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Developed Markets
Western Europe

European Rates Weekly

Would QE work for EMU?

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- **ECB & QE:** We continue to believe "low-for-longer" carry trades are the optimal strategy and, independently of QE, we expect both the 5y sector of core curves and select peripheral markets to perform. The performance could get a boost in case of a QE announcement, but we would not see this as the ECB's primary option.
- **The BoE play catch-up:** The Inflation Report and this week's data highlight both the main bearish drivers of gilts – the improving growth outlook and eventual policy normalisation – and the main bullish driver – falling inflation. We expect the former to dominate over the medium-term, allowing gilts to underperform further vs Bunds.
- **BTP 2s10s steepener:** For a variety of reasons, we wouldn't fade the steepening trend in BTP 2s10s. Given recent market moves, we suggest having a tighter stop on our BTP Apr16-May23 recommendation, but would extend the target to 260bp.
- **Changing EMU sovereign credit dynamics:** Euro area sovereign credit ratings (as rated by Moody's and S&P) have not moved much this year. We detail such changing dynamics as well as Ireland's sub-IG rating. We continue to expect Ireland to be upgraded in the quarters ahead.
- **Euro break-evens and the deflation floor:** 5yr euro break-evens look broadly in line with our revised inflation profile and we expect a range to form around current levels. However, a deflation shock cannot be rule out. In a 'stressed' scenario, the deflation floor could come into play, with BTPei18 offering the best protection.
- **Further downside ahead for UK break-evens:** UK break-even inflation spreads have taken a tumble this week, but the risks are skewed towards further tightening in the near-term. In particular, we are wary of the potential introduction of "cost of living" measures at the Autumn Statement on 5 December.
- **French SSA and covered bonds:** S&P has equalized its rating of the French agencies it rates together with the EFSF to that of France. The reaction has been muted in SSAs and covered bonds. We continue to see relative value in supras vs OATs in the 8yr sector and believe French covered bonds will continue to grind in.
- **Technical outlook:** Bunds remain in an upward channel, with support from the ADX and slow stochastic. Gilts have formed a double bottom this week.
- **Relative value trades:** We highlight a number of relative value opportunities in the 2-10yr sector of the German, French, Dutch and Gilt yield curves.
- **European supply:** Next week's supply comes from Spain (~€3bn), France (~€7.5bn) and the UK (£8.5bn across UKT 2.25% 2023 and new UKT 1.75% 2019).

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	Our duration scorecard for the week ahead is bullish	Trade the range
Money Market	The strong price action following the ECB has benefitted lower-for-longer strategies. We continue to hold ERZ3 1x2 call spread and expect money market rates in general to be well supported in the foreseeable future. The short-sterling red-pack look cheap relative to Eurodollars.	Hold long ERZ3 1x2 call spread
Yield Curve	We expect EUR 10s30s to remain firmly above 65bp in the coming weeks and we continue to like receiving EUR 5y5y vs 15y15y. We expect BTP 2s10s to steepen further given the prospect of new elections before 2015 and next year's increase in issuance. In the UK, we continue to like 2s10s steepeners. An examination of seasonals suggests long-end forwards should not be held beyond November.	UKT 2s10s steepeners Receive EUR 5y5yF vs 15y15yF (or receive EUR 5s15s30s) Sell 10yr OATs vs 5yr and 30yr BTP 2s10s steepener
Cross-market	Over the longer-term, we still expect Bunds to outperform given diverging growth/inflation fundamentals between Europe and the USA. We continue to like 10yr gilt-Bund wideners given the ECB rate cut, low euro area inflation and strong UK data. Gilt-USTs are likely to remain highly correlated, but seasonals suggest being long gilts in December.	Sell 10yr gilts vs Bunds Sell EUR 2y cross-ccy basis Long Bunds vs UST (add on corrections)
EMU Spreads	We expect the front-end of Spain (and Italy) to be supported to year-end due to the absence of event risk, the high level of carry and the potential for market expectations of a new LTRO in 2014 to increase. Separately, we continue to be long Belgium vs France. We expect OAT-Bund spreads to widen over the medium-term and favour expressing wideners in the 5yr point. We expect Irish spreads to remain low in Q4.	Sell France vs Belgium and Germany Take profits on long Bono Apr15s Buy 5yr Belgium vs France Express France-Germany widening positions in the 5yr point
Swap Spreads	Over the medium-term we expect Bund spreads to gradually widen across the curve due to a reduction in 2014 issuance by Germany, the prospect of new elections in Italy next year and US debt ceiling concerns.	Stopped out of long 30yr Bunds vs swaps (Euribor) Buy 5yr gilt (Jul18) ASW
Inflation	Euro break-evens remain under pressure, but we expect them to find support close to current levels, especially as they are looking increasingly attractive vs inflation swaps. UK break-evens have fallen sharply following the downside surprise in October CPI/RPI. We expect them to narrow further ahead of the Autumn Statement on 5 December.	Look for opportunities to buy cash 5yr break-evens vs swaps. Buy Boblei18 vs OATei18 break-evens Buy Boblei18 break-even vs inflation swap
Volatility	We expect the forward EUR 2s10s curve to move up to spot based on our expectation that bund yields will be stable over the next year and more LTROs will pin the front-end. The current level of EUR 2y2y & 5y5y implied skews are too steep when compared to previous levels of implied volatility for a range of underlying rates. We prefer short EUR collar positions hedged with USD longs, instead of outright shorts.	Long 2yr EUR single look CMS 2s10s ATMF cap EUR 2y 10s30s conditional bear-steepener Short EUR 5y5y 100bp wide collar vs USD 5y5y 100bp wide collar
SSA	Supply pressures are likely to wane and have less of an impact on the secondary market in Q4. Many supranationals are near or have met their 2013 funding targets. We expect spreads to remain relatively low and probably nudge tighter still.	Prefer supras to France Trade the range in core agencies vs governments
For a list of outstanding trade strategies please see the Tradesheet section of this report		

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

Duration Scorecard

Figure 2. Bund Weekly Cheat Sheet: 15th-21st November

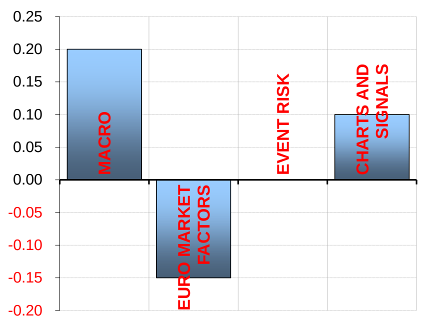
Bund Directional Scorecard (1wk horizon)

RECOMMENDATION	**Long**	RXZ3 (EOD Thurs) = 141.67
Conviction level	**8%**	CTD yield = 1.46% 10day del vol = 6.06%

	SIGNAL STRENGTH (+/-2)		
MACRO	**0.2**		**Weight = 40%**
ECB	1	Monetary policy to be accommodative for as long as needed	7.5%
Fed, BoE and BOJ	1	Citi doesn't expect tapering to occur before March	7.5%
Inflation	1	October print likely to comfirm subdued flash print	7.5%
Growth related data	-1	November PMI likely to indicate continued modest growth	7.5%
Citi surprise	1	Citi Economic Surprise Index down to zero	5.0%
Middle East / Oil	0	Brent has rallied over the last week	5.0%
EURO MARKET FACTORS	**-0.2**		**Weight = 28%**
Supply	0	Supply from France and Spain. Minimal cash flows from semi-core	5.0%
Risk appetite	0	GRAMI index indicates very low levels of risk aversion	5.0%
Flow	0	Net demand for core flat	2.5%
Equity	-1	Eurostoxx50 close to 5 year high	5.0%
Sovereign credit	-1	Peripheral spreads remain relatively tight	5.0%
FX	-1	EUR recovering from lows	5.0%
EVENT RISK	0.0		**Weight = 13%**
Politics	0	No political event likely to impact the market in near-term	5.0%
3yr LTRO	0	We expect a new 2yr LTRO in 1H14	5.0%
Stability mechanisms	0	Nothing on the agenda in the near-term	2.5%
CHARTS AND SIGNALS	**0.1**		**Weight = 20%**
Technicals	1	Strong uptrend on a weekly chart	7.5%
T-Note	0	Neutral	5.0%
CFTC	-1	Positioning slightly short	2.5%
ARTS	1	Moderate long	5.0%

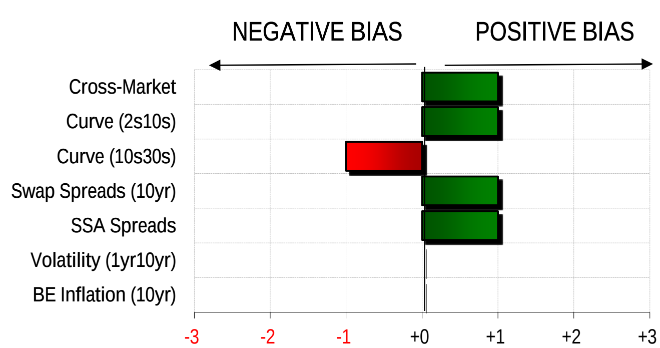
Source: Citi Research Please Note: Futures trading involves a substantial risk of loss

Figure 3. Contribution to Bund Signals



Source: Citi Research

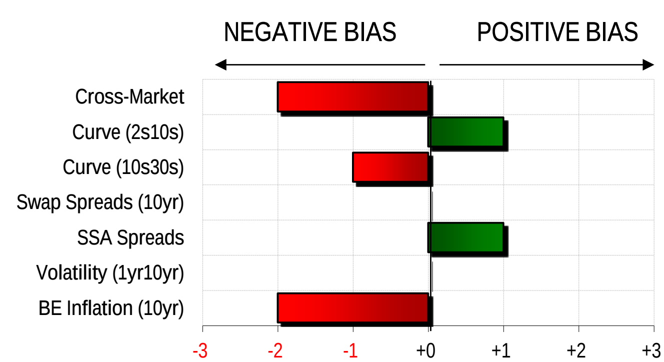
Figure 4. EURO AREA (Near-term Bias)



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 *Euro Rates Strategy*, 8 November 2013 for details

1. Sell France vs Belgium and Germany

Sell BTAN 1.75% Feb17 at 0.51%

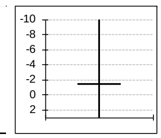
Buy OLO 4% Mar17 at 0.66%

Buy Bobl 0.5% Apr17 at 0.30%

Open 6bp. Current 6bp. Target 16bp. Stop 1bp.

Record of Our Closed Trades

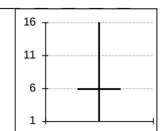
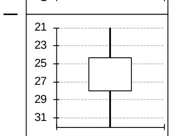
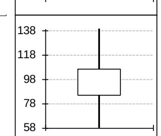
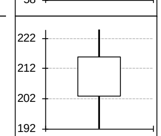
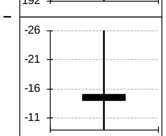
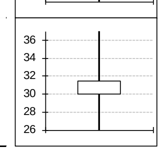
Figure 6. Record of our Closed Trades

Region	Trade	Levels		Rationale	
EUR	Buy 30yr Bund vs swaps (YYS)	Open	-1.5bp		
		Current	-1.5bp	Hit revised Stop 7 November 2013	
Swap Spread	Buy Bund 2.5% Jul44 vs swaps (YYS) at -1.5bp	P&L	0bp		
		Target	-10bp	*European Rates Weekly, 19 September 2013*	
		Stop	3bp	*Revised Stop: The Morning Call, 3 October 2013*	
		Revised Stop	-1.5bp		

Source: Citi Research

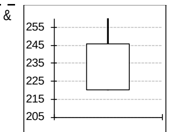
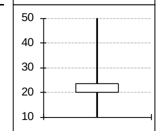
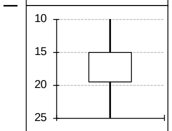
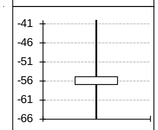
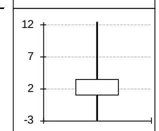
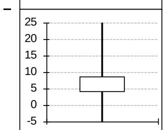
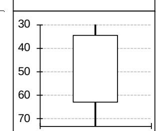
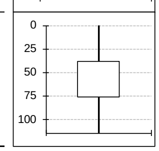
Record of Our Open Trades

Figure 7. Record of our Open Trades

Region	Trade	Levels		Rationale + Publication Date	
EUR	Sell France vs Belgium and Germany	Open	6bp		
		Current	6bp	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%	P&L	0bp		
	Buy OLO 4% Mar17 at 0.66%	Target	16bp		
	Buy Bobl 0.5% Apr17 at 0.30%	Stop	1bp	*Euro Rates Strategy, 8 November 2013.*	
EUR	Long Boblei18 break-even vs OATei18	Open	28bp		
		Current	24bp	Supportive supply profile and attractive entry level.	
Inflation	Buy Boblei18 break-even at 100bp	P&L	4bp		
	Sell OATei18 break-even at 128bp	Target	21bp		
		Stop	32bp	*The Morning Call, 29 October 2013.*	
EUR / UK	Sell UKT Sep23 vs DBR Aug23	Open	85bp	Entry levels are attractive for medium-term gilt-Bund wideners	
		Current	107bp		
Cross Market	Sell UKT 2.25% Sep23 at 2.60%	P&L	22bp		
	Buy DBR 2% Aug23 at 1.75%	Target	140bp	*European Rates Weekly, 24 October 2013.*	
		Stop	58bp	*Revised Stop: UK Rates Strategy, 11 November 2013*	
		Revised Stop	85bp		
UK	Sell UKT Sep23 vs Jan16	Open	203bp		
		Current	216bp	Bear steepening is likely to resume as UK activity data continues to improve	
Curve	Sell UKT 2.25% Sep23 at 2.60%	P&L	13bp		
	Buy UKT 2% Jan16 at 0.57%	Target	225bp		
		Stop	192bp	*European Rates Weekly, 24 October 2013.*	
UK	Buy UKT Sep19 vs Sep17 and Sep22	Open	-15bp		
		Current	-14bp	Attractive RV with positive carry	
Curve	Buy UKT 3.75% Sep19 at 1.72%	P&L	-1bp		
	Sell UKT 1% Sep17 at 1.15%	Target	-26bp		
	Sell UKT 1.75% Sep22 at 2.44%	Stop	-9bp	*European Rates Weekly, 24 October 2013.*	
		Total carry (3mths)	+1.7bp		
UK	Sell UKT Sep23 vs Sep21 and Mar25	Open	30bp		
		Current	31.5bp	Attractive RV with positive carry	
Curve	Sell UKT 2.25% Sep23 at 2.60%	P&L	1.5bp		
	Buy UKT 3.75% Sep21 at 2.18%	Target	37bp		
	Buy 5% Mar25 at 2.72%	Stop	26bp	*European Rates Weekly, 24 October 2013.*	
		Total carry (3mths)	+1.3bp		

Source: Citi Research

Figure 8. Record of our Open Trades (Continued)

EUR	BTP 2s10s steepener	Open	220bp	Redemptions to support 2s in 2014. Political uncertainty & long-end issuance to weigh on 10s.	
		Current	246bp		
Curve	Buy BTP 3.75% Apr16 at 1.98%	P&L	26bp		
	Sell BTP 4.5% May23 at 4.18%	Revised Target	260bp	*European Rates Weekly, 10 October 2013.*	
		Revised Stop	240bp	*Revised Levels: The Morning Call, 14 November2013*	
UK	Sell 30yr gilt swap spreads vs 10yr	Open	20bp		
		Current	24bp	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	P&L	4bp		
	Buy gilt 1.75% Sep22 ASW at 0bp	Target	50bp		
		Stop	10bp	*UK Rates Strategy, 30 July 2013*	
Europe	Buy 5yr Belgium vs France	Open	19.5bp		
		Current	15bp	Tactical long supported by upcoming cash flows.	
Cross Market	Buy OLO 4% Mar18 at 1.15%	P&L	5bp		
	Sell OAT 4% Apr18 at 0.95%	Target	10bp		
		Stop	25bp	*Euro Rates Strategy, 24 July 2013*	
Europe	Buy Boblei18 break-even vs 5yr HICPxT swap	Open	-57bp		
		Current	-55bp	Euro break-evens should be supported by rally in oil and upcoming coupon payments.	
Inflation	Buy Boblei18 break-even at 98bp	P&L	2bp		
	Sell 5yr HICPxT swap at 155bp	Target	-40bp		
		Stop	-66bp	*The Morning Call, 16 July 2013*	
Europe	Buy ERZ3 1x2 call spread	Open	1c		
		Current	3.5c	Dec Euribor has cheapened 30/35c since May ECB rate cut. However, a cut to the deposit rate would be required for a signifcant rally.	
Money Market	Buy ERZ3 99.750/.875 1x2 call spread at 1c	P&L	2.5c		
		Target	12.5c		
		Stop	-3c	*Euribor, 24 June 2013*	
Europe	Receive EUR 10y2y vs 12y3y	Open	4bp		
		Current	9bp	Cheapness of the sector due to legacy ASW positions. The trade offers a positive roll-down for relatively low volatility	
Curve	Receive EUR 10y2y at 3.1%	P&L	5bp		
	Pay EUR 12y3y at 3.14%	Target	25bp		
		Stop	-5bp	*The Morning Call, 23 January 2013*	
Europe	Sell EUR 1y3yF ATMF straddle and buy ATMF-25 receiver	Open	63bp	Fwd levels in front-end EUR swaps are too high when additional policy measures by the ECB are likely to be undertaken	
		Current	35bp		
Volatility	Sell EUR 1y3yF ATMF (=1.36%) straddle for 98bp	P&L	28bp		
	Buy EUR 1y3yF ATMF-25 receiver for 35bp	Target	30bp		
		Stop	73bp	*IIRS 9 August 2012*	
UK	Sell GBP 2y2y ATMF straddle	Open	76bp		
		Current	39bp	The fundamental backdrop in the UK supports selling GBP 2y2y vol	
Volatility	Sell GBP 2y2y ATMF (1.04%) straddle at 76bps	P&L	37bp		
		Target	0bp		
		Stop	114bp	*IIRS 12 July 2012*	

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

ECB: A critical assessment of QE

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The two milestones of monetary policy are long-term neutrality and positive inflation (or low real rates if you prefer). Rule-based policy can be ineffective due to its implied asymmetry at very low nominal rate levels. With hindsight, the "Great Moderation" has much less to do with inflation targeting than central bankers would like us to believe. That is understandable, since the success of a monetary policy strategy is also a result of a central bank's credibility.

We are witnessing a last, almost desperate attempt to defend the bastion of non-discretionary, transparent policymaking by morphing the apparently simple concept of inflation targeting into an increasingly complex set of rules and conditions whose relevance may depend on states of the economy (let's call it forward guidance). If we play this game ad absurdum, we end up with a complex and automated decision system that leaves zero room to discretion. To borrow an analogy from Hollywood, we would be like humans in Terminator, subject to Skynet's uncontrollable intelligence.

