Liquidity tailwinds have reversed

Outlook for modest headwinds for bullets

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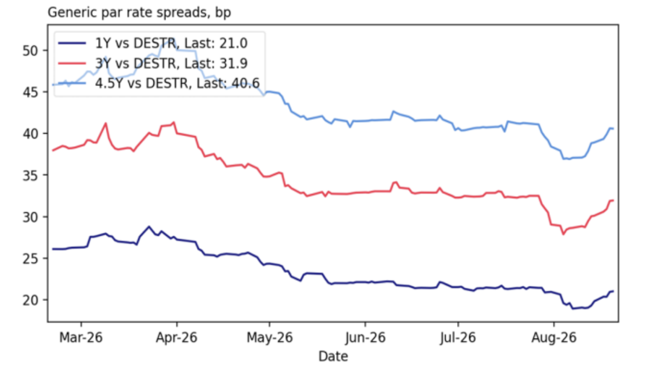
- After peaking at around DKK 375bn in the first half of August, the net position is moving lower again
- The (modest) liquidity headwinds could push bullet spreads vs DESTR 2-5bp wider over the coming weeks
- We prefer longer-dated FRNs to bullets, at least as long as they are available at a discount of ≥5bp to the bullet curve

Bullets have now given back virtually all of the outperformance seen in late July and early August. Issuance and liquidity developments have likely been contributing factors. Looking ahead, the liquidity outlook suggests further modest headwinds for bullets, which could be amplified should Danmarks Nationalbank need to intervene in the FX market to support the Danish krone. At current levels, we prefer longer-dated FRNs to bullets and are (re)opening our recommendation to be long 3Y FRNs vs 3Y bullets.

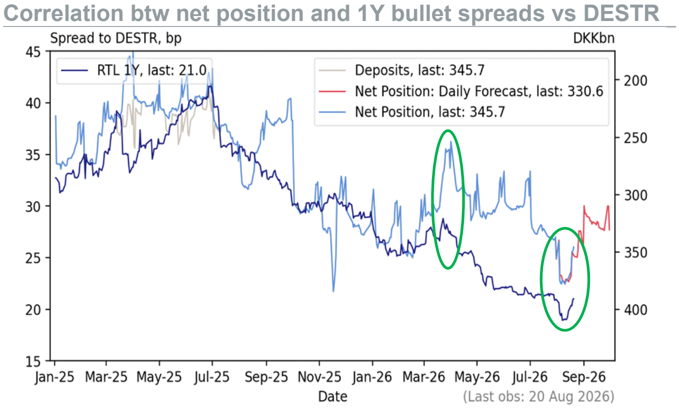
Bullets once again give back recent outperformance



Shows par rate spreads for generic 1Y bullets.

Source: Nykredit Markets

Correlation btw net position and 1Y bullet spreads vs DESTR



Net position (light blue line) is shown on the inverted right-hand axis.

Source: Danmarks Nationalbank, Bloomberg and Nykredit Markets

Bullets: Back to square one!

Bullets have now given back virtually all of the outperformance vs DESTR recorded in late July and early August.

While several factors likely contributed to that outperformance, two of the most important were the low level of issuance and the increase in the net position from around DKK 310bn in May to approx DKK 375bn in the first half of August.

The recent underperformance of bullets may be linked partly to the net position having started to decline again (currently standing at around DKK 350bn), and partly to the recent pickup in issuance activity. The latter is largely driven by the ongoing refinancing auctions, although regular issuance activity also appears to be returning following the summer holiday period.

Liquidity and short-dated bullets

The impact of the net position on spreads is particularly evident for shorter-dated bullets. The lower-left chart shows the spreads vs DESTR for a generic 1Y bullet bond (dark blue line, left-hand axis), the development in the net position (light blue line, inverted right-hand axis), and the latest daily liquidity forecast (red line, inverted right-hand axis).

The chart highlights a clear overall correlation between the net position and 1Y bullet spreads up until March 2026. Thereafter, the two curves diverge to some extent (possibly reflecting a flattening of the yield curve). However, when the net position fell in late March, and especially when it peaked in early August, it continued to leave a clear mark on spread developments (see the two circles). This is also illustrated by the fact that the latest performance in 1Y bullets occurred somewhat later than in 3Y-5Y bullets (see the upper chart) and only after the net position received another upward boost in early August.

Net position set to decline in the coming weeks

The key point now is that the net position has further to fall. Between now and early September, the net position is projected to fall from currently around DKK 345bn to approx DKK 310bn, while it is currently expected to end the year at around DKK 320bn. Based on historical experience, this would, all else equal, suggest a further 2-5bp widening of short-dated bullets vs DESTR over the coming weeks.

In addition, any large-scale interventions by Danmarks Nationalbank aimed at supporting the Danish krone would reduce the net position relative to the current forecast. So far, we have only seen very limited intervention in June (DKK 700m) and none in July. However, there is a possibility that interventions could resume in August.

What about longer-dated bullets?

