



Market Review & Outlook

March 2025

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Market overview

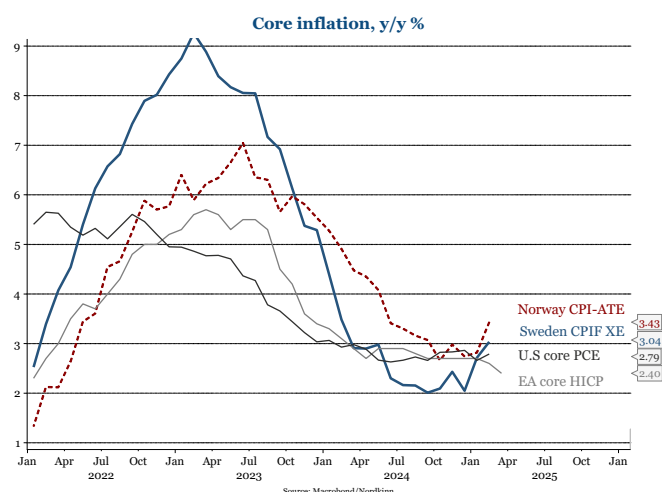
Global overview

The past month has been marked by continued fluctuations in inflation and growth impulses across economies, amid heightened geopolitical tensions. Notably, sizable fiscal measures in the Euro Area and tariff announcements from the U.S. Administration have kept market volatility elevated throughout March.

In the U.S., February's PCE inflation data continued to surprise, with both headline and core figures remaining stubbornly high. Of particular interest to the Federal Reserve is the sticky trend in core PCE inflation, see left hand chart. Consequently, the Fed's communications have underscored a commitment to a cautious, data-driven approach, despite an apparently restrictive monetary policy stance, emphasising "no rush" to cut rates and describing the economy as "in a good place." Labour market indicators remain robust, though some survey data suggest a potential slowdown ahead. Meanwhile, tariff announcements from President Trump have injected additional uncertainty into the outlook, potentially undermining growth prospects while intensifying inflationary pressures. This has contributed to a steepening of the yield curve. A much-anticipated report from the U.S. Trade Representative, set for release on Wednesday, April 2 (a.k.a. "Liberation Day"), will hopefully help markets evaluate the validity of recent market moves.

Across the Atlantic, the Euro Area remains stuck in weak growth amid persistent cost-push pressures. For example, the latest PMI surveys indicate that while cost pressures (and inflation) remain sticky, the growth outlook remains modest at best. In key economies like Germany and France, weak domestic demand and structural challenges have clearly weighed on the region's economic performance. Meanwhile, Germany's fiscal authorities have announced substantial expansionary policies—a mix of increased infrastructure spending and defence investments—to counteract stagnation and bolster a more autonomous European defence. However, while the long-term impact on potential growth may be limited, these fiscal measures will inevitably lead to a higher supply of government debt, stronger demand, and higher inflation. Consequently, this has put upward pressure on long-dated yields and the EUR exchange rate, benefitting our new global theme *"Rebuilding Europe,"* introduced in early March.

Additionally, expectations of an ECB response to tariffs have supported short-term Euro Area interest rates, allowing our global theme *"Geopolitical tensions impacting growth"* to also contribute positively to the Fund's performance in March.



Nordic overview

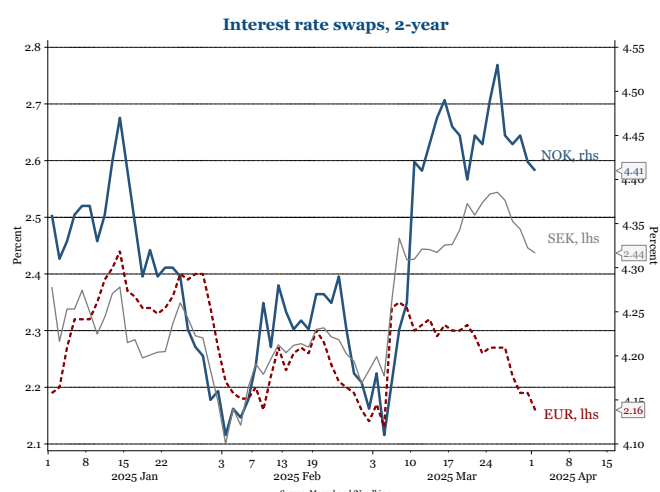
In Sweden, inflation measured by CPIF excluding energy delivered another upside surprise, coming in 0.2 percentage points above expectations at 3.0% y/y. Alongside the January inflation shock, this has prompted market participants to undertake a significant reassessment of current inflationary pressures in the economy, as well as the inflation outlook for the remainder of the year and beyond. However, just two months after the last rate cut, the Riksbank downplayed the inflation surprise, characterising it as "temporary" and attributing it to basket effects (i.e. reweighting) and price increases in only a few components.

