Fixed Income Update Week 36

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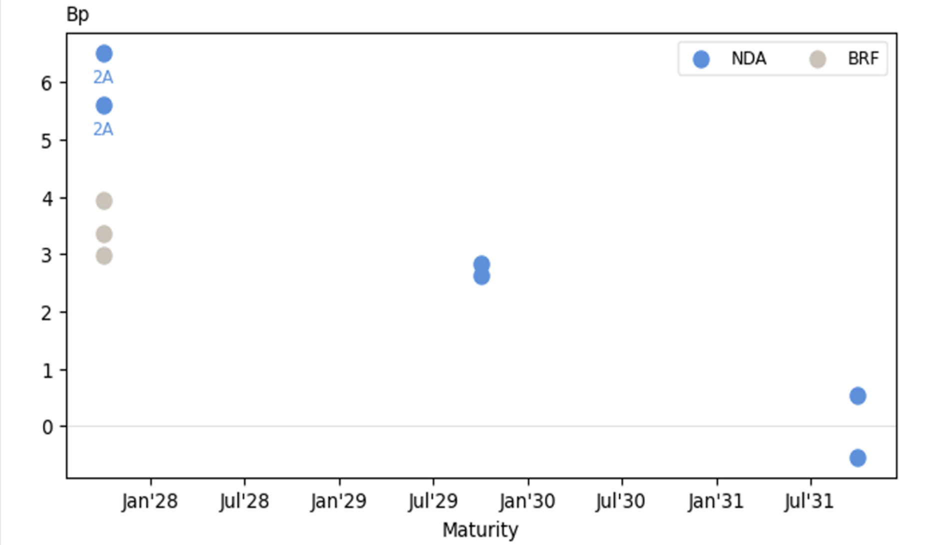
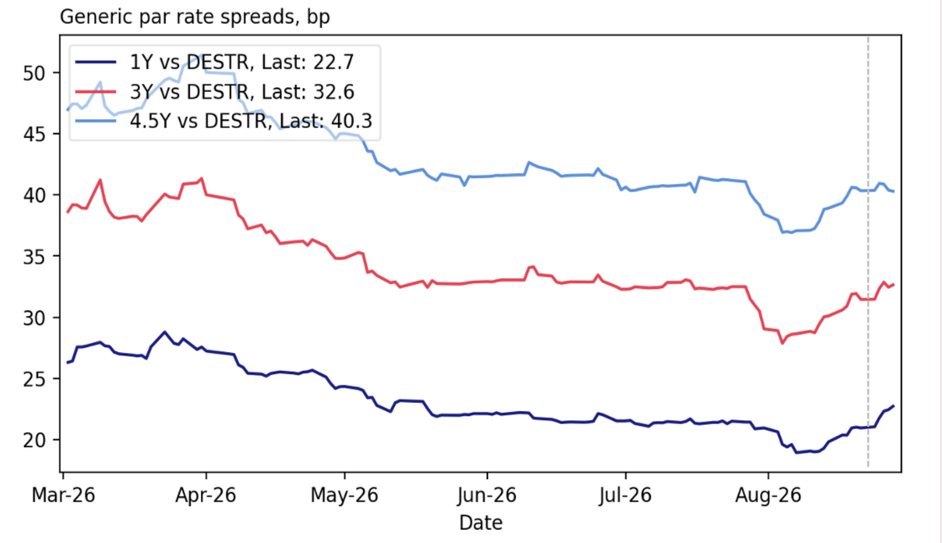
The refinancing is behind us!

- Last week's bullet bond auctions marked the completion of August's refinancing auctions.
- We dare to say that the outcome was as expected, with the 1Y and 3Y bullets from JRK and NDA, respectively trading at spreads of 2-4bp to the prevailing bullet curve (see top chart).
  - This is consistent with the expectation set out in the research note we published last Friday, which pointed out that the prospect of slight liquidity headwinds for bullets argued in favour of spread widening of 2-5bp (see here).
- The auction results have partially fed through to the bullet curve, where we have also seen 1Y-3Y bullets widen vs DESTR over the past week (see bottom chart from the dashed line onwards).
- 5Y bullets have held up better, likely because their hedged and funded return per unit of spread risk did not appear quite as expensive as that of the shorter-dated bullets.
  - However, 5Y bullets may still be affected if the pickup in short-dated FX forwards for a EUR investor (relative to DESTR-ESTR) is reduced.
  - If we do not see substantial intervention in the FX market by Danmarks Nationalbank, however, we may have to wait until 2027 before the net position reaches levels at which the short-dated FX forwards move significantly (see also here).

