

European Rates Weekly

Bund: Assessing Medium-Term Risks

- **Bund outlook:** We review our Bund forecast in light of Citi's new macroeconomic projections. Several risk factors argue for low(er) yields in the longer term, not least the increased probability of realizing a Japanese-type of scenario for the Eurozone. However, we're prepared to look through short-term shocks (including the FTQ-premium related to geopolitical risks in Ukraine). We continue to hold on to our 1.80% forecast for year end and for UST-Bund spreads to widen.
- **EUR vol – buy 6m forward 2s20s bear conditional flattener:** Curve risk stemming from excess liquidity dynamics and ongoing macro hazards can be hedged cheaply in option space given attractive implied volatility differentials.
- **Seasonal support for gilts:** Gilts are likely to benefit in the coming weeks from coupon and redemption money, APF reinvestments and light supply (especially in longs). Historical precedent also shows a tendency for gilts to outperform in March. The best way to capture this is by buying 30yr gilts vs Treasuries, in our view.
- **An abundance of SSA relative value opportunities:** The gyrations in the core government bond market have presented various opportunities to switch into (often better rated) SSAs. In particular we see relative value in the 3y-4r sector between Dutch agencies, German agencies and the EFSF vs France and the Netherlands.
- **Covered Bonds:** Spanish covered bond ratings have been boosted this week by Moody's. Will multi-cédulas follow? We look into underlying rating decisions, OC development and present some relative value opportunities.
- **EMU ratings outlook:** A wave of positive news by the rating agencies and Friday's rather heavy calendar has maintained a focus on EMU credit quality. We see positive momentum on various periphery ratings, including Portugal which we now believe will make a clean exit from its Troika programme.
- **EUREX calendar rolls (H4/M4):** We are bearish on the Bund, Bobl and BTP roll, slightly bearish on the OAT roll and neutral on the Schatz and Buxl rolls.
- **Technicals:** Bunds have broken their 3-week range and various indicators are bullish. We would be wary of any short positions here.. In gilts, a weekly close above 110.55 would form a double bottom and target 115, otherwise a sell-off might trace the rally back to 106
- **Supply:** Within Europe, next week's bond supply comes from Austria (€1.21bn), Germany (€4bn), France (around €8.5bn) and Spain (around €5bn). The UK DMO will issue £4.25bn of a conventional gilt 1.75% 2019 on Tuesday. There is no UST issuance until 11 March 2014.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. Strategy Summary Table

Europe	View	Strategies
Direction	Citi expects a refi cut of 15bp at the March meeting (next week). Inflation is likely to remain subdued and Bund yields low around 1.7% - 1.8% on average.	Buy the dips in Bunds
Money Market	We continue to like decoupling strategies with USD money markets. In the UK, short-sterling is closing in on levels at which we would consider re-establishing shorts (although flight-to-quality is dominating for now).	Remain short US vs Europe in the very front-end
Yield Curve	An attractive way to capture a decline in curvature in the front-end of the euro curve is to receive the belly of EUR 1y1y/3y1y/5y2y using -1:1.5:-1 weights as this trade offers positive carry and a short duration exposure. We recommend taking profits on EUR 5s30s fwd steepeners following the recent wave of core 30yr issuance. Expect BTP 10s to continue outperforming 5s and 30s over the coming weeks. In the UK, curves remain highly directional, led by 10s.	Receive belly of EUR 1y1y/3y1y/5y2y (using -1:1.5:-1 weights) Take profits on EUR 3y2y vs 5y25y (5s30s steepeners) BTP 10s30s steepener
Cross-market	Over the longer-term, we still expect Bunds to outperform USTs given the diverging policy/growth/inflation outlook. Gilts may benefit in the near-term from upcoming cash-flows and APF re-investments, but we would fade any gilt outperformance in 10s given longer-term fundamentals. However, in the long-end, the combination of LDI demand in the UK and supply pressures in the US should richen 15y15y GBP vs USD.	Receive 15y15y GBP vs USD Sell 10yr gilts vs USTs Stay short 10yr gilts vs Bunds Long Bunds vs UST (add on corrections)
EMU Spreads	Periphery market spreads have so far been largely immune from the wider risk-off tone indicating the growing importance of domestic factors as market drivers. A Renzi led Italian coalition is likely to be supportive for the BTP market for now, but over the longer-term we still expect Spain to outperform. Separately, on-going headline risk regarding Austrian banks is likely to weigh on RAGB spreads to Bunds & DSLs. We continue to expect Ireland to gravitate towards the soft core and remain short DSL 37s vs Bunds.	Sell 30yr Austria vs Netherlands Long Spain vs Italy Sell France vs Belgium and Germany (in either 5s or 10s) Sell 20yr DSLs vs Bunds Range trade 10yr OAT-Bunds (50bp/70bp)
Swap Spreads	We suggest tightening stops on swap spread widenings following recent moves. We would look to scale into 30yr Bund ASW widenings at 0bp or above as we expect this spread to remain range bound. In the UK, the 10yr sector looks very rich vs swaps vs the wings.	Hold long 5yr Germany vs swaps Scale into 30yr Bund ASW (Jul44) widenings if above 0bp
Inflation	Flight-to-quality is driving break-evens lower and there may also be some nerves ahead of the EMU HICP flash estimate on Friday. From a relative value perspective, we find 5yr BTPei rich both vs OATei/Bunde and on the domestic curve. In the UK, break-evens may suffer in the near-term given strong supports for conventionals from coupons and APF reinvestments.	Sell BTPei18 vs OATei18 break-even Sell BTPei19 vs BTPei17 and BTPei23 real yield Sell OATei22 vs OATei20 and OATei24 real yield Buy IL gilt 2017 break-even Buy IL68 vs IL44 break-even inflation
Volatility	Whilst black swans can, and indeed have, appeared to wreak havoc on carry trades (they showed up at least twice in 2013), we believe that long positions on receiver swaptions in the top left corner are the safest way to play the ECB at the current market juncture, given the limited downside and the current cheap gamma vol valuation.	Long 1y3y ATMF Receiver Swaption
SSA	Look to the primary market for liquidity pockets to add exposure selectively. Move up in quality, especially from EMU sovereigns of lower ratings, when spread levels and liquidity permit.	Long Dutch agencies vs the Netherlands Long EU vs other supras with larger supply pipelines
For a list of outstanding trade strategies please see the Tradesheet section of this report		

Duration Scorecard

Figure 2. Bund Weekly Cheat Sheet: 28 Feb – 6 Mar

Bund Directional Scorecard (1wk horizon)

RECOMMENDATION	Long
Conviction level	14%

RXH4 (EOD Thurs) = 145.22

CTD yield = 1.25% 10day del vol = 4.12%

SIGNAL STRENGTH (+/-2)

MACRO	0.3	Weight = 35%
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ECB	2	We expect a 15bp cut to the refi-rate next week	10.0%
Fed, BoE and BOJ	0	Dovish Fed forward guidance but modest tapering broadly priced	5.0%
Inflation	1	Citi expects a fall from 0.8% to 0.6% in the flash estimate tomorrow	7.5%
Growth related data	0	PMI & GDP releases likely to point to modest growth	5.0%
Citi surprise	0	Citi Economic Surprise Index close to 0	2.5%
Middle East / Oil	1	Brent retreating from its range-highs	5.0%

EURO MARKET FACTORS	-0.2	Weight = 28%
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Supply	-2	Core supply from Germany, France and Austria. No core cash flows	7.5%
Risk appetite	1	Flight to quality ongoing	5.0%
Flow	-1	Demand for core remains negative (4wk average)	2.5%
Equity	0	Eurostoxx50 stable near its peak	5.0%
Sovereign credit	-1	Peripheral yields at multi year low	5.0%
FX	0	EUR effective exchange rate at middle of its recent range	2.5%

EVENT RISK	0.1	Weight = 18%
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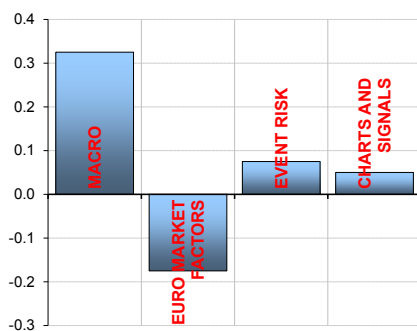
Politics	1	Developments in Ukraine are keeping prompting flight to quality	7.5%
3yr LTRO	0	We expect a new 1yr LTRO in 2H14	5.0%
Stability mechanisms	0	Nothing on the agenda in the near-term	5.0%

CHARTS AND SIGNALS	0.1	Weight = 20%
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Technicals	1	Upward momentum likely to remain strong in the near term	5.0%
T-Note	0	Neutral	5.0%
CFTC	-1	Positioning slightly short	5.0%
ARTS	1	Mild longs	5.0%

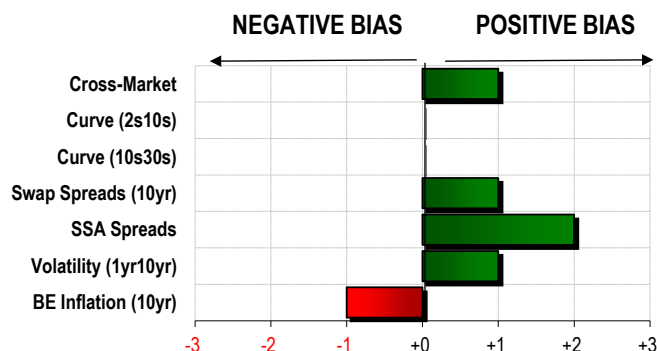
Source: Citi Research Note: Futures trading involves a substantial risk of loss

Figure 3. Contribution to Bund Signals



Source: Citi Research

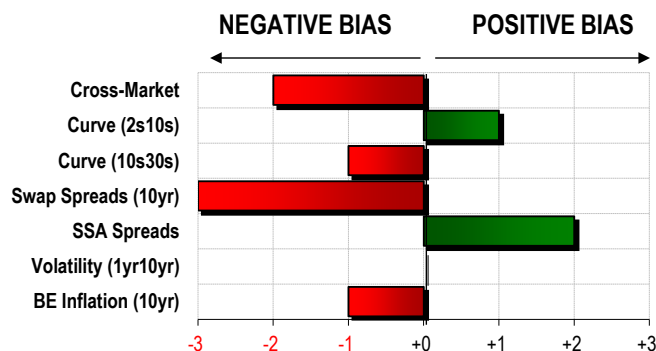
Figure 4. EURO AREA (Near-term Bias)



Source: Citi Research

POSITIVE bias = bullish vs UST, flatter curve, wider swap spreads, tighter SSA spreads, higher implied vol, wider BE inflation

Figure 5. UK (Near-term Bias)



Source: Citi Research

POSITIVE bias = bullish vs Bunds, flatter curve, wider swap spreads, tighter SSA spreads, higher implied vol, wider BE inflation

Tradesheet

New Trade

Please see [The Morning Call](#) for details

1. Buy BTPei18 vs BTPei16

Buy BTPei18 at 1.259%

Sell BTPei16 at 0.594%

Open 66.5bp. Current -46bp. Target PnL 12bps (i.e. including carry). Stop PnL -6bps. Time stop 1 April.

Please see page 16 for details

2. Buy BNG 2.5% Nov17 vs DSL 1.25% Jan18

Buy BNG 2.5% Nov17 at 0.63%

Sell DSL 1.25% Jan18 at 0.53%

Open 10bp. Current 10bp. Target 3bp. Stop 14bp.

Closed Trades

Figure 6. Record of our Closed Trades

Region	Trade	Levels	Rationale
EUR	Receive EUR 3y2y vs 5y25y	Open 117bp Current 141bp P&L 24bp Target 150bp Stop 100bp	Taking Profit. Euro Rates Strategy, 24 February 2014.
Swaps	Receive EUR 3y2y at 203bp Pay EUR 5y25y at 320bp		Euro Rates Strategy, 8 January 2014

Source: Citi Research

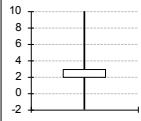
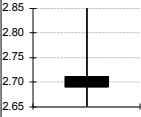
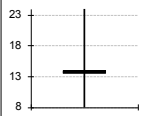
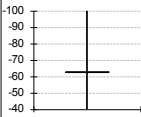
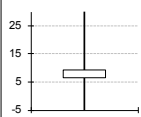
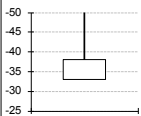
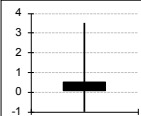
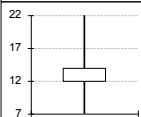
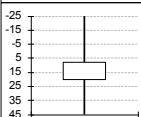
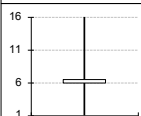
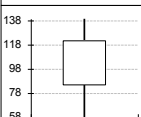
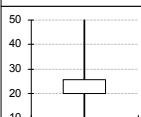
Record of Our Open Trades

Figure 7. Record of our Open Trades

Region	Trade	Levels	Rationale + Publication Date
EUR	Buy BNG 2.5% Nov17 vs DSL 2.25% Jan18	Open 10bp Current 10bp P&L 0bp Target 3bp Stop 14bp	Tactically good entry point for spread compression trade European Rates Weekly, 27 February 2014
SSA	Buy BNG 2.5% Nov17 at 0.63% Sell DSL 2.25% Jan18 at 0.53%		
EUR	Buy BTPei18 vs BTPei16	Open 66.5bp Current 65bp P&L (carry-adj) 3.8bp Target P&L carry-adj 12bp Stop P&L carry-adj -6bp Time Stop 1 April 2014	Long exposure in BTPei real yield with positive carry to 1 April The Morning Call, 25 February 2014
Inflation	Buy BTPei18 at 1.259% Sell BTPei16 at 0.594%		
EUR	Sell BTPei19 vs BTPei17 and BTPei23	Open -46bp Current -42bp P&L 4bp Target -26bp Stop -56bp	Fade the richness of 5yr BTPei. European Rates Weekly, 20 February 2014
Inflation	Buy BTPei17 at 1.04% Sell BTPei19 at 1.53% Buy BTPei23 at 2.48%		
EUR	Sell BTPei18 break-even vs OATei18	Open 13.5bp Current 13bp P&L 0bp Target 28bp Stop 6bp	BTPei likely to reverse some of the richness now that Boblei18 and OATei18 auctions are over. European Rates Weekly, 20 February 2014
Inflation	Sell BTPei18 break-even at 79.5bp Buy OATei18 break-even at 93bp		
EUR	BTP 10s30s steepener	Open 106bp Current 114bp P&L 8bp Target 144bp Stop 90bp	Macro factors, cash flow profile, expect strong demand for new 10yr BTP and +ve carry are supportive for steepeners European Rates Weekly, 20 February 2014
Curve	Buy BTP Aug23 at 3.49% Buy BTP Sep44 at 4.54%		

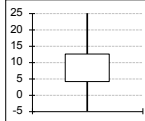
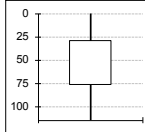
Source: Citi Research

Figure 8. Record of our Open Trades (continued)