Nonetheless, market interest rates rose by 25–30 basis points over the month and the yield curve ended March slightly steeper compared to the beginning of the month. However, relative to the EUR swap curve, the SEK curve flattened as the higher inflation print triggered a repricing of monetary policy expectations for the coming years. Break-Even Inflation rates increased as markets reassessed Swedish inflation. The SEK appreciated by approximately 4% (KIX) over the month, demonstrating impressive resilience even during risk-off sessions. This reflects a clear rotation out of U.S. assets into assets denominated in other currencies.

Overall, Nordkinn successfully captured these market movements, which resulted in strong performance in Sweden-related themes, particularly *"After cuts come growth."*

In Norway, core CPI rose a surprising 3.4% y/y in February, sharply higher than expected and 0.6%-points above the previous month. Consequently, NOK interest rates rose sharply, and the NOK spiked. Just like Sweden, the first two CPI reports of the year clearly indicate that price momentum accelerated in the beginning of the year, see left hand chart. However, unlike the Riksbank, the central bank of Norway interpreted the data as an indication of upside risks to inflation ahead rather than reflecting transitory effects. Higher-than-expected wage growth in 2024 underpinned this assessment, as did a business report pointing to increased economic activity and labour market data revealing lower unemployment than the Norges Bank had expected.

Taken together, at the monetary policy meeting on March 26th the Norges Bank decided to keep the key policy rate at 4.5% for somewhat longer than previously projected. Our Norwegian theme *"Path to policy easing"* benefitted from the relative performance of long-term Norwegian rates versus other markets, as well as from NOK FX trading following the CPI report, offsetting losses on our short-term interest rate exposures.



Outlook

Global outlook

Looking ahead, our base case centres on expectations of steeper yield curves across developed markets over time, driven by a wave of expansionary fiscal policies. However, the near-term outlook for the yield curve is complicated by entrenched inflation and the evolving tariff regime, which further raises inflation while dampening economic activity.

In the U.S., the interplay of high inflation and unsustainable deficit spending is likely to keep rates elevated for some time. Several factors will shape the outlook: First, despite robust labour markets, sustained (albeit moderating) wage pressures and persistent cost-push inflation, driven by new tariffs, will continue to underpin inflation expectations. Second, the Trump Administration's focus on tariffs—such as on automotive and steel imports—adds a layer of uncertainty, weakening business confidence and potentially hampering growth. This could necessitate additional policy accommodation, potentially leading to lower U.S. bond yields.

That said, amid high inflation, any policy easing to restore growth will likely be gradual and potentially delayed until next year, contingent on inflation expectations remaining anchored near target. Should expectations drift even higher, the U.S. risks entering a stagflationary environment, as some commentators suggest. Some measures of inflation expectations have indeed been rising in recent months, warranting close monitoring. Combined with a sizable fiscal deficit driven by expansive spending and tax cuts, elevated inflation expectations suggest that investors should prepare for a prolonged period of high long-term yields.

Turning to the Euro Area, the outlook is more nuanced. While the region continues to grapple with sluggish growth, expansionary fiscal initiatives in key economies—such as Germany's planned boost to defence and infrastructure spending—may help narrow the growth gap with the U.S. However, these measures also translate into dramatically increased public debt issuance, which is likely to push long-end yields higher. On the monetary side, the ECB faces a delicate balancing act. Inflation is gradually approaching target, while labour markets remain remarkably strong, suggesting that a new spell of wage inflation could emerge if demand rebounds. The ECB's recent stance is for a "pragmatic" approach to further rate cuts, indicating that any additional policy easing will shift from consecutive cuts to quarterly changes if needed. Meanwhile, structural reforms and fiscal stimuli could gradually lift growth expectations, steepening the curve as market participants demand higher yields on longer-dated debt to compensate for rising risk premiums.

