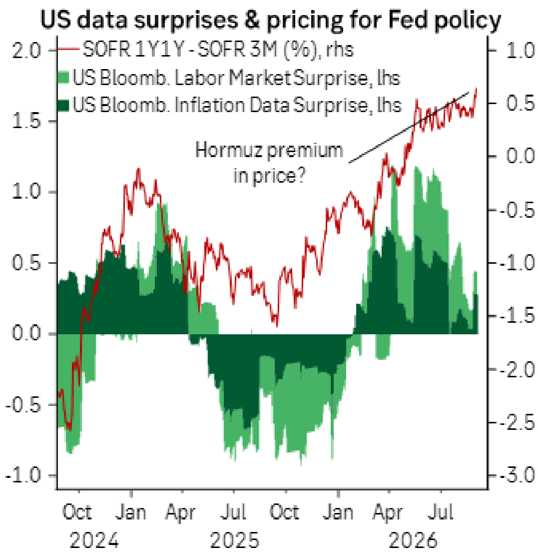
Rate dynamics - external disinflation impulse is key

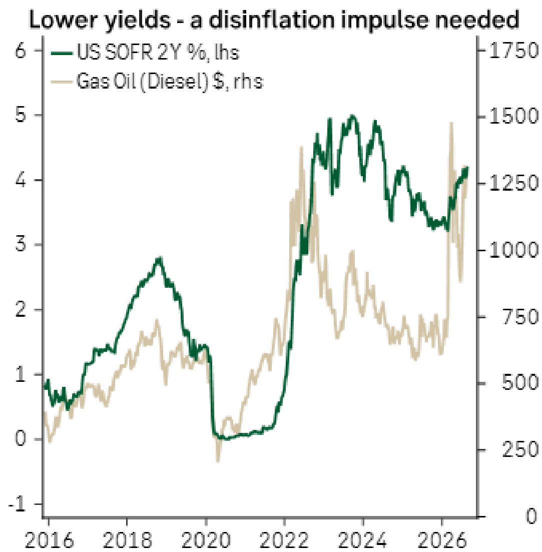
Key points

- **Front-end**: Pricing a Hormuz premium with rates diverging from data surprises on inflation and the labor market in the US.
- **Divergence**: Weak hike case for Riksbank/Bank of Canada; more to do for RBNZ/BOJ; US priced for sticky inflation outcome now.
- **Limited bear flattening**: US curve somewhat steep vs. implied policy setting; bigger bear flattening needs inflation & faltering growth (2022-style); watch for PMIs rolling over.
- **Term premia rising**: Driven by both structural (issuance> savings demand) and cyclical (growth, commodity inflation) forces, currently they are aligned.
- **Japan risk**: Higher JGB yields could reverse capital export → term-premia contagion and stronger Yen.
- **Nature of rising yields**: Real rates up, breakevens stable, no ASW cheapening - not a debt-sustainability story yet; activist Treasury could shift this toward rising breakeven inflation and a USD debasement narrative.
- **Flows**: Global savings going to US equities, not Treasuries; ultimately a weak-USD policy could spur FX intervention/reserve recycling into USTs (2004-06 redux).
- **An orderly shift to a weak-USD policy** needs external disinflation impulse - Bessent's original plan, derailed by Iran conflict.

Front-ends are pricing a Hormuz premium - we look relatively well priced now for a sticky inflation scenario



Source: Bloomberg, Macrobond, SEB



Source: Bloomberg, Macrobond, SEB

Fed Policy Rule in various economic scenarios

Sticky inflation in current Fed pricing

core CPI %YY \ Unemployment rate %	3.5	4.0	4.5	5.0	6.0	6.5
0.5	2.5	2.3	2.1	1.9	1.5	1.3
1.0	2.9	2.7	2.5	2.3	1.9	1.7
1.5	3.3	3.1	2.9	2.7	2.3	2.1
2.0	3.7	3.5	3.3	3.1	2.7	2.5
2.5	4.1	3.9	3.7	3.5	3.1	2.9
3.0	4.5	4.3	4.1	3.9	3.5	3.3
3.5	4.9	4.7	4.5	4.3	3.9	3.7
4.0	5.3	5.1	4.9	4.7	4.3	4.1
4.5	5.6	5.4	5.2	5.0	4.7	4.5
5.0	6.0	5.8	5.6	5.4	5.0	4.8

