Market Review & Outlook

June 2025

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Market overview

Global review

Markets ended the first half of the year on a buoyant note, with global government bonds rallying, supported by easing inflation momentum and a temporary reduction in trade tensions. After a large spike in Q1, the three-month-on-three-month seasonally adjusted rise in core consumer prices has moderated across our core markets (see chart), which—on their own—support the case for looser monetary policy going forward.

In the U.S., both FOMC Governors Bowman and Waller indicated that they are open to cutting interest rates as early as in July, provided they see limited evidence of renewed inflationary pressures. These remarks influenced market expectations, increasing the probabilities of a July rate cut from around 8% to more than 20%, and a September cut from 60% to being fully priced.

However, their views are not widely shared among other Fed officials. Following the decision to keep the policy rate unchanged at 4.25–4.50% on June 18th, Chair Powell warned that upcoming tariff increases could push inflation higher over the summer. He signalled a preference to wait incoming inflation data before considering policy easing. This cautious stance appears to be broadly shared among FOMC members, as reflected in the updated Summary of Economic Projections. While the median 2025 ‘dot’ suggests a 50 bps reduction, most officials appear inclined to wait for greater clarity on the balance of risks to the dual mandate.

Geopolitical risks also continued to influence markets in June, particularly following developments in the escalated Iran-Israel conflict. U.S. strikes in Iran and Tehran's subsequent response—including threats to close the Strait of Hormuz—pushed oil prices more than 10% higher MTD before easing as the ceasefire gained traction. Also, the NATO agreement on June 24th of 5% of GDP defence spending will have lasting impact on bond supply and thereby also longer-term yields.

Our global theme *"Geopolitical tensions impacting growth"* contributed positively to performance, primarily through relative exposure in GBP rates versus EUR and NOK rates as the UK economy showing clear signs of weakness. Additionally, gains came from the steepening of the U.S. Treasury yield curve.

The USD remained under heavy pressure in June, falling to its weakest level in over three years and down more than 10% year-to-date. The decline was mainly driven by reduced global demand for the dollar, reinforced by rising expectations of Fed rate cuts. The EUR/USD exchange rate broke above 1.17 during the month, benefitting our global theme *"Rebuilding Europe."*

Nordic review

In Sweden, CPIF excluding energy fell to 2.5% year-on-year in May, undershooting both market expectations and the Riksbank's forecast. Following unexpectedly high readings earlier this year, the latest figures confirm a softer underlying inflation trend. Coupled with sluggish economic growth—reflected in both hard and soft data—the Riksbank responded appropriately by cutting its key policy rate by 25 bps to 2.00% on June 18th.

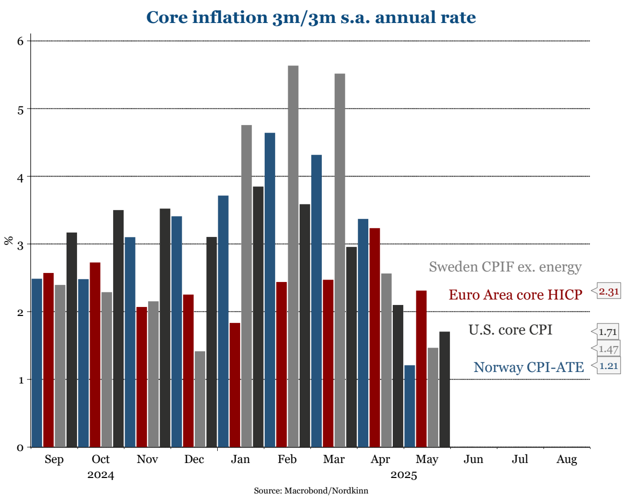
While the rate cut itself was broadly anticipated, the forward guidance surprised on the dovish side. The updated policy rate forecast bottoms out at 1.88% in early 2026, implying nearly a 50% probability of an additional cut by end of 2025. This outlook helped pushing interest rates downwards, including real (i.e. inflation-adjusted) rates, lending support to our new theme: *"Sweden: Revival of the inflation hedge."*

