowly but surely grind lower.

Chart 13. EURNOK and Emerging Markets



Source: Bloomberg and Nordea

Chart 14. The worst part might be behind us in NOK



Denmark

ECB sidelines the central bank

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For some time the Danish krone has gradually weakened against the euro. The currency cross hit a preliminary peak at end-March, rising to around 7.467. The DKK weakening is noteworthy because the Danish central bank has not tried to counter this move so far. As a result, since the beginning of the year the DKK has traded above its central parity.

The combination of a weakened DKK and no intervention by the Danish central bank raises the question whether (perhaps as a result of last year's appointment of Lars Rohde as new central bank governor) a change of regime has taken place at the bank. We do not think that this is the case. Instead we believe that huge uncertainty about the ECB's future actions is the main factor behind the central bank's current strategy of giving the DKK a longer leash than seen hitherto. If our assumption is on the mark, it means that the central bank in the coming months most likely will try to keep the krone weakening in check by intervening in the market and postpone a unilateral rate hike until late summer.

We remain confident in DGBs

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The gradual currency weakening and a possible rate hike on the horizon, speculation around the directionality of DGBs arises, this is not warranted. We are of the opinion that the hike to a large degree already has been priced into the market. This is evident when looking at OIS forward curves between Denmark and the euro area. Here we estimate that at 10bp hike has been priced in when looking at 2 months forward.

Taking a look at the historical development of DGBs (ASW mm) it's clear that the shorter end of the DGB curve (2-5Y) has cheapened in sync with EURDKK, whereas the 7-9Y have been more stable. In breakeven terms vs. Germany the DGB16 can take a hit of 2bp relative to the existing curve over a six month horizon.

Market confidence in DGBs therefore continues to be high, not least exemplified by the latest auction 1 April where the DGB16 was oversubscribed more than four times (bid 15,8bn/offer 3,7). Indeed, even in the light of the gradual DKK currency weakening in April, we have continued to see performance in DGBs vs. Germany.

Chart 15. EUR/DKK and Danish central bank's CD rate

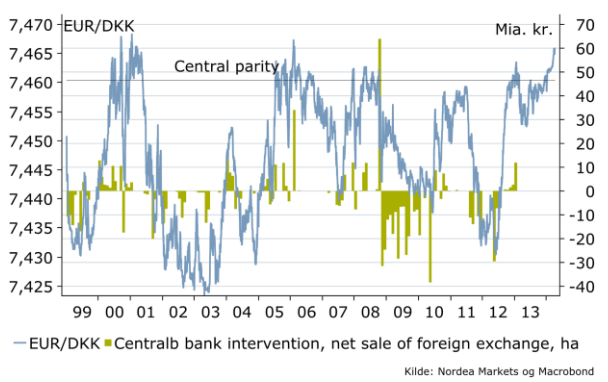
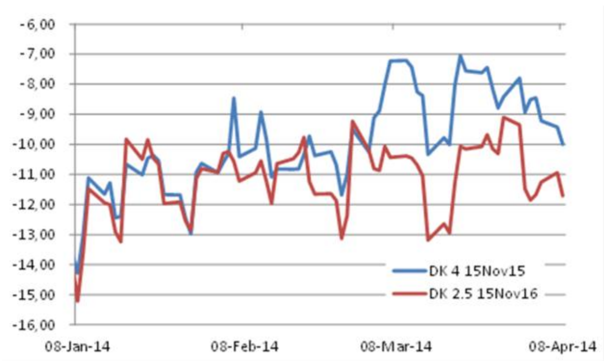


Chart 16. Historical development (asw mm)



Finland – Hold your horses

Ukraine spill-overs risk widening Finnish spreads

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The long awaited Finnish recovery is still left to be seen. Furthermore, the risk of a more severe Russian economic slowdown is considerable and escalation of the crisis would postpone recovery and put upward pressure on Finnish spreads.

In the same time the government is shaking and finding credible solutions to the long term problems, such as the considerable loss of competitiveness and the aging population, is getting harder and harder.

Most likely credit raters will look through this in the near term and S&P will most likely affirm the Finnish AAA rating and the stable outlook on Friday. Addressing structural problems is critical in keeping the rating and outlook.

Finnish economy still struggling

The Finnish economy is struggling hard to regain momentum. Domestic growth engines are absent. Private consumption will decline and labour market conditions will deteriorate further for most of 2014. The economy is expected to start showing better signs by summer. However, as the growth relies on a pick-up in exports, the dampening of Russian growth due to the Ukrainian crisis is a clear risk to the Finnish recovery story in the short term.

Political mess, lags in structural measures

The Finnish Left Alliance party left the government as a protest to the approval of austerity measures. Now the coalition government stands on a shaky ground that is further pressured by expected changes in minister posts.

The prime minister is resigning to pursue EU jobs. The leadership of the Social Democratic Party (thus the minister of finance) is expected to change within few months. Two ministers are also running for the European Parliament. The foreseen nuclear power plant permit approval might pressure the Green party out of the government later this year, which would leave the government with a very slim majority.

Most likely the government will stand until 2015 elections but will have hard time implementing measures to stabilize the debt-to-GDP trend and to address the long term problems the economy faces.

Chart 17. Finnish economic sentiment lagging Euro area

Chart 18 . Uncertainties reflected in the spreads