

FRNs, bullets, callables

– hard to decide which is more expensive?

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Marketing communication

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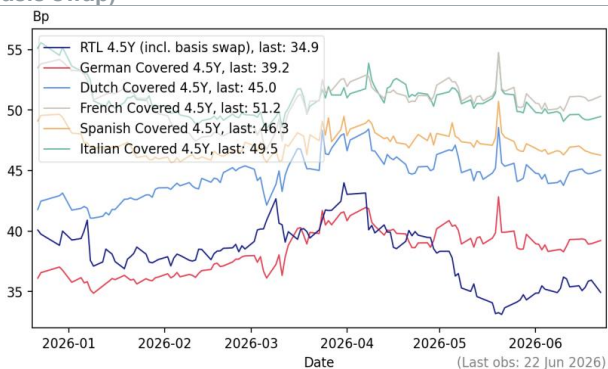
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- Bullets appear expensive, likely underpinned by liquidity and outright yields, albeit we're concerned about spread widening
- FRN-bullets spread balanced against issuance, prospect of steady FRN maturities over the next years should support the spread
- Callables could be in for a few good weeks if volatility continues to decline, but we expect OAS widening over time.

It seems that a peace agreement between the US and Iran may be near. Against this backdrop, we take stock of the current pricing of Danish covered bonds, discuss our spread forecast from here, and assess whether there is any room left for further peace-driven performance. We prefer bullets, including swap overlays, over callables, FRNs over bullets, 5Y bullets over 3Y bullets, and EUR covered bonds against bullets (including basis swap).

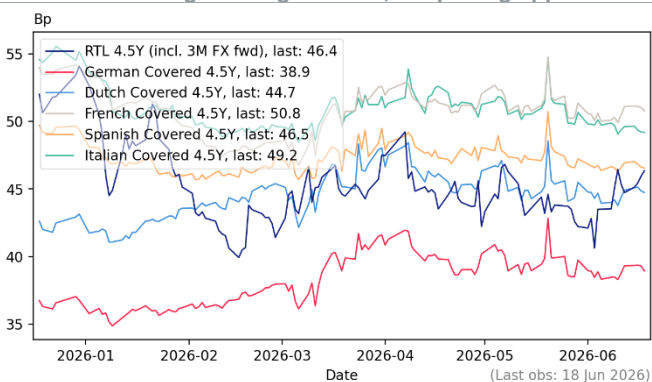
Bullets seems expensive against EUR covered bonds (incl. basis swap)



Shows spreads to ESTR of Danish bullets and European covered bonds.

Source: Bloomberg and Nykredit Markets

If FX risk is managed using FX fwds, the pricing appear fair!



YCS of 4.5Y bullets, incl. 3M FX fwds against YCS of equivalent German CB

Source: Bloomberg and Nykredit Markets

A war in the Middle East, now perhaps over, combined with a rate hike from the ECB/Danmarks Nationalbank, and yet swap spreads of callables, bullets and FRNs have tightened since the end of February. Does this mean that Danish covered bonds as a whole have become expensive? Is the pricing sustainable? Is there room at all for further peace agreement-driven performance?

Bullets look relatively expensive – or do they?

4.5Y bullets normally offer a higher pickup than German covered bonds when viewed against ESTR, including maturity-matched basis swap. Since early May, bullets have, however, traded at a higher price than German covered bonds according to this measure, see top chart. At the same time, bullet spreads to DGB have also tightened relative to German covered bonds to DBR. The immediately expensive relative pricing applies across the curve – but especially at the three-year point. Similarly, a hedged and funded investor would have been able to achieve a better return in Swedish bostäder. In our view, the currently high pricing is driven by a combination of higher outright yields and liquidity abundance.

Looking at bullets vs German covered bonds via a 3M FX forward (rather than a maturity-matched basis swap), gives a slightly different picture. In this comparison, 4.5Y bullets have offered roughly the same pickup vs German covered bonds since early March, as shown in the bottom chart. The difference between the two charts is driven by the increased pickup in 3M FX forwards (also relative to DEST-ESTR) that we have seen since the beginning of May, where the net position again exceeded DKK 300 billion. The increased pickup in 3M FX forwards also appears to have spilled over into the pricing of government bonds and callables.