What does all this have to do with the ECB and QE?

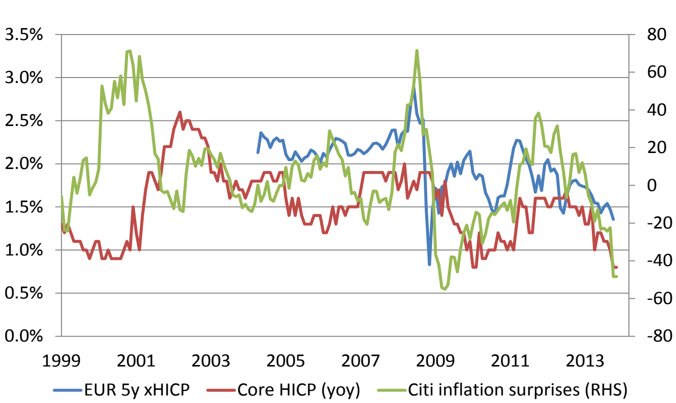
Let's come to the point:

1. **Money neutrality:** Long-term neutrality may actually mean really "long-term", i.e. decades and not just a couple of years. This is one lesson from the BoJ that the German fraction of the ECB may want to borrow.

2. **Inflation:** An economy that is subject to long-term internal rebalancing is highly unlikely to generate enough inflation to drive real interest rates into negative territory, no matter how much a central bank tries to influence inflation expectations by tricking the market with illusionary targets. This is even more the case in the Eurozone, where the level of nominal interest rates is not uniform across member countries. Another lesson from the BoJ.

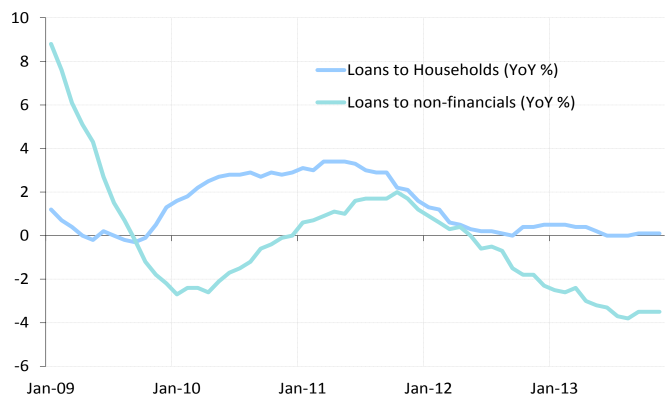
3. **Asset prices:** Quantitative easing works perfectly in boosting the valuation of targeted assets. In other words, if the central bank buys bonds, then - surprise, surprise - yields fall.

Figure 9. Low euro area inflation



Source: Citi Research, Bloomberg

Figure 10. Euro area MFI YoY loan growth



Source: Citi Research, Bloomberg

Given the above points on real interest rates and long-term neutrality, it's not obvious that an economy might experience growth and broad-based inflation as a result of QE. Think about the contraction of lending in the Eurozone as being a demand-side problem and you'll have serious second thoughts about QE. In other words, the decision to invest may not be purely a function of the level of interest rates or the abundance of liquidity.

In addition to a theoretical critique, we can also advance several technical doubts about the implementation of a QE-type strategy in the Eurozone:

- **Index composition:** Germany and France are heavyweights in Citi's EGBI. If the ECB were to purchase bonds based on index weights, then it would have to buy more Bunds than Bonos. This does not make sense to us.
- **Yield dispersion:** The ECB may decide to use a scheme based on the deviation of member countries' government bond yields from some measure of fair value. As an example: A two-country currency area, where country A grows 2% above potential and has an inflation rate that is 2% above the central banks' target and where - in contrast - country B grows 2% below potential and where inflation is 2% below target. Assuming both countries have the same long-term or natural real rate, the Taylor rate for country A would be 2% above the natural rate, while the Taylor rate for country B would be 2% below the natural rate. In that case, assuming a flat term structure and similar bond yields for both countries, this hypothetical central bank may be tempted to buy bonds in country B and sterilise money supply by selling bonds in country A. Now apply this scheme to the Eurozone and ask yourself how happy German taxpayers would be to see their refinancing costs rise.
- **Market environment:** Legal impediments aside, the level of stress as implied by peripheral bond or equity markets is far from levels experienced when the SMP was active. How is the market environment now more exceptional than in Q3-11 such as to require a temporary financing of governments?

The decision to cut interest rates is probably the first sign of loss of ECB independence. Comments on the need to weaken the euro by Mr Moscovici and Mr Saccomanni ahead of the November meeting support this thesis. On the other hand, loss of independence is a pre-requisite for a more integrated economic policy mix and again experience from the relationship between the Japanese government, the MoF and the BoJ may be useful in understanding the value and the role of a central bank once all standard policy tools have been deployed.

Conclusion

From a pure market perspective, we continue to believe that "low-for-longer" carry trades are the optimal strategy in the current environment and - independently of QE - we expect both the 5y sector of core curves as well as selected peripheral markets to perform. The performance could get a boost in case of a QE announcement, but we would not see this as the ECB's primary option and hence attach a low probability to such a scenario.

UK Rates – The BoE play catch-up

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The Inflation Report was broadly in line with expectations (with growth revised up and inflation down), although the forecast revisions were perhaps more aggressive than generally anticipated. The main focus was, understandably, on the new profile for the jobless rate which paves the way for earlier rate hikes than previously implied. In this article, we briefly discuss the reaction of gilts to the Inflation Report and revisit our bearish view on gilts relative to Bunds.

Inflation Report validates front-end pricing

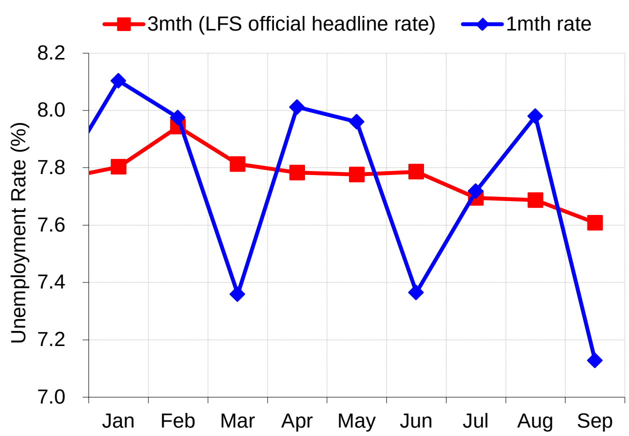
The BoE forecasts are now more in line with market pricing

The relatively muted market reaction to the significant change in the BoE forecasts only serves to emphasise that this was a case of the BoE moving towards market pricing rather than leading market pricing.

The BoE now expect the 7% jobless rate threshold to be reached around 18 months earlier than before

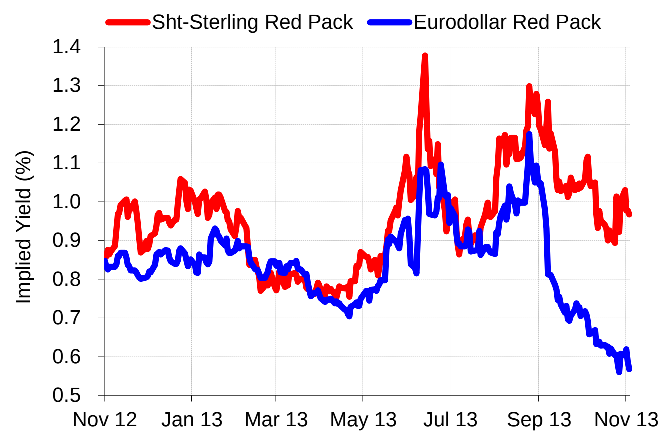
The BoE now expects the jobless rate to reach the 7% threshold around end-2014 (using constant rates) compared with late-2016 previously. The reason for such a significant change was underlined by the latest labour market statistics, released just before the Inflation Report. The headline three-month average jobless rate fell to 7.6% and in doing so edged a little closer to the BoE's 7% threshold. Strikingly, the single-month estimate for September was 7.1% (compared with 8% in August). This series is less informative and very volatile, but highlights the possibility that the jobless rate could fall more quickly than even the BoE's revised forecasts.

Figure 11. Single-month vs three-month average jobless rate



Source: Citi Research, ONS.

Figure 12. Widening differential between Short-stg and Eurodollar



Source: Citi Research, Bloomberg.

The threshold is not an automatic trigger. Much will depend on the inflation outlook at the time the threshold is achieved.

In the press conference, Carney was keen to emphasize, as always, that even when the jobless threshold is achieved, this would not imply an immediate rise in policy rates. Rather, it would depend on an assessment at that time of the amount of slack in the economy, its momentum and the outlook for inflation. He highlighted that the forecasts under constant rates showed an attractive trade-off between growth, unemployment and inflation. This puts some of the focus back on inflation.

GBP front-end looks fair outright, but cheap to USD

Any tightening in the GBP-USD differential in the front-end is more likely to be led by the US leg, in our view

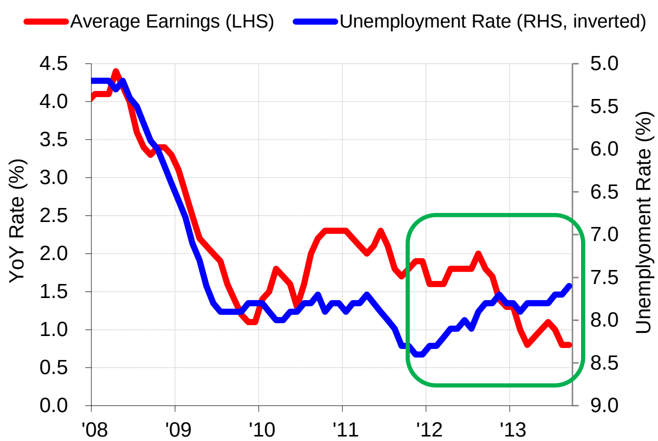
There was little reaction in the outright level of gilt yields across the curve, although 5s did suffer the most on a relative basis both on the curve and vs Bunds. By the end of the day, the very front-end was left broadly unchanged with OIS forwards still pricing in the first hike in Q3 2015 (in line with our forecasts, which already assumed a period with rates on hold after the jobless threshold is reached). The front-end looks fair to us, although it does still stand out as relatively cheap vs the US (as shown by the respective 'red-packs' in Figure 12). Any tightening in this differential is more likely to be led by the US leg, in our view.

Average earnings data likely to become 'the one to watch'

Underlying inflation pressures remain very weak. How this develops will be pivotal to the pace of eventual policy normalisation.

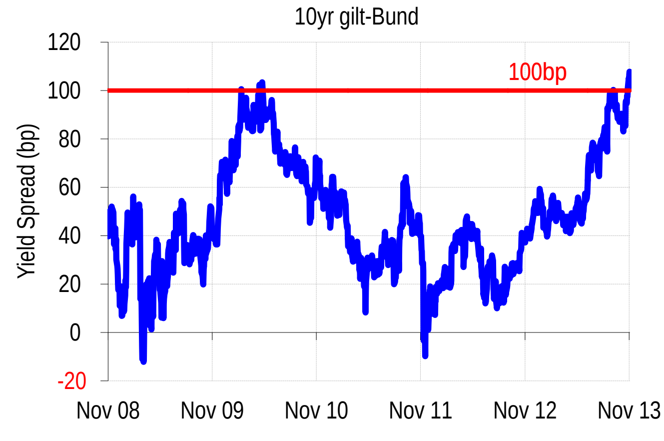
As Carney emphasized, the exact timing of the first hike will depend on the inflation outlook when the jobless threshold is reached. The Inflation Report revised down the inflation forecasts and this week's sharp fall in headline CPI to 2.2% YoY in October, from 2.7% previously, emphasises the benign outlook. The evolution of the medium-term outlook for inflation will depend much on the degree of slack in labour market. In this regard, the average earning data is likely to become a key focus. The data released on Wednesday showed average earnings growth of just 0.7% YoY in October. Moreover, it continues to fall even as the jobless rate falls suggesting workers are pricing themselves into low productivity jobs (Figure 13). However, even though inflation pressures are moderating, the market is likely to maintain a healthy risk premium in the front-end to reflect the possibility of earlier rate hikes.

Figure 13. Average earnings vs the jobless rate



Source: Citi Research, ONS, Bloomberg.

Figure 14. The 10yr gilt-Bund spread has breached 100bp



Source: Citi Research, Bloomberg.

Strategy update – maintain 10yr gilt-Bund wideners

The growth outlook is bearish for gilts, but this is partially offset by the outlook for inflation

The Inflation Report and this week's data highlight both the main bearish drivers of gilts – the improving growth outlook and eventual policy normalisation – and the main bullish driver – falling inflation. We expect the former to dominate over the medium-term allowing gilt yields to drift slowly higher.

The 10yr gilt-Bund spread is likely to widen further driven by diverging fundamentals

On a cross-market basis, we also expect gilts to underperform Bunds. The 10yr gilt-Bund spread has already widened a long way and it is now at its widest level for five years (107bp). A move above 100bp has been hard to sustain in the past: it failed in September and also marked a turning point back in 2010 (Figure 14). However, as we argued earlier this week (see *'Gilt-Bund widening: fade or run?'* of 11 November), we don't expect the 100bp level to act as a turning point this time. The reasons behind the recent widening – upside surprises to UK/US data, ECB rate cut, euro area deflation fears and expectations/realisation of a forecast change by the BoE – expose the diverging fundamental drivers between gilts and Bunds.

We have a medium-term target of 140bp for the 10yr gilt-Bund spread

Trade update: We are maintaining our existing recommendation to be long Bund Aug23 vs gilt Sep23 (entered at 85bp on *24 October*). We are keeping the target of 140bp to reflect the rationale which is long-term fundamentals. However, it now seems prudent to revise the stop higher to +85bp from +58bp at inception. The main risk to this view is probably a further dramatic fall in UK inflation.

Update on BTP 2s10s steepener trade

Nishay Patel

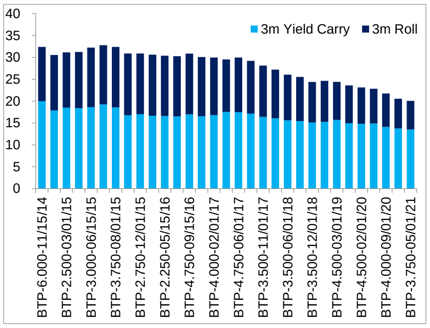
Recap of trade rationale

We recommended BTP Apr16-May23 steepeners on 11 October 2013 (*Impact of 2014 BTP supply on the curve*). Our main reasons for this trade were:

- **Carry:** the attractive carry on offer (over 30bp per 3months).
- **ECB:** expectations of ECB policy being accommodative. Last week's rate cut has reinvigorated interest in carry trades.
- **MFI reinvestments:** the cash flow profile in 2014 being supportive for front-end BTPs given that a large portion of next year's redemptions are likely to be held my domestic banks. As a reminder, MFI holdings increased by €93bn in 2012 (following the announcement of a 3yr LTRO). This was at a time when the bonds maturing in 2014 were within the sub-5yr window.

We believe these reasons are still in place. Specifically, carry on 2016 bonds is still over 30bps on a 3month horizon and the net carry for BTP 2s10s steepeners (using benchmarks) is 13bp every 3months.

Figure 15. 3m total carry on front-end BTPs continues to remain high



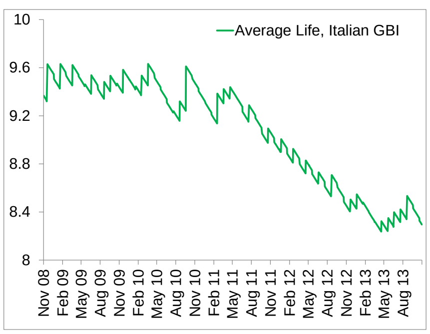
Source: Citi Research

Additional supports for steepeners

Furthermore, we believe that there are a number of additional supports (to the ones we identified in our original recommendation) that are likely to support further steepening:

- **Bond exchanges:** Today, the Italian Treasury announced it would buy back the following bonds in the front-end in exchange for 5yr BTP on the 18th November:
  - BTP Apr15s, BTP Jun15s BTP Dec15s
  - CCTeu Dec15s, CCTeu Oct18s
- **Lengthening average maturity:** recent comments from the head of the Italian Treasury have suggested that Italy will look to extend the average maturity of their debt profile, "*She [Maria Cannata] said the the BTP Italia sale was large and did not help her goal of lengthening the maturity of Italian debt*". As shown in Figure 16, the average maturity of Italian debt eligible for Citi's EGBI has been declining over the last two years.
- **Further ECB action cannot be ruled out:** As noted by the WSJ yesterday[1], ECB's Praet did not rule out the option of purchases of assets by the ECB and a negative deposit rate. This policy stance should be supportive for front-end periphery.

Figure 16. Average life of Italian govt debt that is eligible for Citi's EGBI



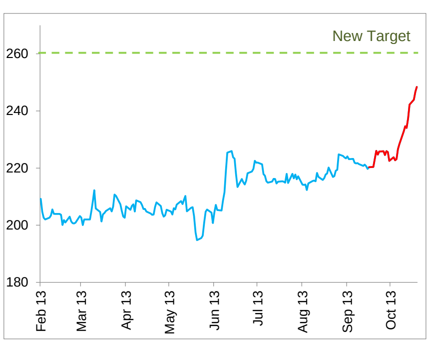
Source: Citi Research

Trade details: Tighten stop and extend target

Taking into account the rate at which the BTP curve has steepened in the last few weeks (Figure 17) we suggest having a tight stop on steepeners. As for our recommendation, we suggest increasing the original stop from 2.05% to 2.40% to lock in profits. Furthermore, we recommend extending the target to 260bp.

- Open 2.20%. New stop: 2.40%. New target 2.60%. Current 2.47%.

Figure 17. Apr16-May23 yield spread



Source: Citi Research

[1] *WSJ – ECB's Praet: All Options on the Table, 13 November 2013*

Fewer EMU downgrades, perhaps an upgrade

Changing sovereign credit dynamics in EMU

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Euro area sovereign credit ratings (as rated by Moody's and S&P) have not moved much this year. In fact, in the EMU-11 universe we typically assess[2], there have just been two rating actions in 2013 (both by S&P – France, AA+ to AA and Italy, BBB+ to BBB). Summing across both Moody's and S&P, this compares with 15 downgrades in 2012 and a staggering 23 downgrades in 2011. We consider this in the context of the nascent EMU recovery together with why certain sovereigns remain sub-IG. This is particularly relevant for Ireland, as it is rated IG by S&P but sub-IG by Moody's. We therefore take a deeper look at why Moody's maintains its Ba1 rating to help understand when Ireland might once again be rated IG by both these rating agencies.