Note: rule assumes a nominal trend growth of 5.5% (pre 2008) Source: SEB

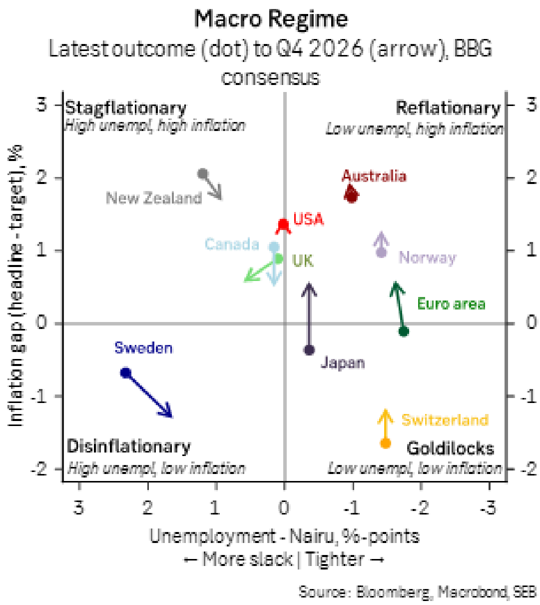
soft landing *no landing* *hard landing* *recession & sticky inflation*

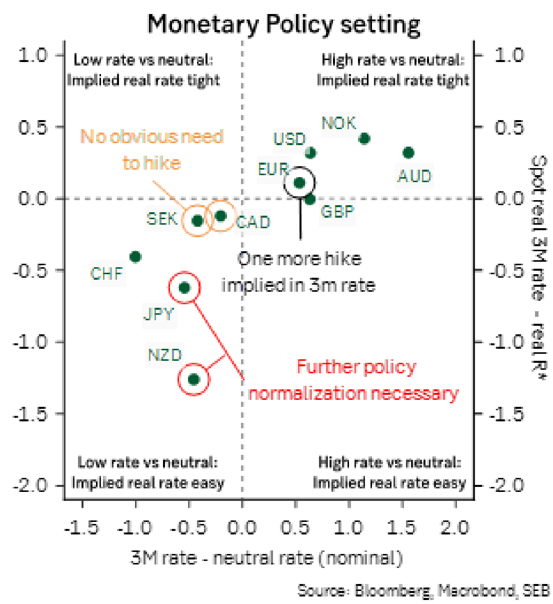
Neutral Rate sensitivty to nominal trend growth

Trend Growth Assumption %					
3	3.5	4	4.5	5	5.5
1.1	1.6	2.1	2.6	3.1	3.7

Source: SEB

Not all countries are the same - starting point for policy setting differs and macro conditions are diverging - e.g. weak case for substantial hikes from SEK and CAD, RBNZ and BOJ have more lifting to do while US now looks priced for a sticky inflation outcome.





Policy rates: Priced - cumulative change

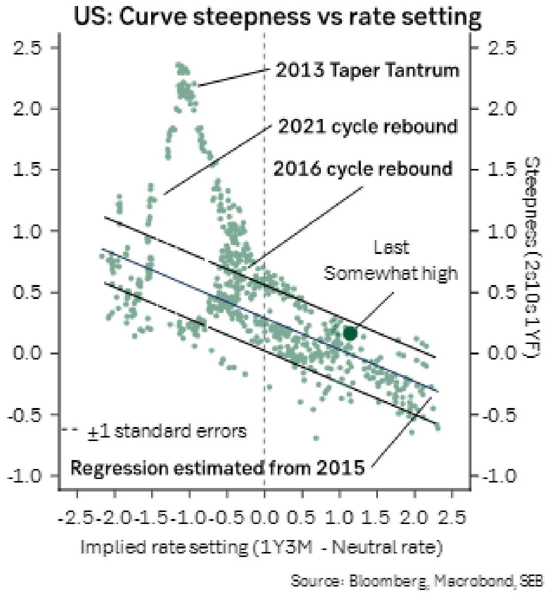
		Fed	BoC	ECB	BOE	SNB	Riksbank	NB	RBA	RBNZ	BOJ
	Spot ref.	3.63	2.28	2.19	3.73	-0.05	1.75	4.25	4.35	2.75	0.98
By Meeting Date	Sep-26	0.15	0.00	0.25	0.03	-0.01	0.10	0.14	0.16		0.28
	Oct-26	0.23	0.08	0.31						0.08	0.32
	Nov-26				0.17		0.22	0.23	0.29		
	Dec-26	0.37	0.25	0.47	0.30	0.06	0.35	0.28	0.31	0.25	0.46
	Jan-27	0.43	0.35				0.35	0.28			0.58
	Feb-27			0.54	0.44				0.37	0.37	
	Mar-27	0.54	0.64	0.65	0.55	0.16	0.62	0.28	0.37		0.69
	Apr-27	0.56	-0.71	0.69						0.49	0.78
	May-27						0.74	0.28	0.38	0.58	
	Jun-27	0.60	0.94	0.74	0.69	0.27	0.84	0.25	0.39		0.87
Rolling	Sep-27	0.64	0.86	0.80	0.74	0.33	0.92	0.25	0.39	0.81	0.98
	Mar-28	0.61	1.06	0.76	0.74	0.47	1.01	0.14	0.32	0.98	1.19
	Sep-28	0.56	1.12	0.75	0.72	0.57	1.03	0.02	0.28	1.11	1.37