EUR	Buy OATe20 and OATe24 vs OATe22		Open 2bp Current 3bp P&L 1bp Target 10bp Stop -2bp	OATe22 looks too rich on the curve; OATe24 likely to perform after auction is out of the way	
Inflation	Buy OATe20 at 0.10% Sell OATe22 at 0.42% Buy OATe24 at 0.72%			Euro Inflation Strategy, 19 February 2014	
UK	Buy IL gilt 2017 break-evens		Open 2.71% Current 2.69% P&L -2bp Target 2.85% Stop 2.65%	We believe that RPI-CPI wedge to widen over the medium-term	
Inflation	Buy IL gilt 2017 break-evens at 2.71%			UK Rates Strategy, 18 February 2014	
EUR	Buy 30yr Netherlands vs Austria		Open 14bp Current 13.6bp P&L -0.4bp Target 24bp Stop 8bp	Close to historically tight levels. Uncertainty surrounding the Austria banking sector should weigh on Austrian bonds	
Cross Market	Buy DSL Jan42 at 2.67% Sell RAGB Jun44 at 2.81%			European Rates Weekly, 12 February 2014	
UK / US	Receive 15y15y GBP vs USD		Open -63bp Current -63bp P&L 0bp Target -100bp Stop -40bp	30yr UK to benefit from LDI while 30yr US faces an increasing supply burden	
Cross Market	Receive 15y15y GBP at 3.61% Pay 15y15y USD at 4.24%			European Rates Weekly, 30 January 2014	
UK / US	Sell UKT 2.25% Sep23 vs UST 2.5% Aug23		Open 6.5bp Current 9bp P&L 3bp Target 30bp Stop -5bp	We expect the MPC to hike three quarters ahead of the Fed	
Cross Market	Sell UKT 2.25% Sep23 at 2.82% Buy UST 2.5% Aug23 at 2.77%			European Rates Weekly, 23 January 2014	
EUR	Buy 5yr Germany vs Swaps		Open -33bp Current -38bp P&L 5bp Target -50bp Stop -33bp	Attractive entry levels, a reduction in swapped issuance and 5yr bund supply in 2014 & a cheap option to express a change in sentiment	
Swap Spreads	Buy Bobl-167 (Oct18) vs swaps (YYS) at -33bp			European Rates Weekly, 16 January 2014 Revised Stop: The Morning Call, 5 Feb	
UK	Buy IL gilt 2068 break-even vs IL gilt 2044		Open 0.5bp Current 0.1bp P&L -0.4bp Target 3.5bp Stop -1bp	A pick-up in LDI activity, extensions in the 15yr+ IL gilt index and infrequent 50yr supply should steepen the 30s50s	
Inflation	Buy IL gilt 2068 break-even at 347bp Sell IL gilt 2044 break-even at 346.5bp			European Rates Weekly, 16 January 2014	
EUR	Long Bund Jan37 vs DSL Jan37		Open 12bp Current 14bp P&L 2bp Target 22bp Stop 7bp	Optically attractive entry level + relative supply pressures are more favourable for Bunds than DSLs	
Cross Market	Buy Bund 4% Jan37 at 2.72% Sell DSL 4% Jan37 at 2.84%			European Rates Weekly, 9 January 2014	
EUR	Long 10yr Spain vs Italy		Open 20bp Current 8bp P&L 12bp Target -25bp Stop 45bp	Spain has a stable rating and lower political risks compared with Italy	
Cross Market	Buy Bono 4.4% Oct23s at 4.26% Sell BTP 4.5% May23s at 4.06%			European Rates Weekly 5 Dec 2013	
EUR	Sell France vs Belgium and Germany		Open 6bp Current 7bp P&L 1bp Target 16bp Stop 1bp	Attractive entry level, possible auction concession and non-supportive cash flow profile for OATs into year-end	
Cross Market	Sell BTAN 1.75% Feb17 at 0.51% Buy OLO 4% Mar17 at 0.66% Buy Bobl 0.5% Apr17 at 0.30%			Euro Rates Strategy, 8 November 2013.	
EUR / UK	Sell UKT Sep23 vs DBR Aug23		Open 85bp Current 122bp P&L 37bp Target 140bp Stop 58bp Revised Stop 85bp	Entry levels are attractive for medium-term gilt-Bund wideners	
Cross Market	Sell UKT 2.25% Sep23 at 2.60% Buy DBR 2% Aug23 at 1.75%			European Rates Weekly, 24 October 2013. Revised Stop: UK Rates Strategy, 11 November 2013	
UK	Sell 30yr gilt swap spreads vs 10yr		Open 20bp Current 26bp P&L 6bp Target 50bp Stop 10bp	Fiscal risks, supply pressures and the absence of QE to put steepening pressure on the gilt curve.	
Swap spread	Sell gilt 3.25% Jan44 ASW at 20bp Buy gilt 1.75% Sep22 ASW at 0bp			UK Rates Strategy, 30 July 2013	

Source: Citi Research

Figure 9. Record of our Open Trades (continued)

Europe		Receive EUR 10y2y vs 12y3y	Open	4bp	Cheapness of the sector due to legacy ASW positions. The trade offers a positive roll-down for relatively low volatility The Morning Call, 23 January 2013	
Curve	Receive EUR 10y2y at 3.1% Pay EUR 12y3y at 3.14%		Current	13bp		
			P&L	9bp		
			Target	25bp		
			Stop	-5bp		
UK		Sell GBP 2y2y ATM straddle	Open	76bp	The fundamental backdrop in the UK supports selling GBP 2y2y vol IIRS 12 July 2012	
Volatility	Sell GBP 2y2y ATM (1.04%) straddle at 76bps		Current	29bp		
			P&L	47bp		
			Target	0bp		
			Stop	114bp		

Source: Citi Research

European Rates Strategy Yield Outlook

Full details can be found in the latest [Global Economic Outlook and Strategy](#).

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Core Europe: Citi now expects a 15bp cut in the ECB refi rate at the March meeting and a 10bp deposit rate cut later in the year. Such loosening of monetary policy is likely to remain supportive for the lower-for-longer theme in core EMU rates markets. 10yr Bunds have averaged 1.74% so far over 2014. We do not expect a substantial deviation of Bund yields from the current levels in the coming three quarters. Core EMU Spreads to Bunds should remain near current levels with OAT-Bund spreads largely range bound about 50bp-80bp.

EMU Periphery: EMU periphery markets continue to enjoy a variety of healthy supports, not least from the various positive announcements from rating agencies (Moody's lifting the negative outlook on Italy's Baa2 rating and separately *upgrading* Spain by one notch from Baa3 to Baa2 positive outlook). We continue to see spreads tightening further to Bunds, but for Bonos to outperform BTPs over the course of 2014. This is largely based on their relative fundamental performance and political environment. For one Spain is expected to grow at 0.9% this year, Italy is expected to grow around 0.3% this year. For Q4 2014, we forecast Bono spreads to Bunds at 160bp and BTP spreads to Bunds at 140bp. We continue to see Ireland gradually tightening towards the soft core, targeting a Q4 2014 spread of 110bp.

UK: The BoE's latest version of guidance suggests that monetary policy will be very data-dependent. We sit in the more optimistic camp on the economy and continue to expect the first hike in Q4 this year. We highlight three main themes. First, the front-end will likely lose its anchor in coming quarters, with bear flattening in 2s10s. Second, that gilts should underperform on a cross-market basis and finally de-couple from USTs (for the 10yr gilt-Treasury spread, we target +30bp in H2 2014). Third, that the 10s30s curve is likely to flatten by more than the usual beta would imply as the result of strong demand for the very long-end as pension funds de-risk.

Figure 10. Interest Rate and Bond Market Forecasts as of 26 February 2014

	Quarterly Average					
	Current	1Q 14F	2Q 14F	3Q 14F	4Q 14F	2Q 15F
Euro Area						
Policy Rate End Quarter	0.25	0.10	0.10	0.10	0.10	0.10
Overnight Rate (EONIA)	0.17	0.15	0.10	0.00	0.00	0.00
3-Month (EURIBOR)	0.26	0.25	0.20	0.15	0.15	0.15
2 Year Schatz Yield	0.12	0.12	0.00	0.05	0.10	0.10
5 Year Bobl Yield	0.68	0.70	0.50	0.50	0.50	0.60
10 Year Bund Yield	1.67	1.70	1.65	1.70	1.80	1.90
30 Year Bund Yield	2.56	2.62	2.60	2.60	2.60	2.60
2-10 Year Bund Curve	155	158	165	165	170	180
10 Year BTP-Bund Spread	194	200	180	170	160	150
10 Year Bono-Bund Spread	187	190	175	160	140	125
2 Year BTP-Schatz Spread	71	75	75	75	75	50
2 Year Bono Schatz Spread	67	75	75	75	75	50
10 Year OAT-Bund Spread	60	65	65	65	65	65
10 Year Swap Spread (Swap Less Govt.), bp	22	25	25	20	20	20
10 Year Breakeven Inflation	138	135	140	145	150	150
UK						
Policy Rate End Quarter	0.50	0.50	0.50	0.50	0.75	1.50
3-Month Libor	0.52	0.55	0.60	0.70	1.00	1.45
2 Year Treasury Yield	0.49	0.53	0.85	1.30	1.50	1.75
5 Year Treasury Yield	1.65	1.70	2.00	2.40	2.60	2.85
10 Year Treasury Yield	2.77	2.85	3.00	3.25	3.40	3.60
30 Year Treasury Yield	3.54	3.55	3.55	3.75	3.85	3.95
2-10 Year Treasury Curve	228	232	215	195	190	185
10 Year Swap Spread (Swap Less Govt.), bp	6	5	10	15	15	20
10 Year Breakeven Inflation	298	300	310	320	325	330

Source: Citi Research

Bund: Assessing Medium-Term Risks

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We review our Bund forecast in light of Citi's new macroeconomic [projections](#). Several risk factors argue for low(er) yields in the longer term¹, not least the increased probability of realizing a Japanese-type of scenario for the Eurozone. However, we're prepared to look through short-term shocks (including the FTQ-premium related to geopolitical risks in Ukraine) and continue to hold on to our 1.80% forecast for year end².

Simple fair value models for Bund yields keep signalling levels that are slightly higher than the current 1.55-1.60%:

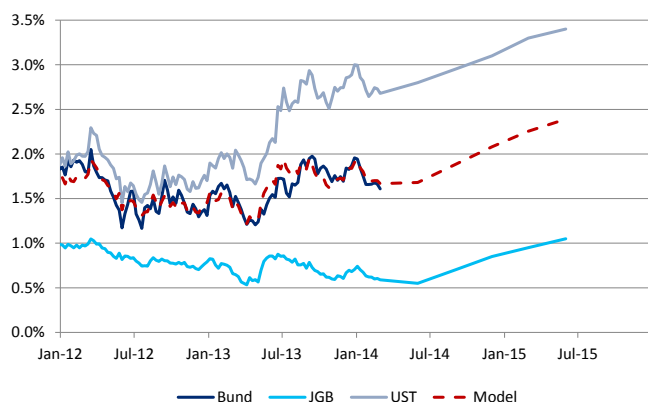
The relationship between Bunds and JGBs is stronger than in the past

■ Naïve linear combinations of JGB and UST yields (Figure 11) suggest a fair value around 2.05-2.10%, based on our latest GEOS. We note how the beta between JGBs and Bunds has increased in 2013 and is now significantly higher than in the past ten years.

Growth and inflation expectations matter

■ Models based on a Taylor rule, as well as a reversion to historical average levels of term, credit and liquidity premium suggest a fair value around 1.80% (Figure 12). Obviously, this estimate is highly sensitive to both variables that enter the Taylor function, i.e. HICP and the output gap.

Figure 11. Naïve Bund model using JGBs and USTs



Source: Citi Research

Figure 12. Fair value model based on Taylor rule

Eurozone	2014	2015	2016	2017	2018
GDP (Citi)	1.1	1.3	1.5	1.6	1.6
Output gap (EC)	-2.4	-1.3	-0.7	-0.3	0.0
HICP (Citi)	0.7	0.7	1.0	1.2	1.5
ECB target	1.9	1.9	1.9	1.9	1.9
ECB refi (Taylor rule)	0.2	0.8	1.2	1.5	1.8
ECB refi / Bund spread	1.5	1.4	1.3	1.2	1.2
Excess liquidity premium	-0.1	-0.1	0.0	0.0	0.0
Bund spread vs EMU	-0.6	-0.6	-0.6	-0.6	-0.6
Bund 10y yield (implied)	1.0	1.5	1.9	2.2	2.5
5y-avg Bund 10y yield	1.8				

Source: EC, ECB, Citi Research

What can we say about the major long-term risks to our forecast? The market still operates in denial of the increasing probability and the perilous consequence of a deflation scenario. This is evident from a variety of indicators:

Perceived deflation risk

■ ECB's Survey of Professional Forecasters³ (SPF), suggests that the probability of negative inflation rates is very low at 1.1%. At the same time, the ECB reports a noticeable revision to near term inflation expectations (2014 -0.4%, 2015 -0.2%).

Inflation surprises

■ Bund yields look (optically) more linked to economic rather than inflation surprises (Figure 13). This is yet another indication that markets still tend to underestimate the impact of negative inflation rates on inter-temporal consumption and economic growth (i.e. on real yields).

¹ We've worked on this subject in the past, e.g. "[Low\(er\)-for-Longer: Themes & Trades](#)" (28 Nov-13).

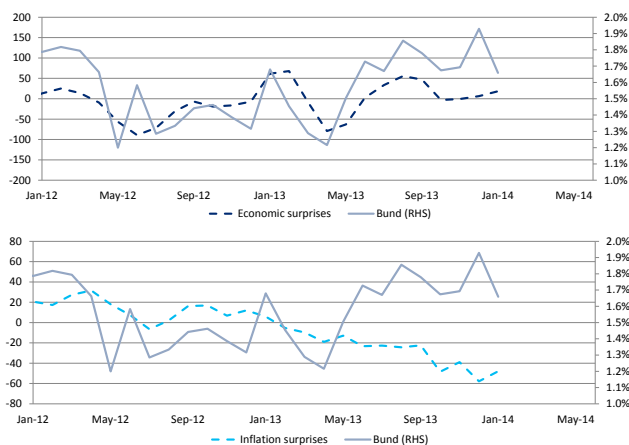
² We've been forecasting 1.8-1.9% for Q4 2014 ever since Aug-13. The Oct-13 Consensus for E2014 was 2.2%, while forwards were implying 2.30% as of 30 Dec-14.

³ [Monthly Bulletin](#) (Feb-14, p. 60)

Market expectations

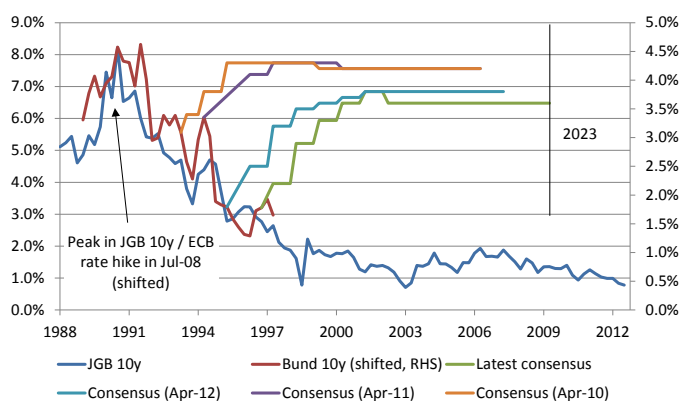
- Consensus forecasts consistently overestimate the equilibrium level of Bund yields as well as their medium-term trend (Figure 14). Over the past 3 years, analysts have trimmed their 10-year ahead Bund yield forecasts by “only” 75bp (from 4.25% to 3.50%), somewhat dismissing the similarities between the Eurozone and Japan.

Figure 13. Growth & inflation surprises vs Bunds



Source: Citi Research

Figure 14. Japan scenario? No way...



Source: Consensus Economics, Citi Research

Geopolitical risks driving Bunds in the short-term...

...but we will look through that in our forecasts: Reduce EGB portfolio duration, while keeping spread tightening view on non-core.

From a short-term perspective, geopolitical risks imply a flight-to-quality premium of approximately 10-15bp in our view. Bunds have rallied by 1.5 figures during the past 3 sessions, widening spreads to UST by almost 5bp and ASW spreads by 2-3bp. While we do not want to dismiss this risk factor, we prefer filtering for it in our longer-term projections, thus concentrating on pure fundamental variables.