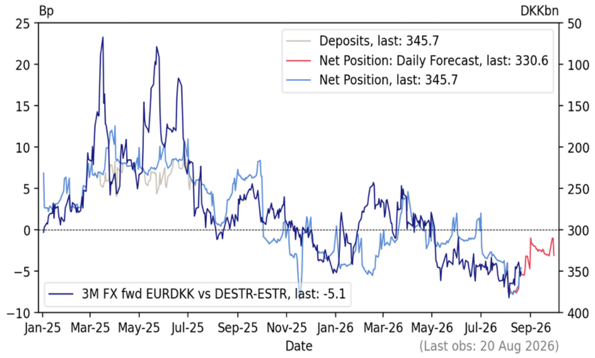
The net position also affects the pricing of longer-dated bullets, partly through FX forwards. There has been a tendency for the implied interest differential between DKK and EUR in short-dated EUR/DKK FX forwards to exceed the difference between DESTR and ESTR (dark blue line in the upper chart) when liquidity has been scarce (light blue line, inverted right-hand axis) – and vice versa when liquidity has been abundant. Put differently, abundant DKK liquidity provides an additional pickup from buying Danish bullets rather than EUR-denominated bonds when short-dated FX forwards are used either to hedge FX risk or to obtain funding. Conversely, low liquidity results in an additional cost.

Since February, 4.5Y bullets have been consistently priced in line with EUR covereds when their spreads vs ESTR are calculated using a short-dated FX forward (specifically 3M), see the middle chart on the right. As a result, the increase in the pickup available in 3M FX forwards since April has contributed to the outperformance of 4.5Y bullets vs DESTR during the period.

Previously (prior to the interest rate increases following the outbreak of the Iran conflict in late February), 4.5Y bullets were consistently priced in line with EUR covereds when their spreads vs ESTR were calculated using a maturity-matched basis swap. Consequently, their spreads vs DESTR were less sensitive to fluctuations in the additional pickup available through short-dated FX forwards. This shift in pricing dynamics, combined with the current pickup available in short-dated FX forwards, implies that 4.5Y bullets appear expensive relative to EUR covereds when compared using a maturity-matched basis swap, as illustrated in the lower chart.

The prospect of less abundant liquidity (see above) is likely to be reflected in the additional pickup available in short-dated FX forwards and could therefore also lead to some widening of the spreads of longer-dated bullets vs DESTR. In practice, we are probably talking about around 2-5bp in the near term. A return to the "old" pricing dynamics, where bullets are priced in line with EUR covereds using a maturity-matched basis swap, would also require around 5bp of spread widening vs DESTR. We already maintain an active recommendation of 4.5Y German covereds vs bullets (including a maturity-matched basis swap).

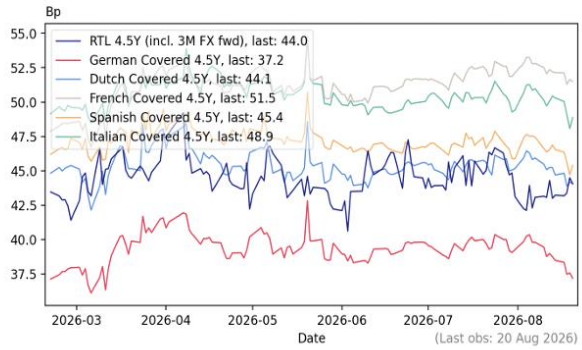
Correlation between net position and 3M FX forwards



The dark blue line shows the difference between the implied interest rate differential in the 3M EUR/DKK FX forward and DESTR-ESTR.

Source: Danmarks Nationalbank, Bloomberg and Nykredit Markets

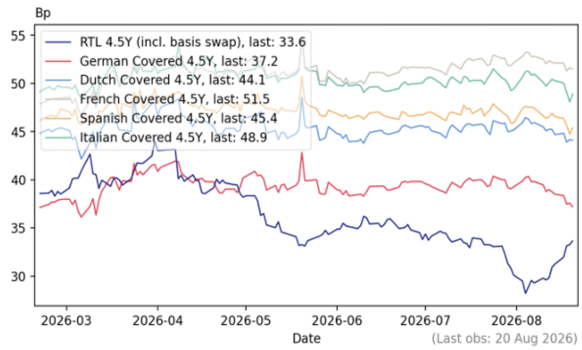
ESTR spreads: EUR covereds and bullets (via 3M FX forward)



Bullet spreads vs ESTR are calculated using a 3M FX forward.

Source: Bloomberg and Nykredit Markets

ESTR spreads: EUR covereds and bullets (via basis swap)



Bullet spreads vs ESTR are calculated using a maturity-matched basis swap.

Source: Bloomberg and Nykredit Markets

Nykredit markets

Net position in the slightly longer term

The expected year-end 2026 net position of just over DKK 320bn is almost identical to the level at which the net position ended 2025. Given the usual seasonal decline in the net position during Q1, the net position may therefore well fall to around DKK 250bn in early Q1 2027, implying the potential for further liquidity headwinds for both short- and longer-dated bullets. We will gain greater clarity later this month when the Ministry of Finance publishes updated forecasts for, among other things, the government's net financing requirement in 2026 and 2027 (and subsequently when a monthly breakdown of the 2027 forecast becomes available). As always, we will provide an update as soon as we know more!