Taken together, the two charts suggest that, over the period shown, the relative pricing between bullets and German

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covered bonds has shifted from being determined on the basis of a basis swap to being driven by a 3M FX forward. The catalyst for such a shift may have been the rise in rates we saw in March following the outbreak of the war in the Middle East. These yield rises – and especially the flattening of the yield curve – have certainly left their mark on the DESTER spreads on short-dated vs longer-dated bullets, see below.

There are indications that the trend in rates has also triggered a shift in the marginal investor in longer-dated bullets, increasing the importance of short-dated FX forwards for pricing. In any case, both the trend in outright yield levels (including the slope of the curve) and the pickup in short-dated FX forwards (driven by the liquidity situation) are expected to be key for pricing in the coming period.

Bullets vs Bostäder

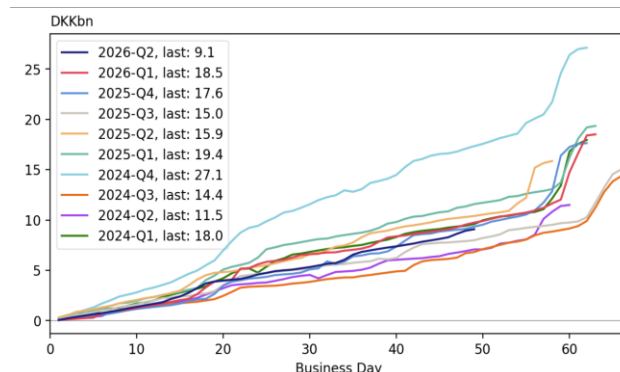
Danish bullets have recently looked expensive relative to Swedish bostäder. However, the performance of bostäder relative to bullets over the past week have reduced the excess return of Swedish bostäder, making it more vulnerable to changes in the funding rate. At present, a Swedish bostäder with a spread risk of 2.7 offers just over 6bp more in hedged and funded return than a Jul'29 (spread risk of 2.9), assuming a funding rate of STIBOR +10bp and DESTER +27bp, respectively. Further out on the curve, the difference is smaller, and a Jan'31 now offers only 3bp less than an equivalent bostäder with a spread risk of 4.3 for Jan'31 vs 4.1 for the bostäder. Although the excess return has narrowed, Danish bullets do not exactly come cheap compared with bostäder, and shorter-dated bullets in particular could still underperform without becoming cheap relative to bostäder.

3Y bullets vs 5Y bullets

We have long thought that 3Y bullets have looked expensive relative to longer-dated bullets. We expected the bullet-DESTER spread curve to flatten again as a result of lower 5Y issuance. However, the flattening of the outright yield curve has increased the demand for shorter-dated bullets, and so far, we have only seen further steepening of the bullet-DESTER spread curve compared with the beginning of 2026, as shown in the upper right-hand chart.

At the same time, 3Y bullet issuance remains low and took another dip in Q2, while 5Y bullet issuance has not fallen by as much as we had expected, see more [here](#). 5Y bullet issuance for Q2 is currently only slightly lower than in Q1 and therefore remains high. If our expectations of end-of-quarter bullet issuance of DKK 7-9 billion prove correct, with more than half in 5Y bullets, 5Y bullet issuance for the quarter will end at DKK 34-36 billion. That would be a modest decline from Q1, which saw just under DKK 40 billion of 5Y bullet issuance, but still a high level. This suggests that more borrowers are choosing 5Y bullets over 3Y bullets, probably as a result of the uncertainty caused by the war in the Middle East. Despite a peace agreement, we believe that more lasting calm in financial markets (and possibly a steepening of the yield curve) is needed before borrowers regain their interest in 3Y bullets to any great extent.