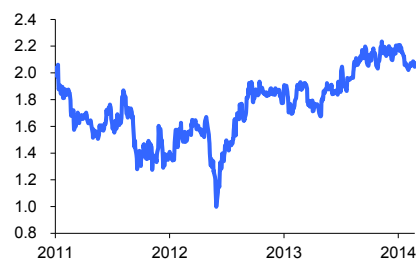
Conclusions & Duration View

We expect Bunds to end the year at 1.80%, with some volatility around our quarterly estimates⁴ primarily resulting from exogenous factors. This represents no deviation from our long-held view, which we were happy to hold even against a strong consensus of 2.2-2.3%. Currently, we're experiencing a rather strong bid due to geopolitical tensions in Ukraine, but we prefer looking through short-term drivers in EGB allocation. We also appreciate that the probability of a “Japan scenario” keeps increasing and we may end up with Bunds eventually trading at or below 1%. However, we need additional evidence in order for this to become our base long-term scenario. We recommend reducing EGB portfolio duration at this stage, while retaining our view of a progressive tightening of non-core vs core.

⁴ Q1 1.70%, Q2 1.65%, Q3 1.70%, Q4 1.80%.

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Figure 15. Evolution of EUR 2s20s



Source: Citi Research

Figure 20. PV01 neutral EUR 6m fwd 2s20s zero-cost bear conditional flattener

Buy	EUR	6m2y	ATMF	Swaption Payer	x7.82
Sell	EUR	6m20y	ATMF+11.5bp	Swaption Payer	x1

Source: Citi Research

EUR Vol: 2s20s bear conditional flattener

Excess liquidity is currently around EUR 119bn and without monetary policy innovation we expect it to collapse to around EUR 45bn by the end of the year. As a result, in such scenario the front-end could be subject to added volatility on the back of increasing upward pressure on EONIA and EURIBOR fixings. In addition, at present ongoing macro and deflationary risks (the latter currently being denied by the ECB) are flattening the curve.

We also note that long-tail options look richer relative to short-tail options on basic implied/realized relative measures across rolling windows (Figure 16 to Figure 19).

Figure 16. Implied/Rlz ratios (21d)

	1y	2y	3y	4y	5y	7y	10y	15y	20y	25y	30y
1m	137%	154%	156%	159%	154%	155%	159%	167%	168%	170%	170%
2m	116%	137%	147%	153%	152%	153%	159%	166%	165%	168%	169%
3m	114%	134%	145%	148%	148%	150%	158%	167%	166%	167%	168%
6m	108%	129%	142%	145%	151%	158%	168%	175%	176%	178%	180%
9m	108%	130%	147%	149%	155%	163%	173%	181%	181%	184%	185%
1y	113%	128%	141%	143%	152%	164%	173%	181%	183%	187%	186%
2y	130%	143%	146%	157%	164%	175%	190%	192%	195%	198%	197%

Source: Citi Research

Figure 17. Implied/Rlz ratios (63d)

	1y	2y	3y	4y	5y	7y	10y	15y	20y	25y	30y
1m	139%	143%	137%	134%	131%	130%	127%	128%	130%	131%	130%
2m	120%	130%	130%	132%	131%	129%	128%	128%	129%	130%	130%
3m	116%	128%	129%	129%	129%	130%	129%	130%	130%	130%	130%
6m	105%	120%	126%	127%	132%	137%	136%	137%	138%	138%	139%
9m	104%	117%	126%	129%	134%	137%	139%	140%	141%	142%	142%
1y	111%	116%	124%	127%	133%	139%	141%	142%	143%	145%	144%
2y	112%	120%	123%	132%	137%	140%	146%	147%	150%	151%	151%

Source: Citi Research

Figure 18. Implied/Rlz ratios (121d)

	1y	2y	3y	4y	5y	7y	10y	15y	20y	25y	30y
1m	139%	116%	107%	105%	102%	101%	101%	104%	106%	107%	107%
2m	116%	103%	102%	102%	101%	100%	102%	103%	104%	105%	106%
3m	109%	101%	101%	100%	100%	102%	103%	106%	106%	106%	107%
6m	88%	92%	97%	97%	101%	106%	108%	110%	112%	112%	114%
9m	81%	90%	96%	99%	103%	107%	111%	114%	114%	115%	116%
1y	80%	89%	95%	99%	103%	109%	113%	116%	117%	118%	118%
2y	87%	94%	97%	103%	108%	112%	119%	121%	123%	124%	125%

Source: Citi Research

Figure 19. Implied/Rlz ratios (255d)

	1y	2y	3y	4y	5y	7y	10y	15y	20y	25y	30y
1m	89%	83%	85%	86%	87%	88%	90%	94%	96%	97%	97%
2m	81%	76%	85%	86%	90%	91%	95%	97%	98%	98%	99%
3m	71%	74%	83%	87%	90%	94%	98%	101%	101%	101%	103%
6m	68%	76%	83%	88%	94%	100%	105%	107%	108%	108%	109%
9m	70%	80%	88%	92%	97%	103%	109%	112%	113%	113%	113%
1y	72%	82%	89%	94%	100%	106%	113%	116%	116%	117%	116%
2y	83%	89%	93%	100%	107%	112%	118%	121%	122%	123%	123%

Source: Citi Research

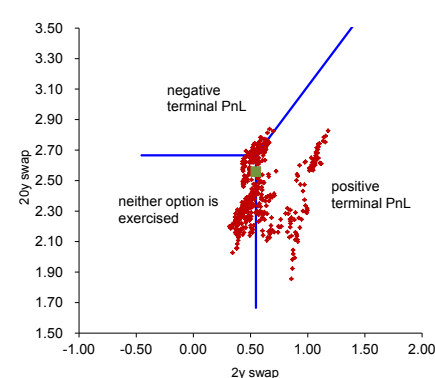
Long positions at the front-end of the gamma region vs. long tails look attractive from a funding standpoint given the generous implied volatility differential. For instance the 6m2y/6m20y implied volatility spread is currently worth around -20bp (Figure 21). In turn a PV01 neutral six month forward 2s20s bear conditional flattener can be executed at zero cost with a short position on 6m20y payer swaption struck 12bp out of the money. Figure 22 shows the attractive decomposition of the terminal payoff (red sample illustrates the dynamics of 2s20s curve segment over the past two years).

Figure 21. Evolution of 6m2y/6m20y implied volatility spread



Source: Citi Research

Figure 22. Decomposition of terminal payoff of 6m fwd 2s20s conditional bear flattener



Source: Citi Research

As a final remark we highlight that the substantial vol pickup implies that notwithstanding the flattening exposure of the strategy, the carry of the position over the first three months is flat. Indeed, the equivalent curve position is negative carry if established in swap space.

UK Rates – The cash-flows are coming

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Next Thursday's MPC meeting will likely announce APF buybacks commencing from the week beginning 10 March as the proceeds from the 2Q14 redemption are reinvested. This is consistent with the MPC's updated forward guidance which states that APF holdings will be re-invested at least until the first rate hike. There will also be significant coupon and redemption money available for reinvestment next week. We detail these cash-flows, upcoming supply and consider their impact on the gilt market. In conclusion, we recommend buying 30yr gilts vs Treasuries.

APF buybacks likely to be split evenly across the curve

APF buybacks totaling £8.15bn are likely to take place over 6 auctions during 10-24 March

The APF holds £8.23bn nominal of 2Q14, which redeems on 7 March 2014. The Bank paid £8.15bn for these holdings and this amount will be re-invested via gilt buybacks. In line with previous reinvestments, we expect the purchases to be announced at next Thursday's MPC meeting with the details in an accompanying Market Notice. We expect the purchases will be evenly split across three maturity buckets; 3-7yrs, 7-15yrs and 15yrs+. There has been some expectation that the purchases could be skewed towards the front-end, but we believe the Bank will be very reluctant to distort the gilt curve in such a way. We expect six auctions in total to take place on Mondays, Tuesdays and Wednesdays. This implies an average size of around £1.35bn per auction. The first auction is likely to take place on Monday 10 March. The Budget will take place on Wednesday 19 March and is likely to mean that the last auction will be pushed back to Monday 24 March. As with previous operations, it is likely that the Bank will not buy any bonds in which it already holds more than 70% of the free-float.

The next potential APF buybacks are in September

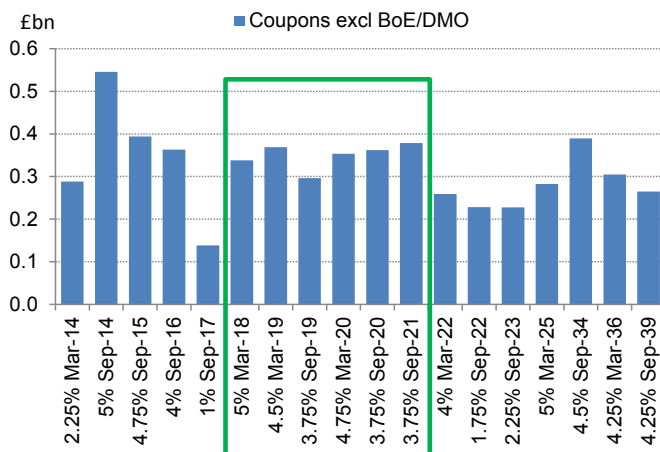
The next gilt redemption will be in September. The Bank own £12.7bn nominal of this bond and paid £14.4bn for them. Assuming there is no rate hike before then (Citi forecast the first hike in November), this will be the next set of APF buybacks.

Coupon payments concentrated in the 5-7yr area

Coupons payments worth £5.8bn (excluding BoE/DMO holdings) will be paid on 7 March

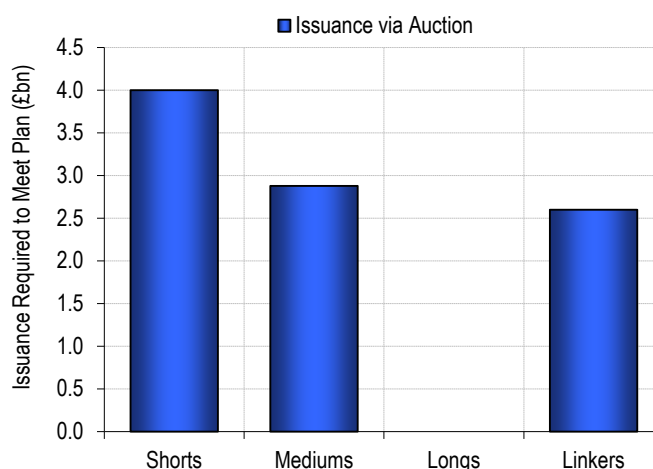
There could also be money coming back to the gilt market from the gilt coupon payments on 7 March and the redemption money from the 2Q14 not held by the BoE/DMO (£26bn). The coupons fall across the curve, although there is a particular concentration around the 5-7yr sector (Figure 23). The coupons amount to £10.7bn, although this falls to £5.8bn when BoE/DMO holdings are excluded.

Figure 23. Gilt coupon payments due on 7 March



Source: Citi Research, DMO, BoE.

Figure 24. Gilt issuance due in March, by sector



Source: Citi Research, DMO.

Supply easily offset by cash-flows

There is around £9.5bn issuance due in March

March is the last month of the 2013/14 fiscal year. There is £10.56bn left to issue (including linkers) to complete the gilt issuance remit. Of this, the DMO expect to raise around £9.45bn via auctions (accounting for the anticipated use of the Post Auction Option Facility). Note, that there will be no more syndications until the new fiscal year. There will also be no more issuance in conventional longs until April at the earliest. The remaining issuance, split by maturity bucket, is shown in Figure 24.

Net conventional supply (gross less coupons & buybacks) totals -£7bn in March

Considering the month of March as a whole, the supply of conventional gilts - just under £7bn - is easily offset by the coupon payments of £5.8bn and APF reinvestments of £8.15bn. This presents a supportive backdrop for gilts as we head into March.

How to trade the March seasonals

Gilts already look rich outright and vs swaps, but have underperformed on a cross-market basis

The cash-flow picture above suggests that gilts should find support over the coming weeks. Gilts have already richened sharply over the last week on an outright basis, led by 10s, although this is largely being driven by flight-to-quality flows amidst rising global geopolitical risks. Month-end demand may also be adding to the broader strong performance of fixed income markets. The richness of gilts can also be seen vs swaps, again especially in 10s. However, gilts have performed less well recently on a cross-market basis, especially vs Bunds with the 10yr spread challenging the multi-year wides.

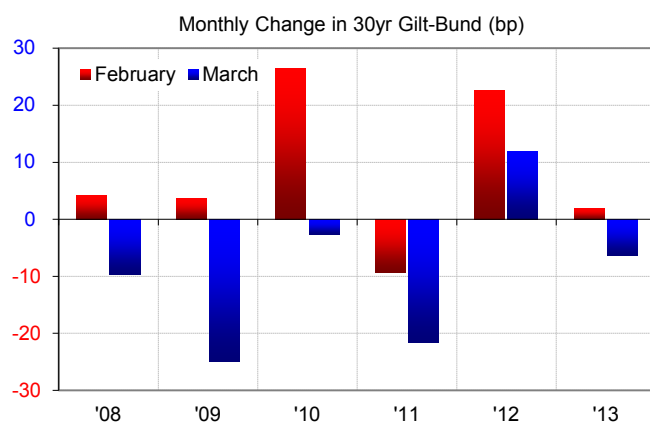
10yr gilts have richened vs both Bunds and Treasuries in 5 of the last 6 years

Of course, the coupons and APF reinvestments have been well anticipated (indeed, we first flagged it at the beginning of the year, see [Supply in 2014: Themes & Trades](#), 9 January). However, precedent suggests that the March seasonals (driven by the entirely predictable coupon payments) do tend to result in 10yr gilt outperformance on a cross-market basis. The 10yr spread vs both Bunds and Treasuries has richened in March in five out of the last six years. This year, there is the added influence of the APF reinvestments.

The seasonal outperformance of gilts in March is also evident in 30s, especially vs Treasuries

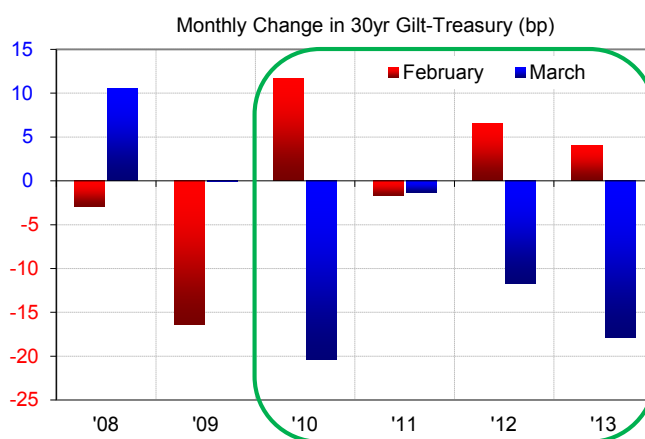
The best way of positioning for gilt outperformance, however, is arguably in the 30yr sector. There is no gilt supply in this sector in March, whereas there will be a new 10yr gilt on 11 March. The historical seasonals for 30yr cross-market spreads also support the view that gilts should outperform in March (Figure 25 and Figure 26). This has been particularly consistent vs 30yr Treasuries with gilts outperforming by more than 10bp in March in three of the last four years, as highlighted in Figure 26.

Figure 25. Change in 30yr gilt-Bund spread in March



Source: Citi Research, Bloomberg.

Figure 26. Change in 30yr gilt-Treasury spread in March



Source: Citi Research, Bloomberg.

What about the fundamentals?

We expect 10yr gilts to underperform vs Bunds/Treasuries over the medium-term

There is another important reason for looking to capture the cash-flows and supply dynamics by going long gilts vs Treasuries in the 30yr sector. Namely, that it is consistent with our longer-term fundamental view. As detailed in our latest yield forecasts (page 9), we continue to expect the 10yr gilt-Bund and gilt-Treasury spread to widen over the coming quarters. For the former, we target +160bp by Q4 (vs +110bp currently) and for the latter +30bp (vs +3bp currently). For the 10yr spreads, we would use any gilt outperformance in March as an opportunity to put on wideners.