Why does Moody's rate some sovereigns sub-IG?

Sovereigns that receive external assistance: Moody's has been clear on why it generally rates those sovereigns which have received external support as sub-IG. First, it is recognized that IMF support is clearly a very effective means of ensuring longer-term sustainability and that it is precisely those sovereigns receiving external aid that are the ones already with credit challenges. These often include high debt levels, weak governance, weak banking systems and structural growth concerns. IMF aid is also critical in avoiding default because typically, sovereigns receiving aid have constrained access to capital markets for funding. In a recent study carried out by the rating agency, Moody's evaluates in more detail how sovereigns that have received IMF support in some form have typically been associated with elevated medium-term credit vulnerabilities[3].

Countries receiving aid have typically had medium term credit concerns

Higher default risk typically: In their study of 168 sovereigns over 1983-2012, Moody's concludes that *"countries with IMF programs have historically defaulted more often than countries without IMF programmes*". Moody's highlights that such cases often involve lengthy macroeconomic adjustment programmes (with Greece being a clear example in EMU). Specifically, it finds that from all the sovereigns in its study who entered an IMF programme, the cumulative 5yr default probability is 16.4% compared with 7.97% for those sovereigns that have not received IMF support. As the rating agency concludes: "*The challenges of restoring fundamental creditworthiness and implementing successful economic and fiscal adjustments are underscored by the fact that the default risk of sovereigns in IMF programs remains, with 16.4% in default within five years, and consistent with Moody's practice of generally assigning non-investment-grade ratings to program countries.*"

The case of Ireland

Decision and ability to exit its programme without further support will likely be seen favourably by the rating agencies

Specific downgrade factors: Ireland was downgraded by Moody's to Ba1 from Baa3 back in July 2011. One key driver was the growing possibility that Ireland would require further official financing once its Troika programme expired at the end of 2013 as it might not be able to borrow on the capital markets[4].

No further support: Ireland has successfully issued twice this year (a total of €7.5bn in two syndications) and is fully funded for 2014 (*We remain constructive on Ireland 31st October*). Significantly, Ireland today stated it would exit its assistance programme without a credit line.

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[2] Germany, France, Italy, Spain, Netherlands, Belgium, Austria, Finland, Ireland, Portugal, Greece

[3] Moody's : "*Sovereign Default Series: IMF Program Participation Underscores Medium-Term Sovereign Credit Challenges"* 23rd August 2013

[4] Moody's "*Key Drivers of Moody's Decision to Downgrade Ireland to Ba1 from Baa3*" 12th July 2011

Ireland demonstrating its ability to fund in markets

2014 issuance and market access: Furthermore, in the most recent development, the NTMA has indicated a provisional 2014 supply pipeline of €6bn-€10bn which will be pre-funding for 2015. The ability to access private capital markets independently is likely to be seen as a positive development by the rating agencies.

Moody's rates Ireland with a Stable Outlook, S&P rates Ireland with a Positive Outlook

Stable outlook: Moody's lifted its negative outlook on its Ba1 rating of Ireland to stable on 20th September. Specifically, the drivers behind the outlook change were:

- Progress in restoring solvency in public finances
- Ireland's diminished susceptibility to renewed loss of market access given its reform progress and improved liquidity position

We expect Ireland to be upgraded

Positive developments regarding Ireland were reinforced in Moody's Credit Analysis (2nd October) where Moody's indicates that ongoing economic rebalancing is likely to engineer more sustainable future growth and that the government's ability to meet and exceed Troika targets has been a key determinant in restoring market confidence. Various fundamental concerns remain and Moody's the stable outlook implies this rating agency probably will not alter its rating straight away. We do however expect Moody's to upgrade Ireland over the next few quarters as we have repeatedly stated in our *Global Economic Outlook and Strategy*.

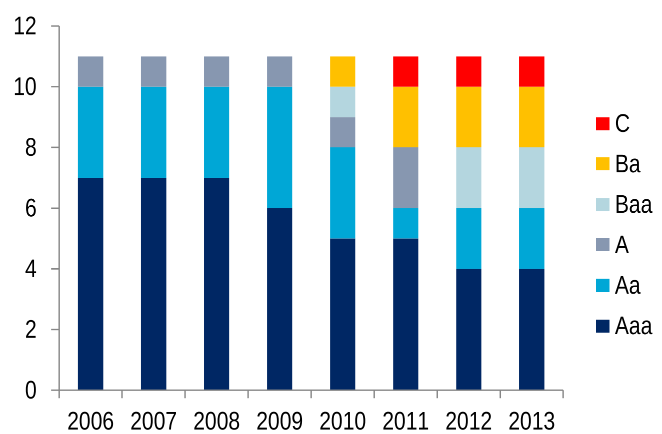
Note that S&P has its BBB+ rating of Ireland on positive outlook – and it is only EMU-11 sovereign to have such an outlook. This reflects an otherwise higher chance of an S&P rating upgrade over the medium term. If we exclude S&P's move on Greece last year (from SD to B-), the last time S&P upgraded a sovereign out of this set of EMU countries was back in December 2004 when it upgraded Spain to AAA from AA+.

The pace of downgrades has dramatically slowed in 2013

Much fewer downgrades of EMU-11 sovereigns in 2013

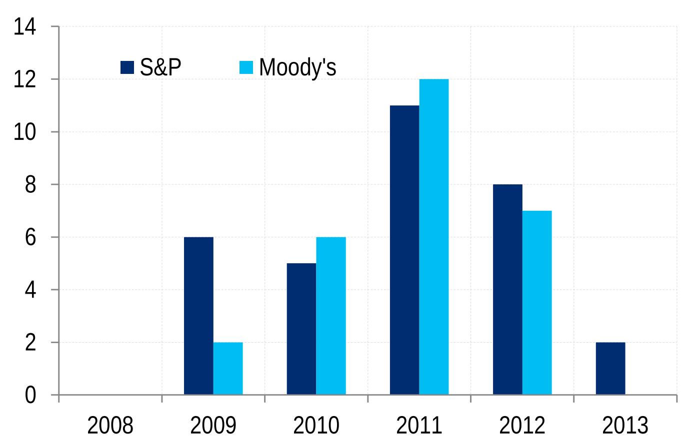
More broadly, there has been a dramatic reduction in the number of downgrades for the EMU-11 sovereigns we typically assess by Moody's and S&P this year. In fact, there have just been two: S&P's one-notch downgrade of Italy to BBB from BBB+ in July and S&P's one-notch downgrade of France to AA from AA+ last week. There have been no downgrades by Moody's within EMU-11 so far this year.

Figure 18. EMU-11 Rating Transitions (Count of sovereigns as rated by Moody's at the end of each year)



Source: Citi Research, Moody's, S&P, Bloomberg

Figure 19. Count of downgrades of EMU-11 sovereigns*



Source: Citi Research *Universe of EMU-11. This is simply a count of whether a downgrade occurred or not – it does not count the number of notches per downgrade

Rating transitions

EMU-11 rating transitions as rated by Moody's can be seen in Figure 18. Here we group the number of EMU-11 sovereigns by rating category over time to illustrate the changing credit dynamics. Back in 2008, 7 sovereigns were rated Aaa and none Baa or below. In 2012, just four EMU-11 sovereigns are rated Aaa by Moody's (Germany, Netherlands, Finland and Austria). This indicates both the speed and extent of change in EMU credit that has occurred throughout the crisis, as judged by the rating agencies. Overall, the credit rating distribution has a lower average quality and a higher rating dispersion (Figure 18). Our second observation is clearly that the number of downgrades per year has slowed: just 2 so far in 2013, both by S&P which is in sharp contrast to 2011 and 2012 (Figure 19).

Various other sovereigns placed back on stable outlook…a trend?

Some sovereigns had returned to stable outlook

Another observation is that various sovereigns have had their outlook put back to "stable" from "negative" – but of course this has often come after several downgrades and is far from suggesting upgrades are imminent. A recent example of this was Moody's action on Portugal in October. This was predicated on improving fiscal and debt trajectory trends. Moody's stated[5] that "*Upward pressure would develop on Portugal's sovereign ratings if the government was able to regain full access to private capital markets, with or without an official backstop, and if the government was to continue to meet its fiscal consolidation targets such that its very high government debt ratio would clearly point to a declining trend.*"

This can be placed among the following "outlook revisions" this year:

- **S&P** placed Finland and Austria on stable outlook in January and Ireland on positive outlook in September (and most recently, France AA stable following a downgrade from AA+)
- **Moody's** placed Portugal on stable outlook in October and Ireland on stable outlook in September
- **Fitch** placed Spain on stable outlook earlier in November

Downgrade risk still remains for certain sovereigns

This is of course not universal: S&P recently placed Portugal on "negative watch" in September. Also, we would not necessarily infer any causal link between what one agency does versus another, noting differences in methodology and economic assumptions. However, in terms of more general factors that affect a variety of sovereigns, we can say that broader drivers of credit quality such as the nascent EMU economic recovery as well as ECB policy (particularly OMT and the LTROs) have been considerable in reducing systemic risks.

Conclusion – fewer rating downgrades but credit risks remain

Upgrades unlikely for now in general. Should more sovereigns move to a stable outlook, this is likely to be seen as a market positive

Although there have been fewer EMU downgrades this year and a number of revisions to "stable" outlooks, many EMU countries have much lower ratings than 2-3 years ago and many continue to have negative outlooks. An abundance of upgrades is therefore unlikely in the medium term. However, a return to economic growth, a political commitment to reform, wider euro-area supports and improved market sentiment clearly marks a very different configuration of risks from 2011 when rating volatility was much higher. An environment in which downgrade risk is reduced is likely to be taken as a further support to improving investor confidence, to the benefit of spreads and the wider market tone in our view.

[5] Moody's "Portugal, Government of" 9th November

Euro inflation: deflation risks & the floor

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Euro break-even inflation spreads remain under pressure with the prospect of a *"prolonged period of low inflation"*, as Draghi put it last week, at the forefront of many investors concerns. In this article, we suggest that euro break-evens, having fallen sharply, are now close to levels which are justified by fundamentals and likely to find some support. However, a further deflation scare cannot be ruled out. In a low-probability 'stressed' scenario in which 5yr break-evens fall a further 25-50bp, the deflation floor is likely to come into play and the risk-reward on BTPei18 is likely to look attractive.

Fundamentals justify a new, lower range for break-evens

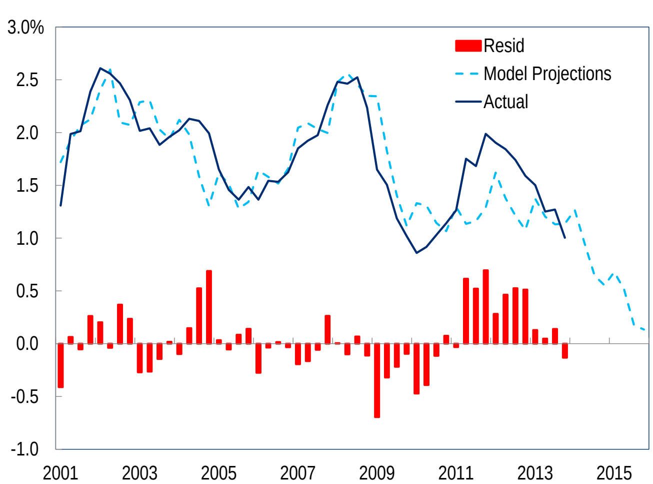
Inflation has surprised on the downside and the inflation market has re-priced

Euro break-even inflation spreads have fallen sharply since the large downside surprise in the flash estimate for euro area inflation on 31 October (0.7% YoY vs original median of 1.1%). The final release will be published on Friday, but it seems unlikely to be revised any lower (with a small chance it is revised slightly higher as the result of rounding).

The reaction of break-evens doesn't look like an overshoot. Rather, it looks consistent with the fundamental outlook.

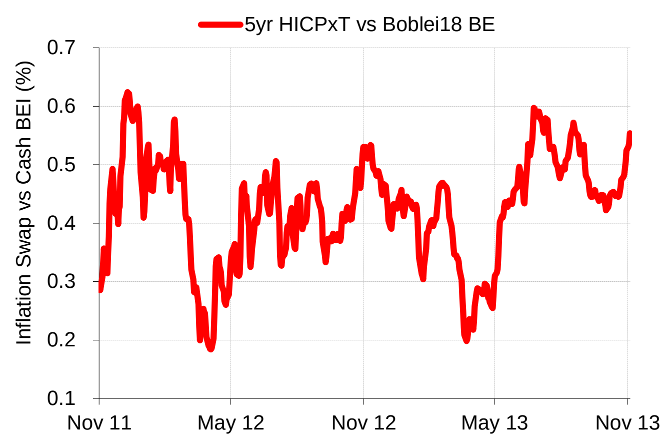
As a consequence of this re-pricing, 5yr euro break-evens are now in the region of 0.75%-1.0% (depending on the issuer) having narrowed around 20bp. From a fundamental perspective, we find it hard to argue with current levels. As our economics team recently argued in some detail (see *Euro Economics Weekly*, 8 November), core euro area inflation, which is already at record lows, is likely to continue to trend lower. In fact, an adapted Phillips curve model for core inflation suggests that it may be close to 0% by the end of 2015 (Figure 20). For headline inflation, Citi now expects an average rate of 0.9% YoY in 2014 and 0.7% in 2015.

Figure 20. EMU realised and projected core inflation, 2001-2015F



Source: Citi Research, Eurostat, Haver, Citi Economics forecasts.

Figure 21. Cash break-evens are historically cheap vs inflation swaps



Source: Citi Research, Bloomberg.

Break-evens may begin to find support around current levels

Support may begin to emerge around current levels, allowing the formation of a new, lower trading range for break-evens

Against this fundamental backdrop, we are not expecting 5yr euro break-evens to stage much of a recovery. Rather, we expect them to settle into a new trading-range around current levels. For now, break-evens remain under downward pressure. However, we expect support to emerge fairly soon, perhaps from real yield buyers or perhaps from interest in cash break-evens vs inflation swaps (as cautious longs are established). As Figure 21 shows, the differential between cash break-evens and swaps has widened sharply in the sell-off and could attract interest around the historic wides. Our base case is that 5yr break-evens (Boblei18) trade around the 70-90bp area in the foreseeable future.

But what if there is a deflation shock?

Euro break-evens could fall much further under a low-probability 'stressed' scenario in which deflation fears escalate and market conditions rapidly deteriorate

The decision by the ECB to cut rates unexpectedly highlights the seriousness of growing deflation risks in the euro area. While already at low levels, euro break-evens could potentially fall much further under a low-probability 'stressed' scenario in which deflation fears escalate and market conditions rapidly deteriorate. A precedent would be late-2011. At this time, BTPei break-evens led a collapse in euro break-evens against the backdrop of a raging EMU crisis, extreme illiquidity and concerns over index exclusion for BTPei. This was less about the fundamental inflation outlook and more to do with market conditions. Given the progress made in the EMU crisis since then, a repeat of such extremes seems unlikely.

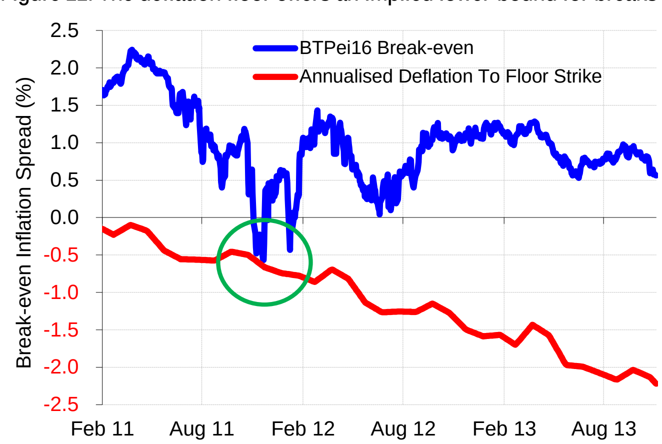
Euro break-evens have been 'floored' before

The precedent from late-2011 suggests that the deflation floor will, under extreme market conditions, provide a lower-bound for break-evens

The episode of late-2011 does, however, offer an insight into the behavior of break-evens when under stress. Euro linkers benefit from a deflation floor with the strike varying according to when the bond was first issued. This effectively creates a lower-bound for break-evens as, in the event of sustained deflation, only the inflation which has already been accrued can be lost. For recently issued bonds, which have accrued less inflation, the implied lower-bound for break-evens is higher than for older issues.

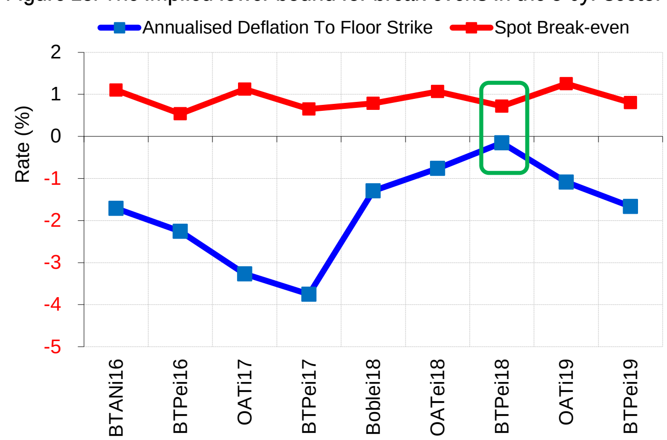
The lower-bound can be seen at work in late-2011 for BTPei16 in Figure 22. The chart shows the break-even for BTPei16 vs the annualised deflation rate required to hit the deflation floor strike. This proved a lower-bound as it made no sense for break-evens to fall below this threshold as it would become a free option.

Figure 22. The deflation floor offers an implied lower-bound for breaks



Source: Citi Research, Bloomberg.

Figure 23. The implied lower bound for break-evens in the 3-6yr sector



Source: Citi Research, Bloomberg.

BTPei18 break-evens will become attractive in a 'stressed' scenario

Due to the lack of new issues in recent years, break-evens are a long way above the implied lower-bound. BTPei18 is the closest at 90bp.

At the current time, break-evens are still a long way above the implied lower-bound which will only come into play in the event of a crisis. This is shown by Figure 23 which compares break-evens in the 3-6yr sector with the annualised deflation rate require to hit each bonds respective strike (we have ignored the three shortest bonds as they are all old 10yrs with strikes well below the current inflation index). Unsurprisingly, BTPei18, as the most recently issued bond, is closest to the implied lower-bound. The floor means that BTPei18 is protected from annualised deflation beyond -0.15% to maturity compared with the current break-even of 0.76%. The differential of around 90bp highlights that we are still a long way from this being a supporting factor. However, in the unlikely event that break-evens fall another 25-50bp, the risk-reward of longs in BTPei18 is likely to become attractive.

