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ASSET MANAGEMENT

Nordkinn Market Review & Outlook – August 2021

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Nordkinn Asset Management is a Nordic Fixed Income specialist based in Stockholm and Oslo. Nordkinn manages the Nordkinn Fixed Income Macro Fund, which seeks to generate stable absolute returns in all market environments.

Nordic markets

The short end of the Swedish yield curve is still too steep in our minds and at odds with the inflation outlook. In addition, since the last monetary meeting, at the beginning of July, ECB has presented their strategy review with a clearer link between realised inflation and the policy reaction function. Hence, rate hikes are not really worth contemplating until underlying inflation has durably reached inflation target. This is in line with earlier Riksbank reasoning, but still, if ECB is reluctant to hike, it will hold back Riksbank actions as well. Consequently, we aim to take advantage of the steep yield curve up to three years under our "*Sweden: Riksbank and market pricing inconcistencies*" theme.

The next Riksbank meeting later in September will most likely be undramatic. While inflation and growth has been a slightly higher, the delta variant creates uncertainties. Moreover, the ECB has announced their new dovish strategy. This should balance things up at the meeting in our view. We doubt the Riksbank is ready to announce its plans for asset purchases in 2022 already at the upcoming meeting. Postponing this decision until the next meeting in November, might provide more clarity about tapering by the Fed and the ECB.

Riksbank´s current rate path is completely flat (up to Q3 2024) and while a possible rate hike three years from cannot be ruled out, the market is already pricing 40 bps of rate hikes by Q3 2024, see chart. More, the current inflation trajectory is below 2% all the way up to the end of the rate path period and it probably needs to be lifted further by then in order to justify a rate hike at the back end of the rate path.

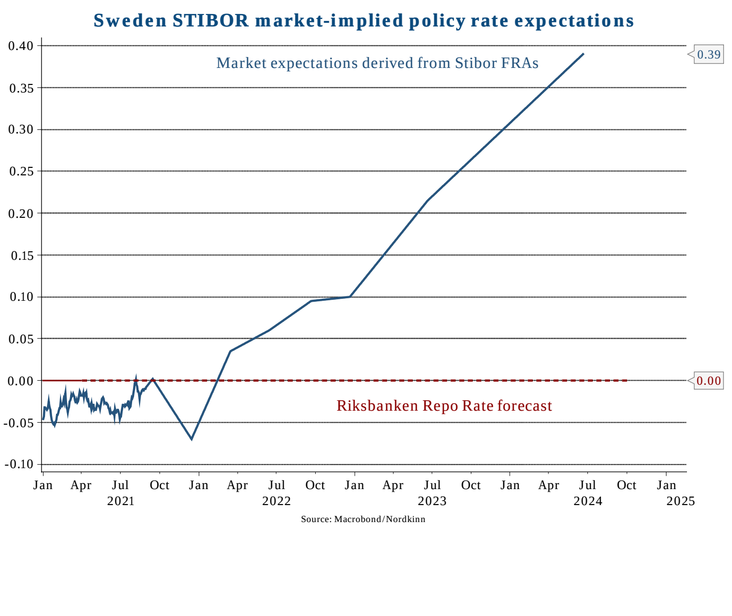
Long dated bond yields in Sweden followed international peers lower during the summer. All equal, the move in Sweden was driven by real rates. Yield curves have flattened but in particular the real rate curve. Although the real rate curve steepened somewhat in the last sessions of the month, it remains flat by historical standards. We expect global real yields to gradually move higher as tapering and investor flows ebb, or even reverse. In our view, it is a question of timing. Historically, Swedish real yields follow global real yields, which we seek to explore within our *"Global: Comparative inflation expectations"* theme.

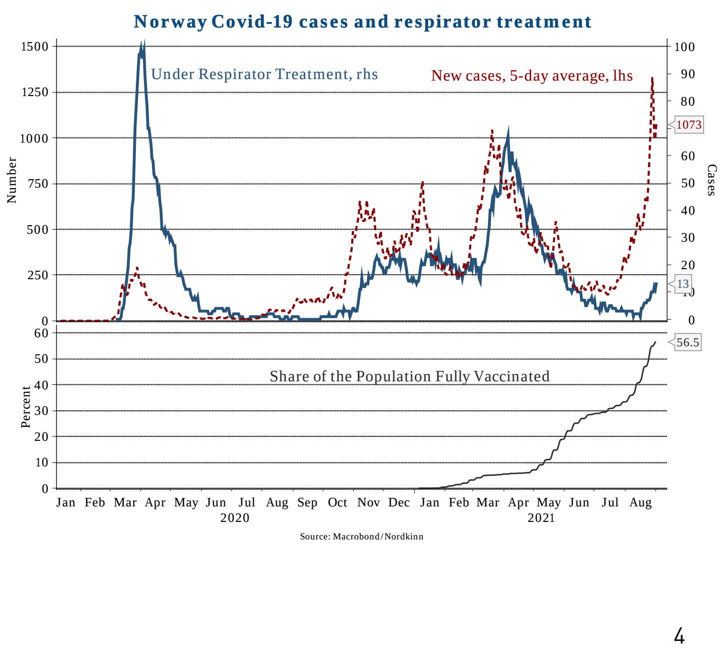
In Norway, while infection rates have risen much faster than expected, we do not anticipate a significant hit to economic activity. More than 70% of the population (or around 90% of all adults) have received at least one vaccine dose, and almost 60% of the population is fully vaccinated. The share of fully vaccinated will continue to increase markedly, and this implies that the health effects of the current Covid-19 wave should be less severe than previous waves. While the number of patients with corona in hospitals is likely to increase somewhat futher, it is unlikely to exceed hospital capacity. Added to that, because a very high share of the population in "risk groups" is vaccinated, the number of patients in intensive care remains low, see chart. Consequently, although we cannot rule out retightening of some restrictions, priority number one for health authorities is to speed up vaccination during September.

The government intends to proceed with its plan to reopen the society entirely when mass vaccination is complete at the end of September. Even with delays, we see a robust outlook for economic growth over coming quarters. This will allow Norges Bank to unfold its normalisation plan with rate lift off on September 23rd and a total of 100 bps of tightening by summer 2022. We continue to believe that the near-term path is relatively robust to minor disturbances in the macro and markets environment.

As the market discounts a somewhat shallower rate outlook than Norges Bank presented in July, we see moderate upside risks for NOK interest rate in coming months. This comes on top of an expected increase in the spread between money market rates and the key policy rate, as structural bank liquidity is set to tighten from September and we see upside risks to USD Libor-OIS spreads ahead. At the same time, we actively trade NOK rates from both sides when deemed appropriate.

Meanwhile, following the recent appreciation of the NOK exchange rates, we have trimmed our long NOK positions as we see a risk of increased market turbulence during Q4 associated with QE tapering discussions on both side of the Atlantics and instead stand ready to act as opportunities present themselves.





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Kungsgatan 33, 6th floor
111 56 Stockholm, Sweden
Phone: +46 8 473 40 50
Telefax: +46 8 473 40 51
E-mail: post@nordkinnam.se

Prinsens gate 22, 6th floor
0157 Oslo, Norway
Phone: +47 22 46 63 00
Telefax: +47 94 77 15 16
E-mail: post@nordkinnam.no