LDI demand should help 30yr gilts to outperform vs Treasuries

However, for the 30yr sector, our medium-term forecasts suggest that the 30yr gilt-Treasury spread could move in the opposite direction. We target -30bp by Q4 vs the current level of -10bp. This is a topic we previously discussed in '[Is it time for gilts to de-couple from Treasuries?](#)', 31 January 2014. An important factor here is that 30yr gilts should benefit from ongoing LDI activity, which is a far more reliable and consistent source of demand than US pension fund inflows into Treasuries.

Strategy summary – buy 30yr gilts vs Treasuries

We look for 30yr gilts to outperform Treasuries over the coming weeks, perhaps by as much as 10bp

The best way to capture the March seasonals, in our view, is to buy 30yr gilts vs Treasuries (note that we already have an existing recommendation to receive 15y15y GBP vs USD, see the *Tradesheet* on page 6).

We are reluctant to buy gilts outright or vs swaps given how far they have already richened (especially the 10yr sector). Moreover, we prefer to look for opportunities to sell 10yr gilts vs both Bunds and Treasuries given our medium-term views (stemming largely from the outlook for relative policy rates).

However, we do see scope for 30yr gilts to richen vs Treasuries, both over the near- and medium-term. The combination of coupon money, APF buybacks and a lack of supply should all help 30yr gilts to outperform Treasuries over the coming weeks, perhaps by as much as 10bp.

Relative value and SSA-EMU spread analysis

A strong rally in core EMU bonds....provides RV in SSAs

Coinciding with geo-political events, a subdued inflation outlook and exacerbated by positioning, core EMU market yields have sharply rallied to YTD lows. At 1.57%, the last time 10yr Germany was at similar levels was back in July 2013. The typically low beta characteristic of many SSAs means that the rally in core EMU has widened certain spreads – but which ones?. Such spread widening is not so much a function of deteriorating fundamental credit quality, but rather a due liquidity differences.

Dutch agencies vs the Netherlands

Assessing the Dutch agency sector, we can see how BNG bonds are currently trading vs a fitted and interpolated cash curve for the Netherlands' government bonds (Figure 27). Charting box whiskers with 6m spread history reveals that it is the 3yr and 4yr sectors that are now trading cheaply to the Dutch sovereign.

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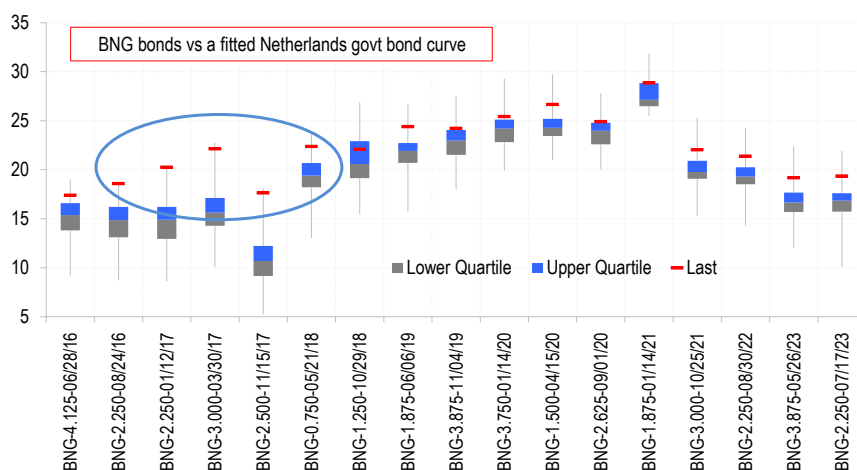
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Buy BNG 2.5% Nov17s at 0.63%

vs DSL 1.25% Jan18s at 0.53%

Open 10bp, Target 3bp, Stop 14bp

Figure 27. BNG vs a fitted Netherlands govt bond curve (box whiskers, 6m trading history)



Source: Citi Research

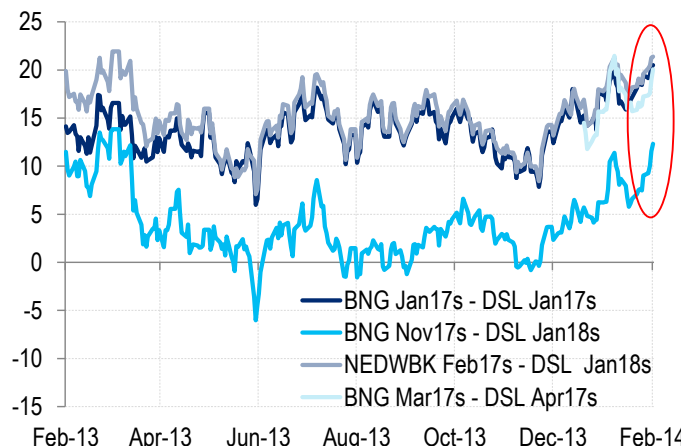
- **3yr BNG vs the Netherlands:** With various spreads now outside their 12 month historical range, we think current levels provide a ripe entry point for certain compression trades. Various examples are given in Figure 28 and Figure 29.

Figure 28. BNG Nov17s and DSL Jan18s (Yields, %)



Source: Citi Research

Figure 29. 3yr and 4yr Dutch agencies vs the Netherlands (Spread, bp)

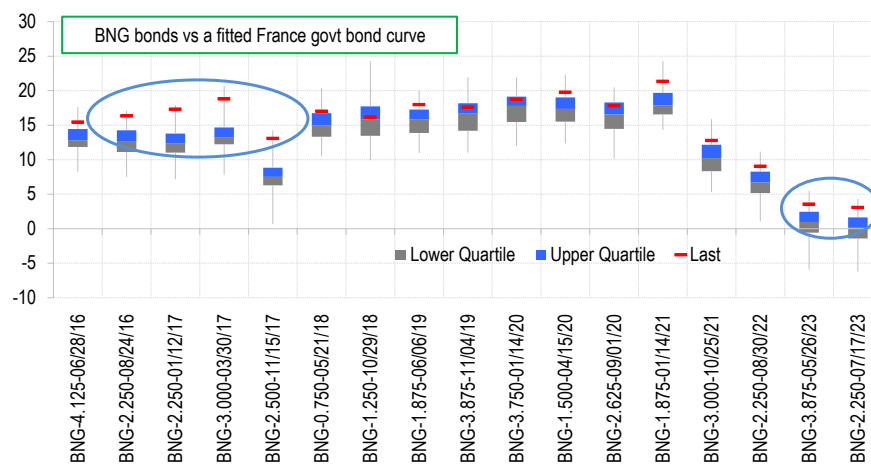


Source: Citi Research

Dutch agencies vs France – hunting out the value

It is also shorter dated Dutch agency bonds which have lagged the move lower in French yields. Taking the difference between BNG yields and French government bond yields and plotting box whiskers with 6m history, reveals relative value in the 3yr sector, but also in the 10yr sector (Figure 30).

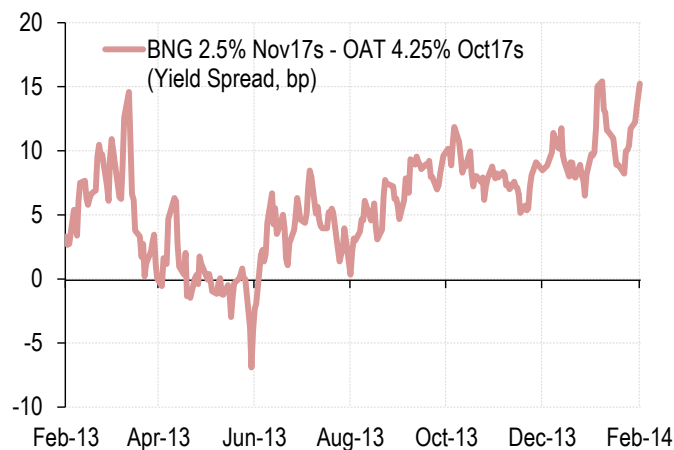
Figure 30. BNG vs a fitted France govt bond curve (box whiskers, 6m trading history)



Source: Citi Research

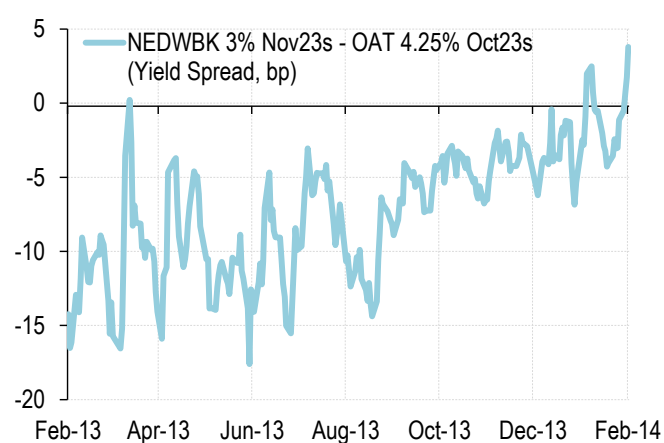
- **3yr BNG vs France:** Spreads have widened the most vs France in the 3yr sector. 3yr BNG is now historically attractive at around 15bp to OATs (Figure 31).
- **9yr NEDWBK vs France:** We also see value in longer-dated sectors. Recent moves in France now mean it is just about possible to move into NEDWBK in the 9yr sector at a spread *pick-up* which is historically unusual (Figure 32).

Figure 31. 3yr BNG – 3yr France (Spread, bp)



Source: Citi Research

Figure 32. 9yr NEDWBK – 9yr France (Spread, bp)



Source: Citi Research

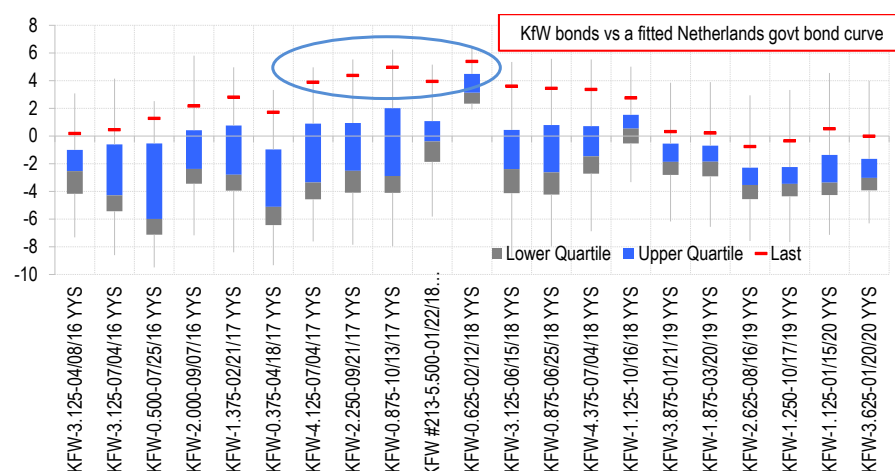
Germany agencies – tight to Bunds, so where's the value?

German agencies naturally remain locked in a range to Bunds, and at 30bp in the 7yr sector, there's growing evidence that this range is now actually tighter than has been observed in the past. It's therefore more worthwhile to analyse the relative value vs other key sovereigns such as France and the Netherlands.

KfW vs the Netherlands

The box whisker of yield spreads between KfW and the Netherlands' fitted curve also indicates the relative value in the 3yr sector.

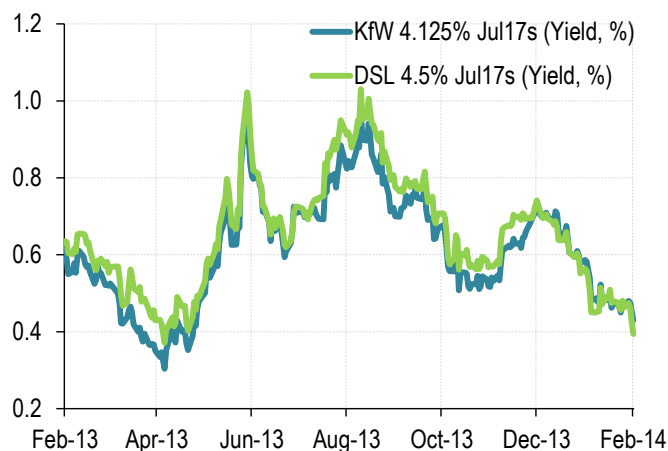
Figure 33. KfW vs a fitted Netherlands' gov't bond curve (box whiskers, 6m trading history)



Source: Citi Research

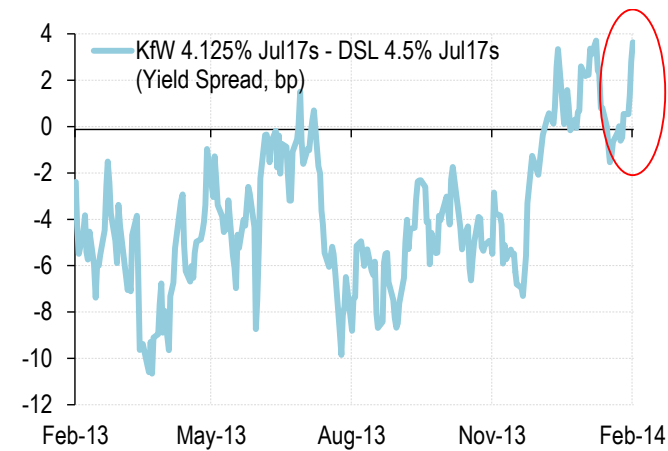
- **3yr KfW vs the Netherlands:** The sharp move lower in DSLs compared with KfW has pushed some spreads back to extremes. In the 3yr sector, it is now possible to achieve a small spread pick-up (Figure 34, Figure 35).

Figure 34. 3yr KfW and 3yr Netherlands Yields (%)



Source: Citi Research

Figure 35. 3yr KfW – 3yr Netherlands (Yield Spread, bp)

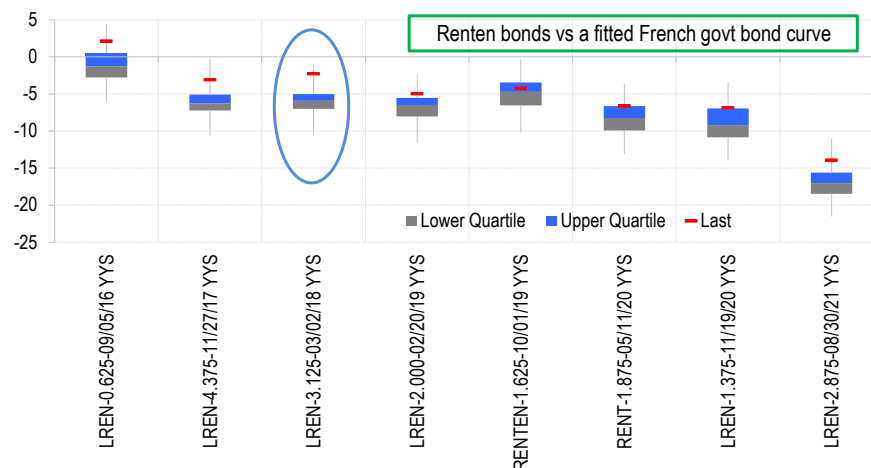


Source: Citi Research

RENTEN vs France

The box whisker of yield spreads between RENTEN and France's fitted curves also points to relative value in the 4yr sector (Figure 36).