UK inflation: further downside ahead

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This week's inflation data for October posted a large downside surprise with RPI printing at 2.6% YoY vs a median of 2.9% and the previous reading of 3.2%. The risks look skewed towards a further inflation undershoot in the near-term. This suggests a cautious approach to UK break-evens, at least on a tactical basis until after the Autumn Statement. We also see scope for UK break-evens to underperform further vs euro break-evens in the near-term. The longer-term outlook for break-evens depends much on the likely pace of policy rate normalization.

Front-end break-evens look vulnerable on a tactical basis

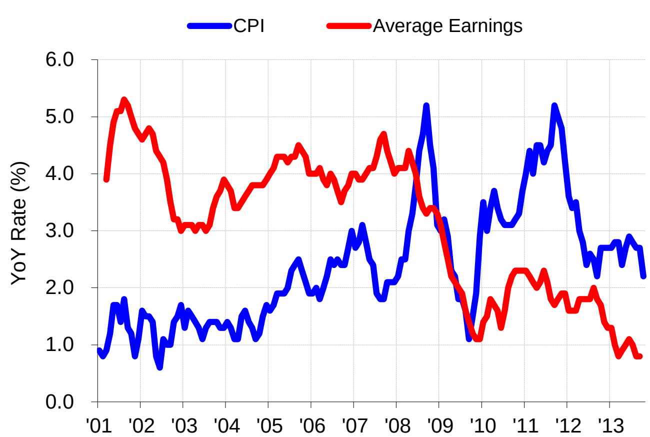
We are not inclined to fade the sharp narrowing in front-end break-evens

This week's large undershoot in inflation, together with the downward revision to the BoE's inflation forecasts, has prompted a re-assessment of the UK inflation outlook. Break-evens have reacted strongly with the 2017s down by almost 15bp this week. However, we are not inclined to fade this move.

The possible introduction of "cost of living" measures at the Autumn Statement poses a downside risk for break-evens

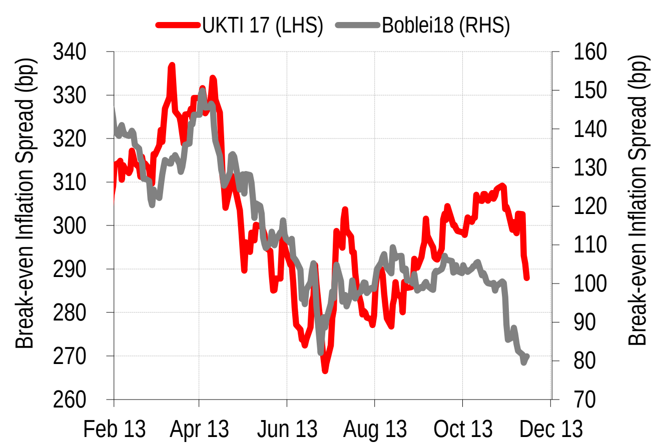
The near-term risks are skewed towards further downside, in our view. In particular, we would highlight the Autumn Statement on the 5 December. While CPI fell in October, it remains well above average earnings growth which also fell further this week (Figure 24). The "cost of living" debate has become a huge political issue and the government may well respond with measures in the Autumn Statement to reduce household energy bills. This could prompt a further reassessment of the inflation outlook and weigh on front-end break-evens.

Figure 24. UK CPI remains some way above average earnings growth



Source: Citi Research, Bloomberg.

Figure 25. UK break-evens are catching up with euro break-evens



Source: Citi Research, Bloomberg.

A strong current and weak oil prices also present downside risks to inflation

There are also downside risks to UK break-evens from the ongoing appreciation of trade-weighted sterling which is moving towards the 5yr highs. At the same time, oil prices are under downward pressure. Both of these factors are likely to impact the front-end while the long-end, as always, is likely to be relatively immune.

UK break-evens could fall further vs euro break-evens, at least in the near-term

It is also worth noting that, even after this week's correction, front-end break-evens in the UK have lagged the recent narrowing in euro break-evens by some distance (Figure 25). For example, the differential between UKTI 2017 and Boblei18 break-evens is still 30bp wider than mid-August even having corrected by 15bp in the last few days. In a fundamental sense, this widening is justified as the context of the respective downside inflation surprises is very different. In the euro area, it has prompted deflation fears, whereas in the UK it merely implies that inflation will fall back below the MPC's official target of 2%. However, on a tactical basis, we expect UK break-evens to continue to play catch-up, especially given the risks associated with the Autumn Statement detailed above. Moreover, we expect to see support emerging for euro break-evens around current levels (see page 16).

Long-term view: pace of policy normalisation key to RPI

As discussed above, we would not look to fade the narrowing in front-end break-evens until after the Autumn Statement at the earliest. At that time, we will re-assess the longer-term outlook for RPI with respect to the prevailing level of break-evens.

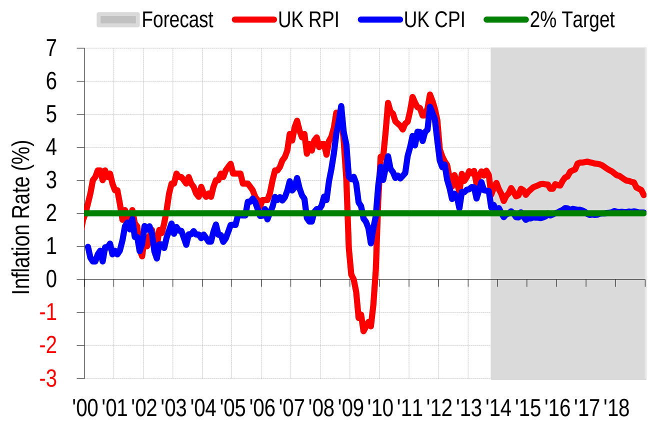
The current level of front-end break-evens is consistent with our long-term RPI profile, as it stands today

As it stands today, front-end break-evens actually look quite fairly priced relative to our RPI profile. For example, the 2017 break-even inflation rate is currently around 2.9% compared with our RPI forecast over this period of 3%. However, the current RPI profile does not include the impact of any measures aimed at household energy bills. It is therefore vulnerable to a downward correction following the Autumn Statement.

The outlook for policy rates feeds into the outlook for RPI

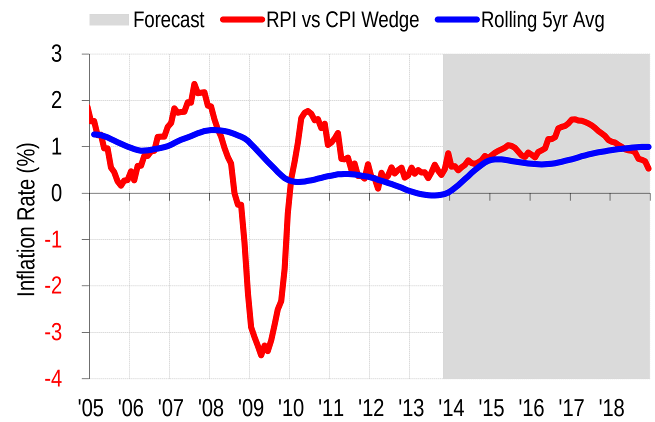
The longer-term outlook for inflation will ultimately depend on the amount of spare capacity in the economy and wage growth. This will, in turn, help to inform the timing and speed of rate hikes which are always crucial to the longer-term outlook for RPI (thanks to the mortgage interest payments component). We currently anticipate rate hikes to begin in 2015 and only rise slowly thereafter. This should drive a wider wedge between CPI and RPI, as shown in our economists' current forecasts (Figure 26 and Figure 27). As the first rate hike comes into view, the likely pace of policy nomalisation will become an increasingly important factor in determining value in front-end break-evens.

Figure 26. UK RPI vs CPI outlook



Source: Citi Research, ONS, Citi Economics Forecasts.

Figure 27. UK RPI vs CPI wedge



Source: Citi Research, ONS, Citi Economics Forecasts.

Strategy summary – break-evens likely to fall further

The risks to UK break-evens are skewed towards further downside in the near-term

UK break-evens have taken a tumble this week, but the risks are skewed towards further downside in the near-term. In particular, we are wary of the potential introduction of "cost of living" measures at the Autumn Statement. As such, we see scope for front-end break-evens to fall further and even underperform euro break-evens over the short term.

SSA Strategy – fallout from France's rating

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Since we last published when France's rating was lowered by S&P to AA Stable (*Euro Rates Strategy, 8th Nov*), there have been several developments within the SSA space. Our key message is that we do not consider the downgrade of France to be a significant market event, as justified by the limited SSA spread reaction.

SSA implications of S&P's downgrade of France

Figure 28. What happens when S&P downgrades France?

	S&P Rating		January 2012 S&P Report Date
France	AA+ Neg	↓	13-Jan-12
EFSF	AA+ Neg	↓	16-Jan-12
EIB	AAA Neg		16-Jan-12
CADES	AA+ Neg	↓	17-Jan-12
EU	AAA Neg		20-Jan-12

	S&P Rating		November 2013 S&P Report Date
France	AA Stable	↓	08-Nov-13
EFSF	AA Stable	↓	08-Nov-13
French SSA	AA Stable	↓	12-Nov-13

Source: Citi Research, S&P

January 2012 precedent: To evaluate the relevance and implication of the sovereign downgrade of France, it is important to recognize that the connection between France and SSAs differs depending on the fundamental characteristics of the guarantee in question. We can also take a look at what S&P did the last time France was downgraded back in January 2012. Here, within days, the EFSF and CADES had their ratings normalized, but at the time, the AAA ratings of EIB and EU were re-stated (Figure 28). As S&P stated when it normalized the rating of CADES in January 2012, "*[u]nder our methodology applicable to government-related entities (GREs), we equalize the ratings on GREs with their related sovereign when we believe there is an "almost certain" likelihood that they would receive timely and sufficient extraordinary support from that sovereign.*"[6]

EFSF moved to AA Stable: The first subsequent rating action came on the same day (last Friday) whereby the EFSF had its own rating normalized to AA Stable. For various reasons, the EFSF is more closely connected to the ratings of large, highly rated sovereigns within its structure. As S&P detailed in its Research Update (8th November), "*The downgrade reflects that EFSF's long-term obligations are fully supported by guarantees from EFSF members rated 'AA' or above by Standard & Poor's, and no longer only by members rated 'AA+' or above.*" This action had a muted market reaction and we continue to view the EFSF as a highly rated, core market SSA issuer which will remain important in providing market liquidity for many years ahead. We would therefore recommend buying any weakness and not anticipate further rating actions by S&P regarding the EFSF over the medium term.

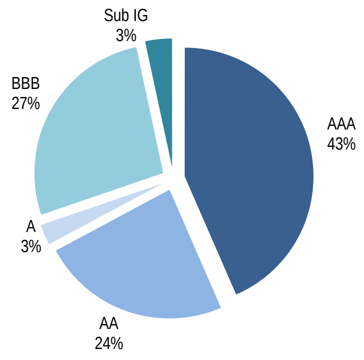
French agencies moved to AA Stable: In line with S&P's criteria regarding government-related entities (GREs), S&P has normalized the rating on the French agencies it rates to that of France. It stated[7] that this reflected their "*opinion that there is an "almost certain" likelihood that they would receive timely and sufficient extraordinary support from the French government*." The affected agencies were:

- Agence Francaise de Developpement
- Assistance Publique - Hopitaux de Paris
- Caisse Centrale de Reassurance
- Caisse des Depots et Consignations
- Caisse Nationale des Autoroutes
- Societe Anonyme de Gestion de Stocks de Securite
- Societe de Financement Local
- Unedic

[6] S&P "Rating Actions Taken on 25 Eurozone Government Related Entities Following Sovereign Actions" 19th January 2012.

[7] S&P "Ratings on Eight French Government-Related Entities Lowered to 'AA' Following Similar Action on France; Outlook Stable" 12th November

Figure 29. EIB Capital Share by Broad Rating



Source: Citi Research, EIB, S&P

EU: The EU is rated AAA negative outlook by S&P and due to fundamental characteristics (for example its low level of debt, strong legal framework), we do not think a downgrade of the EU is mechanical fall out due to the move on France. Specifically, in their last summary on the EU (4th December 2012), S&P stated "*[t]he negative outlook reflects our view that there is at least a one-in-three chance that we could lower the rating by 2014. Downward rating pressure could build if we were to downgrade a 'AAA' rated EU member (currently these are Denmark, Finland, Germany, Luxembourg, Netherlands, Sweden, and the U.K.) or should there be further deterioration in the overall creditworthiness of its 27 members.*"

EIB: The EIB is rated AAA stable by S&P – having recently had its own "negative outlook" removed on 22nd October following the €10bn increase in its paid-in capital. It has the support of 28 EU member states, good asset quality and strong legal and market franchise. Its stable outlook reflects the low chance of a rating change over the medium term. France also has a lower weight within EIB's capital structure (16%) compared with the EFSF (22%) as EIB has a broader base of guarantors (all 28 EU states). At present, EIB's AAA shareholders (as rated by S&P) account for 43% of total subscribed capital (Figure 29); AA rated shareholders account for 24%.

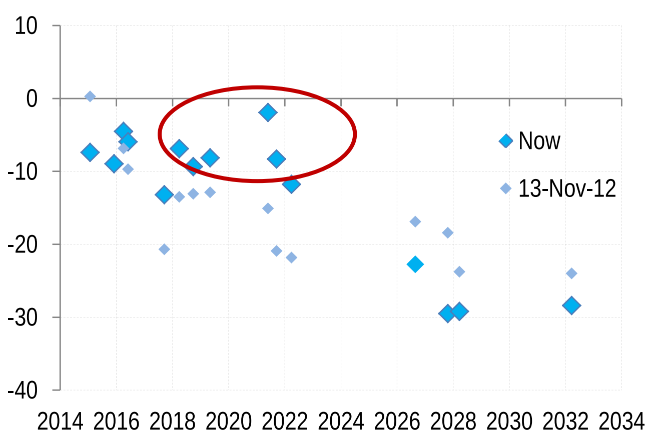
Little reaction in spreads and France is still relatively tight

We do not view this rating action as a significant market event and the spread reaction has been understandably muted. Demand for France remains firm and the 10yr OAT-Bund spread remains at tight levels (47bp).

We continue to like EU vs OATs

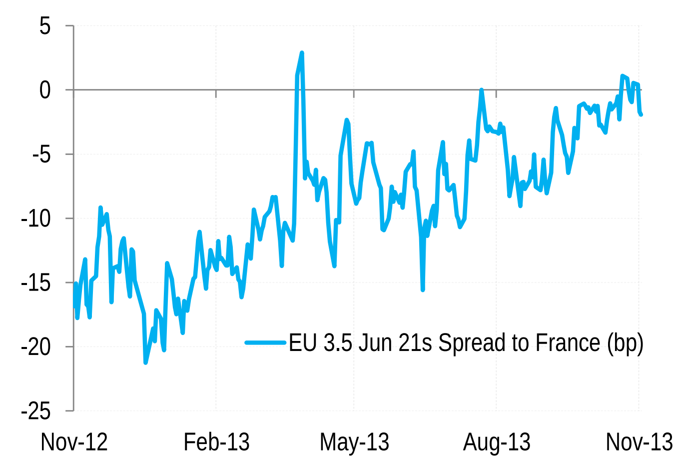
The EU has much less debt (at around €55bn) than its peers and issuance next year is set to be just €2.6bn in Q1 and €2.1bn in Q2. It is also rated AAA/Aaa (S&P, Moody's) and spreads to France are in the single digits in the belly of the curve (Figure 30). Fundamentally (now a two notch S&P rating differential between France) and technically (relative supply profiles) the case for switching out of France and into supras like the EU looks historically appealing. An example of the cheapening of the EU to OATs is shown in the 8yr sector in Figure 31. Further examples can be found in our recent *Euro SSA Strategy - Strategies for trading supranationals*.

Figure 30. EU bonds to France (Spread curve to OATs, bp)



Source: Citi Research

Figure 31. 8yr EU to France (Spread, bp)



Source: Citi Research

Covered Bond Strategy

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France downgrade – are French covered bonds next?

Last week, France was downgraded by S&P while it received a stable outlook. For further implications of this rating action, please see *Euro Rates Strategy - S&P Lowers France to AA Stable – Market Implications.* So far, French covered bonds are highly rated by S&P: all covered bonds are rated AAA while on a volume weighted basis, S&P is the most important rating agency for French secured paper.

Covered bond rating downgrades to be expected

Direct links: Covered bonds can be affected directly by a downgrade of the sovereign. In the case of S&P, there is a direct link as the potential uplift of a covered bond rating is currently limited to six notches in case of mortgage covered bonds and four notches in case of public sector covered bonds. Until the end of this week, S&P has asked for comments for amendments to the rating methodology which would result in a reduction of the potential uplift for mortgage covered bonds to four notches and public sector covered bonds to two notches (for further information, please see our latest *Euro SSA and Covered Bond Monthly*).

Cover pool composition can be detrimental for potential downgrades…

Indirect links: There are also indirect links between the sovereign rating and the covered bond rating. On the one hand, the collateral composition can be detrimental. Hence, mortgage covered bonds should not be affected by a downgrade of public sector exposure. Obviously, covered bonds backed by loans to the public sector can be affected by sovereign downgrades if the borrower's credit quality is reduced. One example in the recent past is Obligations Foncière (OF) program of BNP Paribas. The OF are mainly backed by export credit agency loans guaranteed by sovereigns: Germany (34%), France (32%), UK (13%) and USA (21%) are the guarantors. When Fitch downgraded the United Kingdom earlier this year, the covered bonds followed to AA+.

…but also the reaction of bank ratings to sovereign downgrades

Apart from this link, it happened in the past that banks were downgraded in line with the sovereign, especially in the Iberian markets. This eventually leads to a decrease of the rating buffer between covered bonds and the issuing entity which could also result in a downgrade of the covered bonds. Note, however, that this should not be expected on a broad basis as S&P already announced on Friday that systemically important French banks would not be affected by the downgrade of the sovereign.

OH should not be affected

Affected banks: Predictability for covered bond rating actions decreased over the years. However, it is quite clear which covered bond programs will not be affected. We do not expect covered bond rating actions on mortgage covered bond programs (Obligations à l'Habitat). In several OF programs, the collateral composition is very diverse leaving such programs with a relatively low share of domestic public sector exposure and therefore a lower probability of rating actions.