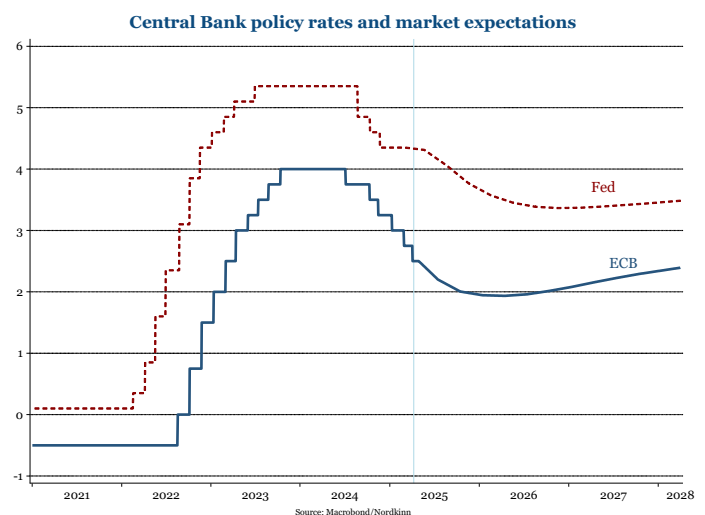
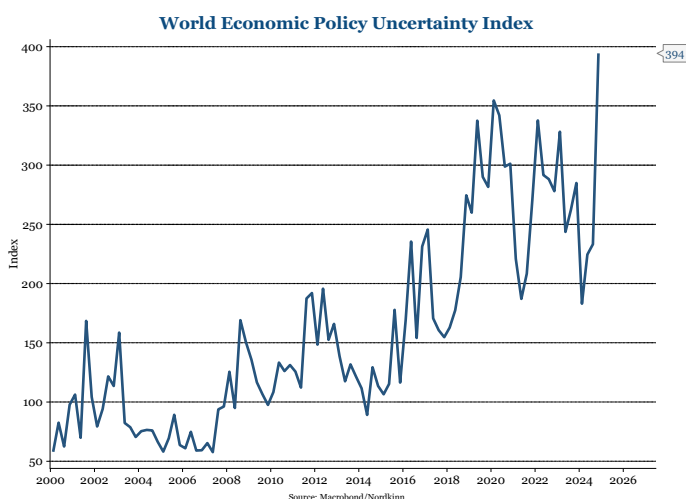
As discussed in this month's report and our previous issues, numerous global risks persist, particularly the evolving trade policy landscape. The possibility of further U.S. tariff hikes and reciprocal measures could dampen global demand, slow economic momentum, and complicate central banks' efforts to stabilise inflation without suppressing growth. Similarly, tariffs and recent years' unsustainable fiscal expansion could unanchor inflation expectations, causing long-term rates to rise far more than currently anticipated, with detrimental effects on asset prices.

Moreover, geopolitical tensions—especially amid ongoing trade disputes—could exacerbate uncertainty (see left hand chart), prompting investors to demand additional compensation for holding longer-dated securities. While any of these risks materialising would ultimately support our steepening positions, the sequencing remains uncertain, adding complexity to the risk spectrum investors face.

Currently, the main macro risk is for a sudden shift in the inflation outlook, echoing the deflationary conditions of the 2010s, characterised by persistently low inflation and lower rates on longer-dated maturities. This is why we scrutinise every detail of inflation outcomes, near and far. Key drivers of a more severe scenario would include lower commodity prices, weaker labour markets, and a recessionary shift in demand—especially if triggered by fiscal tightening.

Given the varying starting points and trajectories of different economies, we continue to explore relative trades, and other spreads (e.g., asset swaps) affected by fiscal policy developments. Recent months have also reinforced our long-held view that Europe is undervalued. We have therefore introduced a new global theme, "*Rebuilding Europe*," seeking to capitalise on both a stronger European growth outlook and a significant increase in government bond supply.

In summary, despite near-term uncertainties from tariffs, fiscal imbalances, and geopolitical risks (see left hand chart), persistent inflation and expansive fiscal policies remain strong drivers of a long-term trend toward higher long-term bond yields. However, as we closely monitor geopolitical developments and unpredictable policy decisions, the risk of weaker global economic conditions is increasing, potentially justifying a shift toward easier monetary policy. While the market already prices in lower rates—see right-hand chart—a scenario of significantly slower economic growth could prompt a more pronounced policy easing next year than currently anticipated.



Outlook

Nordic outlook

The Swedish economy is in the early stages of recovery. Consumption is gradually improving, and the trade balance remains strong. Meanwhile, the late-cycle labour market appears to have stabilised. Increased government spending on defence and infrastructure could further support the recovery, with potential spillover benefits to Swedish manufacturing from Germany's new fiscal expansion.

However, risks to the economy persist. As for all countries, trade policy uncertainty is a primary concern. The full impact of potential trade barriers is challenging to assess, but investment and consumption decisions could be adversely affected. Additionally, elevated food inflation is already weighing on Swedish consumer confidence and may delay a broader consumption rebound. Despite these challenges, we currently believe the positive factors outweigh the negatives.