Bullet auctions: Spread vs the then-prevailing bullet curve



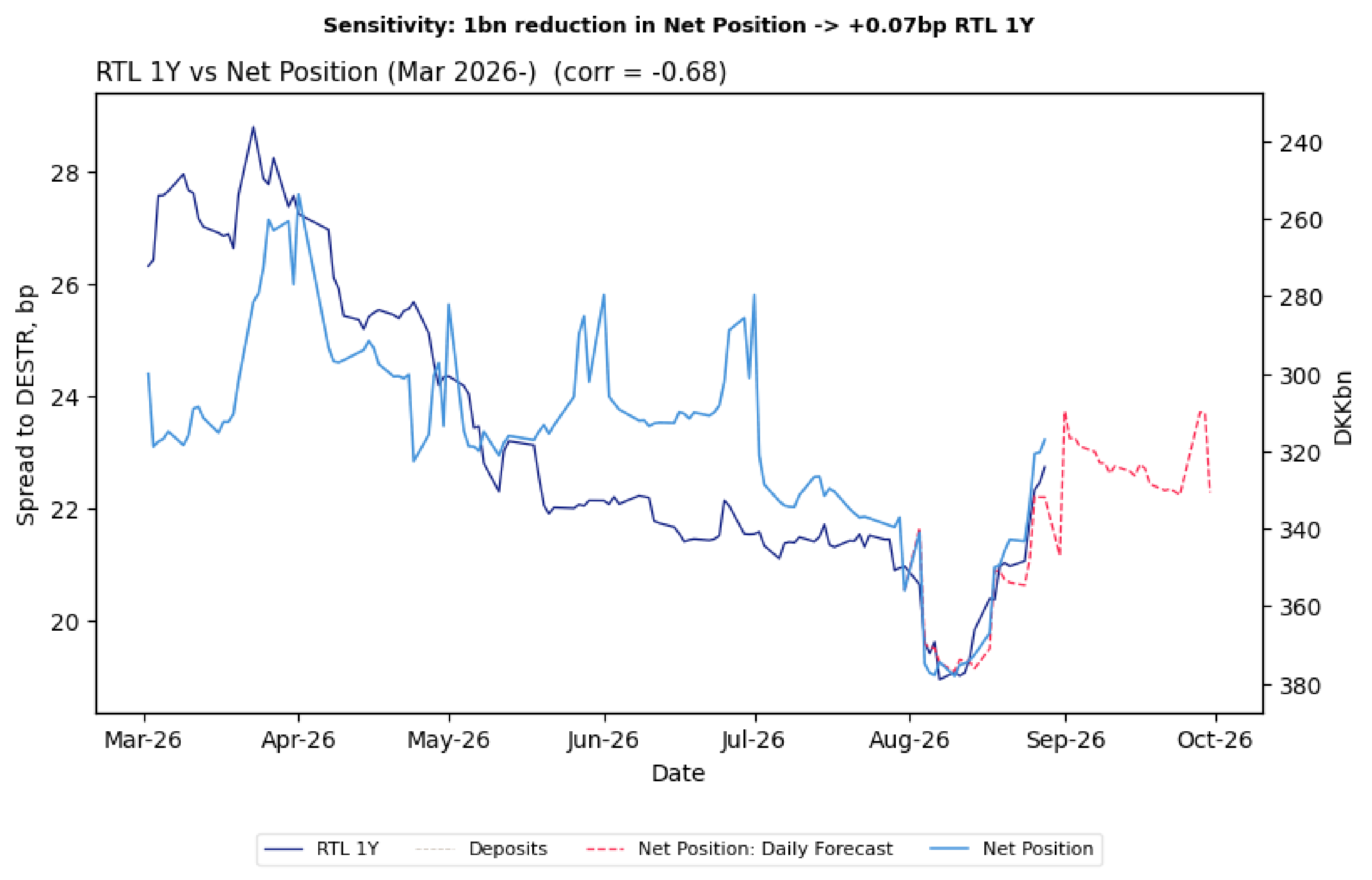
Bullets: Spreads vs DESTR



Correlation between Net Position and bullets

- The correlation between the Net Position and the 1Y bullet-DESTR spread suggests that bullets should underperform DESTR by just under 1bp for every DKK 10 billion reduction in the Net Position.

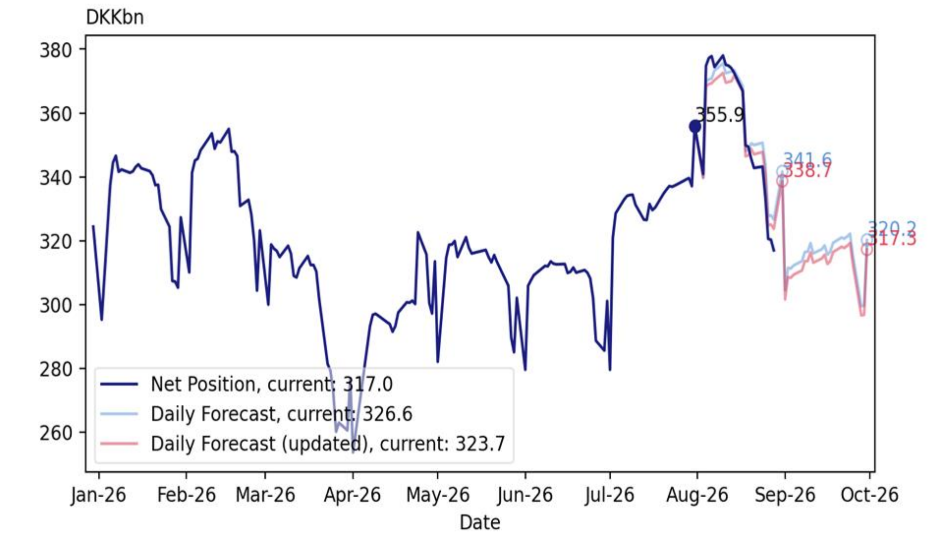
- Provided that the correlation holds, 1Y bullets only require about one bp of additional spread widening in the current round.



