

Emerging Insight

We still like to receive the 1y1y in Israel

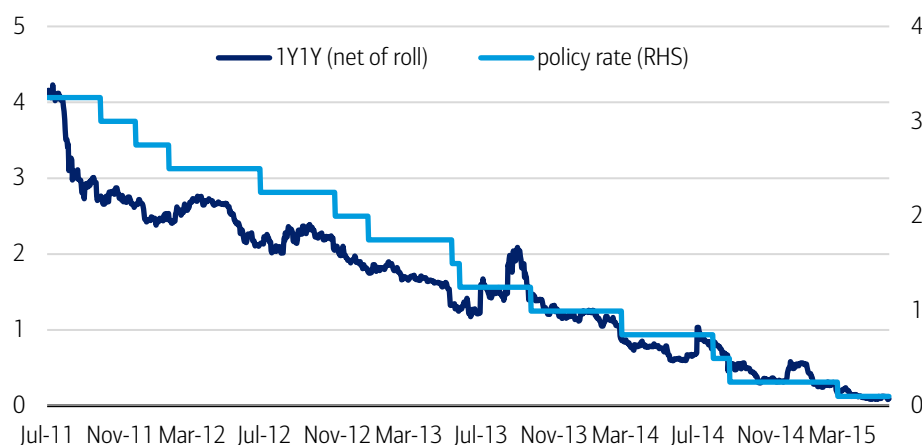
Key takeaways

- The market consistently underprices cutting cycles in Israel. The best trade is to receive the front end until the last cut.
- 2011-15 + 2008-09 easing cycles are the best playbooks for the current one. 1y1y usually outperforms 1y/2y at the start.
- We continue to receive 1y1y: 1) it is the most mispriced vs BofA policy rate forecast; 2) it offers the best carry and roll.

By Mikhail Liluashvili

Chart of the day: The market consistently underprices easing cycles in Israel

The 2011-15 cutting cycle offers the best playbook for the current: continue to receive 1y1y



Source: Bloomberg, BofA Global Research

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Israel's front end should reprice lower

Israel is the only exception in EEMEA from our bigger picture view that suggests focusing on long FX trades rather than receivers (see [Emerging Convictions, 27 February 2024](#)). The market consistently underprices cutting cycles in Israel, especially long ones. As a result, the front end should keep drifting lower and we continue to receive the 1y1y (open: 3.17, current: 3.32). Please see [EM Alpha: Receive 1y1y in Israel](#). Risks are a more-hawkish-than-expected BOI and intensification of geopolitical risks. Market pricing is also more hawkish than our baseline policy rate forecast right now, especially for the 1y1y swap, which also offers, in our view, one of the best carries and rolls for receivers.

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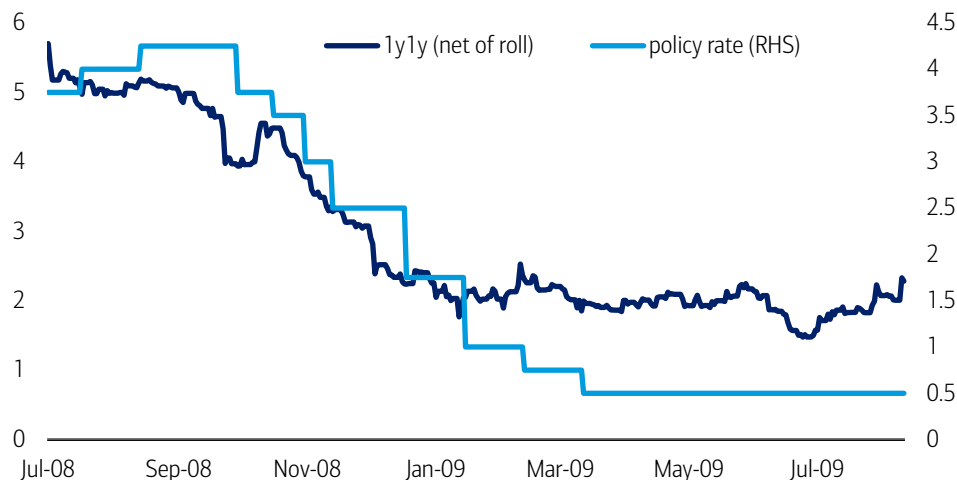
BoI is Bank of Israel

The market consistently underprices cutting cycles in Israel – we receive 1y1y

In all previous cutting cycles in Israel, 1y, 1y1y and 2y swaps drifted lower (net of carry and roll) after the first two cuts. Moreover, except for in the 2008-09 cycle, front-end swaps always bottomed around the last BoI cut. We believe the current easing cycle is unlikely to be an exception and front-end receivers should continue to work.

Exhibit 1: In the 2008-09 easing cycle the receiver stopped working two cuts before the last

