

## UK Rates Strategy

### Attractive value in 30yr gilts ahead of auction

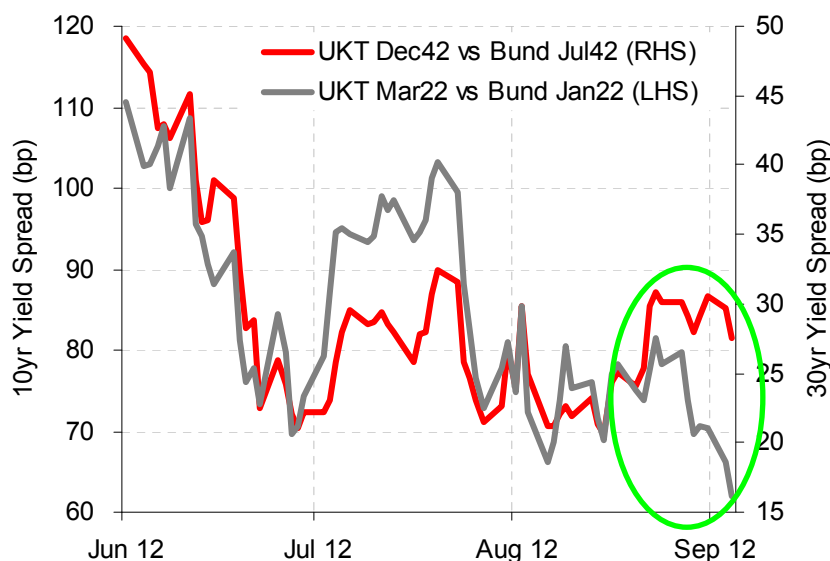
- The UK DMO will re-open £1.75bn of UKT 4.5% 12/2042 tomorrow.
- This supply is small when compared with the amount of coupon money hitting the gilt market in the coming days (£5.8bn excluding BoE/DMO holdings).
- Moreover, 30yr gilts have cheapened vs Bunds and on the curve vs 10s. A concession is also evident within the 30yr sector.
- **Trades:**
  - Buy UKT 4.5% 12/42 vs DBR 3.25% 7/42
  - Buy UKT 4.5 12/42 vs UKT 4.75% 12/38

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**Jamie Searle**  
+44-20-7986-9493  
jamie.searle@citi.com

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Figure 1. 30yr gilts have underperformed Bunds of late, in contrast to 10s



Source: Citi Research, Bloomberg.

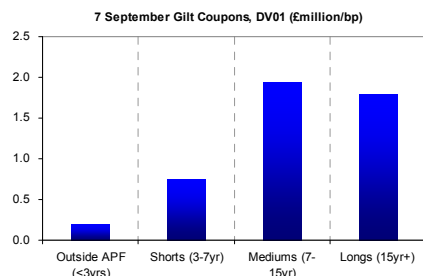
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## Attractive value in 30yr gilts

**Auction details:** The UK DMO will re-open £1.75bn of UKT 4.5% 12/2042 tomorrow.

Figure 2. 7 September Gilt Coupons (DV01)



Source: Citi Research, Bloomberg.

**Trade idea: Buy UKT 4.5% 12/42 vs DBR 3.25% 7/42**

**Strong coupon support:** The gilt market should benefit in the coming days from £5.8bn coupon payments (excluding BoE/DMO holdings) due on 7 September (the total number including BoE/DMO holdings is £10.5bn). Longs account for £0.9bn of this, enough to offset half of the supply. The sector breakdown of the coupons, in DV01 terms, is shown in Figure 2.

**30s lagging cross-market:** Bunds have come under pressure ahead of Thursday's all-important ECB meeting and ahead of the new 10yr tomorrow. Meanwhile, gilts have undoubtedly benefited from anticipation of reinvestment flows from the 7 September coupon payments. Consequently, 10yr gilts have outperformed Bunds in the last week or so by around 8bp. The opposite is true in 30s where gilts have cheapened vs Bunds. This highlights a concession going into today's auction and, in our view, presents a tactical cross-market opportunity to buy 30yr gilts vs Bunds.

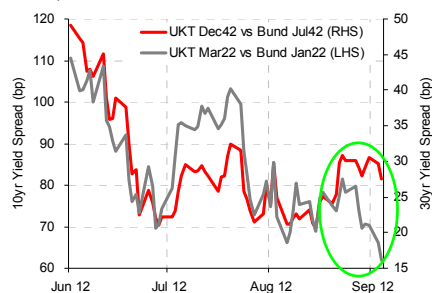
**Flattening bias:** An alternative way of presenting the dislocation shown in Figure 3 is the 10s30s gilt-Bund box. The box has moved sharply in recent weeks (Figure 4). Flatteners on the gilt curve now look attractive vs steepeners in Bunds on a tactical basis. Moreover, we also like this trade over the medium-term. For now, the gilt curve remains directional, but, eventually, we expect QE to reassert a flattening bias.

**Plenty more QE to come:** The consensus is still underestimating QE, in our view. The latest Reuters survey shows a median of £425bn for the total amount the BoE will spend of QE. In contrast, our economists forecast total QE of £500bn. This is the highest forecast in the survey and is matched by only one other forecast (out of 44). Our QE forecast suggests the APF buckets will eventually have to be skewed towards the long-end.

**Trade idea: Buy UKT 4.5 12/42 vs UKT 4.75% 12/38**

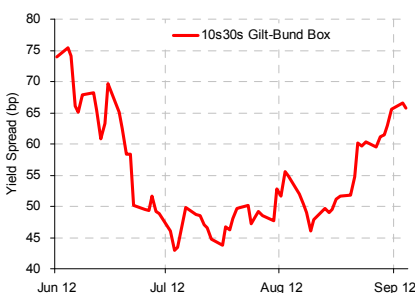
**The 42s offer good value within the 30yr sector:** The 42s have cheapened by around 2bp in the fly vs the 38s and 46s (Figure 5). For those looking at curve extensions, switching into the 42s looks particularly good value. For example, the pick-up out of 38s and into 42s has improved by 2bp in the last couple of weeks to +12bp currently.

Figure 3. 30yr gilts have underperformed Bunds, in contrast to 10s



Source: Citi Research, Bloomberg.

Figure 4. The 10s30s gilt curve has steepened relative to the Bund curve



Source: Citi Research, Bloomberg.

Figure 5. The 42s have cheapened within the 30yr sector



Source: Citi Research, Bloomberg.

## Conclusion

This supply is small when compared with the amount of coupon money hitting the gilt market in the coming days. Moreover, 30yr gilts have cheapened vs Bunds and on the curve. A concession is also evident within the 30yr sector and switching out of the 38s and into the 42s looks attractive, in our view.

## Appendix A-1

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