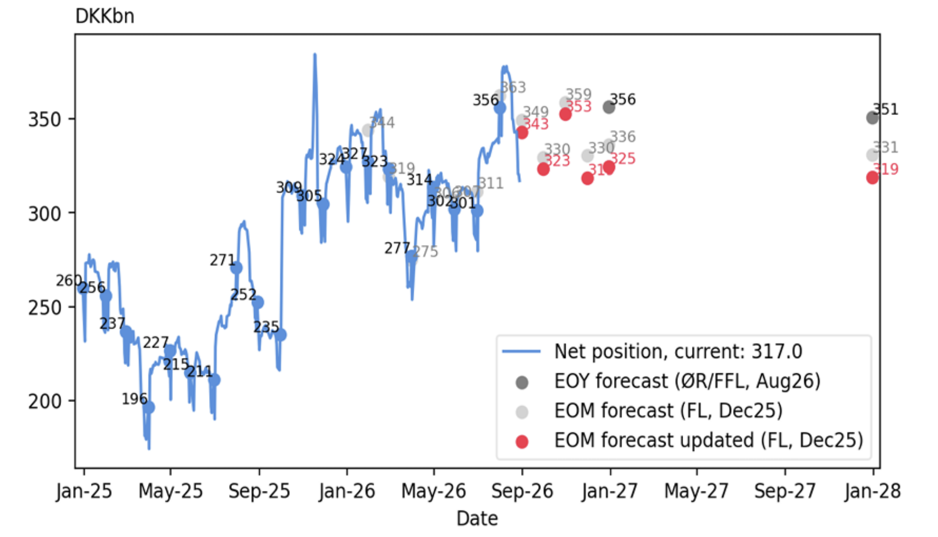
Liquidity outlook

- Last week, we received new estimates of the government's financing requirement in 2026 and 2027 from the Danish Ministry of Finance in connection with the August edition of the economic survey.
- Starting with 2027, the expected financing requirement for 2027 indicates that the net position will, overall, move sideways in 2027 – assuming an unchanged target for the issuance of government bonds (DKK 65 billion).
  - We must wait a little longer for a month-by-month breakdown of the financing requirement for 2027 from Danmarks Nationalbank, but it is expected that the usual seasonal decline in the net position in Q1 can also be expected to reach a level of DKK 40-60 billion next year.
  - Depending on the starting level of the net position in 2027, this could well put pressure on the pickup in short-dated FX forwards (vs DESTR-ESTR).
- Looking at 2026, the new estimates of the net financing requirement for 2026 (DKK 9 billion) indicate that the net position will end 2026 at DKK 350–360 billion.
  - The new estimate of the net financing requirement in 2026 represents a modest downward revision relative to the December 2025 estimate (DKK 15 billion).
  - If one assumes that the latest monthly forecast (from December 2025) remains valid for the rest of the year – and thus does not anticipate a significant catch-up in the net financing requirement, which YTD is just over DKK 40 billion lower than implied by the December forecast, the net position is on track to end 2026 at DKK 320-330 billion.
  - Experience in recent years shows that a catch-up is by no means a given.
- It is not insignificant whether the net position ends 2026 at DKK 350-360 billion or DKK 320-330 billion, and interventions in the FX market by Danmarks Nationalbank could reduce it further.
  - In August, the net position has, for instance, fallen by about DKK 5 billion more than expected, which we believe can be attributed precisely to intervention(s) in the FX market.