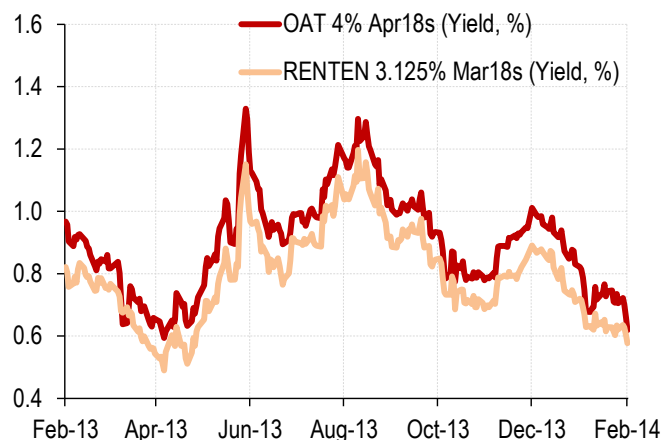
Figure 36. RENTEN vs a fitted France govt bond curve (box whiskers, 6m trading history)



Source: Citi Research

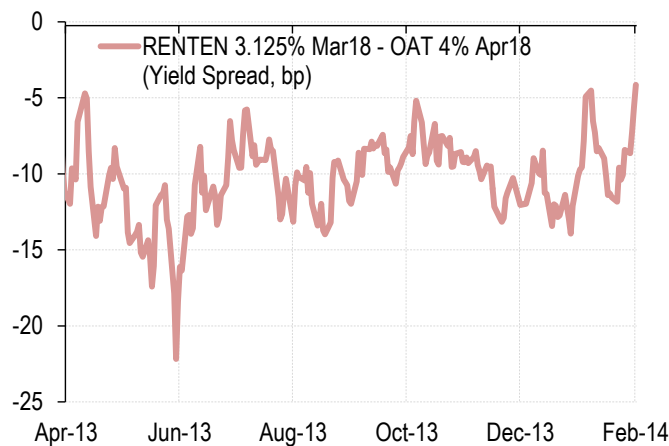
- **4yr RENTEN vs France:** The switch out of 4yr France and into RENTEN can be made at a historically low spread give-up of around 5bp (Figure 37, Figure 38).

Figure 37. 4yr RENTEN and 4yr France (Yields, %)



Source: Citi Research

Figure 38. 4yr RENTEN – 4yr France (Yield Spread, bp)



Source: Citi Research

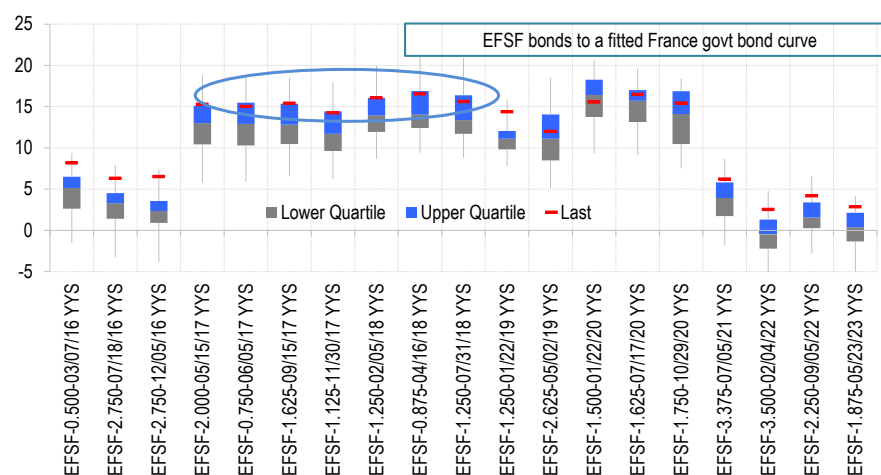
Not forgetting the supras...where's the value in EFSF?

The near systematic cheapening of SSAs in the 3yr-4yr sector vs various EMU sovereigns is not just confined to agencies (although, it is vs agencies where we see slightly better relative value). Supras, such as the EFSF, are also trading relatively cheaply to sovereigns such as France in this same sector.

EFSF vs France

Relative value analysis between the EFSF and interpolated French yields reveal that spreads are relatively cheap in the 3yr-4yr sector based on 6 months of yield history. Unlike some of the agencies, they have not broken out of their ranges convincingly but are near historical extremes (Figure 39).

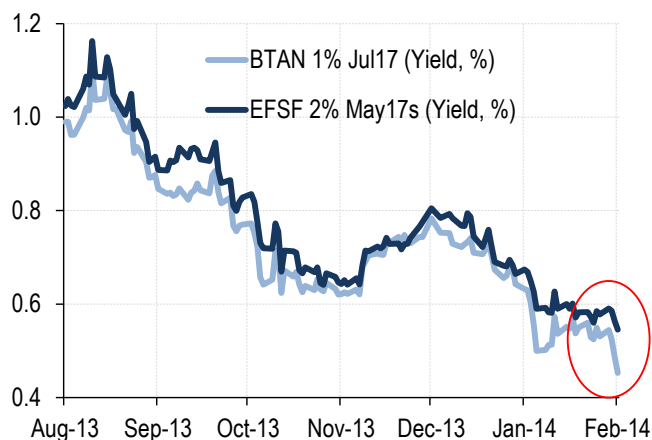
Figure 39. EFSF vs a fitted France govt bond curve (box whiskers, 6m trading history)



Source: Citi Research

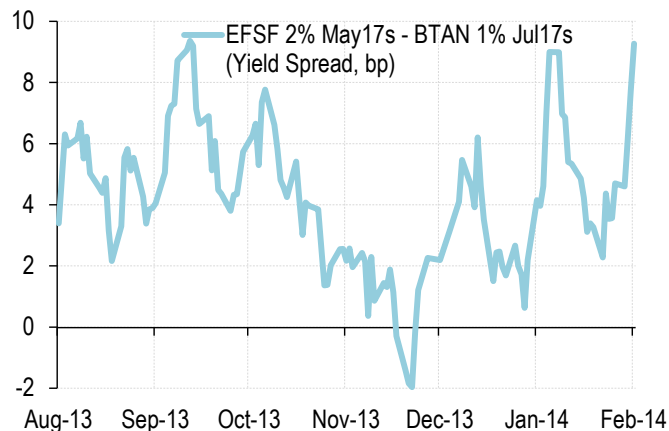
- **3yr EFSF vs France:** Although supras have joined in the rally perhaps a little more than the agencies, there are still some differentials which are likely to attract attention. One such example is the yield spread between EFSF May17s and BTAN Jul17s which is now near the wides of its range (Figure 40, Figure 41).

Figure 40. EFSF May17s and BTAN Jul17s (Yields, %)



Source: Citi Research

Figure 41. EFSF May17s – BTAN Jul17s (Yield Spread, bp)



Source: Citi Research

Conclusion and relative value summary

The gyrations in the core government bond market have presented various opportunities to switch into (often better rated) SSAs. In particular we see relative value in the 3y-4r sector between Dutch agencies, German agencies and the EFSF vs France and the Netherlands.

Covered Bond Strategy

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Spanish covered bond ratings have been boosted this week by Moody's. Will multi-cédulas follow? We look into underlying rating decisions, OC development and present some relative value opportunities.

Multi-cédulas: time for upgrades?

Upgrades in Spain are en vogue

Over recent weeks, the Spanish covered bond market has seen an increase in rating activity with [upgrades of several multi-cédulas by Fitch](#) and multi-notch upgrades [of Tier-1 single-cédulas](#) this week by Moody's. Moreover, we should expect Moody's to take actions on Spanish multi-cédulas quite soon. In the past, Moody's usually took rating actions on the multi structures on a quarterly basis. However, we understand that the still pending results on the request for comments concerning a new anchor point for covered bond ratings against the background of the single resolution regime led to a substantial delay on rating actions in this segment. We expect that once the results of the RFC on the new anchor point are implemented, Moody's will publish on multi-cédulas as well.

Several rating actions and methodology amendments during the last seven months

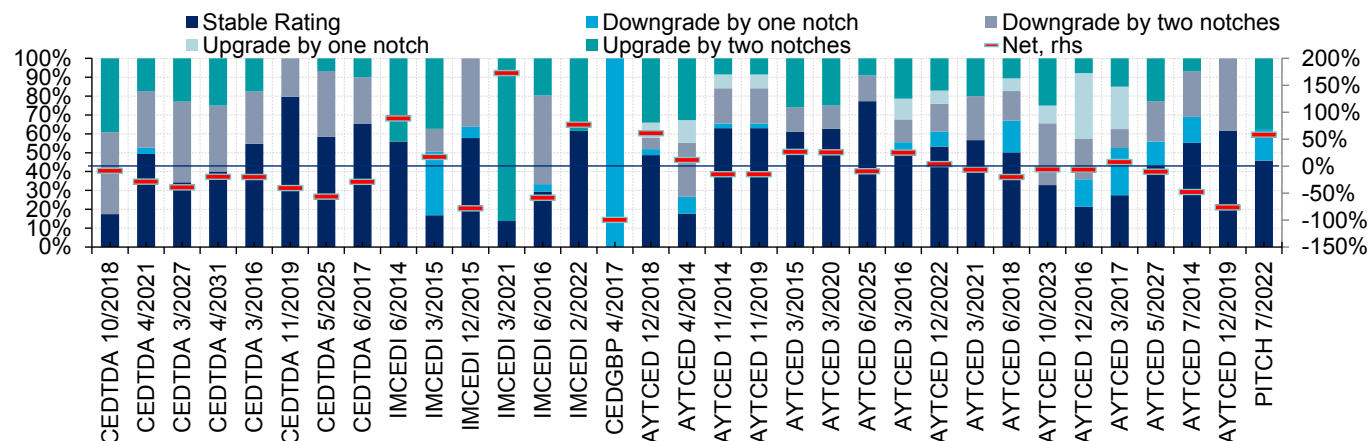
During the last seven months, there have been several rating actions on Spanish banks as well as amendments to assumptions within the covered bond rating methodology. Below the most important ones are listed:

- In July 2013, several Tier-2 banks' covered bonds were downgraded by as much as three notches (among others Bankia, Caja Rurales Unidas and Unicaja). This rating action also led to a change of some multi-cédula ratings to "review for downgrade". The rating actions on the single-cédulas were mainly driven by a downgrade of the senior unsecured rating.
- In September 2013, Moody's published a request for comment on a new approach to determine the anchor point for covered bond ratings given the progress on a European-wide resolution regime. Our conclusion of this change in methodology is that covered bonds issued by lower rated entities would receive less pressure on their ratings while selected upgrades might be on the cards.
- In December 2013, Moody's raised its Timely Payment Indicator from "Improbable" to "Probable" within its methodology. The consequence was that those covered bonds that have been downgraded in July have been upgraded again, albeit only a few came back to pre-July rating levels.
- This week, several Tier-1 covered bond ratings have been upgraded by one or even two notches from A3 to A1 and A2, respectively. This action followed the upgrade of the sovereign and the change in the sovereign ceiling for covered bonds.

Some multi-cédulas' underlying programs have seen substantial upgrades recently

The following graph summarizes the above mentioned rating actions on single-cédulas backing the different multi-structures on a volume-weighted basis. On average, underlying rating actions on single-cédulas have been slightly negative (in order to calculate the net effect, the volume upgraded/downgraded by two notches has been multiplied by +2/-2 while we haven't used factors for one-notch upgrades/downgrades). It can be seen that there are some very positive (e.g. IMCEDI 03/21 and IMCEDI 06/14) and negative outliers (e.g. CEDGBP 04/17). It might be surprising that the average net effect has been negative but this is mainly explained by the fact that some of the banks which have been upgraded recently are not active in the multi-cédula segment (e.g. Bankinter) or play a minor role (Banco Santander and Santander CF).

Figure 42. Rating actions on underlying single-cédulas since the last rating action on multi-cédulas in May 2013, volume weighted

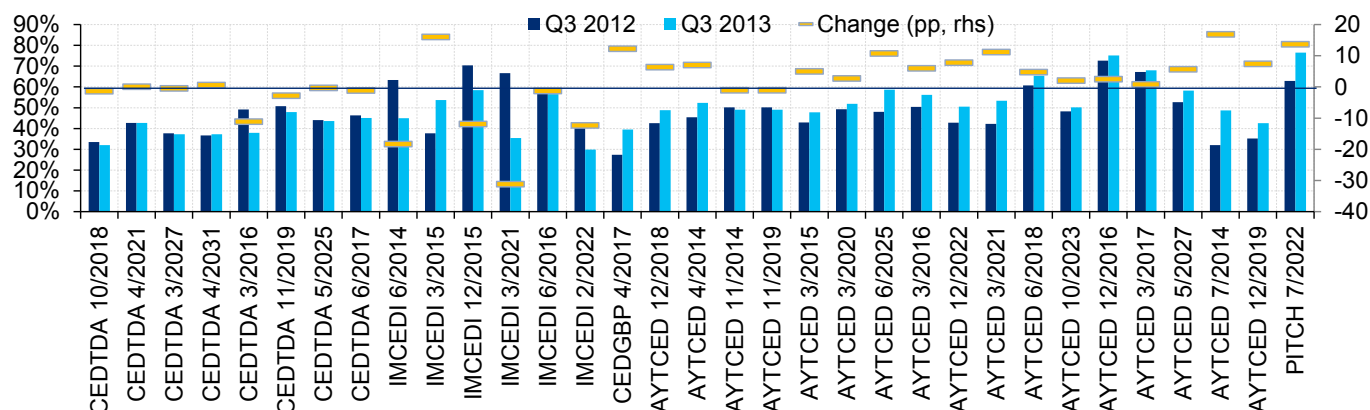


Source: Moody's, Citi Research; net effect: if > 0%, more underlying single-cédulas have been upgraded than downgraded in the observed period

Multi-cédula rating actions are impacted by several factors...

Although it is a helpful guideline to look at the development of underlying single-cédula ratings, one needs to be cautious as ratings of multi-structures are impacted by several other factors. Obviously, the most important factor is expected loss assumptions on the underlying single-cédulas. It should be stated here that the latest upgrades were driven by a technical factor (higher country ceiling) although lower expected loss assumptions should correlate indirectly positively with a higher sovereign rating. A main impact on expected loss assumptions is the credit quality of the cover pool as well as potential refinancing and interest-rate mismatch risks. Such factors display a lower potential risk, the higher the OC buffer is. Total OC levels continued to decrease during the observed period, in some cases by up to 50pp. When comparing eligible OC development in Figure 43, it can be observed that these OC levels increased over the observed period on average. Generally, the negative outliers can be found within the IM cédula structures.

Figure 43. Development of weighted average eligible OC levels (%) and the 1yr change (pp, rhs)



Source: Moody's, Citi Research;

...but also by the sovereign ceiling

An obvious additional factor that impacts the rating is the country ceiling which is also applicable for multi-cédulas. At current stage, 30% of all multi-cédulas are rated at A3 which was the country ceiling until recently. Hence, the uplift of the ceiling by two notches is a positive factor for multi-structures. However, it is not as straightforward to forecast potential upgrades as it was the case for single-cédulas.

One further important factor is the effect of liquidity support which is expected to improve the probability of timely payment. On the one hand, there is the possibility of maturity extension which is given in most multi-structures but differs widely with respect to the lengthening period (between two years and 16 years). On the other hand, multi-structures benefit from liquidity facilities or reserve funds which assure that cover payments are covered. As the credit of the facility provider can differ so can the impact on the final rating. In most cases, the facility provider is ICO, Natixis or Banco Santander.

RV Opportunities

We continue preferring IMCEDI 03/21

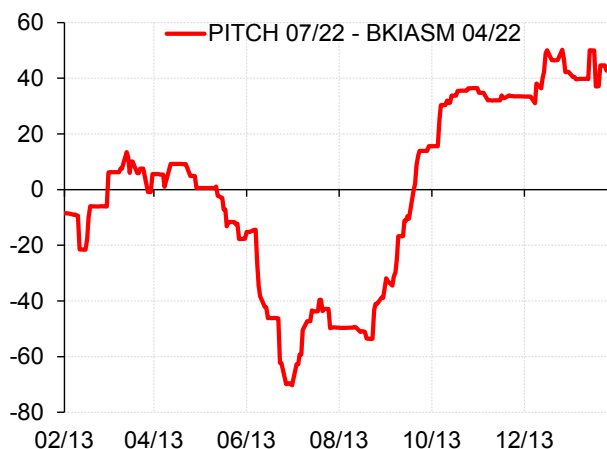
We continue to prefer our recommendation on IMCEDI 03/21 within the multi-cédula segment. The bond has been upgraded by Fitch recently. Although OC levels suffered substantially, 86% of the participating banks were upgraded by two notches recently. And given the spread pick-up over other multi-cédulas this still looks attractive. Moreover, we recommend switching from BKIASM 04/22 to PITCH 07/22. The latter cheapened by more than 100bp against the former while being rated significantly better with further upside pressure.