CAFFIL will probably be downgraded

A company which is directly linked to the sovereign is SFIL and its covered bond issuing affiliate CAFFIL. In the case of CAFFIL, covered bonds are capped one notch above the sovereign rating. As France has been downgraded to AA, CAFFIL covered bonds should be following the one notch downgrade and get an AA+ rating.

Other OF with high public sector exposure to France might follow

Covered bonds whose issuing entity is not directly linked to the sovereign but whose cover pool is exposed to France could also be affected. In case of CMARK SCF, a one-notch downgrade should be expected as well. Note however, that the issuer's mortgage covered bonds should not be affected. For ACASCF and SOCSCF the loss of AAA should also be expected as the exposure to France is rather high (54% and 92%, respectively).

BNPSCF might be able to withstand downgrade pressure

Things might look better in case of BNPSCF. When S&P affirmed its AAA in May, it said that a downgrade by the sovereign would not result in an automatic downgrade of the covered bonds. The fact that the exposure to France is only 32% should be helpful when compared to the SCF programs mentioned above.

CFF should not be affected

No rating effects: Other SCF programs are not rated by S&P (AXA Bank Europe SCF and CIF Euromortgage) or secure covered bonds with mortgage loans. Moreover, obligations foncières backed by a mixed cover pool are not categorized as public sector covered bonds by S&P given the highly diversified cover pool. Hence, the rating agency grants up to six (old criteria) or four (new criteria) notch uplift for these covered bonds and a downgrade should not be expected. In case of LBPSFH, the entity has an indirect link to the sovereign but S&P announced that a one-notch downgrade of France would not affect the parent company's rating. Apart from that, LBPSFH should still have enough leeway to withstand a downgrade of the mother company.

Figure 32. Selected French covered bond issuers and possible rating actions

Covered Bond Issuer	Main collateral	Parent company	Current rating (S&P)	Expected Rating (S&P)	Main geographic concentration
ACASCF	Public sector	Crédit Agricole	AAA	AA+	France (92%)
BNPSCF	Public sector	BNP Paribas	AAA	AAA	Germany (34%)
CAFFIL	Public sector	Société de Financement Local	AAA	AA+	France (69%)
CMARK	Public sector	Credit Mutuel Arkea	AAA	AA+	France (100%)
LBPSFH	Mortgage	La Banque Postale	AAA	AAA	France (100%)
SOCSCF	Public sector	Société Générale	AAA	AA+	France (92%)

Source: Citi Research

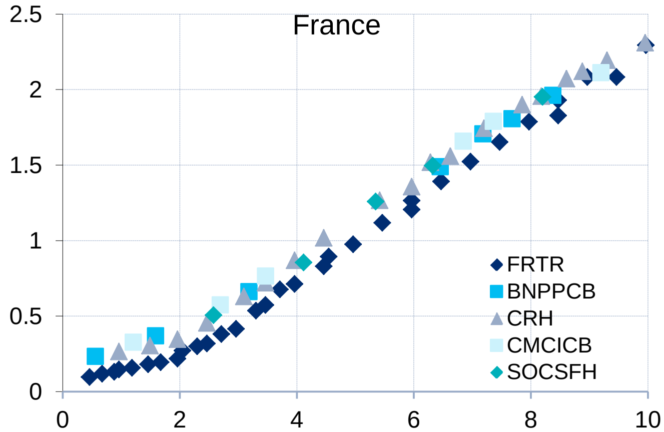
Widening vs swaps should be limited

Secondary market implications: We don't expect French covered bonds' secondary levels to be affected negatively by the potential rating actions. The impact of losing the top notch rating has decreased over recent years as market participants' investment guidelines have become more flexible and even highly rating sensitive investors changed their stance on external ratings. This has also been necessary as the overall market volume of highly rated paper decreased constantly over the last years. Moreover, the German pfandbrief market impressively shows that tight pricing can also be achieved with double A rated covered bonds. Hence, we think that French covered bonds can continue to grind tighter in the future. This should also be seen against the background of €29bn of redemptions in 2014 which makes us believe we'll see a second consecutive year of net negative issuance in France.

French covered bonds trade tight versus OAT on a historical basis…

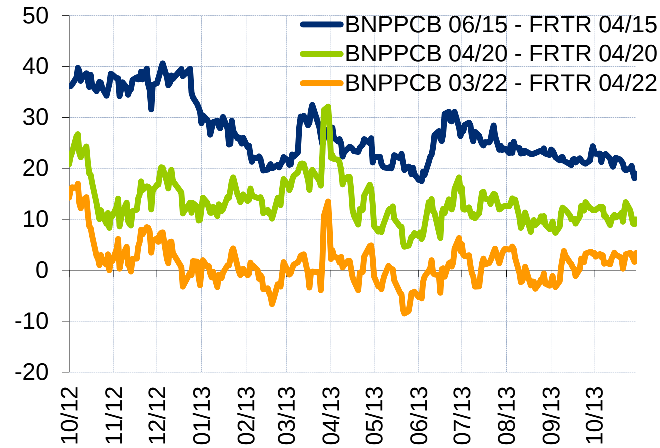
Covered bonds vs OAT: In the longer end of the curve, several French covered bonds trade in line or more expensive than OAT. On a historical basis, covered bonds trade tight to SSA and government debt. However, as noted previously several times, we think that in the longer-term covered bonds could go even tighter to government bonds – also in the belly of the curve. We generally argued that the supply forecasts in both markets develop differently: higher net supply in the government bond market and shrinkage of the French covered bond segment. The preliminary results of EBA investigation on liquidity which affect the composition of the LCR might also lead to higher demand for French covered bonds by bank treasuries – especially in the belly of the curve (for more information on that, please see our latest *Euro SSA and Covered Bond Monthly*).

Figure 33. French covered bonds and OAT, yield, %



Source: Citi Research

Figure 34. BNPPCB vs OAT, ASW-Spread, bp



Source: Citi Research

…but might go even tighter in the longer term

These arguments have mainly been driven by demand and supply patterns in both markets. However, we now begin to see a more distinct rating differentiation between the sovereign and the French covered bond market. However, we don't think that rating pressure persists and we expect a stable rating of AA for France by S&P over the medium term. Note that Moody's also has a negative outlook on the sovereign while Fitch rates the country AA+ and gives a stable outlook. Nevertheless, in case of S&P the rating differential between mortgage covered bonds and OAT is two notches now. Hence, the rating difference becomes a more valid argument to explain the current pricing and the possibility of covered bonds trading more expensive than government bonds. We would opine that it is especially the case for mortgage covered bonds and covered bonds issued by CRH.

Technical update: Bunds and gilts

Bunds: uptrend intact

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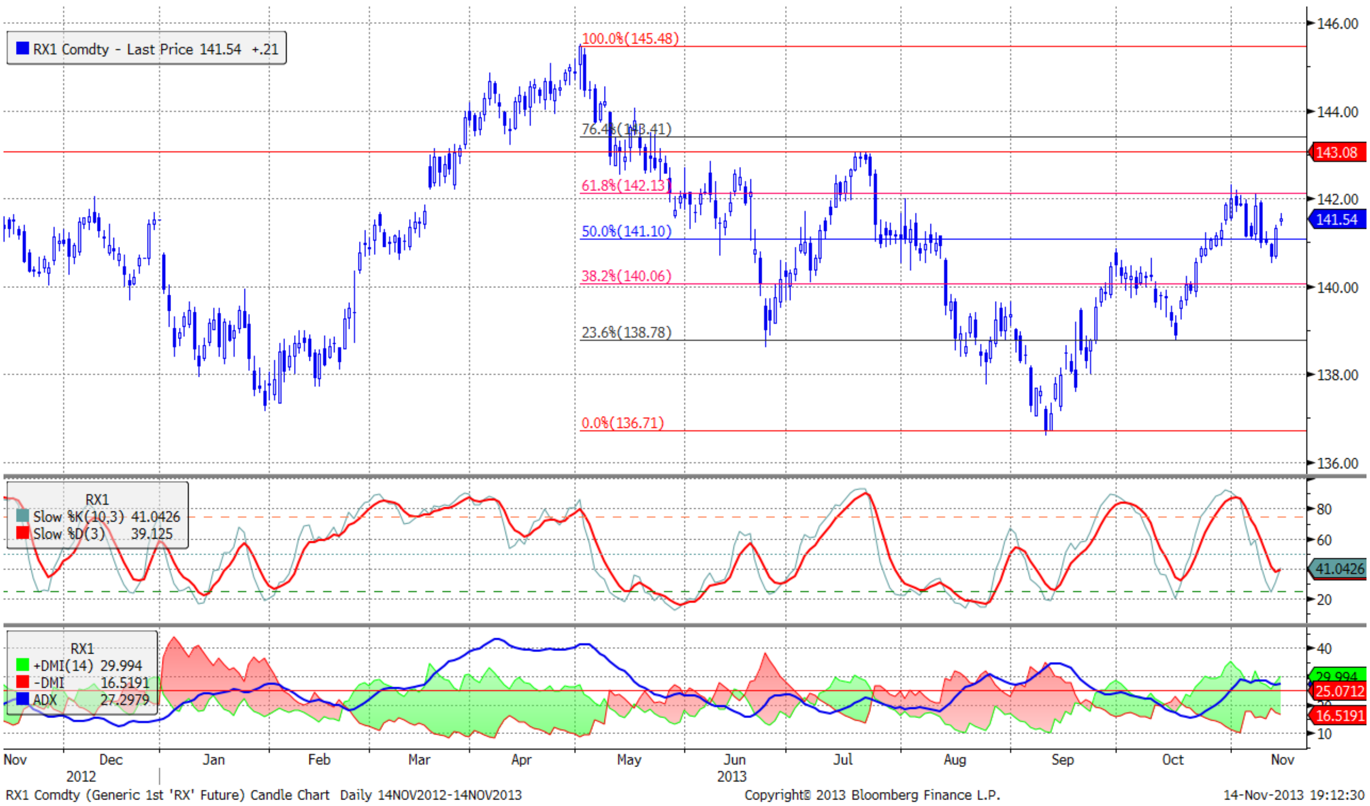
Figure 35 shows a daily candlestick chart of continuous 10yr Bund futures. A white candle indicates that the closing level is above the opening level, and a blue candle indicates that the closing level is below the opening level. Wicks (or shadows) on both ends indicate the intraday range.

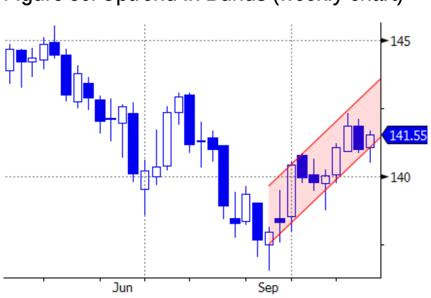
Technicals remain bullish for Bunds on both daily and weekly charts. Bunds shrugged off the double top earlier this week and rallied past the strong resistance in the 141-141.15 region. On the daily chart, ADX confirms an uptrend. The slow stochastic is also out of the oversold territory after briefly touching it and has crossed the trigger line. These are all bullish signals. The longer term uptrend can be seen on the weekly chart (Figure 36). A break out of this 2month old channel will indicate an acceleration/ reversal in the rally.

Figure 35. 10yr continuous Bund futures with Fibonacci levels, slow stochastic (10,3,3) and 14day ADX (daily chart)



Source: Bloomberg

Figure 36. Uptrend in Bunds (weekly chart)



Source: Bloomberg

Resistance: We see the first resistance in the 142.1 region which was tested twice during the recent rally and coincides with 61.8% Fibonacci retracement of May-September sell-off (on a roll-adjusted basis). The next resistance will be in the 143.1 region which was the highest level reached in June-July pull-back.

Support: The 141 region will now act as a support. This is the 50% retracement level and coincides with the 30week and 50week moving averages. 139.8-140 is the next major support region with multiple Fibonacci levels.

The channel lower for the next week is 141.47 and the channel upper 143.60.

Gilts: 109.7-110 key to direction, bullish bias

Gilts seem to have successfully rallied past the key resistance zone of 109.7-110 today after several attempts during the week. This zone remains the key to further price action. Gilts formed a Head and Shoulders pattern over the last month with the neckline at 110, however they have formed a double bottom this week with 109.7 as the resistance. Therefore, if this break is sustained and gilts manage to stay above 110, the double bottom might lead to a near-term rally, otherwise the H&S would be the driver with a target of 107.7 (Figure 37).

We would give slightly more weight to the latest development, supported by a turning slow stochastic and potential “Bollinger Bounce” (Figure 38).

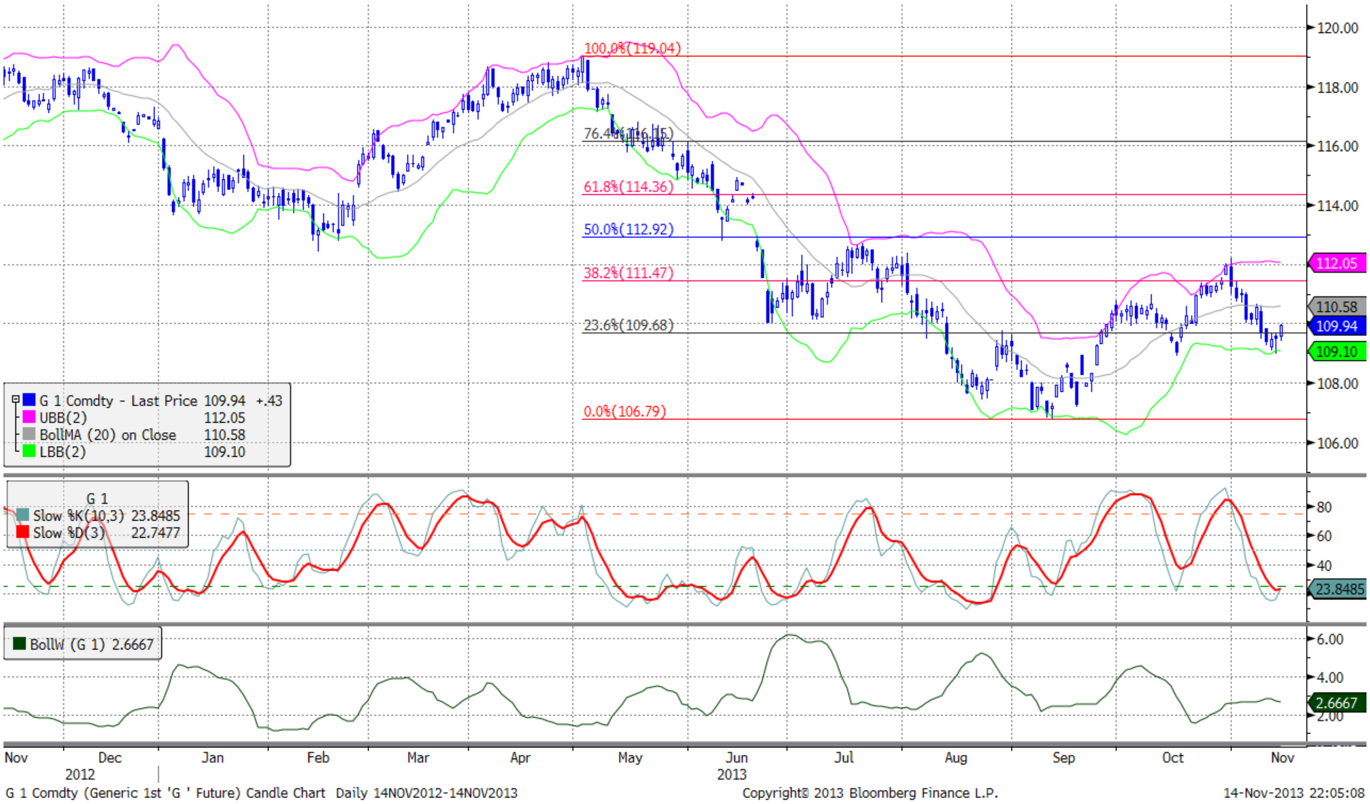
Figure 37. Double bottom vs Head and Shoulders pattern (1 month chart of 30 minutes interval)

Source: Bloomberg

Resistance: The first key resistance is around the 111.5 area, which is the 38.2% retracement of May-September sell-off and could not be broken last week. The next strong resistance is in the 112.7-112.9 region, which is also the 50% retracement level.

Support: The first key support is in the 107.7-107.9 region, which is the lowest weekly close of the year and is also the target of the H&S.

Figure 38. 10yr continuous gilt futures with Fibonacci levels, slow stochastic (10,3,3) and 20day Bollinger Bands



Source: Bloomberg

Relative value trades

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We highlight a number of relative value opportunities in the 2-10yr sector of the German, French, Dutch and Gilt yield curves.

Germany: 7s9s flattener

Switch into Jan22s

- Switch from 3% Jul20 to 2% Jan22 for 38bp (3m carry: 0.3bp) - Figure 39

France: fade the richness of Oct16s or Apr18s

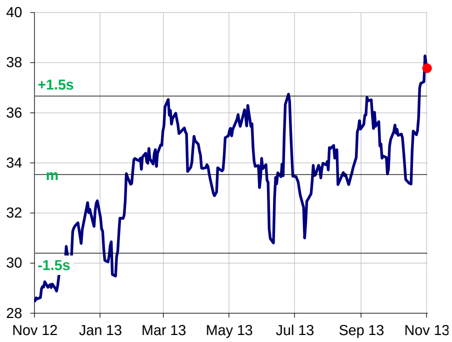
Sell Apr18s vs surrounding issues

- Sell 4% Apr18 vs 4.25% Oct17 and 3.5% Apr20 (3m carry: 0.1bp) - Figure 40

Sell Oct16s vs surrounding issues

- Sell 5% Oct16 vs 3.25% Apr16 and 4.25% Oct17 (3m carry: 1.4bp) - Figure 41

Figure 39. Germany: 2% Jan22 – 3% Jul20 yield spread (bp)



Source: Citi Research

Figure 40. France: 4.25% Oct17, 4% Apr18, 3.5% Apr20 microfly (bp)

Source: Citi Research

Figure 41. France: 3.25% Apr16, 5% Oct16, 4.25% Oct17 microfly (bp)

Source: Citi Research

Netherlands: 5s6s flattener, fade the richness of Jul20s

Switch into Jul19s

- Switch from 1.25% Jan18 to 4% Jul19 for 37bp (3m carry: 1.2bp) - Figure 42

Sell Jul20s vs surrounding issues

- Sell 3.5% Jul20 vs 4% Jul19 and 2.25% Jul22 (3m carry: -1.3bp) - Figure 43

UK: take advantage of cheapness of Sep19s

Buy Sep19s vs surrounding issues

- Buy 3.75% Sep19 vs 1.25% Jul18 and 3.75% Sep20 (3m carry: +0.8bp) - Figure 44

Figure 42. Netherlands: 4% Jul19 – 1.25% Jan18 yield spread (bp)

Source: Citi Research

Figure 43. Netherlands: 4% Jul19, 3.5% Jul20, 2.25% Jul22 microfly (bp)

Source: Citi Research

Figure 44. UK: 1.25% Jul18, 3.75% Sep19, 3.75% Sep20 microfly (bp)

Source: Citi Research

Relative value tables

Regular readers will be familiar with the Relative Value Appendix showing individual bonds from the major EMU/UK markets in the context of their 6-month trading range relative to our fitted curve. We have expanded this approach and summarized the results below.