Net Position and Daily Forecast

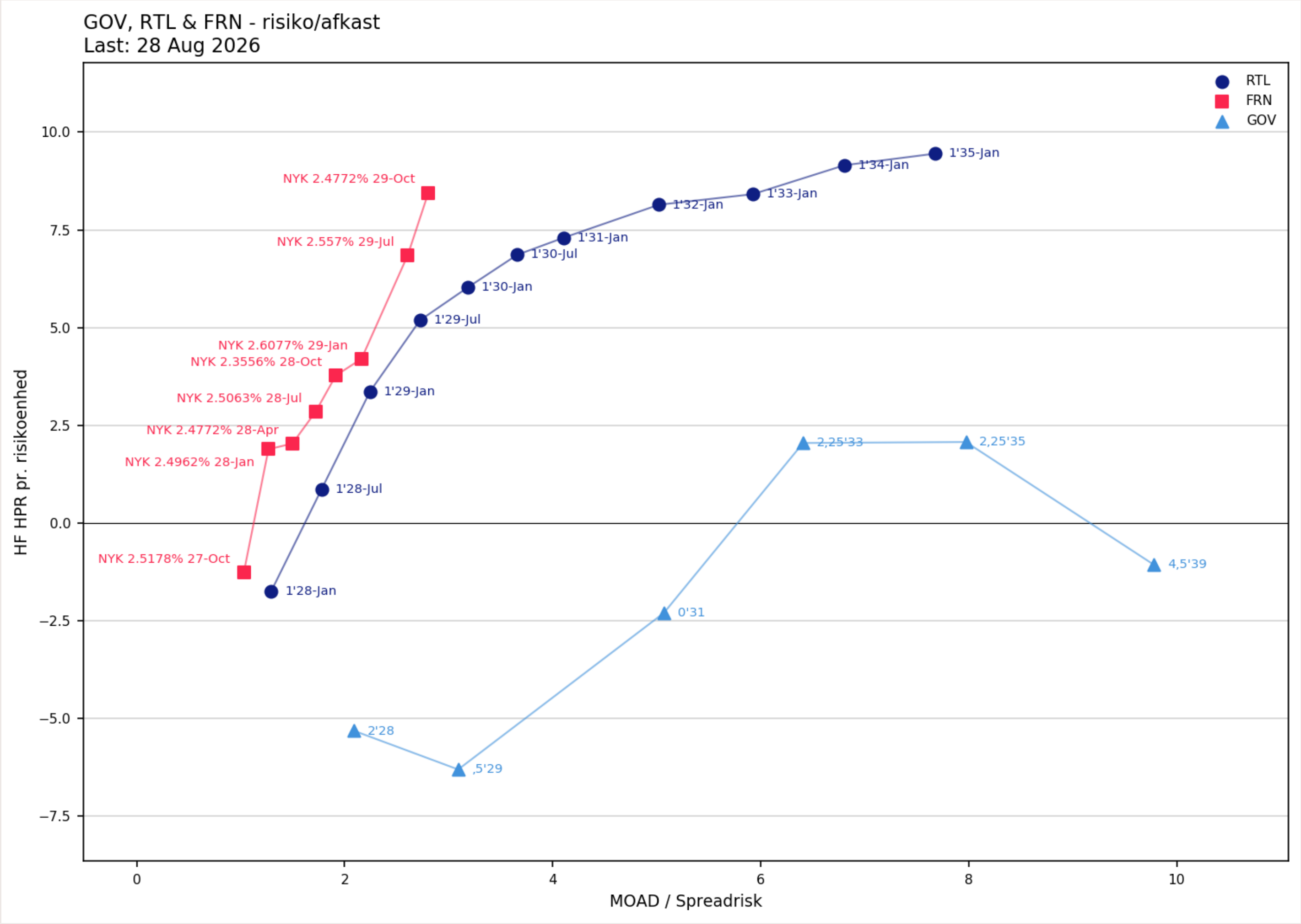


Net Position and Forecast for 2026 and 2027



Where it the greatest value?

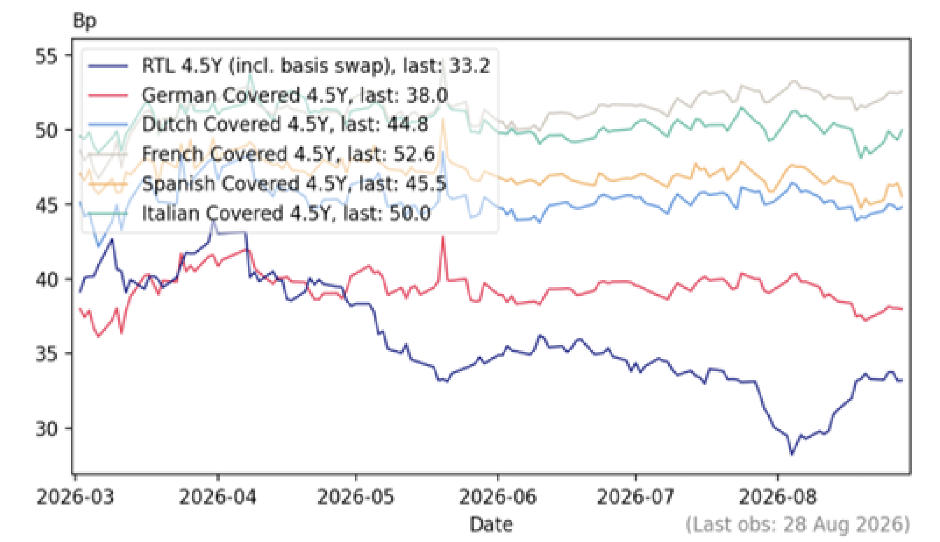
- The chart shows the hedged and funded (HF) return for FRNs, bullets and government bonds adjusted for duration.
- The chart assumes an identical repo rate for all three types of bonds.
- Especially the longest FRNs offer H&F investors an excess return compared with bullets.
- DGB33 and DGB35 are currently the most attractive, and this is also where foreign investors are primarily showing interest in DGBs.
- Following spread widening between FRNs and bullets during the summer, the spread has generally tightened again in August.
- However, short-dated FRNs have underperformed bullets marginally.