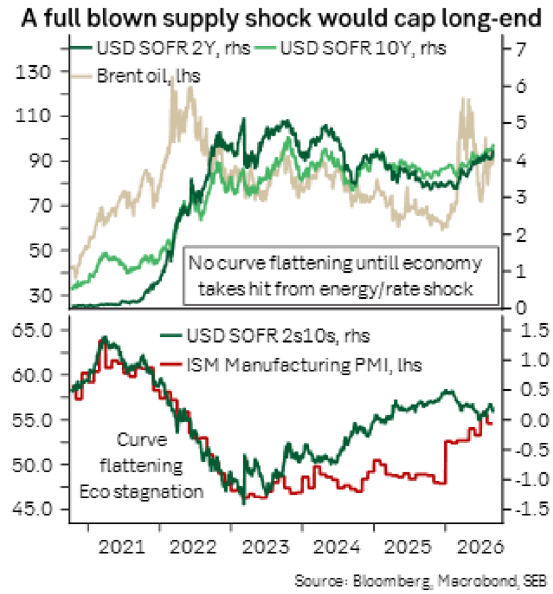
Source: Bloomberg, SEB

Too much? Justified Too much Too much Justified

Why are curves not bear flattening more?

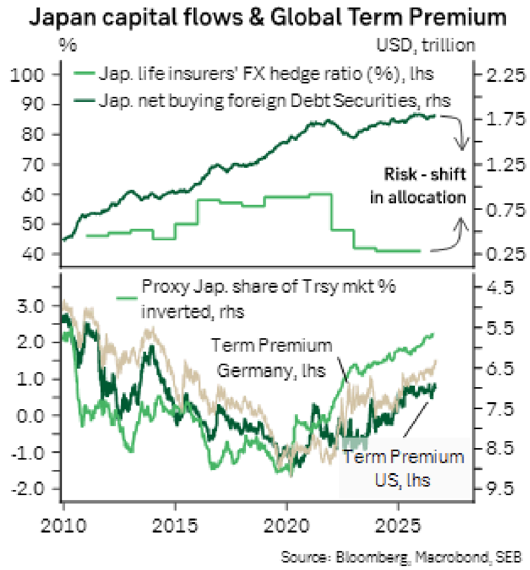
For example the US Curve is somewhat steep compared to the implied policy setting (hikes priced relative to the neutral rate), as the long end is moving up with front-rates. **A significant bear flattening requires inflationary conditions with a faltering business cycle** as in 2022 (negative supply shock), and we are not there (yet). I.e. any sign that global PMIs are topping out/rolling over would be the point where the longer-end becomes more capped.