For example, Figure 45 shows the five cheapest and richest bonds in Germany relative to a fitted yield curve (shown on the left half of the page) and to the euro swap curve (right half of page). The table identifies benchmarks and CTDs and also gives the amount outstanding and initial issue date.

Figure 45. Yield Spread and CAS to Fitted Relative Value Curve (6m History)

GERMANY

Versus Govt Curve (CAS)

	Rank		ZScore	Issued	Size (€bn)
Richest	1	1.00 Oct18 (5y)	-2.29	Sep13	13
	2	2.00 Aug23 (10y)	-2.04	Sep13	14
	3	4.25 Jul18 (OE)	-1.75	May08	21
	4	0.50 Feb18	-1.70	Jan13	17
	5	3.50 Jul19	-1.55	May09	24
	5	1.25 Oct16	1.26	Sep11	16
	4	2.25 Sep21	1.28	Aug11	16
	3	3.00 Jul20	1.35	Apr10	22
	2	2.25 Sep20	1.99	Aug10	16
Cheapest	1	2.50 Jan21	2.57	Nov10	19

Versus Swap Curve (CAS)

	Rank		ZScore	Issued	Size (€bn)
Richest	1	0.00 Dec15 (2y)	-1.00	Nov13	5
	2	1.50 Sep22	0.14	Sep12	18
	3	1.75 Jul22 (RX)	0.23	Apr12	24
	4	1.50 Feb23	0.36	Jan13	18
	5	4.25 Jul18 (OE)	0.37	May08	21
	5	3.75 Jan17	2.29	Nov06	20
	4	3.50 Jan16	2.31	Nov05	23
	3	2.75 Apr16	2.55	Apr11	18
	2	1.25 Oct16	2.58	Sep11	16
Cheapest	1	4.00 Jul16	2.61	May06	23

Source: Citi Research

Figure 46 (overleaf) looks at bonds of all maturities. For investors with maturity restrictions we have also provided another set of summary tables (Figure 47 and Figure 48) which looks at bonds shorter than 12 years and longer than 8 years, and uses the same criteria as Figure 46 to highlight the richest and cheapest bonds in these narrower maturity spectrums.

These summary tables should help facilitate efficient screening of bonds and, among other things, provide a selection of starting points when considering switches.

EMU relative value table – all maturities

Figure 46. Coupon Adjusted Spread to Fitted Curve and Swap Curve by Country (6m History); All bonds on each curve

Versus Govt Curve (CAS) | Versus Swap Curve (CAS)

GERMANY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	1.00 Oct18 (5y)	-2.29	Sep13	13	Richest	1	0.00 Dec15 (2y)	-1.00	Nov13	5
	2	2.00 Aug23 (10y)	-2.04	Sep13	14		2	1.50 Sep22	0.14	Sep12	18
	3	4.25 Jul18 (OE)	-1.75	May08	21		3	1.75 Jul22 (RX)	0.23	Apr12	24
	4	0.50 Feb18	-1.70	Jan13	17		4	1.50 Feb23	0.36	Jan13	18
	5	3.50 Jul19	-1.55	May09	24		5	4.25 Jul18 (OE)	0.37	May08	21
	5	1.25 Oct16	1.26	Sep11	16		5	3.75 Jan17	2.29	Nov06	20
	4	2.25 Sep21	1.28	Aug11	16		4	3.50 Jan16	2.31	Nov05	23
	3	3.00 Jul20	1.35	Apr10	22		3	2.75 Apr16	2.55	Apr11	18
	2	2.25 Sep20	1.99	Aug10	16		2	1.25 Oct16	2.58	Sep11	16
Cheapest	1	2.50 Jan21	2.57	Nov10	19	Cheapest	1	4.00 Jul16	2.61	May06	23

FRANCE

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	5.00 Oct16	-2.06	Oct00	29	Richest	1	4.00 Oct38	-1.44	Oct05	24
	2	1.75 Feb17	-1.79	Feb11	20		2	4.75 Apr35	-1.42	Apr03	21
	3	4.75 Apr35	-1.77	Apr03	21		3	4.50 Apr41	-1.38	Apr09	24
	4	3.00 Apr22	-1.65	Feb12	33		4	4.00 Apr55	-1.30	Apr04	15
	5	1.00 Jul17	-1.56	Jul11	18		5	3.25 May45 (30y)	-1.27	May12	9
	5	3.50 Apr26	0.86	Apr10	30		5	0.25 Nov15 (2y)	0.09	Nov12	21
	4	3.50 Apr20	0.88	Feb10	36		4	3.75 Oct19	0.13	Oct08	32
	3	3.25 May45 (30y)	1.06	May12	9		3	2.25 Feb16	0.17	Feb10	29
	2	1.00 Nov18 (5y)	1.36	Nov12	17		2	1.00 Nov18 (5y)	0.33	Nov12	17
Cheapest	1	3.75 Oct19	2.16	Oct08	32	Cheapest	1	2.25 May24	0.45	Nov13	4

ITALY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.50 Dec18 (5y)	-2.55	Sep13	11	Richest	1	3.75 Apr16 (BTS)	-2.30	Apr11	16
	2	5.00 Aug34	-1.91	Aug03	21		2	2.75 Dec15	-2.28	Dec12	16
	3	4.75 Sep16	-1.56	Sep11	16		3	2.25 May16	-2.28	Apr13	15
	4	5.50 Sep22	-1.15	Mar12	20		4	4.75 Sep16	-2.27	Sep11	16
	5	5.50 Nov22 (IK)	-1.03	May12	21		5	3.75 Aug16	-2.25	Feb06	27
	5	3.75 Aug21	2.16	Feb06	28		5	4.75 Sep44 (30y)	-0.99	Mar13	9
	4	3.75 Mar21	2.25	Sep10	24		4	4.00 Feb37	-0.98	Aug05	25
	3	4.00 Sep20	2.26	Mar10	25		3	5.00 Sep40	-0.96	Sep09	21
	2	4.75 Sep21	2.39	Mar11	25		2	5.00 Aug39	-0.94	Aug07	19
Cheapest	1	5.00 Mar22	2.63	Sep11	18	Cheapest	1	3.75 May21	-0.28	Oct13	5

N'LANDS

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	2.50 Jan33	-1.94	Mar12	10	Richest	1	3.75 Jan42 (30y)	-0.77	May10	14
	2	1.25 Jan18	-1.42	Jul12	15		2	2.50 Jan33	-0.64	Mar12	10
	3	4.00 Jul16	-0.98	Jul06	13		3	4.00 Jan37	-0.52	Apr05	13
	4	1.25 Jan19 (5y)	-0.68	Jun13	8		4	1.25 Jan18	0.05	Jul12	15
	5	1.75 Jul23 (10y)	-0.67	Mar13	16		5	1.25 Jan19 (5y)	0.10	Jun13	8
	5	2.25 Jul22	1.02	Feb12	15		5	4.50 Jul17	0.71	Jul07	15
	4	4.00 Jan37	1.16	Apr05	13		4	3.25 Jul21	0.81	Mar11	16
	3	3.75 Jan23	1.17	Jan06	11		3	2.25 Jul22	0.91	Feb12	15
	2	3.25 Jul21	1.62	Mar11	16		2	3.75 Jan23	0.96	Jan06	11
Cheapest	1	0.00 Apr16	1.69	Jan13	13	Cheapest	1	0.00 Apr16	1.53	Jan13	13

SPAIN

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.75 Oct18 (5y)	-2.27	Jul13	15	Richest	1	3.15 Jan16	-1.68	Sep05	21
	2	4.70 Jul41 (30y)	-2.16	Sep09	12		2	3.25 Apr16	-1.58	Nov10	21
	3	4.80 Jan24	-1.48	Sep08	15		3	4.30 Oct19	-1.55	Jun09	19
	4	4.30 Oct19	-1.31	Jun09	19		4	4.10 Jul18	-1.54	Feb08	19
	5	4.10 Jul18	-1.10	Feb08	19		5	4.50 Jan18	-1.53	Nov12	19
	5	5.40 Jan23	1.17	Jan13	17		5	4.20 Jan37	-0.77	Jan05	16
	4	4.20 Jan37	1.68	Jan05	16		4	4.90 Jul40	-0.75	Jun07	13
	3	3.25 Apr16	2.02	Nov10	21		3	4.70 Jul41 (30y)	-0.75	Sep09	12
	2	3.30 Jul16	2.21	Apr13	17		2	5.15 Oct28	-0.71	Jul13	5
Cheapest	1	5.50 Apr21	3.53	Jan11	24	Cheapest	1	5.15 Oct44	1.27	Oct13	4

BELGIUM

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.25 Sep16	-2.02	Jan06	13	Richest	1	3.75 Jun45 (30y)	-1.08	Sep13	4
	2	4.25 Mar41	-1.48	Apr10	12		2	4.25 Mar41	-1.00	Apr10	12
	3	3.75 Sep20	-1.46	Jan10	18		3	4.00 Mar32	-0.90	Mar12	8
	4	4.00 Mar19	-1.06	Jan09	11		4	5.00 Mar35	-0.86	May04	18
	5	1.25 Jun18 (5y)	-0.93	Feb13	12		5	3.25 Sep16	-0.79	Jan06	13
	5	4.25 Sep22	0.35	Jan12	15		5	4.00 Mar18	-0.46	Jan08	12
	4	2.75 Mar16	0.67	Mar10	10		4	4.00 Mar17	-0.45	Jan07	11
	3	3.50 Jun17	0.92	Mar11	13		3	3.50 Jun17	-0.36	Mar11	13
	2	5.00 Mar35	1.31	May04	18		2	3.00 Sep19	-0.29	Apr12	9
Cheapest	1	3.00 Sep19	1.88	Apr12	9	Cheapest	1	2.75 Mar16	-0.29	Mar10	10

Source: Citi Research

EMU relative value table – max 12yr maturity

Figure 47. Coupon Adjusted Spread to Fitted Curve and Swap Curve by Country (6m History); Bonds with a Maximum Maturity of 12yrs

Left: Versus Govt Curve (CAS) — Right: Versus Swap Curve (CAS)

GERMANY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	1.00 Oct18 (5y)	-2.29	Sep13	13	Richest	1	0.00 Dec15 (2y)	-1.00	Nov13	5
	2	2.00 Aug23 (10y)	-2.04	Sep13	14		2	1.50 Sep22	0.14	Sep12	18
	3	4.25 Jul18 (OE)	-1.75	May08	21		3	1.75 Jul22 (RX)	0.23	Apr12	24
	4	0.50 Feb18	-1.70	Jan13	17		4	1.50 Feb23	0.36	Jan13	18
	5	3.50 Jul19	-1.55	May09	24		5	4.25 Jul18 (OE)	0.37	May08	21
	5	1.25 Oct16	1.26	Sep11	16		5	3.75 Jan17	2.29	Nov06	20
	4	2.25 Sep21	1.28	Aug11	16		4	3.50 Jan16	2.31	Nov05	23
	3	3.00 Jul20	1.35	Apr10	22		3	2.75 Apr16	2.55	Apr11	18
	2	2.25 Sep20	1.99	Aug10	16		2	1.25 Oct16	2.58	Sep11	16
Cheapest	1	2.50 Jan21	2.57	Nov10	19	Cheapest	1	4.00 Jul16	2.61	May06	23

FRANCE

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	5.00 Oct16	-2.06	Oct00	29	Richest	1	3.00 Apr22	-1.23	Feb12	33
	2	1.75 Feb17	-1.79	Feb11	20		2	2.25 Oct22	-1.15	Oct11	24
	3	3.00 Apr22	-1.65	Feb12	33		3	4.25 Oct23 (OAT)	-1.03	Oct06	33
	4	1.00 Jul17	-1.56	Jul11	18		4	5.00 Oct16	-1.01	Oct00	29
	5	4.25 Oct17	-1.53	Oct06	28		5	3.25 Oct21	-0.99	Oct10	35
	5	2.50 Oct20	0.64	Oct09	33		5	0.25 Nov15 (2y)	0.09	Nov12	21
	4	1.00 May18	0.75	May12	21		4	3.75 Oct19	0.13	Oct08	32
	3	3.50 Apr20	0.88	Feb10	36		3	2.25 Feb16	0.17	Feb10	29
	2	1.00 Nov18 (5y)	1.36	Nov12	17		2	1.00 Nov18 (5y)	0.33	Nov12	17
Cheapest	1	3.75 Oct19	2.16	Oct08	32	Cheapest	1	2.25 May24	0.45	Nov13	4

ITALY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.50 Dec18 (5y)	-2.55	Sep13	11	Richest	1	3.75 Apr16 (BTS)	-2.30	Apr11	16
	2	4.75 Sep16	-1.56	Sep11	16		2	2.75 Dec15	-2.28	Dec12	16
	3	5.50 Sep22	-1.15	Mar12	20		3	2.25 May16	-2.28	Apr13	15
	4	5.50 Nov22 (IK)	-1.03	May12	21		4	4.75 Sep16	-2.27	Sep11	16
	5	4.50 May23 (10y)	-0.99	Mar13	18		5	3.75 Aug16	-2.25	Feb06	27
	5	3.75 Aug21	2.16	Feb06	28		5	5.00 Mar25	-1.38	Mar09	22
	4	3.75 Mar21	2.25	Sep10	24		4	3.75 Mar21	-1.22	Sep10	24
	3	4.00 Sep20	2.26	Mar10	25		3	4.50 Mar24	-1.12	Aug13	14
	2	4.75 Sep21	2.39	Mar11	25		2	3.75 Aug21	-1.07	Feb06	28
Cheapest	1	5.00 Mar22	2.63	Sep11	18	Cheapest	1	3.75 May21	-0.28	Oct13	5

N'LANDS

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	1.25 Jan18	-1.44	Jul12	15	Richest	1	1.25 Jan18	0.05	Jul12	15
	2	4.00 Jul16	-0.98	Jul06	13		2	1.25 Jan19 (5y)	0.10	Jun13	8
	3	1.25 Jan19 (5y)	-0.69	Jun13	8		3	4.00 Jul18	0.12	Feb08	15
	4	1.75 Jul23 (10y)	-0.65	Mar13	16		4	4.00 Jul19	0.37	Feb09	14
	5	4.00 Jul18	-0.63	Feb08	15		5	1.75 Jul23 (10y)	0.40	Mar13	16
	5	4.50 Jul17	0.49	Jul07	15		5	4.50 Jul17	0.71	Jul07	15
	4	2.25 Jul22	1.03	Feb12	15		4	3.25 Jul21	0.81	Mar11	16
	3	3.75 Jan23	1.17	Jan06	11		3	2.25 Jul22	0.91	Feb12	15
	2	3.25 Jul21	1.61	Mar11	16		2	3.75 Jan23	0.96	Jan06	11
Cheapest	1	0.00 Apr16	1.69	Jan13	13	Cheapest	1	0.00 Apr16	1.53	Jan13	13

SPAIN

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.75 Oct18 (5y)	-2.38	Jul13	15	Richest	1	3.15 Jan16	-1.68	Sep05	21
	2	4.80 Jan24	-1.48	Sep08	15		2	3.25 Apr16	-1.58	Nov10	21
	3	4.30 Oct19	-1.32	Jun09	19		3	4.10 Jul18	-1.55	Feb08	19
	4	4.10 Jul18	-1.19	Feb08	19		4	4.30 Oct19	-1.55	Jun09	19
	5	4.00 Apr20	-1.07	Jan10	20		5	4.50 Jan18	-1.53	Nov12	19
	5	3.15 Jan16	0.93	Sep05	21		5	5.50 Apr21	-1.17	Jan11	24
	4	5.40 Jan23	1.17	Jan13	17		4	4.80 Jan24	-1.12	Sep08	15
	3	3.25 Apr16	2.01	Nov10	21		3	5.40 Jan23	-1.11	Jan13	17
	2	3.30 Jul16	2.21	Apr13	17		2	4.40 Oct23 (10y)	-1.07	May13	17
Cheapest	1	5.50 Apr21	3.53	Jan11	24	Cheapest	1	4.65 Jul25	-0.99	Feb10	14

BELGIUM

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	3.25 Sep16	-2.02	Jan06	13	Richest	1	3.25 Sep16	-0.79	Jan06	13
	2	3.75 Sep20	-1.46	Jan10	18		2	4.00 Mar22	-0.68	May06	14
	3	4.00 Mar19	-1.06	Jan09	11		3	3.75 Sep20	-0.68	Jan10	18
	4	1.25 Jun18 (5y)	-0.93	Feb13	12		4	2.25 Jun23 (10y)	-0.66	Jan13	14
	5	5.50 Sep17	-0.63	Jun02	8		5	4.25 Sep21	-0.62	Jan11	15
	5	4.25 Sep21	-0.27	Jan11	15		5	4.00 Mar18	-0.46	Jan08	12
	4	4.25 Sep22	0.36	Jan12	15		4	4.00 Mar17	-0.45	Jan07	11
	3	2.75 Mar16	0.67	Mar10	10		3	3.50 Jun17	-0.36	Mar11	13
	2	3.50 Jun17	0.92	Mar11	13		2	3.00 Sep19	-0.29	Apr12	9
Cheapest	1	3.00 Sep19	1.88	Apr12	9	Cheapest	1	2.75 Mar16	-0.29	Mar10	10

Source: Citi Research

EMU relative value table – min 8yr maturity

Figure 48. Coupon Adjusted Spread to Fitted Curve and Swap Curve by Country (6m History); Bonds with a Minimum Maturity of 8yrs

Left: Versus Govt Curve (CAS) | Right: Versus Swap Curve (CAS)

GERMANY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	2.00 Aug23 (10y)	-2.04	Sep13	14	Richest	1	1.50 Sep22	0.14	Sep12	18
	2	4.00 Jan37	-1.41	Jan05	23		2	1.75 Jul22 (RX)	0.23	Apr12	24
	3	2.50 Jul44 (30y)	-1.26	Apr12	16		3	1.50 Feb23	0.36	Jan13	18
	4	1.50 Sep22	-1.11	Sep12	18		4	2.00 Jan22	0.53	Nov11	20
	5	1.50 Feb23	-1.06	Jan13	18		5	1.50 May23	0.81	May13	18
	5	3.25 Jul42	0.10	Jul10	15		5	4.00 Jan37	1.65	Jan05	23
	4	4.25 Jul39	0.12	Jan07	14		4	3.25 Jul42	1.71	Jul10	15
	3	6.25 Jan30	0.51	Jan00	9		3	4.75 Jul34	1.77	Jan03	20
	2	2.00 Jan22	0.61	Nov11	20		2	4.25 Jul39	1.88	Jan07	14
Cheapest	1	4.75 Jul40 (UB)	0.89	Jul08	16	Cheapest	1	4.75 Jul40 (UB)	1.97	Jul08	16