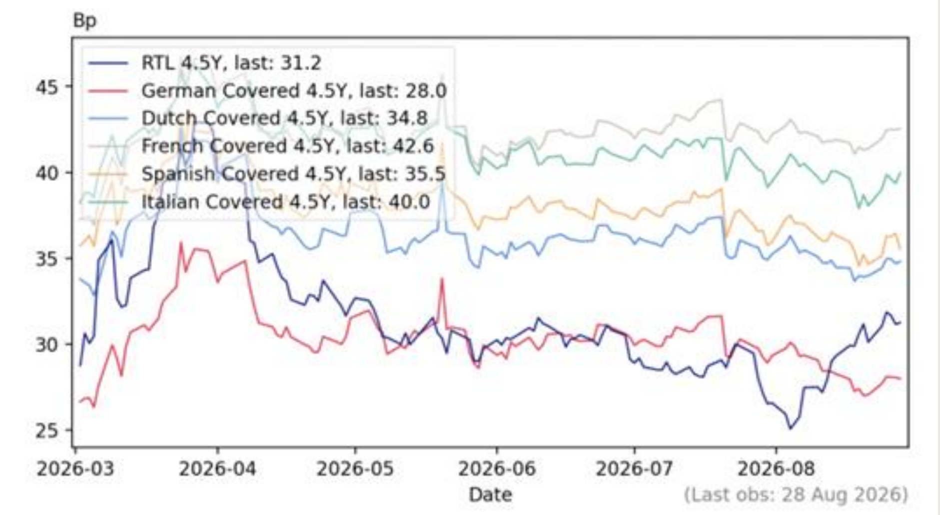
Relative pricing

- To assess the relative pricing of bullets, we typically compare them with EUR covered bonds.
- At the same time, we look at the government-mortgage bond spread between DBR and the covered bond spreads in the various countries.
- Both charts show an increasingly rich pricing of Danish bullets over the spring and summer, with spreads bottoming out at the end of July.
- Since then, Danish bullets have lost about 5bp relative to both swaps and government bonds.
- Thus, the current pricing is somewhat less stretched as it was a month ago, although Danish bullets can hardly be considered cheap.
- Given the liquidity outlook for the remainder of 2026, the pricing currently appears broadly fair.
- On Wednesday, 2 September, Danmarks Nationalbank will publish data on the currency reserve and any interventions in August. The market will thus gain greater certainty as to how far we are from a unilateral Danish interest rate hike.

Bullets and EUR covered bonds: Spreads vs ESTR



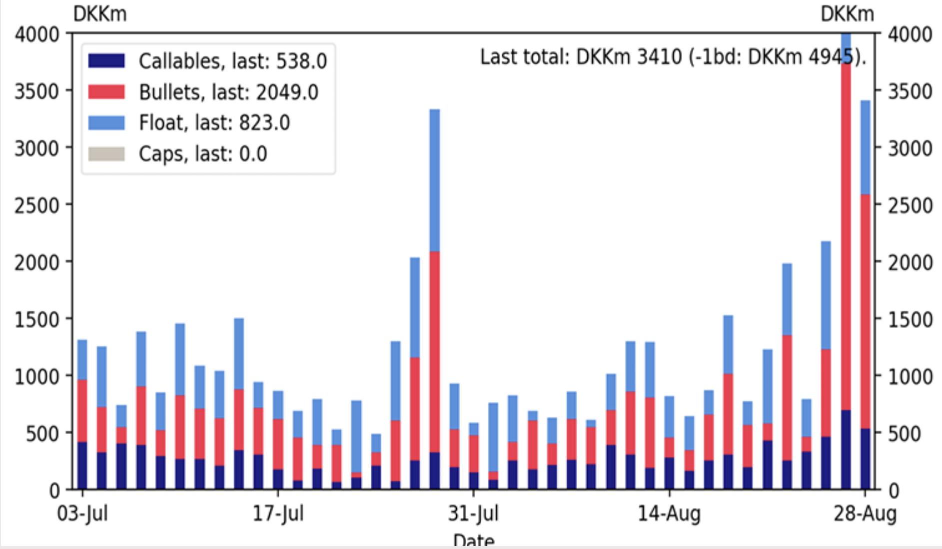
Bullets and EUR covered bonds: Spreads vs DGB/DBR



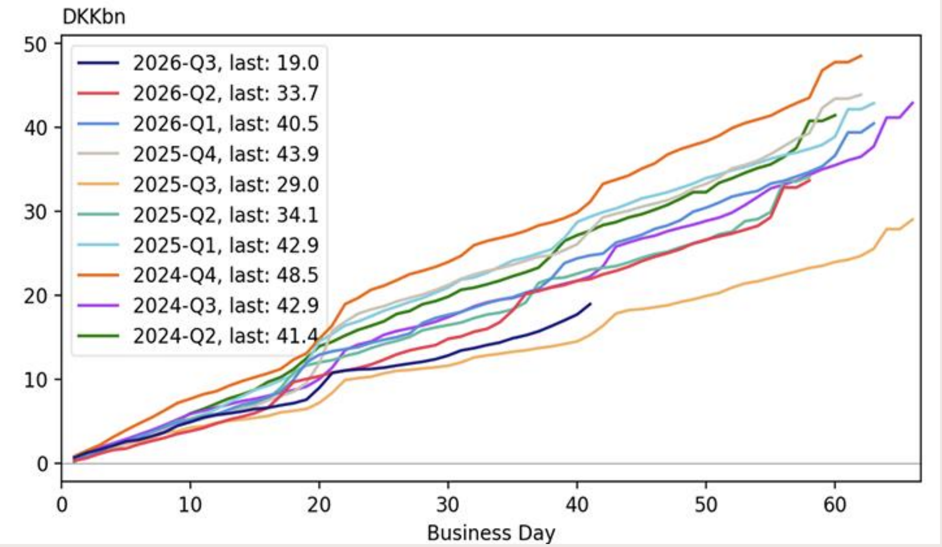
Is issuance back from the summer holidays?

- Daily issuance appears to have picked up during last week.
- Naturally, bullet issuance last week was chiefly driven by the auction offering. However, issuance of both callables and FRNs rose somewhat from the otherwise low levels we have seen over the summer.
- The daily issuance of callables last week was about DKK 500 million per day, up from around DKK 100-200 million.
- Some of this is likely attributable to last week effectively being the final opportunity for issuance in 4'56 (apart from today, which would require T+0 settlement).
- It seems likely that the issue of callables may tick down slightly again.
- The FRN issuance also rose to around DKK 800 million per day, about a doubling from what has been the case over the summer.
- It is not our expectation that the FRN issuance will rise significantly from here.
- We still expect the daily issuance to total around DKK 1.5-2 billion per day.
- Accordingly, we expect bullet issuance in the coming weeks to be around DKK 600-800 million per day.