Figure 44. Prefer IMCEDI 03/21 to CEDTDA 04/21, yield spread, bp



Source: Citi Research

Figure 45. Prefer PITCH 07/22 to BKIASM 04/22, mid-ass, bp



Source: Citi Research

Conclusion

The Spanish multi-cédula segment has been the top-performer year-to date in the covered bond universe as the compression trade continued. One main factor has been the positive momentum with respect to rating stability and/or upgrades. Although total OC numbers continued to fall since the mid of 2012, eligible OC numbers recovered in general. The latest positive changes to single covered bond ratings in Spain has probably been a further prove of recovery of Spain and the cédula market. Additional rating actions are foreseeable. We expect Moody's to act soon given the fact that the final outcome of the Request for comments seems to be on delay and the impact of this will be awaited before further effects are assessable. We expect the final outcome of Moody's rating actions on multi-cédulas to be slightly positive although downgrades should not be ruled out. For more information on OC development and and treatment of multi-cédulas under a default scenario, please see our latest [Covered Bond Strategy](#) publication.

Sovereign Ratings Outlook

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The *Sovereign Ratings Outlook* is a joint product between the Citi economics and rate strategy teams, with input from various other research teams. We aim to forecast the direction and scale of sovereign debt ratings (local currency), as well as any changes in the ratings outlook, for a range of countries. These are our judgments over the ratings outlook, rather than model-determined recommendations. All economic and fiscal forecasts are consistent with those published in Citi's monthly "*Global Economic Outlook and Strategy*" or other research. We do not aim to make a judgment on the financial market implications of ratings changes, except in so far as we expect any such market implications to affect other sovereign ratings.

Given economic updates in this publication and based on rating agency criteria, we highlight our economists' and strategists' main expectations for sovereign ratings over the near (2-3 quarters) and longer (2-4 years) term.

Figure 46. Advanced Economies — Sovereign Long-Term Debt Ratings and Citi Ratings Forecasts

Country	S&P Ratings				Moody's Ratings			
	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Canada	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3 (Stable)	A1 ↓
Germany	AAA	Stable	AAA (Stable)	AAA	Aaa	Neg	Aaa (Stable)	Aaa
France	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa1 (Neg)	Aa2 ↓
Italy	BBB	Neg	BBB (Neg)	BBB- ↓	Baa2	Stable	Baa2 (Stable)	Baa3 ↓
Spain	BBB-	Stable	BBB- (Stable)	BBB ↑	Baa2	Pos	Baa2 (Pos)	Baa1 ↑
Austria	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg)	Aaa
Belgium	AA	Neg	AA (Neg)	AA	Aa3	Neg	Aa3 (Neg)	Aa3
Finland	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Greece	B-	Stable	B- (Stable)	B-	Caa3	Stable	Caa3 (Stable)	Caa3
Ireland	BBB+	Positive	A- (Stable) ↑	A- ↑	Baa3	Positive	Baa2 (Stable) ↑	A3 ↑↑↑
Netherlands	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg)	Aa1 ↓
Portugal	BB	Neg	BB+ (Pos) ↑	BBB- ↑↑	Ba3	Stable	Ba2 (Pos) ↑	Baa3 ↑↑↑
UK	AAA	Neg	AAA (Stable)	AAA	Aa1	Stable	Aa1 (Pos)	Aaa ↑
Switzerland	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Sweden	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Denmark	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Norway	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
EU	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg)	Aa1 ↓
ESM	Not rated				Aa1	Neg	Aa1 (Neg)	Aa2 ↓
EFSF	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa1 (Neg)	Aa2 ↓

Note: Arrows denote expected ratings changes from the current rating. (Neg) denotes negative outlook. (Neg W) denotes negative watch. SD means Selective Default. (P) means Provisional. The number of arrows denotes the expected change in ratings notches from the current level. We show a maximum of five arrows even for countries where we expect more than five notches of ratings change. NA Not available. Sources: Moody's, S&P and Citi Research

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Expected Ratings Issues

Spain — now Baa2 positive by Moody's: Since we last published, Spain became the latest sovereign to benefit from a ratings upgrade when Moody's revised its rating from Baa3 stable to Baa2 positive on 21 February ([Euro Rates Strategy - Spain Upgraded By Moody's To Baa2](#)). The report acknowledged the general economic improvement and the reduced implementation risks of Spain's reform agenda. However, drilling into the drivers, Moody's growth and debt forecasts did not change much from their last report (continuing to expect growth around 0.8% in 2014 and debt-to-GDP to peak at around 102% in the middle of the decade). Assessing their scorecard representation, the main change came in their "event risk" score which moved from "M+" to "M-" (where M stands for "moderate" and is in the middle of their scale from "Very High" to "Very Low"). This essentially reflects lower funding costs, the security of market access and the assessment that broader contagion fears are reduced. With the rating now on positive outlook, we believe further upgrades are likely over the longer term.

Italy — now Baa2 stable by Moody's: Moody's also revised its outlook on Italy's Baa2 rating from negative to stable since we last published. This was driven primarily by two factors: 1) the resilience of the government's financial strength (Moody's expecting debt to GDP to level off in 2014) and 2) the reduction in tail risks associated with Italy's contingent liabilities. We do not anticipate any change in Italy's rating in the quarters ahead. However, due to remaining concerns about Italy's competitive position and growth outlook, Citi expects downgrade risks to remain over the longer-term.

Portugal — a return to market is a credit positive: Risks to Portugal's growth outlook are now to the upside and bond yields continue to tumble (10yr Portugal is now around 4.84% from a high of over 7.5% over the last 12 months and an all-time peak of over 16% in early 2012). We now expect that Portugal can and will exit its Troika programme without the need for extra official support. We expect rating agencies increasingly to acknowledge this and, in doing so, we expect an upgrade by Moody's and S&P later this year.

Ireland — Moody's upgraded Ireland from Ba1 Stable (sub-IG) to Baa3 Pos (IG) on 17 January. Ireland is now rated Investment Grade by all three rating agencies with a positive outlook by both Moody's and S&P. We expect another upgrade of Ireland by both agencies later this year ([Ireland UPGRADED](#)).

Austria — Austria's banking sector weaknesses remain an important sovereign credit driver. On balance, we do not think a downgrade of Austria by Moody's is automatic on Friday, and our base case is for the Aaa negative outlook to remain.

Germany — Given subsiding event risk and the improved market tone, we believe Moody's will restore Germany's Aaa outlook from negative to stable this Friday ([The Morning Call - The Week Ahead: 24th February-2nd March](#)).

UK — Given the strong performance of the UK economy, we believe S&P will return its AAA rating of the UK back to stable in 2014. The next opportunity for this to occur is on 6 June when the UK features in S&P's calendar. We also see the growing possibility that Moody's places the UK back onto positive outlook and ultimately upgrades the rating from Aa1 to Aaa. This is largely based on the strongly improved growth environment.

US — The US is rated AA+ Stable by S&P and Aaa Stable by Moody's and we do not anticipate any change in the US rating over the long term.

Figure 47. Upcoming Rating Calendar

Date	Sovereign	Rating Agency	Current Rating	Current Outlook
28-Feb-14	Austria	Moody's	Aaa	Neg
28-Feb-14	Belgium	S&P	AA	Neg
28-Feb-14	Luxembourg	Moody's	Aaa	Neg
28-Feb-14	Germany	Moody's	Aaa	Neg
07-Mar-14	Netherlands	Moody's	Aaa	Neg
07-Mar-14	Belgium	Moody's	Aa3	Neg
14-Mar-14	EU	Moody's	Aaa	Neg
21-Mar-14	Cyprus	Moody's	Caa3	Neg
21-Mar-14	Greece	S&P	B-	Stable
28-Mar-14	Austria	S&P	AA+	Stable
28-Mar-14	Estonia	Moody's	A1	Stable
28-Mar-14	Luxembourg	S&P	AAA	Stable

Sources: Citi Research, Moody's, S&P and Bloomberg

EUREX Calendar Rolls (H4/M4)

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In this section we provide a snapshot of our latest views on the EUREX calendar rolls. A full write up of the Bund, Bobl and Schatz rolls can be found in [Euro Rates Strategy](#) and the OAT, BTP and Buxl rolls can be found in [The Morning Call](#)

Summary of our views

- Bearish on the Bund, Bobl and BTP rolls
- Slightly bearish on the OAT roll
- Neutral on the Schatz and Buxl rolls

Figure 48. Summary of views

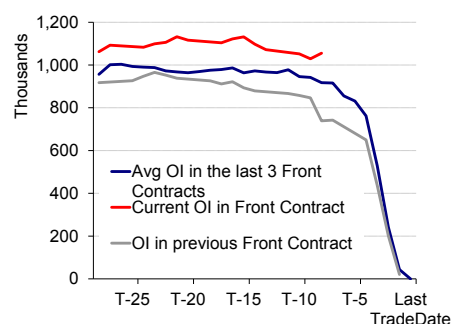
	RX	OE	DU	BUXL	OAT	IK
Market Level (at the time of writing)	190	165	7	100	167	61
Fair Value for roll (using mid-mkt repo)	187	167	9	99	161	54
View	Bearish	Bearish	Neutral	Neutral	Slightly Bearish	Bearish
Action	Longs roll early and shorts late	Longs roll early and shorts late	-	-	Longs roll early and shorts late	Longs roll early and shorts late
Main driver(s)	Positioning	Positioning	Positioning and yield curve	Positioning	Positioning	Positioning and yield changes
Probability of CTD switch in either contract	very low	very likely in the front contract	very low	high	very low	very high
Hedge ratio (H4 to M4): 1000 vs	1009	1005	880	999	1003	910

Source: Citi Research

3 points worth noting

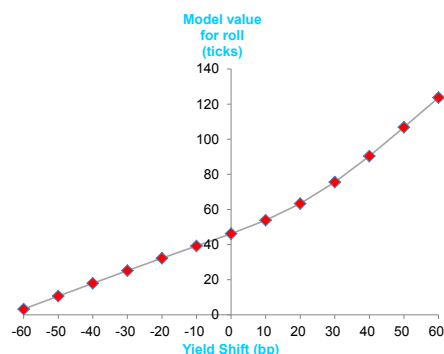
- The probability of a CTD switch in the March Bobl contract and both Buxl contracts is very high but we do not expect a CTD switch to have an impact on the roll.
- There is a lot of optionality in the BTP roll and we would expect the fair value of the roll to decrease as BTP yields fall.
- The open interest in the front Bund and BTP contracts is much higher than the average level in the last 3 front contracts

Figure 49. Open Interest on the Bund roll is much higher than previous rolls



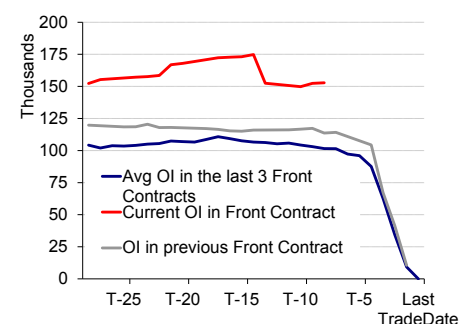
Source: Citi Research

Figure 50. The fair value of the roll should decrease if BTPs rally further



Source: Citi Research

Figure 51. Open Interest in the BTP roll is much higher than average levels



Source: Citi Research

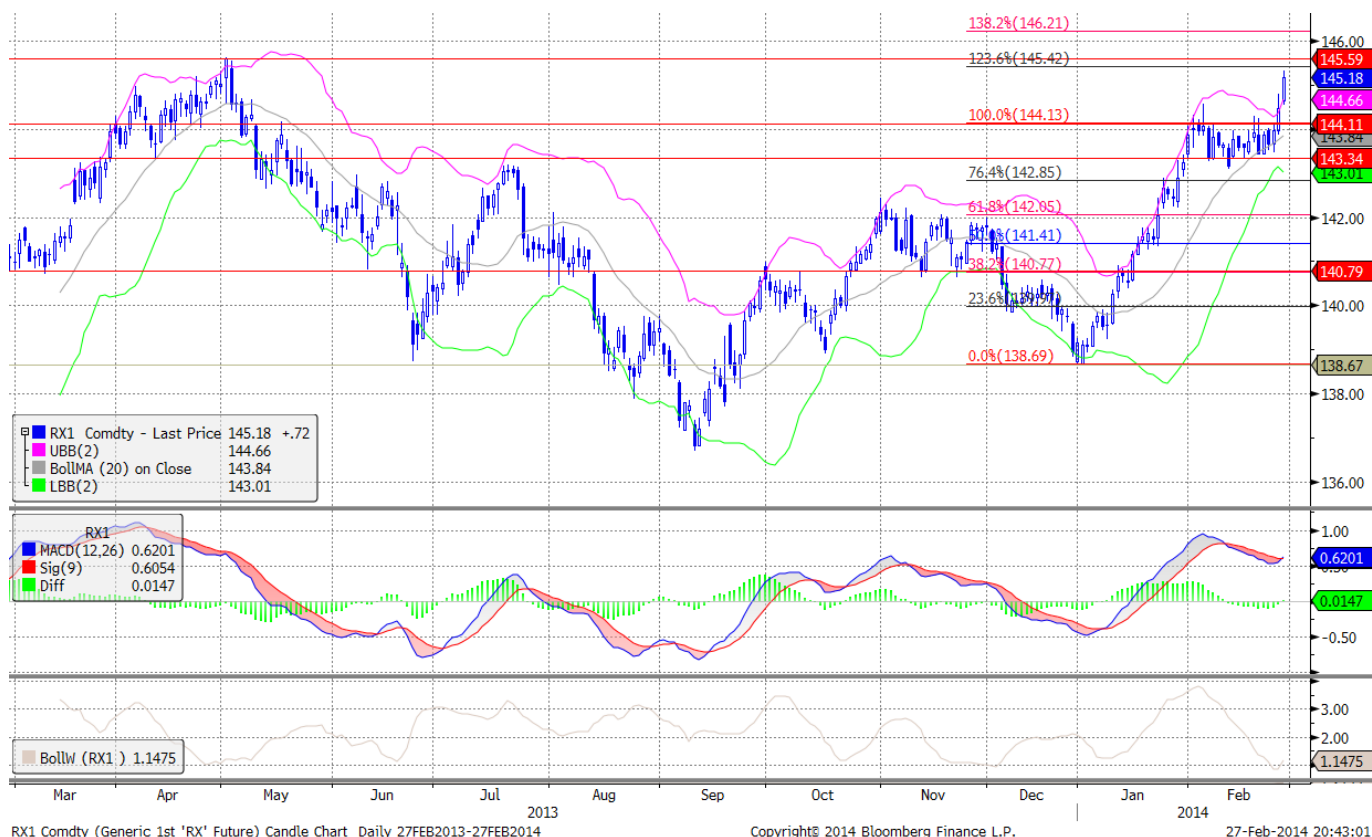
Technical update: Bunds and gilts

Bunds – wait for signs of slowing momentum

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Bunds have broken their 3-week range of 80c and have already reached its measuring target over the last two days (Figure 52). It is currently testing the long-term resistance at 145.2 seen on the monthly chart, a level where 2008-2013 rally ended. Various technical indicators like RSI, slow stochastic and MACD now indicate strong upward momentum. The Chaikin oscillator has also crossed over into the positive territory today. We would be wary of any short positions here. However, the move is stretching Bollinger bands, which indicates that this uptrend might be short-lived. Therefore we would wait for signs of slowing momentum to enter shorts.