FRANCE

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	4.75 Apr35	-1.77	Apr03	21	Richest	1	4.00 Oct38	-1.44	Oct05	24
	2	3.00 Apr22	-1.65	Feb12	33		2	4.75 Apr35	-1.42	Apr03	21
	3	4.00 Oct38	-1.54	Oct05	24		3	4.50 Apr41	-1.38	Apr09	24
	4	2.25 Oct22	-1.14	Oct11	24		4	4.00 Apr55	-1.30	Apr04	15
	5	5.75 Oct32	-1.13	Oct00	25		5	3.25 May45 (30y)	-1.27	May12	9
	5	4.25 Oct23 (OAT)	-0.17	Oct06	33		5	4.25 Oct23 (OAT)	-1.03	Oct06	33
	4	1.75 May23 (10y)	0.25	May12	26		4	1.75 May23 (10y)	-0.98	May12	26
	3	2.75 Oct27	0.70	Oct11	16		3	2.75 Oct27	-0.88	Oct11	16
	2	3.50 Apr26	0.86	Apr10	30		2	3.50 Apr26	-0.75	Apr10	30
Cheapest	1	3.25 May45 (30y)	1.06	May12	9	Cheapest	1	2.25 May24	0.45	Nov13	4

ITALY

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	5.00 Aug34	-1.91	Aug03	21	Richest	1	5.50 Sep22	-1.54	Mar12	20
	2	5.50 Sep22	-1.15	Mar12	20		2	5.50 Nov22 (IK)	-1.51	May12	21
	3	5.50 Nov22 (IK)	-1.03	May12	21		3	4.50 May23 (10y)	-1.42	Mar13	18
	4	4.50 May23 (10y)	-1.00	Mar13	18		4	4.75 Aug23	-1.40	Feb08	25
	5	5.75 Feb33	-0.88	Feb02	15		5	5.00 Mar22	-1.40	Sep11	18
	5	4.00 Feb37	0.12	Aug05	25		5	4.75 Sep28	-1.03	Jan13	14
	4	5.00 Aug39	0.66	Aug07	19		4	4.75 Sep44 (30y)	-1.00	Mar13	9
	3	5.00 Sep40	0.72	Sep09	21		3	4.00 Feb37	-0.98	Aug05	25
	2	4.75 Sep28	0.99	Jan13	14		2	5.00 Sep40	-0.96	Sep09	21
Cheapest	1	5.00 Mar22	2.62	Sep11	18	Cheapest	1	5.00 Aug39	-0.95	Aug07	19

N'LANDS

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	2.50 Jan33	-1.94	Mar12	10	Richest	1	3.75 Jan42 (30y)	-0.77	May10	14
	2	1.75 Jul23 (10y)	-0.65	Mar13	16		2	2.50 Jan33	-0.64	Mar12	10
	3	3.75 Jan42 (30y)	0.96	May10	14		3	4.00 Jan37	-0.52	Apr05	13
	3	2.25 Jul22	1.03	Feb12	15		3	1.75 Jul23 (10y)	0.40	Mar13	16
	2	4.00 Jan37	1.16	Apr05	13		2	2.25 Jul22	0.91	Feb12	15
Cheapest	1	3.75 Jan23	1.17	Jan06	11	Cheapest	1	3.75 Jan23	0.96	Jan06	11

SPAIN

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	4.70 Jul41 (30y)	-2.17	Sep09	12	Richest	1	5.85 Jan22 (FBB)	-1.23	Nov11	19
	2	4.80 Jan24	-1.47	Sep08	15		2	4.80 Jan24	-1.12	Sep08	15
	3	5.90 Jul26	-0.97	Mar11	10		3	5.40 Jan23	-1.11	Jan13	17
	4	5.15 Oct44	-0.78	Oct13	4		4	5.90 Jul26	-1.08	Mar11	10
	5	4.90 Jul40	-0.07	Jun07	13		5	4.40 Oct23 (10y)	-1.07	May13	17
	5	4.65 Jul25	0.32	Feb10	14		5	4.20 Jan37	-0.77	Jan05	16
	4	5.15 Oct28	0.35	Jul13	5		4	4.90 Jul40	-0.75	Jun07	13
	3	5.75 Jul32	1.05	Jan01	15		3	4.70 Jul41 (30y)	-0.75	Sep09	12
	2	5.40 Jan23	1.20	Jan13	17		2	5.15 Oct28	-0.70	Jul13	5
Cheapest	1	4.20 Jan37	1.67	Jan05	16	Cheapest	1	5.15 Oct44	1.27	Oct13	4

BELGIUM

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	4.25 Mar41	-1.59	Apr10	12	Richest	1	3.75 Jun45 (30y)	-1.08	Sep13	4
	2	4.00 Mar32	-0.98	Mar12	8		2	4.25 Mar41	-1.00	Apr10	12
	3	4.00 Mar22	-0.65	May06	14		3	4.00 Mar32	-0.90	Mar12	8
	4	2.25 Jun23 (10y)	-0.47	Jan13	14		4	5.00 Mar35	-0.86	May04	18
	4	3.75 Jun45 (30y)	-0.25	Sep13	4		4	4.50 Mar26	-0.73	Jun11	8
	3	4.50 Mar26	0.24	Jun11	8		3	4.00 Mar22	-0.68	May06	14
	2	4.25 Sep22	0.31	Jan12	15		2	2.25 Jun23 (10y)	-0.66	Jan13	14
Cheapest	1	5.00 Mar35	1.29	May04	18	Cheapest	1	4.25 Sep22	-0.60	Jan12	15

Source: Citi Research

UK relative value table

Figure 49. Coupon Adjusted Spread to Fitted Curve and Swap Curve by Country (6m History)

ALL

	Versus Govt Curve (CAS) Rank	Bond	ZScore	Issued	Size (€bn)		Versus Swap Curve (CAS) Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	2.25 Mar14	-3.18	Mar09	35	Richest	1	2.25 Mar14	-1.58	Mar09	35
	2	1.00 Sep17	-2.09	Mar12	31		2	1.00 Sep17	-0.08	Mar12	31
	3	3.75 Sep20	-1.72	Jun10	24		3	4.00 Sep16	0.26	Mar06	35
	4	4.25 Dec55	-1.33	May05	23		4	1.75 Jan17	0.45	Aug11	27
	5	4.75 Mar20	-1.25	Mar05	33		5	5.00 Sep14	0.69	Jul02	41
	5	5.00 Mar25 (G)	1.41	Sep01	33		5	4.25 Dec40	2.68	Jun10	24
	4	4.50 Mar19	1.59	Sep08	35		4	4.50 Sep34	2.84	Jun09	26
	3	5.00 Sep14	1.61	Jul02	41		3	4.25 Sep39	3.00	Mar09	19
	2	3.75 Jul52	1.62	Sep11	20		2	4.25 Mar36	3.01	Feb03	23
Cheapest	1	2.75 Jan15	2.69	Nov09	29	Cheapest	1	4.75 Dec38	3.06	Apr04	25

2yr - 7yr

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	1.00 Sep17	-2.11	Mar12	31	Richest	1	1.00 Sep17	-0.08	Mar12	31
	2	3.75 Sep20	-1.74	Jun10	24		2	4.00 Sep16	0.25	Mar06	35
	3	4.75 Mar20	-1.27	Mar05	33		3	1.75 Jan17	0.45	Aug11	27
	4	4.00 Sep16	-0.22	Mar06	35		4	2.00 Jan16	0.74	Nov10	32
	5	2.00 Jan16	0.53	Nov10	32		5	3.75 Sep20	1.17	Jun10	24
	5	1.25 Jul18 (5y)	0.55	Feb13	34		5	5.00 Mar18 (WX)	1.19	May07	34
	4	1.75 Jan17	0.80	Aug11	27		4	4.75 Mar20	1.24	Mar05	33
	3	3.75 Sep19	1.17	Jul09	28		3	1.25 Jul18 (5y)	1.27	Feb13	34
	2	5.00 Mar18 (WX)	1.26	May07	34		2	3.75 Sep19	1.91	Jul09	28
Cheapest	1	4.50 Mar19	1.58	Sep08	35	Cheapest	1	4.50 Mar19	2.22	Sep08	35

7yr - 15yr

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	2.25 Sep23 (10y)	-0.90	Jun13	16	Richest	1	4.00 Mar22	1.28	Feb09	37
	2	3.75 Sep21	-0.34	Mar11	28		2	3.75 Sep21	1.31	Mar11	28
	3	4.00 Mar22	-0.25	Feb09	37		3	2.25 Sep23 (10y)	1.57	Jun13	16
	4						4				
	5						5				
	5						5				
	4						4				
	3	4.25 Dec27	0.13	Sep06	29		3	1.75 Sep22	1.76	Jun12	28
	2	1.75 Sep22	1.17	Jun12	28		2	5.00 Mar25 (G)	1.90	Sep01	33
Cheapest	1	5.00 Mar25 (G)	1.40	Sep01	33	Cheapest	1	4.25 Dec27	2.13	Sep06	29

>15yr

	Rank	Bond	ZScore	Issued	Size (€bn)		Rank	Bond	ZScore	Issued	Size (€bn)
Richest	1	4.25 Dec55	-1.37	May05	23	Richest	1	4.25 Dec55	1.12	May05	23
	2	4.25 Jun32	-1.15	May00	35		2	4.25 Dec49	1.13	Sep08	19
	3	4.25 Dec49	-1.09	Sep08	19		3	3.75 Jul52	1.27	Sep11	20
	4	4.25 Dec40	-1.07	Jun10	24		4	3.50 Jul68	1.29	Jun13	10
	5	4.00 Jan60	-0.59	Oct09	19		5	4.00 Jan60	1.46	Oct09	19
	5	4.25 Sep39	0.22	Mar09	19		5	4.25 Dec40	2.67	Jun10	24
	4	4.25 Dec46	0.26	May06	21		4	4.50 Sep34	2.84	Jun09	26
	3	3.25 Jan44 (30y)	0.56	Oct12	19		3	4.25 Sep39	2.99	Mar09	19
	2	4.75 Dec30	0.94	Oct07	29		2	4.25 Mar36	3.01	Feb03	23
Cheapest	1	3.75 Jul52	1.50	Sep11	20	Cheapest	1	4.75 Dec38	3.05	Apr04	25

Source: Citi Research

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 50. 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 TYZ3 (UST)	G Z3 (Gilt)	RXZ3 (Bund)
18 Nov (Mon)	US	1.25 - 1.75	Outright Treasury Coupon Purchases: 15/2/2036 - 15/11/2043		-32k		
18 Nov (Mon)	US	3 - 4	Outright Treasury Coupon Purchases: 31/8/2019 - 15/11/2020		-24k		
19 Nov (Tue)	UK	3.8	2¼% Treasury Gilt 2023 (issue and size confirmed)			34k	
19 Nov (Tue)	US	2.75 - 3.5	Outright Treasury Coupon Purchases: 15/2/2021 - 15/11/2023		-29k		
20 Nov (Wed)	US	1.25 - 1.75	Outright Treasury Coupon Purchases: 15/2/2036 - 15/11/2043		-32k		
21 Nov (Thu)	Spain	3.0	Obligaciones 2yr, 5yr and 10yr (estimated tenors and size)				14k
21 Nov (Thu)	France	7.5	BTAN, OAT 2yr and 5yr / OATi (estimated tenors and size)				30k
21 Nov (Thu)	UK	4.8	New 1.75% Treasury Gilt 2019 (issue and size confirmed)			24k	
21 Nov (Thu)	US	13.0	10-Year TIPS (re-opening)		160k		
21 Nov (Thu)	US	4.25 - 5.25	Outright Treasury Coupon Purchases: 30/11/2017 - 15/8/2018		-22k		
22 Nov (Fri)	US	1.25 - 1.75	Outright Treasury Coupon Purchases: 15/2/2036 - 15/11/2043		-32k		
			Weekly $DV01 of Issuance	14.9			
			Total Number of Futures Contracts		-11k	58k	45k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYZ3 (UST)	G Z3 (Gilt)	RXZ3 (Bund)
25 Nov (Mon)	Belgium	2.5	OLO 5yr, 10yr and 30yr (estimated size and tenors)				26k
25 Nov (Mon)	US	32.0	2-Year		80k		
25 Nov (Mon)	US	2.75 - 3.5	Outright Treasury Coupon Purchases: 15/2/2021 - 15/11/2023		-29k		
26 Nov (Tue)	Italy	4.0	New CTZ Dec15 (estimated issue and size)				7k
26 Nov (Tue)	Italy	0.8	BTPei (estimated size)				6k
26 Nov (Tue)	Netherlands	2.5	DSL 0% Apr16 reopening (issue confirmed, size €2-3bn)				4k
26 Nov (Tue)	UK	1.2	Mini tender (estimated date and size)			3k	
26 Nov (Tue)	US	35.0	5-Year		211k		
26 Nov (Tue)	US	1.25 - 1.75	Outright Treasury Coupon Purchases : 15/2/2036 - 15/11/2043		-32k		
27 Nov (Wed)	Germany	4.0	Bund 2% Aug23 reopening (issue and size confirmed)				32k
27 Nov (Wed)	US	29.0	7-Year		240k		
28 Nov (Thu)	Italy	6.0	BTP 5yr and 10yr (estimated tenor and size)				37k
28 Nov (Thu)	UK	2.6	3¼% Treasury Gilt 2044 (issue confirmed, estimated size)			49k	
			Weekly $DV01 of Issuance	62.6			
			Total Number of Futures Contracts		470k	51k	114k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYZ3 (UST)	G Z3 (Gilt)	RXZ3 (Bund)
04 Dec (Wed)	Germany	4.0	Bobl 167-Oct18 reopening (issue and size confirmed)				17k
05 Dec (Thu)	Spain	3.0	Bono 2yr and 5yr (estimated tenors and size)				10k
05 Dec (Thu)	France	6.0	OAT 5yr, 10yr and 15yr (estimate tenors and size)				52k
			Weekly $DV01 of Issuance	12.0			
			Total Number of Futures Contracts		0k	0k	80k

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYZ3 (UST)	G Z3 (Gilt)	RXZ3 (Bund)
10 Dec (Tue)	Austria	1.3	RAGB 5yr and 10yr (estimated size and tenors)				8k
10 Dec (Tue)	UK	1.3	0¾% Index-linked Treasury Gilt 2047 (issue confirmed, estimated size)			58k	
10 Dec (Tue)	US	30.0	3-Year		75k		
11 Dec (Wed)	Germany	5.0	Schtaz Dec15 reopening (issue and size confirmed)				9k
11 Dec (Wed)	US	21.0	10-Year (re-opening)		235k		
12 Dec (Thu)	Italy	4.5	BTP 3yr and 15yr (estimated tenors and size)				28k
12 Dec (Thu)	Italy	1.0	CCTeu (estimated size)				4k
12 Dec (Thu)	UK	4.7	Re-opening of conventional gilt maturing on 22 July 2019 (issue confirmed, estimated size)			24k	
12 Dec (Thu)	US	13.0	30-year (re-opening)		304k		
			Weekly $DV01 of Issuance	69.1			
			Total Number of Futures Contracts		614k	82k	49k

The next release of the tentative outright Treasury operation schedule will be at 3 p.m. on November 27, 2013. Therefore we have included Fed buybacks upto November 27 in this calendar.

Source: DMOs, Citi Research

EUR: Coupons & Redemptions (next 3 mths)

Figure 51. EMU-10 Redemptions over the next three months (€bn)

	Redemptions = €133bn										
Redemptions	DEU 39	FRA 22	NLD 16	ITA 34	ESP 14	BEL 0	AUT 1	FIN 0	PRT 0	GRC 0	IRL 7
(Fri) 13-Dec-13	15.0										
(Sun) 15-Dec-13				20.0							
(Sat) 04-Jan-14	24.0										
(Sun) 12-Jan-14		21.7									
(Wed) 15-Jan-14			15.7				1.3				6.8
(Fri) 31-Jan-14				14.5	14.2						

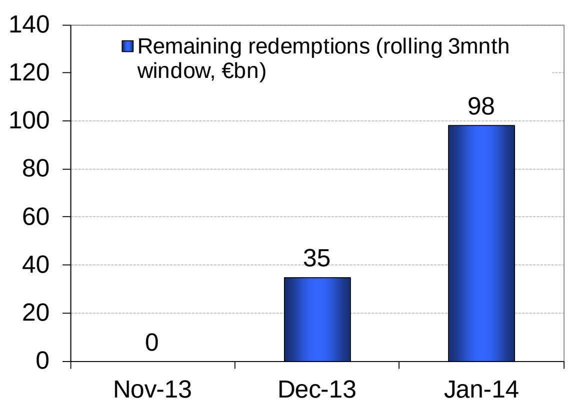
Source: DMOs, Bloomberg, Citi Research

Figure 52. EMU-10 Coupon Payments over the next three months (€bn)

	Coupons = €38bn										
Coupons	DEU 11	FRA 1	NLD 4	ITA 12	ESP 8	BEL 0	AUT 1	FIN 0	PRT 0	GRC 0	IRL 0
(Fri) 15-Nov-13				0.7							
(Fri) 22-Nov-13							0.3				
(Mon) 25-Nov-13		0.2									
(Sun) 01-Dec-13				1.4							
(Fri) 13-Dec-13	0.0										
(Sun) 15-Dec-13				0.9							
(Wed) 01-Jan-14				0.4							
(Sat) 04-Jan-14	10.6										
(Sun) 12-Jan-14		0.5									
(Wed) 15-Jan-14		0.5	4.0	0.4			0.6				0.3
(Mon) 20-Jan-14											0.0
(Sun) 26-Jan-14							0.1				
(Fri) 31-Jan-14					8.4						
(Sat) 01-Feb-14				8.4							