Daily issuance (OMX)



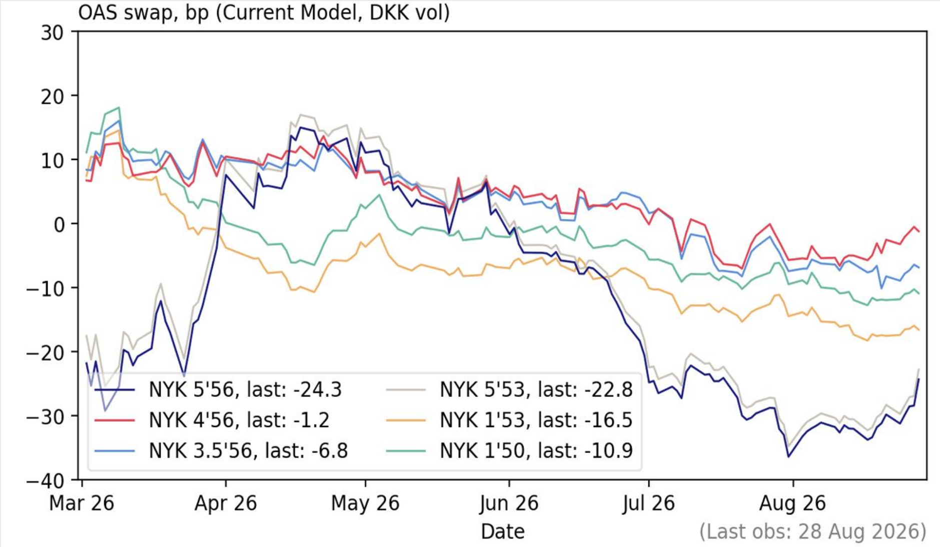
Callables: Iss. Net of Refi Auctions (CIRMIL)



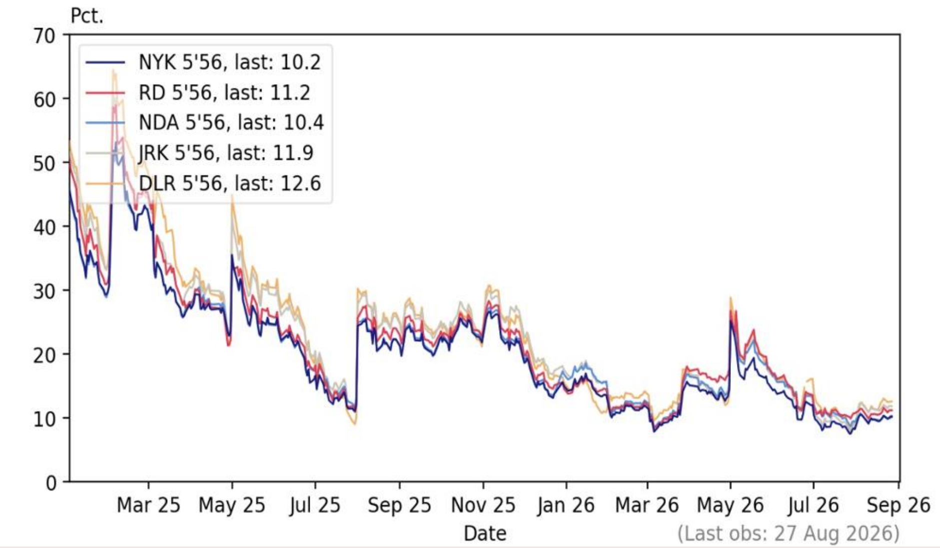
Another poor week for 5% callables

- 5% bonds continued to lose ground in OAS terms last week
- Although 5% bonds have lost just under 8bp vs swaps over the last two weeks, this has only brought them back to about the same spread levels as at the beginning of July, and the strong performance we saw throughout June has thus not been reversed.
- We continue to interpret the spread widenings as a reaction to the opening of a 5'59 IO drawing closer.
- However, the yield still needs to rise at least 30bp for 5'59IO to come into play.
- Breakeven prepayments against duration-equivalent bullets are virtually unchanged despite the spread widening in 5% bonds, as short-dated bullets have likewise lost ground in recent weeks.
- Overall, we see a greater probability of further spread widening in 5% bonds than the opposite.
- 4'56 also lost a little ground over the past week, probably due to the additional issuance.
- Lower issuance should be able to give them some tailwinds relative to other coupons this week.