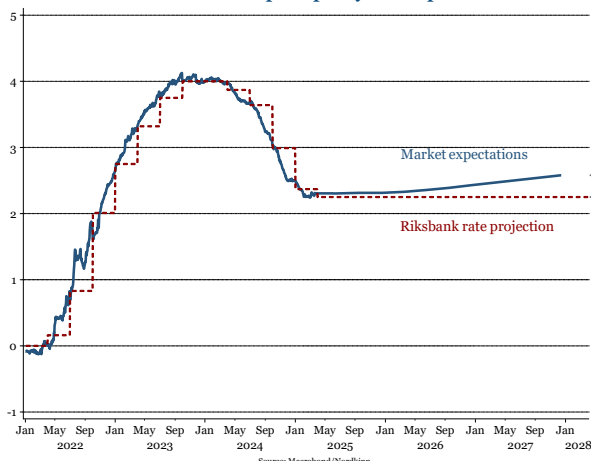
As noted in the review section above, the Riksbank downplayed the inflationary impulse at the start of the year, despite a historically large forecast error. Given persistent cost pressures and rising price plans across all sectors, we are less complacent than the central bank. A heat map in the Monetary Policy Report illustrates inflationary pressure since 2021. While the chart indicates inflationary pressure is lower today than in 2022—just before the inflation surge—this is an unusual benchmark. CPIF exceeded 10% in December 2022, while the average inflation rate since 2021 stands at 3.75%.

A stronger SEK could contribute to disinflation later in the year, but inflation remains elevated across several key categories. Among the twelve major groups in the CPI basket, many have experienced their highest or second-highest price increases in the past decade, including food, clothing, housing, communication, recreation, restaurants, and hotels.

Taken together, the risk is that the Riksbank underestimates inflationary pressures in the economy and may be forced to tighten policy again later this year or next. This risk is not adequately priced in by the market, in our view. Consequently, while some rebound in relative interest rates is possible following March's underperformance, we do not consider Swedish fixed income particularly attractive at this stage. Despite the risks posed by tariffs, Sweden's economic outlook appears relatively strong, though inflation remains a concern.

We maintain our themes, *"After cuts come growth"* and *"Bond supply set to expand,"* as both should benefit from continued relative economic improvement, a more accommodative fiscal policy, and persistent inflationary pressures.

Sweden Stibor-implied policy rate expectations



Turning to Norway, the surprise spike in core inflation convinced the Norges Bank to keep the key policy rate unchanged at 4.50% for longer than previously expected. Importantly, this decision was not solely a response to the February CPI. In addition, wage growth in 2024 reached 5.6%, which was 0.4 percentage points higher than the Norges Bank's December forecast, indicating that significant cost pressures remain. Moreover, the labour market has shown resilience, with unemployment ticking lower, while business surveys have indicated slightly higher economic growth than expected. Taken together, the Norges Bank judged that the risks to inflation warranted a tighter monetary policy stance than previously projected.

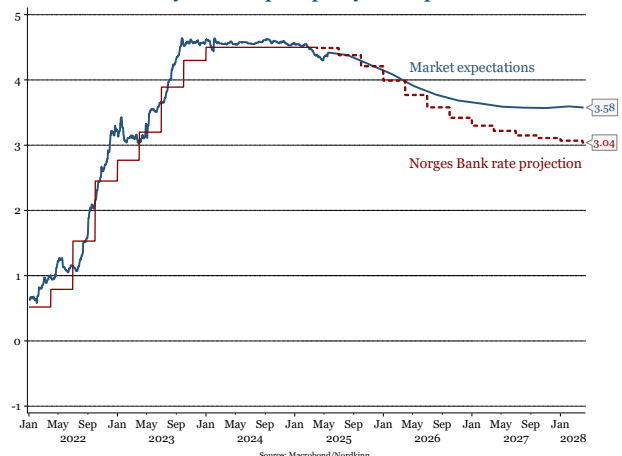
The updated interest rate projection—conditional on growth, labour market developments, and inflation—suggests that the key policy rate should be lowered to 4.00% by year-end, starting in the second half. This view aligns broadly with current market expectations, as illustrated in the accompanying chart.

We see the risks surrounding this forecast as tilted toward a slightly more front-loaded easing cycle than the market currently anticipates. At the March 27th press conference, Governor Bache stated that if the pickup in inflation in January and February proves more temporary than assumed, or if unemployment rises more than projected, the policy rate may be reduced faster than currently envisaged.

Both risks could materialise, in our view. Starting with inflation, we believe a significant portion of the inflation surprise in 2025 reflects food prices following a different seasonal pattern than in 2024 due to a late Easter. Our food price tracker suggests that prices fell marginally in March and are likely to decrease substantially in early April as competition ahead of the Easter holiday intensifies. This is the opposite of the 2024 pattern, where competition intensified in February and March before prices surged in April, May, and June. Consequently, while core CPI inflation may remain elevated around 3.5% in March, we expect a return to below 3.0% in Q2.

Additionally, labour market participants agreed on 4.4% total wage growth in 2025, sharply down from 2024 and slightly below the Norges Bank's latest projection. Finally, the global trade war poses a risk of slowing economic growth and increasing unemployment. Consequently, we maintain our *"Norway: Path to looser policy"* theme, even though the rate cutting cycle has been delayed.

Norway Nibor-implied policy rate expectations



About Nordkinn

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Our focus is to generate stable absolute returns that exhibit low correlation to other assets. Our Nordkinn Fixed Income Macro Fund was launched in 2013.

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