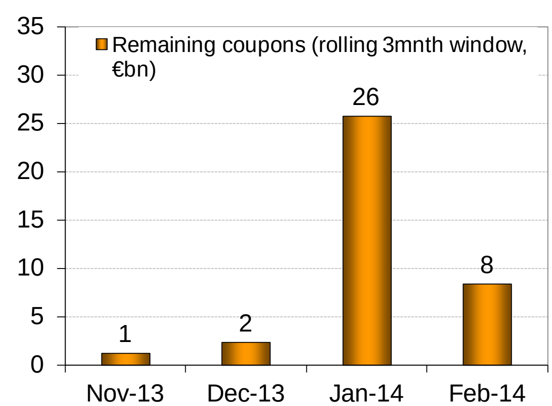
Source: DMOs, Bloomberg, Citi Research

Figure 53. EMU-10 remaining redemptions over the next 3months (€bn)



Source: DMOs, Bloomberg, Citi Research

Figure 54. 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 55. 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 1	19 Nov (Tue)	Spain	6month (16 May 2014) and 12month (new bill) - tenors confirmed, estimated size	5.15
			Total Size in Week 1	5.2
Week 2	26 Nov (Tue)	Spain	3month (21 February 2014), 9month (22 August 2014) - tenors confirmed, estimated size	3.6
	27 Nov (Wed)	Italy	6month (30 May 2014; issue confirmed, estimated size)	7.15
			Total Size in Week 2	10.8
Week 4	10 Dec (Tue)	Spain	6month (20 June 2014) and 12 month (new bill) - tenors confirmed, estimated size	5.15
	11 Dec (Wed)	Italy	12month (12 December 2014; issue confirmed, estimated size)	7.15
			Total Size in Week 4	12.3

Italy announces issue size 3 business days before the auction
Spain announces issue details 1 business day before the auction

Source: DMOs, Citi Research

2013 projections for bill supply

Figure 56. 2013 Italy and Spain Bill Supply – Citi Forecast (Euro Billion)

SPAIN	3m	6m	9m	12m	18m	Gross Supply	Redemptions	NCR
Jan	1.3	1.8		3.2	2.5	9	5	3
Feb	1.0	2.9	3.7	3.6		11	9	2
Mar	1.8	2.3	2.6	4.0		11	12	-2
Apr	0.9	1.3	2.2	4.6		9	8	1
May	0.9	1.2	2.6	3.3		8	6	2
Jun	1.1	1.1	2.6	4.0		9	10	-1
Jul	0.9	1.9	3.0	2.9		9	5	3
Aug	1.1	1.4	3.1	3.0		9	11	-3
Sep	0.8	1.7	2.8	3.8		9	8	1
Oct	0.7	1.0	2.8	4.5		9	8	1
Nov	1.0	1.4	2.6	3.8		9	11	-2
Dec	1.0	1.4	2.6	3.8		9	9	
Total	12.4	19.4	30.5	44.4	2.5	109	102	7

ITALY	3m*	6m	9m	12m	Flexible BOT	Gross Supply	Redemptions	NCR
Jan		9.8		9.8		20	21	-2
Feb		10.1		9.7		20	19	
Mar		9.4		7.8		17	19	-2
Apr	3.0	9.2		8.9		21	18	3
May		9.2		7.0	3.0	19	16	4
Jun		9.2		7.0		16	16	
Jul		9.8		7.0	2.5	19	11	9
Aug		9.8		8.6		18	18	
Sep		8.6		9.8	3.0	21	20	2
Oct		9.8		9.8		20	18	1
Nov		7.2		7.2		14	17	-2
Dec		7.2		7.2		14	25	-11
Total	3.0	109.0		99.5	8.5	220	219	1

*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 57. Citi Inflation Forecasts

Month	EUR HICPxT Index Forecast	EUR HICPxT MoM Change	EUR HICPxT YoY Change	France CPIxT Index Forecast	France CPIxT MoM Change	France CPIxT YoY Change	UK RPI Index Forecast	UK RPI MoM Change	UK RPI YoY Change	US CPURNSA Index Forecast	US CPURNSA MoM Change	US CPURNSA YoY Change
Sep 13	117.11	0.5	1.0	125.60	-0.2	0.7	251.90	0.4	3.2	234.15	0.1	1.2
Oct 13	116.94	-0.1	0.6	125.44	-0.1	0.5	251.90	0.0	2.6	234.05	-0.0	1.2
Nov 13	116.93	-0.0	0.8	125.30	-0.1	0.6	252.50	0.2	2.8	233.75	-0.1	1.5
Dec 13	117.32	0.3	0.8	125.73	0.3	0.6	254.10	0.6	3.0	233.35	-0.2	1.6
Jan 14	116.09	-1.0	0.8	125.57	-0.1	1.0	252.60	-0.6	2.8	234.55	0.5	1.9
Feb 14	116.43	0.3	0.8	125.74	0.1	0.8	254.10	0.6	2.6	235.25	0.3	1.3

Source: Citi Research, Bloomberg *Shaded = Already released*

Figure 58. US TIPS Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp) 1 Dec	Carry: RY (bp) 1 Jan	Carry: RY (bp) 1 Feb	Ref	BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp) 1 Dec	Carry: BE (bp) 1 Jan	Carry: BE (bp) 1 Feb	ZC Swap - BE Spread (bp)	Chg (bp)
Repo (%)				*0.09*	*0.09*	*0.09*									
TIPS 1/15	-1.02	-15	-16	1	-12	-36	*US-2.250-01/31/15*	119	14	15	1	-13	-38	9	-8
TIPS 4/15	-1.03	-15	-16	1	-10	-29	*US-2.500-04/30/15*	123	14	15	1	-11	-31	-4	-10
TIPS 7/15	-1.35	-14	-14	0	-11	-29	*US-4.250-08/15/15*	160	14	14	-1	-12	-31	6	-11
TIPS 1/16	-1.17	-11	-11	0	-7	-20	*US-2.625-02/29/16*	154	13	13	0	-9	-23	6	-11
TIPS 4/16	-1.08	-11	-12	0	-6	-16	*US-2.000-04/30/16*	149	12	12	0	-8	-19	7	-11
TIPS 7/16	-1.34	-8	-8	0	-7	-17	*US-4.875-08/15/16*	182	9	9	-1	-9	-21	3	-8
TIPS 1/17	-1.07	-5	-5	0	-4	-12	*US-3.125-01/31/17*	176	6	6	0	-7	-17	8	-5
TIPS 4/17	-0.90	-6	-6	1	-3	-10	*US-0.875-04/30/17*	169	8	8	0	-6	-15	13	-6
TIPS 7/17	-1.05	-15	-15	0	-4	-11	*US-4.750-08/15/17*	193	17	17	-1	-7	-16	10	-16
TIPS 1/18	-0.81	-2	-2	1	-2	-8	*US-3.500-02/15/18*	192	5	5	-1	-6	-14	10	-3
TIPS 4/18	-0.67	-1	-1	1	-2	-6	*US-0.625-04/30/18*	185	5	5	0	-5	-12	14	-3
TIPS 7/18	-0.79	-7	-7	1	-2	-7	*US-4.000-08/15/18*	203	11	11	-1	-6	-13	13	-9
TIPS 1/19	-0.52	3	3	1	-1	-5	*US-2.750-02/15/19*	198	1	1	0	-5	-11	17	0
TIPS 7/19	-0.48	4	4	1	-1	-4	*US-3.625-08/15/19*	211	2	1	-1	-5	-11	15	-0
TIPS 1/20	-0.18	3	3	1	0	-3	*US-3.625-02/15/20*	195	4	3	0	-4	-9	30	-2
TIPS 7/20	-0.14	4	4	1	0	-3	*US-2.625-08/15/20*	209	3	3	0	-4	-9	24	-2
TIPS 1/21	0.09	5	4	1	0	-2	*US-3.625-02/15/21*	198	2	2	0	-4	-8	34	-1
TIPS 7/21	0.14	5	5	1	0	-1	*US-2.125-08/15/21*	213	3	2	0	-4	-8	27	-2
TIPS 1/22	0.33	5	5	1	1	-1	*US-2.000-02/15/22*	207	3	3	0	-3	-7	32	-2
TIPS 7/22	0.36	5	5	1	1	-1	*US-1.625-08/15/22*	217	3	2	0	-3	-7	28	-2
TIPS 1/23	0.50	6	5	1	1	0	*US-2.000-02/15/23*	213	3	3	0	-3	-7	31	-3
TIPS 7/23	0.51	6	6	1	1	0	*US-2.500-08/15/23*	219	3	3	0	-3	-7	31	-3
TIPS 1/25	0.68	6	6	1	1	0	*US-7.625-02/15/25*	211	2	2	-1	-3	-7	42	-2
TIPS 1/26	0.79	7	6	1	1	0	*US-6.000-02/15/26*	218	2	2	-1	-3	-6	38	-2
TIPS 1/27	0.88	10	9	1	1	1	*US-6.625-02/15/27*	218	-1	-1	-1	-3	-6	40	0
TIPS 1/28	0.98	7	7	1	1	1	*US-6.125-11/15/27*	217	2	1	-1	-3	-6	43	-2
TIPS 4/28	0.95	7	7	1	1	1	*US-5.500-08/15/28*	228	2	2	0	-3	-6	30	-2
TIPS 1/29	1.01	7	7	1	1	1	*US-5.250-02/15/29*	226	2	1	0	-3	-6	36	-2
TIPS 4/29	1.00	7	7	1	1	1	*US-5.250-02/15/29*	228	2	2	0	-3	-6	33	-2
TIPS 4/32	1.13	5	5	1	1	1	*US-5.375-02/15/31*	225	4	4	0	-2	-5	42	-4
TIPS 2/40	1.42	5	4	1	1	1	*US-4.625-02/15/40*	226	2	2	0	-2	-4	49	-3
TIPS 2/41	1.43	2	2	1	1	1	*US-4.750-02/15/41*	226	5	5	0	-2	-4	49	-5
TIPS 2/42	1.49	6	6	0	1	1	*US-3.125-02/15/42*	231	1	1	0	-2	-4	45	-1
TIPS 2/43	1.49	5	5	0	1	1	*US-3.125-02/15/43*	232	2	1	0	-2	-4	44	-1

Source: Citi Research, Bloomberg

Figure 59. EUR Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp) 1 Dec	1 Jan	1 Feb	Ref	BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp) 1 Dec	1 Jan	1 Feb	ZC Swap - BE Spread (bp)	Chg (bp)
Repo (%)				*0.10*	*0.11*	*0.11*									
OATei15	-0.95	7	1	10	-5	-12	*FFRG 4/15*	111	-8	-3	10	-5	-12	11	3
BUNDei16	-0.51	5	0	8	-1	-4	*BUND 1/16*	60	-4	0	8	-1	-4	15	1
BTANi16	-0.82	-1	2	-5	-13	-21	*FFRG 4/16*	110	1	-2	-5	-14	-23	38	3
BTPei16	1.04	-11	-16	9	6	9	*BTP 8/16*	55	-3	0	7	-1	71	60	0
OATi17	-0.62	-1	1	-3	-9	-14	*FFRG 4/17*	115	2	-0	-4	-10	-17	39	-0
BTPei17	1.55	-3	-7	7	6	10	*BTP 8/17*	64	-9	-7	5	-1	70	61	7
BOBLei18	-0.42	4	2	4	0	-2	*BUND 1/18*	82	-3	-0	4	-1	-3	30	0
OATei18	-0.29	6	4	4	0	-1	*FFRG 4/18*	107	-5	-3	3	-2	-4	35	3
BTPei18	1.77	-4	-7	6	6	9	*BTP 8/18*	73	-6	-4	4	-1	48	62	4
OATi19	-0.19	4	5	-2	-5	-7	*FFRG 4/19*	127	-3	-4	-3	-7	-12	43	3
BTPei19	1.94	-1	-4	5	5	8	*BTP 9/19*	95	-10	-8	3	-2	-4	48	8
BUNDei20	-0.19	7	5	3	0	0	*BUND 1/20*	105	-6	-4	3	-1	-3	30	3
OATei20	0.04	6	5	3	1	1	*FFRG 4/20*	131	-5	-3	2	-2	-4	26	2
OATi21	0.24	6	7	-1	-3	-4	*FFRG 4/21*	138	-4	-5	-2	-6	-9	47	3
BTPei21	2.52	4	2	4	5	8	*BTP 9/21*	99	-8	-7	2	-2	-3	61	5
OATei22	0.42	6	5	3	1	1	*FFRG 4/21*	120	-4	-3	2	-2	-4	52	1
BUNDei23	0.19	7	6	2	1	1	*BUND 1/22*	116	-4	-4	2	-1	-3	47	0
OATi23	0.50	4	5	-1	-2	-3	*FFRG 10/23*	176	-3	-4	-2	-5	-8	23	-1
BTPei23	2.77	6	4	3	4	7	*BTP 8/23*	105	-9	-8	2	-1	26	71	5
OATei24	0.70	5	4	2	1	2	*FFRG 10/23*	156	-4	-3	1	-2	-4	30	0
BTPei26	3.02	5	4	3	4	6	*BTP 3/26*	115	-8	-7	1	-1	-3	76	5
OATei27	0.91	4	3	2	1	2	*FFRG 4/26*	173	-3	-3	1	-2	-3	26	1
OATi29	0.86	2	3	-1	-1	-1	*FFRG 4/29*	200	-1	-2	-1	-4	-7	21	-1
OATei32	1.07	4	3	2	1	2	*FFRG 10/32*	195	-3	-3	1	-2	-3	13	2
BTPei35	3.06	2	1	2	2	4	*BTP 8/34*	167	-1	-1	1	-2	16	42	-0
OATei40	1.17	2	1	1	1	1	*FFRG 4/41*	212	-1	-1	0	-1	-3	5	1
BTPei41	3.40	3	2	2	2	4	*BTP 9/40*	154	0	0	1	-2	-3	63	-1

Source: Citi Research

Figure 60. UK Gilts Inflation-linked Carry (based on forecasts above) – One week changes

Bond	RY (%)	Chg (bp)	Carry-adj chg	Carry: RY (bp) 1 Jan	1 Feb	1 Mar	Ref	BE (bp)	Chg (bp)	Carry-adj chg	Carry: BE (bp) 1 Jan	1 Feb	1 Mar	ZC Swap - BE Spread (bp)	Chg (bp)
Repo (%)				*0.42*	*0.42*	*0.42*									
UKTi Jul16	-1.97	10	10	3	5	7	*UKT 9/16*	272	-4	-4	1	2	3	38	-0
UKTi Nov17	-1.53	18	17	-2	0	13	*UKT 3/18*	288	-11	-10	-5	-5	6	17	-15
UKTi Nov19	-0.93	17	16	0	2	12	*UKT 9/19*	276	-8	-8	-3	-4	3	35	-1
UKTi Apr20	-0.80	14	13	4	6	9	*UKT 3/20*	276	-6	-6	0	0	0	31	-3
UKTi Nov22	-0.36	16	15	1	3	10	*UKT 3/22*	280	-7	-7	-3	-3	2	45	2
UKTi Mar24	-0.08	16	15	1	3	9	*UKT 3/25*	298	-7	-6	-2	-3	1	28	2
UKTi Jul24	-0.10	14	13	3	6	8	*UKT 3/25*	300	-4	-4	0	-1	-1	34	0
UKTi Nov27	0.03	14	13	1	3	7	*UKT 12/27*	313	-4	-4	-2	-3	0	34	1
UKTi Mar29	0.13	12	11	1	2	7	*UKT 12/30*	319	-1	-1	-2	-3	-1	29	-1
UKTi Jul30	0.04	10	10	3	4	6	*UKT 6/32*	335	-0	-0	0	-1	-1	22	-9
UKTi Nov32	0.09	11	10	1	2	6	*UKT 6/32*	330	-1	-1	-2	-3	-1	31	1
UKTi Mar34	0.14	10	10	1	2	5	*UKT 9/34*	332	-1	-1	-2	-3	-1	28	-0
UKTi Jan35	0.10	8	8	2	3	4	*UKT 3/36*	338	0	0	-1	-1	-2	25	-0
UKTi Nov37	0.10	9	9	1	2	5	*UKT 12/38*	340	-1	-1	-2	-3	-1	27	-0
UKTi Mar40	0.11	7	7	1	1	4	*UKT 9/39*	342	1	1	-2	-3	-2	24	0
UKTi Nov42	0.08	6	6	1	1	4	*UKT 12/42*	346	0	0	-2	-3	-2	24	-1
UKTi Mar44	0.12	5	5	1	1	3	*UKT 1/44*	349	1	1	-2	-2	-2	20	-2
UKTi Nov47	0.09	6	5	0	1	3	*UKT 12/46*	347	-0	-0	-2	-2	-2	22	-1
UKTi Mar50	0.09	5	5	0	1	3	*UKT 12/49*	346	0	0	-2	-2	-2	22	-1
UKTi Mar52	0.09	5	4	0	1	3	*UKT 7/52*	347	0	-0	-2	-2	-2	21	-1
UKTi Nov55	0.05	4	4	0	1	3	*UKT 12/55*	348	0	0	-1	-2	-2	22	-1
UKTi Mar62	0.04	4	4	0	1	2	*UKT 1/60*	348	0	0	-1	-2	-2	20	-1
UKTi Mar68	0.04	4	3	0	1	2	*UKT 7/68*	350	1	0	-1	-2	-2	18	-1

Source: Citi Research

Summary of Recent Publications

Date	Publication	Topic	Page	Region
14-Nov-13	NOTE	Weekly Supply Monitor: Euro, UK and US Supply Outlook	-	Global
13-Nov-13	NOTE	Euro Rates Strategy: EUREX & LIFFE Calendar Rolls (Z3/H4): A First Look	-	Global
11-Nov-13	NOTE	European Flow Monitor: Strong demand for Spain across the curve	-	EUR
11-Nov-13	NOTE	UK Rates Strategy: Gilt-Bund widening: fade or run?	-	UK
8-Nov-13	NOTE	Euro Rates Strategy: S&P Lowers France to AA Stable – Market Implications	-	EUR
7-Nov-13	European Weekly	ECB: Where Do We Stand on Low-4-Longer?	8	EUR
		Bunds: Update on Fair Value	9	EUR
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4-Nov-13	NOTE	European Flow Monitor: Growing demand for the core; led by Netherlands	-	EUR
4-Nov-13	NOTE	Euro Rates Strategy: Update on front-end peripheral trades	-	EUR
4-Nov-13	NOTE	Euro SSA Strategy: Strategies for trading supranationals	-	EUR
1-Nov-13	NOTE	Euro SSA and Covered Bond Monthly: Acronyms to look out for in 2014	-	EUR
1-Nov-13	NOTE	Euro Rates Strategy: First thoughts on next week's new 10yr OAT	-	EUR
31-Oct-13	European Weekly	EUR: Recap of Positions We Like(d)	9	EUR
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		EGB: We remain constructive on Ireland	16	EUR
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		Covered Bond Strategy: Upheaval in the Dutch mortgage market?	23	EUR
		Technicals: bullish for Bunds	27	EUR

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Appendix A-1

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