30Y callables: OAS swaps



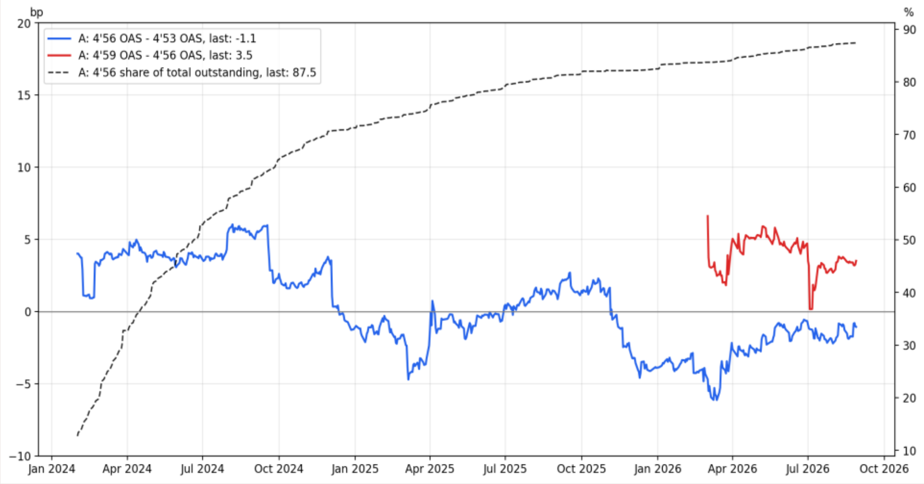
Break Even Prepayments vs MOAD Eq Bullets



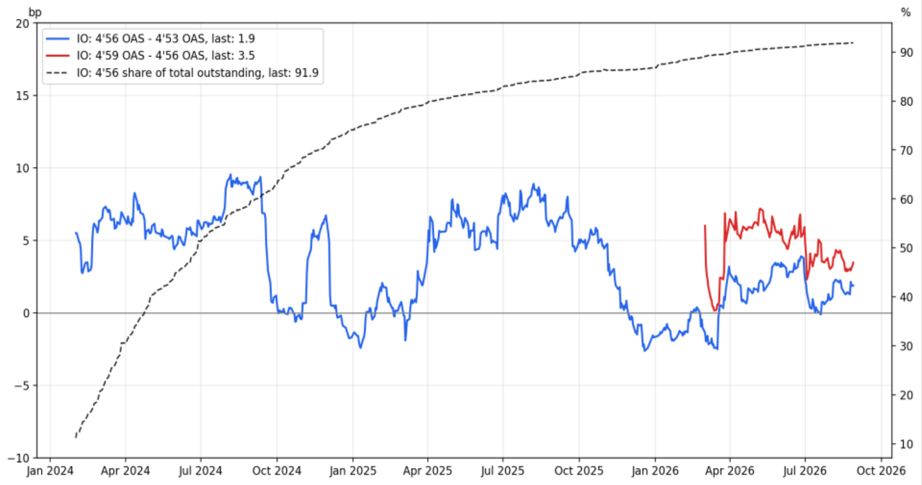
Change of maturity class from 4'56 to 4'59

- Tomorrow, issuance in 4'56 will close, after which all new issuance will take place exclusively in 4'59.
- NYK 4'59 still consists of very small series, with approx DKK 0.9 billion in non-IO and DKK 0.3 billion in IO, compared with DKK 107 million and DKK 53 billion, respectively, in NYK 4'56.
- Given the current pace of issuance, it will take up to two years before these series approach each other in size.
- 4'59 is currently trading 3-4bp higher in terms of OAS than 4'56, and we do not expect this spread differential to disappear in the short term. 4’56 will therefore, with all probability, remain the benchmark and most liquid series for quite some time yet.
- The experience from 4'53/4'56 provides a useful guide for the maturity class spread. During the build-up of the 4'56 series, the spread was predominantly around 1-5bp, while the IO spread was more volatile.
- We therefore see 1-5bp as a reasonable neutral range. Above 5bp, we prefer 4'59, while below 1bp, we prefer 4'56.

Maturity class spread and relative series volume – non-IO



Maturity class spreads and relative issuance – IO



Foreign investors want government bonds and long-dated bullets/FRNs

- Foreign investors reduced their portfolio of bullets and FRNs in July.
- The reasons are the following:
  - Maturities of DKK 8.8 billion and DKK 4.5 billion, respectively, of bullets and FRNs on 1 July.
  - Active sell-off of DKK 4 billion of bullets and DKK 2.9 billion of FRNs.
- The sell-off has been centred around short maturities.
- Foreign investors continue to buy 3-year FRNs and 5Y bullets.
- The buying of 3Y FRNs is likely driven by the higher FRN-bullets spread at the 3Y point in July.
- We attribute the buying of 5Y bullets to the higher hedged and funded return per unit of spread risk in longer maturities relative to short maturities.
- Foreign investors continue to buy Danish government bonds.
- Their portfolio rose by DKK 3 billion in July and has increased by DKK 35 billion over the course of 2026, from DKK 175 billion to DKK 210 billion.
- Their ownership share rose by 4.7pp in 2026 to 36.3%, the highest level since the end of 2014.