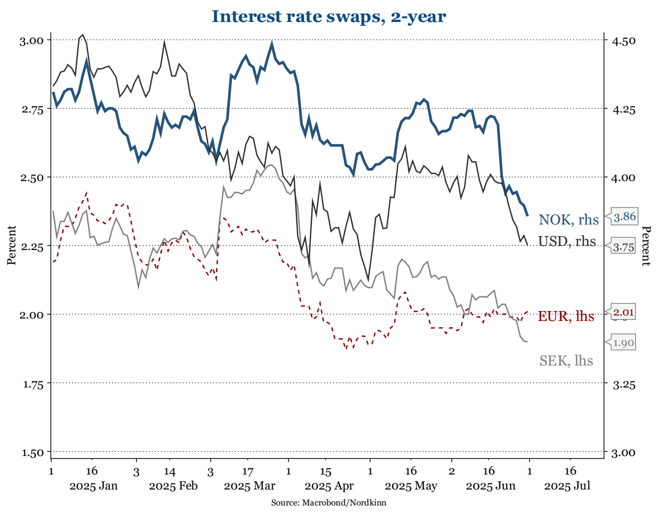
Meanwhile, continued heavy government bond issuance weighed on sovereigns relative to covered bonds, which outperformed amid growing expectations of further easing—reinforcing our theme *"Sweden: Bond supply set to expand."*

In Norway, core inflation eased to 2.8% year-on-year in May, again coming in below both consensus estimates and Norges Bank's own projections. The data suggest that the Q1 inflation spike was driven by transitory factors. At the same time, economic activity surprised to the upside in Q1, and survey indicators point to continued solid growth through Q2 and Q3.

Nevertheless, the benign inflation prints, and expectations of further disinflation over the medium term, prompted Norges Bank to deliver a 25 bps rate cut to 4.25% on June 19th, which was a major surprise to markets. All 17 analysts surveyed by Bloomberg had expected the rate to be unchanged at 4.50%.

Market interest rates fell sharply following the decision. The immediate reaction was concentrated in very short-dated instruments—reflecting broad-based expectations of a stable policy rate ahead of the policy decision. While the updated rate path projected only a gradual easing over the coming year, markets quickly began to factor in some probability of additional dovish surprises going forward. The decline in Norwegian interest rates, both outright and relative to peers, contributed positively to our theme: *"Norway: Path to policy easing."* Our new Norwegian theme *"Lags in yield and curve dynamics"* had a marginally negative contribution on net as gains from steeper NOK curve positions was offset by a sell-off in Norwegian government bonds versus swaps.





Outlook

Global outlook

So far, there is little evidence of tariff-driven inflationary pressures in the U.S.—which is not surprising, as it typically takes time for consumer prices to reflect new tariffs. While the timing of the impact is uncertain, the 2018–2019 tariff shock offers a useful reference point: we estimate that it could take 3–4 months for the effects to feed through to consumer prices. In addition, higher short-term inflation expectations, supply chain adjustments, and second-round effects could contribute to some inflation persistence. However, it remains unclear as to how much of the tariff burden firms will ultimately pass through to end-consumers.

Against this backdrop of uncertainty, it is understandable that Chair Powell and most of the FOMC prefer to assess the data before deciding when and how much to ease monetary policy. At the same time, tariffs could weigh on growth and eventually push unemployment higher.

A meaningful deterioration in the labour market would likely prompt the FOMC to consider rate cuts sooner. The recent rise in the 4-week moving average of jobless claims to around 245k warrants monitoring, as does the uptick in Worker Adjustment and Retraining Notification (WARN) filings (see chart). However, these developments are not yet sufficient to shift the Fed's stance.

That said, if signs of increased layoffs are accompanied by a clear rise in the unemployment rate, and the pass-through from tariffs to inflation proves limited, a lower policy rate will be consistent with the Fed's dual mandate. Overall, while the U.S. economy remains on a relatively solid footing—with low and stable unemployment—downside risks to growth and upside risks to unemployment support current market expectations for a 25 bps rate cut in September, followed by further easing over the coming year. We believe that a cut in July still is premature.

We also see scope for a further increase in the term premium on U.S. government bonds, as the sharp rise in supply continues to outpace foreign investor demand. In our view, this sets the stage for a steeper U.S. yield curve.

Elsewhere, we also anticipate steeper yield curves in Europe, reflecting a combination of increased bond supply and gradually improving growth prospects, as governments dramatically are ramping up fiscal spending on defence and infrastructure in line with their commitments to NATO.

In FX markets, we remain bearish on the USD, driven by fading U.S. exceptionalism and a more growth-supportive policy mix abroad. In our view, the risk of weaker U.S. labour market data has increased on the margin, which will further weigh on the dollar over the summer.

Nordic outlook

In Sweden, the recovery in economic activity has been weaker than expected, although some of the recent deterioration likely reflects temporary factors. Uncertainty surrounding external developments is expected to weigh on growth this year, primarily through weaker exports and subdued private investment. While households have remained cautious in their spending so far, we expect lower interest rates and rising real incomes to gradually support a rebound in consumption.