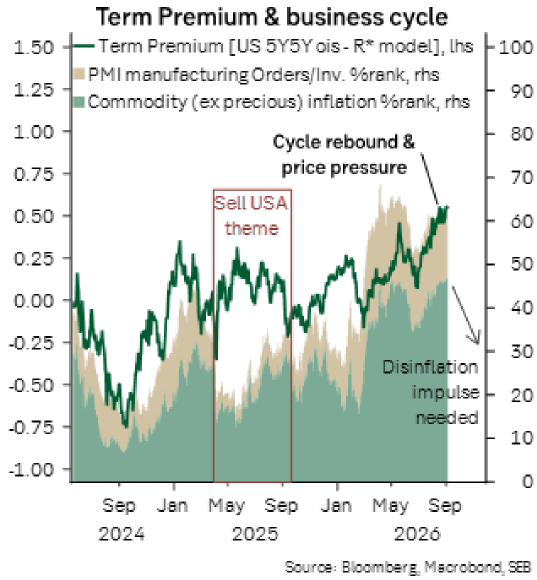


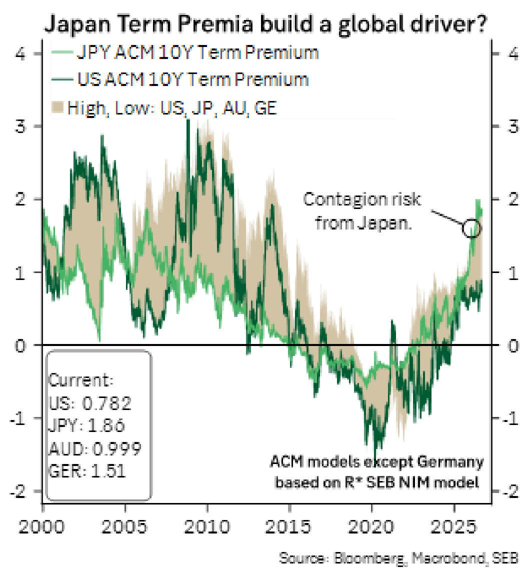


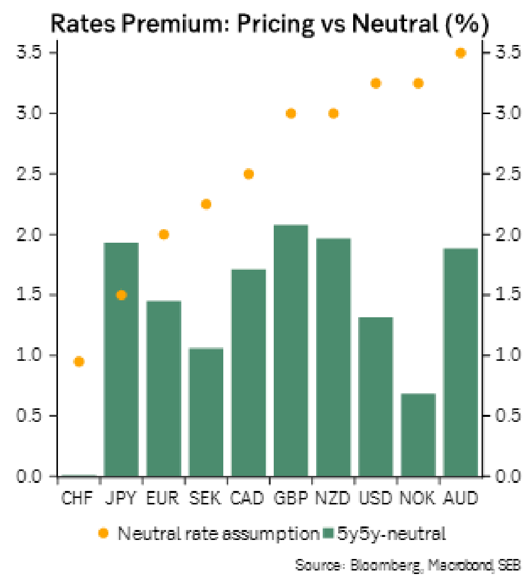
Term premia have been rising globally for structural demand/supply reasons and cyclical conditions. The rise in issuance is outpacing the structural demand from global savings (e.g. falling share of Japanese ownership in US Treasuries). Meanwhile an improving business cycle and the commodity inflation impulse is also correlated with rising term-premia. It is not straight forward to disentangle these structural/cyclical effects but at the moment they are acting in the same direction.

A real risk in the current environment with higher yields in Japan is that the Japanese export of capital reverses - domestics reallocating home to JGBs would essentially lead to term-premia contagion from Japan to the rest of the world and implicitly a stronger Yen.







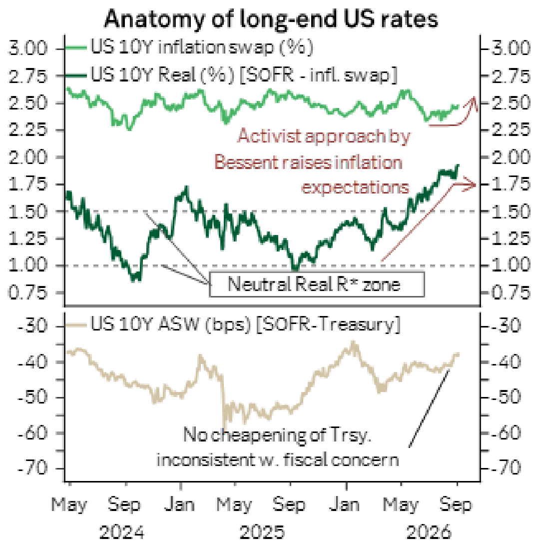


Shifting dynamics - so far the rise in term premia is mainly reflected in terms of higher real long-term interest rates while break even inflation has stayed stable, but also there has been no cheapening of treasuries on ASW - i.e. **supply/demand dynamics have led to higher term premia via real rates but this is not driven by rising debt sustainability concerns**, which should have shown up in the asset swap. However, a more activist Scott Bessent/Treasury could shift the dynamic towards rising BE inflation instead and a tendency of financial repression/ USD debasement narrative).

Looking at flows - the world is no longer recycling its savings into the treasury market (as the yield curve conundrum period of 2004-2006) but in to US equities.

Ultimately it would suit the US well with a weak USD policy which triggers increased FX intervention, and build of FX reserves, in the Middle East and Asia that could be recycled back into the treasury market. I.e. a repeat of the 'yield curve conundrum years'.

Key in shifting from the current strong USD equilibrium to a weak one in an orderly fashion would be an external disinflation impulse - as was Scott Bessent's plan from the start, but was derailed by the conflict with Iran.



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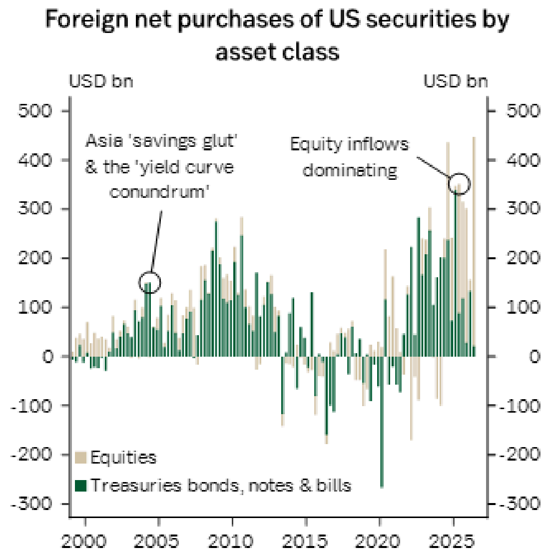

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