Figure 52. 10yr continuous daily Bund futures with Fibonacci levels, MACD (12,26) and 20-day Bollinger bands



RX1 Comdty (Generic 1st 'RX' Future) Candle Chart Daily 27FEB2013-27FEB2014 Copyright© 2014 Bloomberg Finance L.P. 27-Feb-2014 20:43:01

Source: Bloomberg

Resistances

1. 145.6 (1-year peak on a roll-adjusted basis and 23.2% Fibonacci extension of the latest rally)
2. 146.2 (38.2% Fibonacci extension)

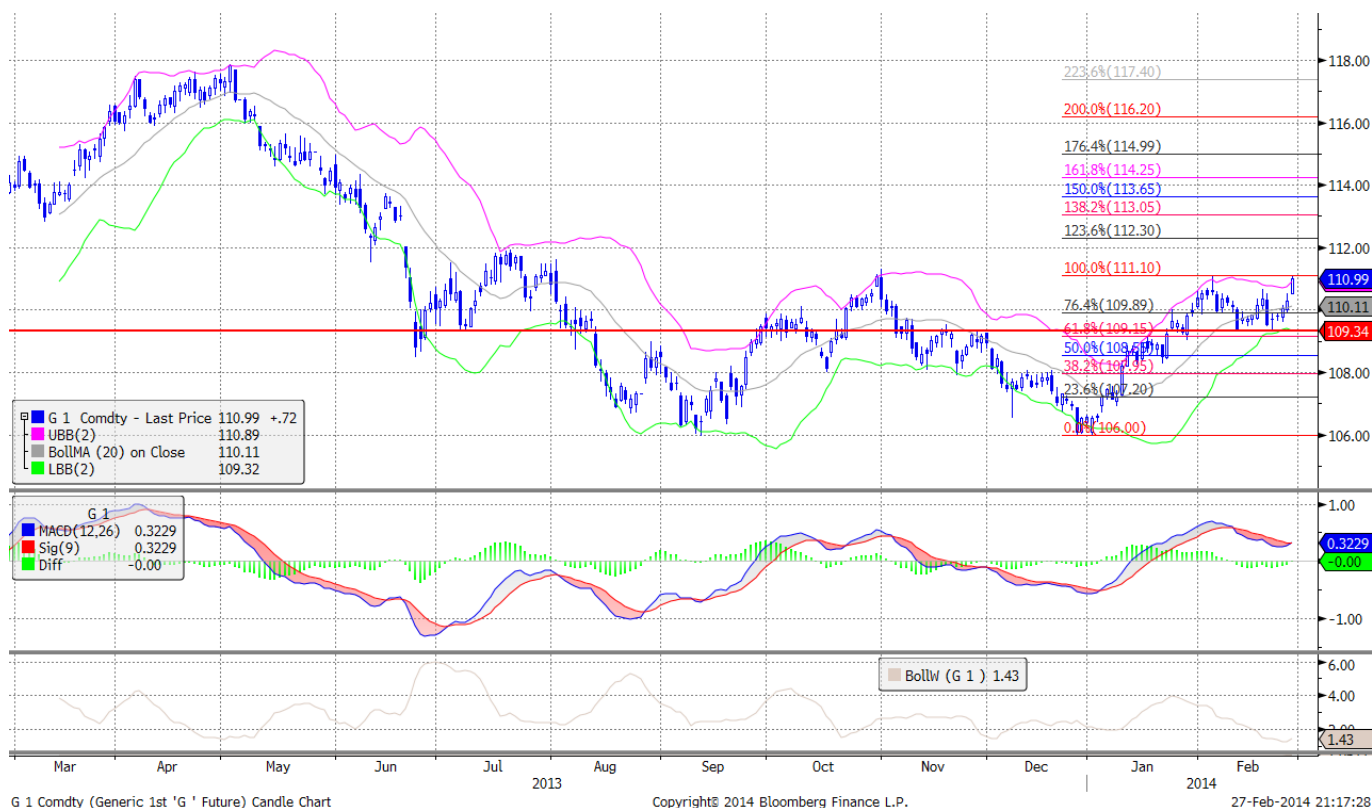
Supports

1. 144.1 (previous resistance, will now act as a support)
2. 143.3 (bottom of the recent trading range)
3. 142 (38.2% retracement level).

Gilts – a sustained breach of 110.55 would target 115

Gilts have broken the short term range on the upside and the move is accompanied by high volumes. This also prevented the formation of a double top (Figure 53). However, on a longer term horizon, we would wait for the weekly close tomorrow vis-à-vis 110.55 (Figure 54). A close above 110.55 would break the 7-month range and would be considered very bullish from a technical perspective. If such a move is sustained, it would also form a double bottom and give a measuring target of 115. However, a close below 110.55 would mean a continuation of the range trading with a target of 106.

Figure 53. 10yr continuous daily gilt futures with Fibonacci levels, MACD (12,26) and 20-day Bollinger bands



G 1 Comdty (Generic 1st 'G' Future) Candle Chart

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27-Feb-2014 21:17:28

Source: Bloomberg

Figure 54. Gilt futures (weekly chart)



Source: Bloomberg

Supports

1. 109.34 (recent support below the possible double top formation)
2. 107.9 (strong support and 61.8% Fibonacci retracement of the latest rally)
3. 106 (bottom of the current trading range and also the lowest level in a year, on a roll-adjusted basis)

Resistances

1. 112.3 (23.6% Fibonacci extension)
2. 113 (38.2% Fibonacci extension).

4 Week Auction Calendar: US, EMU-10, UK

Mohit Aggarwal
Nishay Patel

This is an excerpt from our latest [Weekly Supply Monitor](#) that was published earlier today. For further details (such as a breakdown of upcoming coupon payments, redemptions and our longer term supply forecasts) please see the original note.

Figure 55. Provisional Auction Calendar for the Next Four Weeks, Gross Issuance (Billions), DV01 (USD Millions)

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 \$million/bp	Approx. Number 10yr Futures		
					TYH4 (UST)	G H4 (Gilt)	RXH4 (Bund)
04 Mar (Tue)	Austria	1.2	RAGB 1.15% Oct18 and 1.75% Oct23 (issue confirmed, size €1.21bn)				7k
04 Mar (Tue)	UK	4.25	1.75% Treasury Gilt 2019 (issue and size confirmed)			24k	
05 Mar (Wed)	Germany	4.0	Bobl Feb19 re-opening (issue and size confirmed)				16k
06 Mar (Thu)	France	8.5	OAT 5yr, 10yr and 30yr (estimated tenors and size)				98k
06 Mar (Thu)	Spain	5.0	Bono 2yr, 5yr and 15yr (estimated tenors and size including post auction facility)				22k
Weekly \$DV01 of Issuance				27.5			
Total Number of Futures Contracts					0k	24k	143k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 \$million/bp	Approx. Number 10yr Futures		
					TYH4 (UST)	G H4 (Gilt)	RXH4 (Bund)
11 Mar (Tue)	Germany	1.0	Boblei/Bundei (estimated size)				8k
11 Mar (Tue)	Netherlands	3.0	DSL Apr17 re-opening (issue confirmed, estimated size)				5k
11 Mar (Tue)	UK	3.2	New conventional gilt maturing on 7 September 2024 (issue confirmed, estimated size)			32k	
11 Mar (Tue)	US	30.0	3-Year		97k		
12 Mar (Wed)	Germany	4.0	Schatz Mar16 re-opening (issue and size confirmed)				7k
12 Mar (Wed)	US	21.0	10-Year (re-opening)		230k		
13 Mar (Thu)	Italy	7.5	BTP 3yr, 7yr and 15yr (estimated tenor and size)				38k
13 Mar (Thu)	Ireland	1.0	Ireland 5yr and 10yr (estimated tenor and size)				6k
13 Mar (Thu)	UK	1.4	01/8% Index-linked Treasury Gilt 2019 (issue confirmed, estimated size)			8k	
13 Mar (Thu)	US	13.0	30-year (re-opening)		294k		
Weekly \$DV01 of Issuance				65.0			
Total Number of Futures Contracts					621k	40k	63k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 \$million/bp	Approx. Number 10yr Futures		
					TYH4 (UST)	G H4 (Gilt)	RXH4 (Bund)
19 Mar (Wed)	Germany	4.0	Bund Feb24 re-opening (issue and size confirmed)				30k
20 Mar (Thu)	France	9.7	OAT 2yr and 5yr, index-linked OAT (estimated tenors and size)				33k
20 Mar (Thu)	Spain	5.0	Bono 5yr, 10yr and 30yr (estimated tenors and size)				43k
20 Mar (Thu)	US	13.0	10-Year TIPS (re-opening)		153k		
21 Mar (Fri)	Italy	3.5	CTZ (estimated size)				6k
21 Mar (Fri)	Italy	1.2	BTPei (estimated size)				9k
Weekly \$DV01 of Issuance				31.9			
Total Number of Futures Contracts					153k	0k	122k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 \$million/bp	Approx. Number 10yr Futures		
					TYH4 (UST)	G H4 (Gilt)	RXH4 (Bund)
24 Mar (Mon)	Belgium	4.0	We believe the auction will be cancelled and a 5yr syndication will be conducted in March. Should the auction be conducted, we would expect it to be around €3bn.				16k
25 Mar (Tue)	Netherlands	5.0	New DSL Jul24 via DDA (issue confirmed, min €5bn)				38k
25 Mar (Tue)	US	32.0	2-Year		103k		
26 Mar (Wed)	US	35.0	5-year		190k		
26 Mar (Wed)	US	13.0	2-Year FRN (re-opening)		42k		
27 Mar (Thu)	UK	1.4	0.25% Index-linked Treasury Gilt 2052 (issue confirmed, estimated size)			52k	
27 Mar (Thu)	US	29.0	7-year		225k		
28 Mar (Fri)	Italy	5.8	BTP 5yr and 10yr (estimated tenor and size)				33k
28 Mar (Fri)	Italy	1.8	CCTeu (estimated size)				7k
Weekly \$DV01 of Issuance				67.2			
Total Number of Futures Contracts					559k	52k	94k

The next release of the tentative outright Treasury operation schedule will be at 3 p.m. on February 28, 2013. Therefore we have not included Fed buybacks in this calendar.

Source: DMOs, Citi Research

EUR: Coupons & Redemptions (next 3 mths)

Figure 56. EMU-10 Redemptions over the next three months (€bn)

Redemptions = €107bn											
Redemptions	DEU 34	FRA 21	NLD 0	ITA 28	ESP 15	BEL 9	AUT 0	FIN 0	PRT 0	GRC 0	IRL 0
(Sat) 01-Mar-14				13.4							
(Fri) 14-Mar-14	15.0										
(Fri) 28-Mar-14						8.7					
(Tue) 01-Apr-14				14.8							
(Fri) 11-Apr-14	19.0										
(Fri) 25-Apr-14		20.7									
(Wed) 30-Apr-14					15.4						

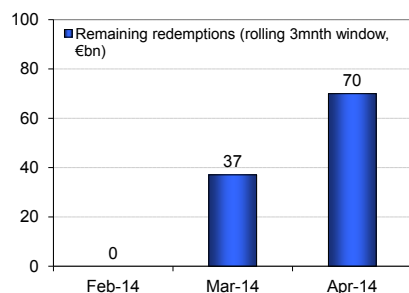
Source: DMOs, Bloomberg, Citi Research

Figure 57. EMU-10 Coupon Payments over the next three months (€bn)

Coupons = €55bn											
Coupons	DEU 3	FRA 18	NLD 0	ITA 17	ESP 5	BEL 6	AUT 2	FIN 1	PRT 1	GRC 0	IRL 2
(Thu) 27-Feb-14	0.4										
(Sat) 01-Mar-14				7.2							
(Tue) 11-Mar-14	0.0										
(Thu) 13-Mar-14	0.0										0.6
(Fri) 14-Mar-14	0.0										
(Sat) 15-Mar-14				1.9			1.4				
(Tue) 18-Mar-14											0.1
(Thu) 20-Mar-14											0.2
(Fri) 28-Mar-14						6.5					
(Mon) 31-Mar-14					0.3						
(Tue) 01-Apr-14				0.2							
(Mon) 07-Apr-14	0.1										
(Tue) 08-Apr-14	0.5										
(Thu) 10-Apr-14	0.4										
(Fri) 11-Apr-14	0.4										
(Sun) 13-Apr-14	0.0										
(Tue) 15-Apr-14	0.7		0.1	0.8				0.8	0.6		
(Fri) 18-Apr-14											1.0
(Sun) 20-Apr-14							0.3				
(Fri) 25-Apr-14		16.8									
(Wed) 30-Apr-14					4.7						
(Thu) 01-May-14				5.6							
(Mon) 12-May-14				0.2							
(Thu) 15-May-14	0.3			0.8							
(Tue) 20-May-14											0.0
(Fri) 23-May-14							0.1				
(Sun) 25-May-14		1.4									

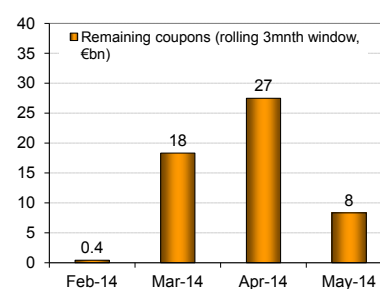
Source: DMOs, Bloomberg, Citi Research

Figure 58. EMU-10 remaining redemptions over the next 3months (€bn)



Source: DMOs, Bloomberg, Citi Research

Figure 59. EMU-10 remaining coupons over the next 3months (€bn)



Source: DMOs, Bloomberg, Citi Research

ESP and ITA Bill Issuance Projections

This page contains our projections for Spanish and Italian bill supply in 2013.

Auction calendar for the next four weeks

Figure 60. Provisional Bill Auction Calendar for the Next Four Weeks, Gross Issuance (Billions), DV01 (EUR Million/bp)

Week	Date	Country	Issue Details	Total Size (€bn)
Week 2	11 Mar (Tue)	Spain	6month (19 September 2014) and 12month (new bill) - tenors confirmed, estimated issue and size	5.3
	12 Mar (Wed)	Italy	12 month (13 March 2015; issue confirmed, estimated size)	9
Total Size in Week 2				14.3
Week 3	18 Mar (Tue)	Spain	3month (20 June 2014) and 9month (21 December 2014) - tenors confirmed, estimated issue and size	3.4
Total Size in Week 3				3.4
Week 4	27 Mar (Thu)	Italy	6 month (30 September 2014; issue confirmed, estimated size)	8.5
Total Size in Week 4				8.5

Italy announces issue size 3 business days before the auction

Spain announces issue details 1 business day before the auction

Source: DMOs, Citi Research

2014 projections for bill supply

Figure 61. 2014 Italy and Spain Bill Supply – Citi Forecast (Euro Billion)

SPAIN	3m	6m	9m	12m	18m	Gross Supply	Redemptions	NCR
Jan	1.0	1.0	2.2	3.1		7	8	-1
Feb	0.9	1.0	2.5	4.0		8	11	-3
Mar	0.9	1.3	2.5	4.0		9	10	-1
Apr	0.9	1.5	3.0	4.0		9	12	-3
May	0.9	1.5	3.0	4.0		9	8	1
Jun	0.9	1.5	3.0	4.0		9	14	-4
Jul	0.8	1.5	3.0	4.0		9	8	2
Aug	0.8	1.5	3.0	4.0		9	8	2
Sep	0.8	1.5	3.0	4.0		9	8	2
Oct	0.8	1.5	3.0	3.8		9	9	
Nov	0.8	1.5	3.0	3.8		9	8	1
Dec	0.8	1.5	3.0	3.8		9	8	1
Total	10.0	16.8	34.2	46.3		107	111	-3

ITALY	3m*	6m	9m	12m	Flexible BOT	Gross Supply	Redemptions	NCR
Jan		8.1		9.3		17	20	-2
Feb		9.0		8.0		17	19	-2
Mar		9.0		9.0		18	16	2
Apr	3.0	9.0		9.0		21	17	4
May		9.0		6.5	3.0	19	14	5
Jun		9.0		6.5		16	16	
Jul		9.0		6.5		16	18	-3
Aug		9.0		8.0		17	18	-1
Sep		8.5		8.0	3.0	20	19	1
Oct		8.5		8.0		17	19	-2
Nov		7.0		7.0		14	16	-2
Dec		7.0		6.0		13	15	-2
Total	3.0	102.1		91.8	6.0	203	206	-3