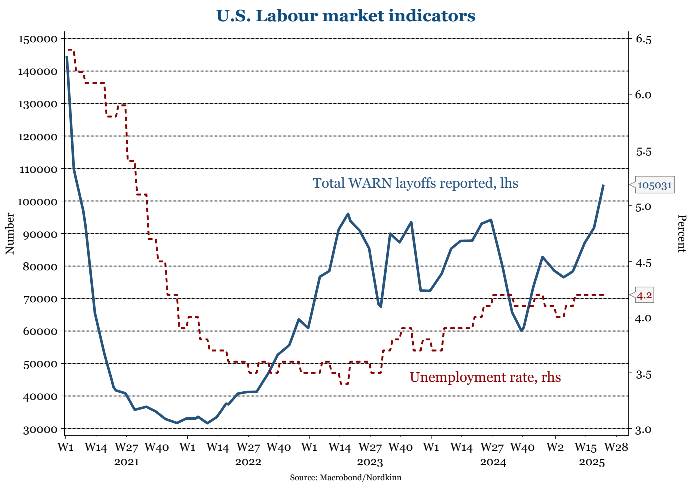
Swedish rates have rallied significantly since the Riksbank cut its key policy rate to 2.00% in June and signalled roughly a 50/50 probability of another cut. Markets are currently pricing in almost 50 bps of additional easing—a degree of dovishness we view as stretched, given that our outlook for growth and inflation does not differ meaningfully from the Riksbank's own projections. Against this backdrop, paying SEK rates versus European peers appear increasingly attractive.

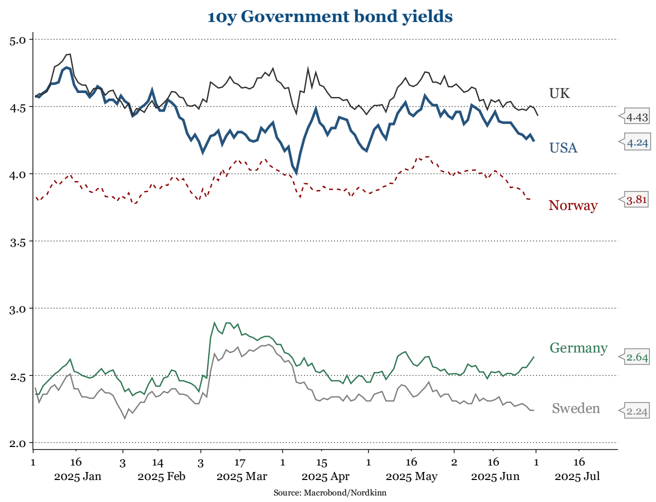
Meanwhile, government bond supply is set to increase substantially, driven by higher defence spending and potential investments in expanding the nuclear power system. We remain bearish on Swedish government bonds in general, particularly at the longer end of the curve.

Turning to Norway, Norges Bank's surprise rate cut in June triggered a significant repricing of future policy expectations, as investors now discount for the potential of further dovish surprises. Additionally, receiver flows from systematic accounts have reinforced the downward momentum in yields, while corporate payer flows have been largely absent. As a result, markets are currently pricing in a quarterly pace of rate cuts, with the policy rate expected to reach 3.25% by next summer. While this is slightly more aggressive than Norges Bank's own projections, we believe it is broadly justified given our forecast for continued disinflation in the coming months and quarters.

We see risks in both directions relative to current market pricing. On one hand, if households respond strongly to lower interest rates, Norges Bank may opt for a more gradual rate-cutting cycle and a higher terminal rate than currently anticipated. On the other hand, if the global slowdown exerts a more pronounced drag on the Norwegian economy and labour market, the central bank may accelerate the pace of easing.

Norwegian government bonds should benefit from upcoming rate cuts, particularly as these assets become increasingly attractive to foreign investors hedging their FX exposure. Moreover, the outlook for government borrowing remains contained, as any increase in fiscal spending will be financed through higher petroleum revenue spending rather than through additional bond issuance.





About Nordkinn

Nordkinn Asset Management is a fixed income specialist based in Stockholm and Oslo. We invest in the global fixed income and currency markets – with a particular focus on our home markets Norway and Sweden.

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.

Hamngatan 11, 3rd floor
111 47 Stockholm, Sweden
Phone: +46 8 473 40 50
E-mail: post@nordkinnam.se

Prinsens gate 22, 6th floor
0157 Oslo, Norway
Phone: +47 22 46 63 00
E-mail: post@nordkinnam.no