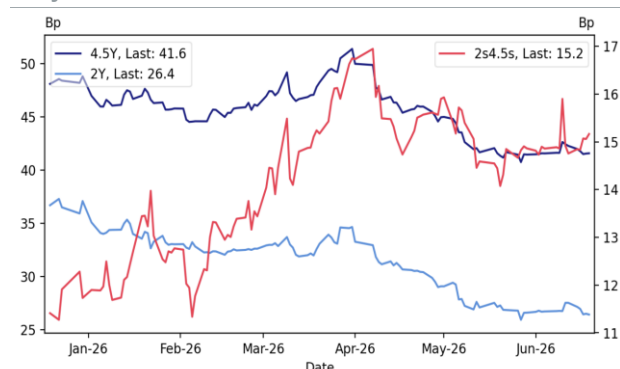
3Y bullet issuance fell in Q2



Shows accumulated 3Y bullet issuance based on changes in outstanding amounts.

Source: Nykredit Markets

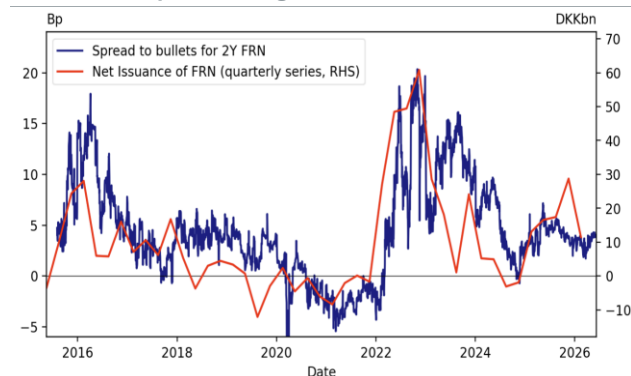
The bullet-DESTER curve has steepened since the start of the year



Shows bullet spreads vs DESTER, including 2s4.5s.

Source: Nykredit Markets

FRN-bullets spread is aligned with FRN issuance



Shows FRN issuance vs bullet spread for a generic 2Y FRN.

Source: Nykredit Markets

So: Net position or yield curve?

The net position is set to rise further to a level of DKK 330-360 billion in the second half of 2026, so liquidity abundance looks likely to persist for now. Thus, the tailwinds of the additional pickup in short-dated FX forwards may continue for some time yet. In the meantime, we think that the most likely outcome, provided the peace agreement becomes permanent, is a partial normalisation of outright yields. Nevertheless, the latest ECB rate hike means that the short-dated outright yields are unlikely to return all the way to their pre-war starting point any time soon

This suggests that the slope of the bullet-DESTTR spread curve is unlikely to flatten to this level, contrary to what we expected at the beginning of the year. Given the current slope of the bullet-DESTTR spread curve, however, we see a greater probability of flattening than the opposite, although the extent is likely to be limited. At the same time, 5Y bullets offer slightly more hedged and funded returns than 3Y bullets, owing to the roll-down in 5Y bullets. If choosing between 3Y bullets and 5Y bullets, we prefer 5Y bullets. Overall, we expect the entire bullet curve to widen.

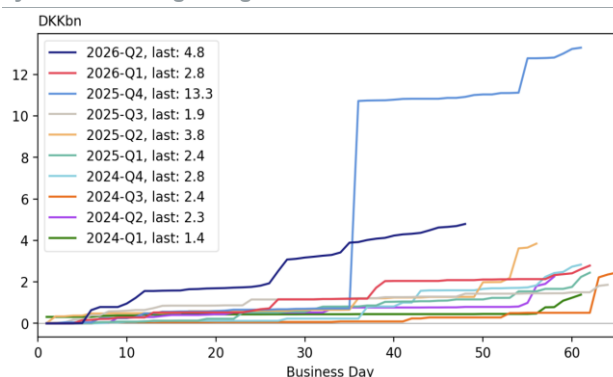
FRN-bullets spread is aligned with issuance

FRNs have tightened alongside bullets, and if one considers bullets expensive, then FRNs are expensive as well. The FRN-bullets spread, however, appears to be aligned with issuance, while FRN maturity over the next two years is also expected to be distributed more evenly (see more [here](#)). This points to a more stable FRN-bullets spread.

