

Investing Opportunities in Sweden

October 2011

- **Short-term interest rates are more likely to rise than fall in 2012**
- **Bond yields are unsustainably low and will rise with global yields**
- **The krona is not under any obvious pressure to rise or fall**

Economic activity has rebounded solidly during the past eighteen months with growth of 7% in 2010. This has contributed to rapidly rising employment and the redeployment of capital that had become idle during the 2008/2009 recession. The public sector and household sectors remain well placed to expand further but firms appear to have been increasing their stock levels at an unsustainably rapid pace. The pace of economic growth slowed towards 4% in the first half of 2011 and a further slowdown is likely. Consumer price inflation has risen, partly due to higher energy prices, but ongoing global competitive forces should see inflation generally remain contained (see table of key forecasts).

Expectations of monetary policy have fluctuated during the past year. Initially, the rapid economic rebound and the accompanying commencement of a tightening cycle by the Riksbank caused financial market expectations of short-term interest rates to adjust upwards but the turbulence in global financial markets during 2011 has led to a renewed lowering of interest rate expectations (see top chart). FRA prices indicate that official interest rates are now expected to remain at 2% through the coming two years. The risks are heavily skewed towards higher interest rates than implied by current financial market prices.

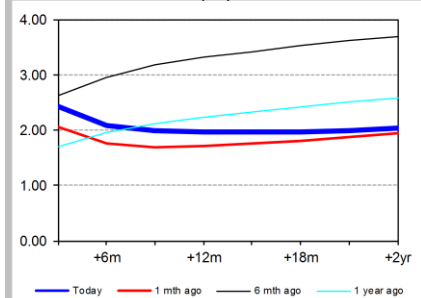
Bond yields have been very low in recent years and have taken another dip in recent months as global bond yields have tumbled. Despite rising in the past few weeks, Swedish 10 year yields are negative in real terms and the yield curve is unusually flat. The current level of yields is below the multi-decade lows reached in 2010 (see middle chart). Swedish bond spreads are smaller than historical norms so when global yields rebound, Swedish bond yields will almost certainly rise. Indeed, Swedish bond yields will probably rise by more than global yields if Swedish short-term interest rates are also increasing.

The krona has now fully rebounded from its sharp drop in 2008/09. In trade-weighted terms, it moved from a multi-decade low back up towards the high point of the past decade before declining slightly recently (see bottom chart). Even though the currency is relatively high compared with the past decade it is still well below the levels of the 1990s and remains supported by the sizeable external trade surplus. There are no obvious reasons why the Swedish krona should be biased towards either appreciating or depreciating.

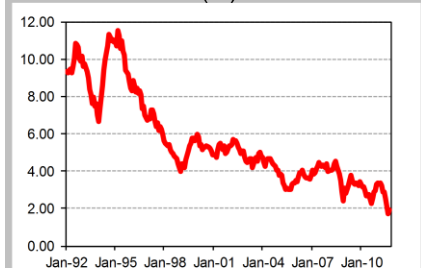
The equity market has fallen sharply in tandem with global markets during recent months and the total loss during the past twelve months has been near -15%. The appreciation of the krona removes one of the positive factors for the corporate sector but the economic environment is likely to be sufficiently favourable that positive equity returns are possible.

Key Forecasts			
	Dec-12	Dec-13	Dec-14
GDP	2	2	2
CPI	2	3	3
Riksbank	4.00	5.00	5.00
10 year	4.50	5.00	5.00
EUR/SEK	8.75	8.75	8.75
NOK/SEK	1.13	1.13	1.13
SEK/USD	7.00	7.29	7.61

90 Day FRA Strips (%)



10 Year Bond Yields (%)



Swedish Krona (Real Trade Weighted Index)