FRNs+CF & bullets: Nominal monthly changes

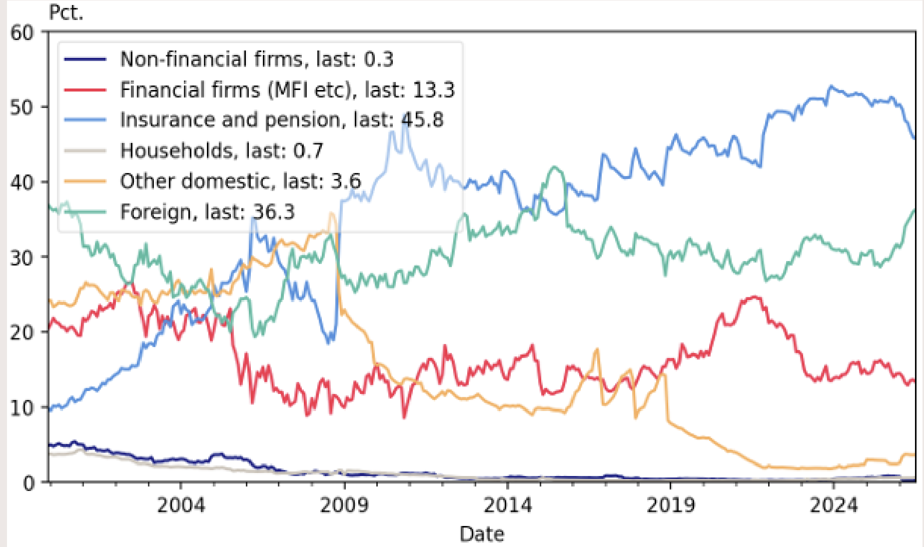
FRN+CF: Foreign sector nominal holdings monthly change

Bond type	2026-Jul	2026-Jun	2026-May	2026-Apr	2026-Mar	2026-Feb	2026-Jan
1Y	-5.3	-2.6	-4.7	-6.9	0.4	-7.8	0.7
3Y	2.9	3.2	11.2	0.0	1.7	14.0	3.3
5Y	-0.6	1.7	10.4	0.3	-0.3	0.0	1.2
5Y+	0.1	-0.1	0.0	0.1	-0.1	0.0	0.0
Total holdings monthly change	-3.0	2.1	16.9	-6.4	1.7	6.2	5.3

RTL: Foreign sector nominal holdings monthly change

Bond type	2026-Jul	2026-Jun	2026-May	2026-Apr	2026-Mar	2026-Feb	2026-Jan
1Y	-6.1	1.5	-13.5	-10.9	-7.7	8.1	-6.6
3Y	-2.2	1.3	2.6	0.4	-2.1	9.9	0.6
5Y	4.2	4.5	7.2	0.8	6.3	10.0	0.7
5Y+	0.0	0.1	0.1	0.3	0.0	0.0	0.1
Total holdings monthly change	-4.1	7.4	-3.6	-9.5	-3.4	27.9	-5.2

Danish government bonds: Ownership interest



Recommendations

- Our recommendations have generally had a good week.
  - Our recommendation(s) of 4% callables vs a barbell of 5% and 1%, mainly due to the 5% callables having had a tough week.
  - Our recommendation of 5Y bullets vs 3Y bullets (swap-hedged) has moved into the money due to last week's flattening of the bullets-DESTR spread curve. We do not see much further performance potential, and close the recommendation.
- Our recommendation of German covered bonds vs 5Y bullets (including basis swap) lost a little ground last week
  - However, we still do not expect that the current relative pricing of 5Y bullets can be maintained in the slightly longer term. We maintain this recommendation.
- We close our recommendation of 5Y bullets + swap/swaption overlays, which has moved into the money following the recent underperformance in callables (see bottom chart).
  - We see less potential for relative performance in 5Y bullets vs callables from here.
  - The two proposed overlays (EUR1Y10Y swaption or EU051030 swap barbell) have worked well.

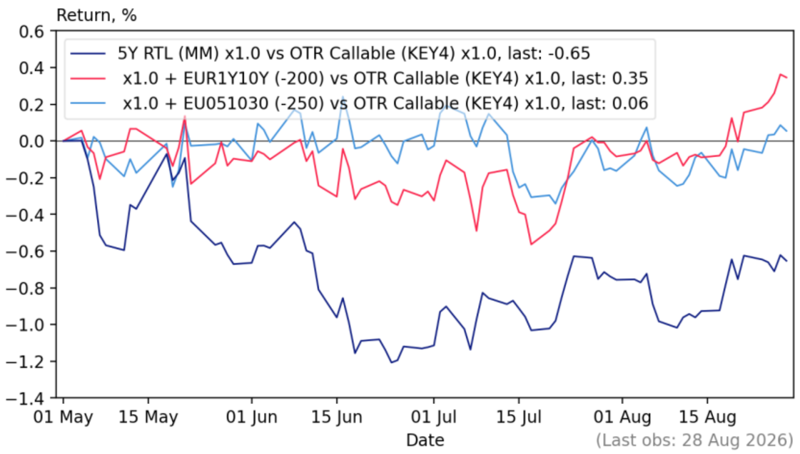
Current recommendations

Opening date	Name	Return 5bd	Total return
2026-06-01	RD 4'56IO vs NYK 4'56IO	-0.00	0.01
2026-06-15	DGBi'34 vs DGBi'30 (BOX)	0.03	-0.78
2026-06-26	RTL5 vs RTL3	0.05	0.04
2026-07-07	4'56 vs 1'50 & 5'53	0.11	-0.56
2026-08-21	3Y FRN vs RTL	0.02	0.01

Outlook recommendations

Opening date	Name	Return 5bd	Total return
2025-08-25	CITA vs CIBOR 3M FRN	-0.01	-0.02
2025-11-27	CIBOR 6M vs CIBOR 3M FRN	0.00	0.13
2026-01-15	NYK 4'56 vs RD 5'56 + JRK 1.5'53 IO	0.10	-1.15
2026-01-26	4'56 vs RTL5	0.01	0.22

Recommendation: 5Y bullets + overlays vs OTR callables



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Recommendation	
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Sell	50%

As at 13.12.2024
Note: Distribution of our recommendations, which therefore add up to 100%.

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