Conversely, ongoing FRN issuance has increased in Q2, primarily as a result of higher issuance of CIBOR3M FRNs, although issuance of CIBOR6M and CITA 6M FRNs has also risen since Q1. In terms of issuers, the increase in FRN issuance has come from RD, NYK and JRK. RD and NYK still account for the largest share of issuance, but the biggest increase in FRN issuance is found in JRK, albeit from a very low starting point, as shown in the top chart. Comparing JRK's accumulated FRN issuance in Q2 with the equivalent point in the previous quarter, that is, before the end-of-quarter issuance, their FRN issuance has risen by around DKK 3 billion. This is roughly the same increase as seen in NYK's FRN issuance, with NYK remaining the largest FRN issuer. The increase in JRK's FRN issuance has come at the expense of their bullet issuance, which has decreased by approximately the same amount. This suggests that JRK's new product, Jyske Frihed, is being funded with CIBOR 3M FRNs.

The question is whether JRK's FRN issuance can continue to rise sufficiently to put pressure on the FRN-bullet spread going forward. For now, we are less concerned about this. Even if all of JRK's 1Y bullet issuance comes as FRN issuance in future, this would add DKK 6-8 billion to FRN issuance, which should not lead to more than 1-2 bp of widening in the FRN-bullets spread (based on the historical relationship). However, if there is a shift from 1Y bullets to FRNs at future refinancing auctions, the effect could be larger. At the October payment date, JRK has about DKK 20 billion maturing in 1Y bullets (and subsequently almost DKK 24 billion at the January payment date),

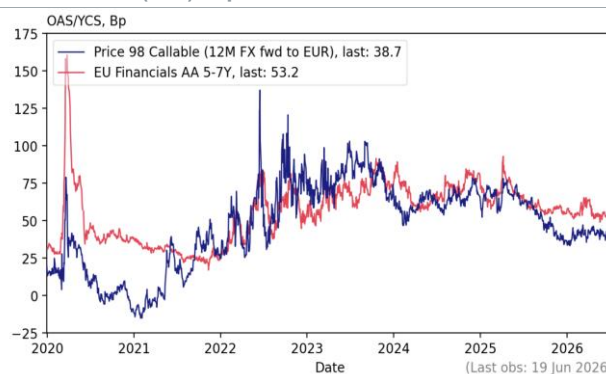
Jyske Frihed is gaining solid traction



Shows JRK's accumulated FRN issuance by quarter, excluding refinancing offering, based on outstanding amounts.

Source: Nykredit Markets

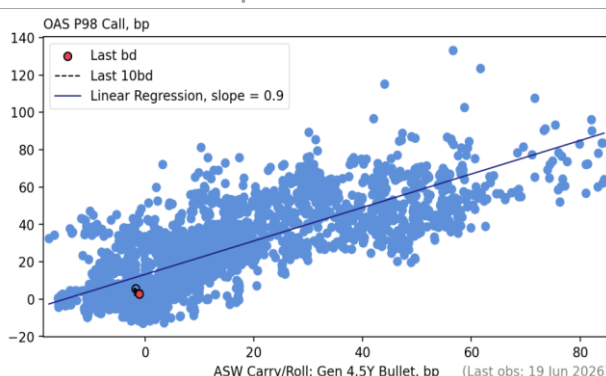
Callables are (still) expensive vs EU financials



Shows swap spreads on callables and European credit bonds.

Source: Nykredit Markets

Callables are on the expensive side vs bullets



Shows OAS of OTR callables vs ASW carry/roll-down on 5Y bullets.

Source: Nykredit Markets

and a decent share of this could potentially end up being re-financed with FRNs.

For now, FRN issuance for Q2 looks set to land a couple of billion Danish kroner higher than Q1, and, as mentioned, that issuance level is well-aligned with the current spread.

Callables may benefit from vol, but that is about it

The peace agreement should bring volatility down further, which is positive for callables. We therefore expect callables to gain in price over the coming weeks, and they have already risen notably since last Sunday.

We are more sceptical about whether there is OAS performance potential in callables. First, we struggle to see why the peace agreement should generate OAS performance. Callables have maintained a stable OAS level throughout the entire war so there is no obvious OAS normalisation potential. At the same time, callables still look expensive relative to European senior financials – as they have since last autumn – and they are also slightly expensive relative to longer-dated bullets.