*3month bills will be issued only for specific cash needs. In this case, auctions shall be held on the 12 month BOT auction dates

Source: DMOs, Bloomberg, Citi estimates

Inflation Forecasts, Carry & Weekly Changes

Figure 62. Citi Inflation Forecasts

Month	EUR HICP _{XT}			France CPI _{XT}			UK RPI			US CPURNSA		
	Index	MoM	YoY	Index	MoM	YoY	Index	MoM	YoY	Index	MoM	YoY
	Forecast	Change	Change	Forecast	Change	Change	Forecast	Change	Change	Forecast	Change	Change
Jan 14	115.93	-1.2	0.7	125.04	-0.6	0.5	252.60	-0.3	2.8	233.92	0.4	1.6
Feb 14	116.23	0.3	0.6	125.42	0.3	0.6	253.60	0.4	2.4	234.90	0.4	1.2
Mar 14	117.50	1.1	0.5	126.59	0.9	0.7	254.20	0.2	2.2	236.40	0.6	1.6
Apr 14	117.83	0.3	0.9	126.49	-0.1	0.8	255.30	0.4	2.3	236.90	0.2	1.9
May 14	117.84	0.0	0.8	126.75	0.2	0.9	256.00	0.3	2.4	237.40	0.2	1.9
Jun 14	117.87	0.0	0.7	126.88	0.1	0.9	256.20	0.1	2.6	237.60	0.1	1.8

Source: Citi Research, Bloomberg

Shaded = Already released

Figure 63. US TIPS Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp)				BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp)			ZC Swap - BE Spread (bp)	Chg (bp)
				1 Apr	1 May	1 Jun	Ref				1 Apr	1 May	1 Jun		
Repo (%)				0.08	0.08	0.08									
TIPS 4/15	-1.79	-13	-10	20	49	108	US-2.500-04/30/15	192	10	6	19	48	107	19	6
TIPS 7/15	-2.12	-12	-9	14	34	77	US-4.250-08/15/15	231	8	5	13	33	74	23	7
TIPS 1/16	-1.65	-13	-11	12	29	61	US-2.625-02/29/16	197	8	6	11	27	58	21	1
TIPS 4/16	-1.49	-14	-12	11	27	55	US-2.000-04/30/16	187	11	9	10	24	50	16	-4
TIPS 7/16	-1.72	-13	-11	9	22	46	US-4.875-08/15/16	220	7	5	8	19	41	11	-0
TIPS 1/17	-1.29	-12	-11	9	21	42	US-3.125-01/31/17	194	7	5	7	17	36	21	-1
TIPS 4/17	-1.09	-11	-10	9	20	39	US-0.875-04/30/17	187	6	5	7	16	33	21	-2
TIPS 7/17	-1.25	-11	-10	8	18	36	US-4.750-08/15/17	214	5	4	6	14	29	15	-0
TIPS 1/18	-0.91	-12	-12	8	17	33	US-3.500-02/15/18	201	5	4	5	12	26	21	-1
TIPS 4/18	-0.74	-12	-12	7	16	31	US-0.625-04/30/18	193	4	4	5	12	24	24	-0
TIPS 7/18	-0.88	-12	-12	7	15	29	US-4.000-08/15/18	215	4	3	4	10	21	19	0
TIPS 1/19	-0.59	-12	-12	7	15	28	US-2.750-02/15/19	206	4	3	4	10	20	22	1
TIPS 7/19	-0.52	-14	-14	6	14	26	US-3.625-08/15/19	215	6	5	3	8	18	23	-1
TIPS 1/20	-0.27	-14	-13	6	13	25	US-3.625-02/15/20	204	5	4	3	8	16	31	-1
TIPS 7/20	-0.23	-14	-14	6	12	23	US-2.625-08/15/20	218	4	4	3	7	14	26	1
TIPS 1/21	-0.01	-16	-16	6	12	22	US-3.625-02/15/21	207	6	5	3	6	13	35	-1
TIPS 7/21	0.01	-15	-15	5	11	20	US-2.125-08/15/21	220	6	5	2	6	12	29	-0
TIPS 1/22	0.22	-16	-16	5	11	19	US-2.000-02/15/22	212	7	6	2	5	11	36	-1
TIPS 7/22	0.22	-15	-15	5	10	18	US-1.625-08/15/22	223	4	4	2	5	10	32	2
TIPS 1/23	0.36	-17	-17	5	10	18	US-2.000-02/15/23	216	7	6	2	4	10	36	-0
TIPS 7/23	0.36	-17	-17	4	9	17	US-2.500-08/15/23	223	6	6	2	4	9	35	-0
TIPS 1/24	0.47	-15	-15	4	9	16	US-2.750-02/15/24	218	5	5	2	4	9	38	1
TIPS 1/25	0.54	-18	-18	4	9	16	US-7.625-02/15/25	211	6	6	1	4	8	48	-1
TIPS 1/26	0.67	-16	-16	4	8	15	US-6.000-02/15/26	215	4	3	1	3	7	46	1
TIPS 1/27	0.76	-11	-11	4	8	15	US-6.625-02/15/27	215	-1	-1	1	3	7	48	5
TIPS 1/28	0.85	-11	-11	4	8	13	US-6.125-11/15/27	214	-1	-2	1	2	6	51	5
TIPS 4/28	0.83	-13	-13	4	8	14	US-5.500-08/15/28	224	1	0	1	3	7	40	2
TIPS 1/29	0.89	-13	-13	4	7	13	US-5.250-02/15/29	223	1	1	1	3	6	44	2
TIPS 4/29	0.88	-14	-14	4	8	14	US-5.250-02/15/29	224	2	2	1	3	6	42	1
TIPS 4/32	0.99	-13	-13	3	7	12	US-5.375-02/15/31	223	1	1	1	2	5	46	0
TIPS 2/40	1.28	-14	-14	2	5	9	US-4.625-02/15/40	221	2	2	0	1	3	51	-2
TIPS 2/41	1.30	-10	-11	2	5	8	US-4.750-02/15/41	221	-1	-2	0	1	3	51	2
TIPS 2/42	1.35	-11	-11	2	4	7	US-3.125-02/15/42	225	-1	-1	0	1	2	48	2
TIPS 2/43	1.35	-13	-13	2	4	7	US-3.125-02/15/43	227	2	2	0	1	2	46	-1

Source: Citi Research, Bloomberg

Figure 64. EUR Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp)			Ref	BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp)			ZC Swap - BE Spread (bp)	Chg (bp)
				1 Apr	1 May	1 Jun					1 Apr	1 May	1 Jun		
Repo (%)				0.15	0.14	0.13									
OATei15	-0.76	-4	2	-85	-76	7	FFRG 4/15	90	3	-3	-85	-76	6	16	-3
BUNDei16	-0.31	-4	-0	-54	-45	9	BUND 1/16	37	1	-3	-54	-44	10	13	-0
BTANI16	-0.71	-5	-4	-27	-18	22	FFRG 4/16	91	0	-1	-27	-18	21	33	-4
BTPei16	0.59	-6	-4	-42	-31	18	BTP 8/16	55	-4	-7	-46	-39	6	40	4
OATi17	-0.57	-7	-6	-19	-12	16	FFRG 4/17	95	-2	-3	-19	-13	14	34	-2
BTPei17	0.94	-9	-8	-30	-21	15	BTP 8/17	69	-4	-6	-34	-29	3	35	3
BOBLEi18	-0.35	-2	-0	-27	-22	4	BUND 1/18	62	-6	-8	-27	-23	3	27	5
OATei18	-0.25	-5	-4	-25	-20	5	FFRG 4/18	87	-6	-8	-26	-22	2	34	3
BTPei18	1.24	-7	-6	-23	-15	14	BTP 8/18	73	-6	-8	-26	-22	2	42	6
OATi19	-0.20	-11	-11	-11	-6	12	FFRG 4/19	109	-3	-3	-13	-9	8	34	-2
BTPei19	1.42	-11	-10	-19	-12	12	BTP 9/19	88	-2	-4	-22	-19	1	37	1
BUNDei20	-0.18	-6	-4	-19	-15	4	BUND 1/20	89	-5	-7	-20	-17	1	27	4
OATi20	0.04	-10	-9	-18	-14	5	FFRG 4/20	111	-5	-7	-19	-17	0	27	2
OATi21	0.22	-12	-12	-8	-3	10	FFRG 4/21	120	-4	-4	-9	-7	5	42	-1
BTPei21	2.00	-9	-9	-13	-7	11	BTP 9/21	91	-6	-8	-17	-15	0	54	5
OATei22	0.35	-10	-9	-13	-10	4	FFRG 4/21	106	-5	-7	-15	-13	-1	50	3
BUNDei23	0.13	-9	-8	-12	-9	3	BUND 1/22	103	-3	-4	-13	-11	0	47	3
OATi23	0.45	-12	-12	-6	-2	9	FFRG 10/23	150	-6	-6	-8	-6	3	28	1
BTPei23	2.35	-11	-11	-11	-6	10	BTP 8/23	98	-7	-8	-14	-12	0	65	6
OATei24	0.62	-12	-11	-10	-7	4	FFRG 10/23	133	-7	-8	-12	-11	-1	39	5
BTPei26	2.62	-8	-8	-8	-4	9	BTP 3/26	106	-7	-8	-11	-10	-1	75	5
OATei27	0.82	-11	-10	-8	-6	4	FFRG 4/26	156	-5	-6	-10	-9	-2	30	2
OATi29	0.78	-12	-12	-4	-1	7	FFRG 4/29	183	-4	-4	-6	-5	1	22	1
OATi32	0.97	-12	-12	-7	-5	3	FFRG 10/32	181	-4	-5	-8	-8	-2	19	2
BTPei35	2.68	1	1	-5	-2	6	BTP 8/34	156	-11	-12	-8	-8	-2	46	10
OATei40	1.08	-12	-12	-5	-3	2	FFRG 4/41	195	-5	-5	-6	-6	-2	13	3
BTPei41	3.00	-4	-4	-4	-2	5	BTP 9/40	142	-6	-6	-7	-6	-2	68	4

Source: Citi Research

Figure 65. UK Gilts Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp)			Ref	BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp)			ZC Swap - BE Spread (bp)	Chg (bp)
				1 Apr	1 May	1 Jun					1 Apr	1 May	1 Jun		
Repo (%)				0.42	0.42	0.42									
UKTi Jul16	-1.94	-1	-2	2	5	7	UKT 9/16	272	-2	-2	1	2	3	33	2
UKTi Nov17	-1.45	-4	-7	-13	-6	-4	UKT 3/18	285	-5	-3	-15	-11	-11	24	-11
UKTi Nov19	-0.89	-7	-8	-7	-2	0	UKT 9/19	278	-4	-3	-10	-7	-8	37	3
UKTi Apr20	-0.81	-8	-9	3	5	8	UKT 3/20	281	-4	-4	0	0	0	29	3
UKTi Nov22	-0.42	-9	-11	-5	-1	1	UKT 3/22	281	-3	-2	-7	-5	-6	42	2
UKTi Mar24	-0.16	-10	-11	-4	0	2	UKT 3/25	294	-3	-2	-6	-5	-5	28	2
UKTi Jul24	-0.22	-10	-10	2	4	7	UKT 3/25	300	-3	-3	0	0	0	30	2
UKTi Nov27	-0.04	-8	-9	-3	0	2	UKT 12/27	308	-4	-3	-5	-4	-5	33	2
UKTi Mar29	0.07	-6	-7	-2	0	2	UKT 12/30	314	-3	-3	-4	-4	-4	27	1
UKTi Jul30	0.00	-6	-6	2	3	5	UKT 6/32	327	-4	-4	0	0	-1	22	-5
UKTi Nov32	0.05	-5	-6	-2	0	1	UKT 6/32	322	-5	-4	-4	-4	-4	32	3
UKTi Mar34	0.09	-5	-5	-2	0	1	UKT 9/34	325	-5	-4	-4	-3	-4	29	2
UKTi Jan35	0.06	-5	-5	1	3	4	UKT 3/36	332	-5	-5	0	-1	-1	25	3
UKTi Nov37	0.07	-4	-5	-2	0	1	UKT 12/38	333	-5	-5	-3	-3	-4	27	3
UKTi Mar40	0.08	-4	-5	-1	0	1	UKT 9/39	335	-5	-4	-3	-3	-4	25	4
UKTi Nov42	0.04	-4	-5	-1	0	1	UKT 12/42	339	-4	-4	-3	-3	-4	24	2
UKTi Mar44	0.08	-5	-5	-1	0	1	UKT 1/44	341	-4	-4	-3	-3	-3	21	2
UKTi Nov47	0.05	-4	-5	-1	0	1	UKT 12/46	341	-4	-4	-3	-3	-3	22	2
UKTi Mar50	0.06	-4	-5	-1	0	1	UKT 12/49	338	-4	-4	-2	-3	-3	22	2
UKTi Mar52	0.06	-4	-5	-1	0	1	UKT 7/52	339	-4	-4	-2	-2	-3	21	2
UKTi Nov55	0.03	-4	-4	-1	0	1	UKT 12/55	339	-4	-4	-2	-2	-3	22	2
UKTi Mar62	0.03	-4	-4	-1	0	1	UKT 1/60	338	-4	-4	-2	-2	-3	21	2
UKTi Mar68	0.03	-4	-4	-1	0	0	UKT 7/68	340	-4	-4	-2	-2	-3	18	3

Source: Citi Research

Summary of Recent Publications

Date	Publication	Topic	Page	Region
25-Feb-14	NOTE	Euro Rates Strategy: EUREX Calendar Rolls: Bund, Bobl & Schatz	-	EUR
25-Feb-14	NOTE	Euro SSA Strategy: Relative Value Insights – Near-Term Supports for KfW	-	EUR
24-Feb-14	NOTE	Euro Rates Strategy: 30yr Bund auction & update on EUR 5s30s fwd steepeners	-	EUR
24-Feb-14	NOTE	European SSA Strategy: Weekly Chart-Pack And Market Monitor: 14-21 February	-	EUR
24-Feb-14	NOTE	Covered Bond Strategy: Alert: Rating actions on Spanish cédules to be expected	-	EUR
24-Feb-14	NOTE	European Flow Monitor: Net demand for Italy is at a 26-week low	-	EUR
24-Feb-14	NOTE	Euro Rates Strategy: Alert: Spain Upgraded By Moody's To Baa2	-	EUR
21-Feb-14	NOTE	Linker Index Projection: Changes supportive for Germany vs France and Italy	-	EUR
21-Feb-14	NOTE	EMU Month-End Index Projections: Month-end changes most supportive for France	-	EUR
21-Feb-14	NOTE	European Rates Strategy: Gilt Calendar Roll (H4/M4): Tactical RV trade	-	UK
20-Feb-14	European Weekly	Italy and the near-term BTP outlook	9	EUR
		BTP RV: curve betas & trading strategies	13	EUR
		Euro inflation: fade the richness of 5yr BTPei	16	EUR
		Liquidity: Intra-Week Dynamics	18	EUR
		EUR Vol: A PCA Glance At Long-Dated Swaptions	20	EUR
		SSA Strategy – a look at YTD supply	23	EUR
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18-Feb-14	NOTE	UK Rates Strategy: Bullish data today: bearish tomorrow?	-	UK
18-Feb-14	NOTE	Euro Rates Strategy: Italy: The Renzi effect?	-	EUR
17-Feb-14	NOTE	Flow Monitor: Net demand for core markets has slipped to negative territory	-	EUR
17-Feb-14	NOTE	European SSA Strategy: Weekly chart-pack and market monitor: 7th Feb – 14th Feb	-	EUR
17-Feb-14	NOTE	Euro Rates Strategy: Moody's rating of Italy unchanged, outlook now stable	-	EUR
17-Feb-14	NOTE	Covered Bond Strategy: CaixaBank to amortize covered bonds early	-	EUR
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10-Feb-14	NOTE	European Flow Monitor: Diverging flows between Italy & Spain	-	EUR
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Appendix A-1

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