We have previously pointed out that one of the reasons for the expensive relative pricing of callables has been the negative net growth in the segment. However, as projected, this has moderated this year, with negative net growth in Q1 of around DKK -3 billion and Q2 looks set to land at roughly the same level. There is therefore no longer the same mismatch between issuance and reinvestment need that we saw last year, when negative net growth ranged from DKK -6 to DKK -16 billion per quarter. So, while low issuance may still buoy up the callables segment (and the risk from large refinancing into lower coupons from 5% bonds is more or less gone), we think it plays a smaller role than it did last autumn. Issuance of callables has also fallen further in H1 2026, probably as a result of the higher yield level. If yields decrease slightly again, callable issuance could also recover somewhat.

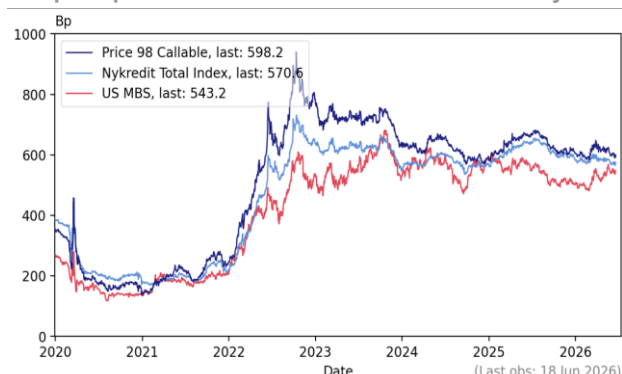
In addition to the fairly large negative net growth in the segment last autumn, we also saw foreign holdings of callables increase for the first time for an extended period. This happened during a period when the pickup on callables vs US MBS had risen notably (see the bottom chart on the page). Part of that pickup has since disappeared again, and the foreign ownership share in callables has also fallen back to the same level as last summer. Last week's yield increase has further reduced the pickup, which may put an additional damper on already modest foreign demand.

Conclusion

We believe callables could have some good weeks – if the ceasefire is negotiated into an actual peace agreement – on the back of volatility normalisation. However, we also believe that Danish covered bonds are due a price correction.

We expect a permanent peace agreement to lead to lower outright yields, which should generally result in spread widening. However, we doubt that the slope of the outright yield curve will return to its pre-war level. We believe that tap issuance will continue to include a fair amount of 5Y bullets and not many 3Y

The pickup on callables vs US MBS has fallen this year



Shows yields on US MBS and Danish callables (including 3M FX forward into USD).

Source:

bullets. We therefore do not expect the bullet-DESTR curve to flatten much in the near future – and certainly not beyond what we saw at the beginning of the year – and have therefore closed our recommendations from January of both 5Y bullets vs 1Y bullets and 5Y bullets vs 3Y bullets out of the money.

At current levels, however, we prefer 5Y bullets over 3Y bullets due to better roll-down, and we believe the probability that the bullet-DESTR spread curve flattens by a few points from here is greater than the opposite. We are therefore opening a new recommendation of 5Y bullets vs 3Y bullets – mainly as a carry case and secondarily based on a modest performance potential.

We expect the entire bullet curve to widen, so that bullets once again will trade above German covered bonds in both government and swap spreads, including basis swap. Accordingly, we recommend 4-5Y German covered bonds vs 4-5Y Danish bullets.

We expect callables to underperform bullets in OAS terms in order to restore balance in relative pricing. We therefore prefer bullets, including swap overlays, to replicate the performance potential in callables from a normalisation of volatility. Where investors are unable to add swap overlays to their bullets, we lean towards callables, owing to the price potential from a decline in volatility.

We think the FRN-bullets spread appears to be aligned with issuance, and we doubt that issuance will rise sufficiently to alter this materially in the near term.

If JRK continues to increase its FRN issuance at the same pace in coming quarters, this could potentially put some limited pressure on the FRN-bullet spread. However, we do not see this as a significant risk, and we do not see the spread impact exceeding 1-2bp in that scenario.

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