This is quite a rare occurrence



Source: Bloomberg, BofA Global Research

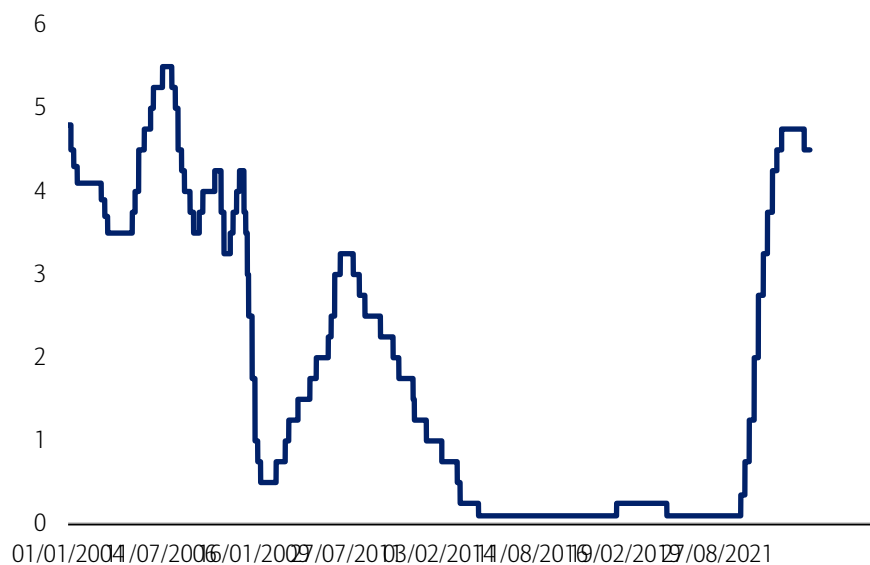
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The current cycle should be a long one...

As is the case in Czechia (see [FEMEA Strategy Viewpoint: The CNB cuts – receive Czech rates. 12 February 2024](#)), long easing cycles follow long hiking cycles and vice versa. Moreover, the cumulative amount of cuts in an easing cycle is usually similar to the total hikes in a previous cycle. The 2008-09 easing cycle was an exception due to the Global Financial Crisis. As a result, the current cycle is likely to last at least 12 months, in our view.

Exhibit 2: The current easing cycle is likely to be long

Previous hiking cycles lasted more than 12 months (the chart shows the policy rate in Israel)



Source: Haver, BofA Global Research

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... most closely resembling 2011-15...

We believe that the 2011-15 easing cycle is the best playbook for the current one because: (1) it lasted almost 3.5 years; and (2) there was a lot of easing (315bps in total), but it was spread over time. So far, communication from the Bol and its cautious 25bps cut in January and a hawkish hold in February suggest that the central bank will proceed slowly. The cycle is unlikely to be as long as in 2011-15, but it should still be longer than all the other previous cycles, in our view.

...and the current cycle might have elements of 2008-09

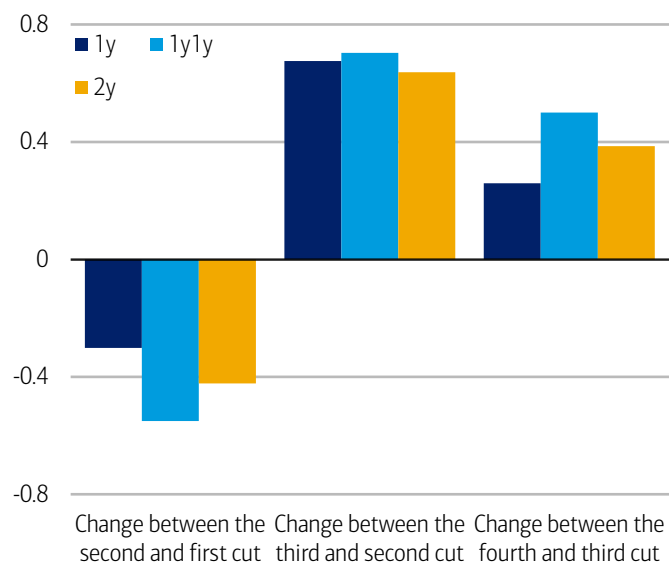
The current cycle might also have elements of 2008-09, which lasted for only about six months, but saw an aggressive 350bp easing of monetary policy. In both 2011-15 and 2008-09, the receiver trade in 1y, 1y1y and 2y swaps continued to work as the Bol was cutting the policy rate. That said, the receiver trade ended before the last hike, which is quite a rare occurrence (Exhibit 1).

1y1y usually outperforms 1y and 2y at the start of the easing cycle

The 1y1y usually outperformed the 1y and 2y between the second and fourth cuts in the 2008-09 and 2011-15 cycles. However, the 1y1y underperformed between the first and second cut (Exhibit 3-Exhibit 4). The 1y1y outperformance is not surprising given that market's ability to forecast cycles declines over time.

Exhibit 3: 2008-09: 1y1y usually outperformed 1y/2y at the start

However, it underperformed between the first and second cuts

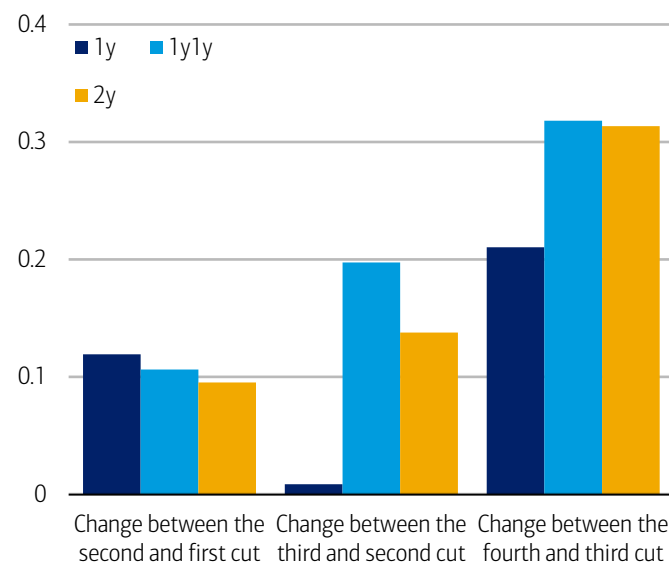


Source: Bloomberg, BofA Global Research

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Exhibit 4: 2011-15: 1y1y usually outperformed 1y/2y at the start

However, it underperformed 1y between the first and second cuts



Source: Bloomberg, BofA Global Research

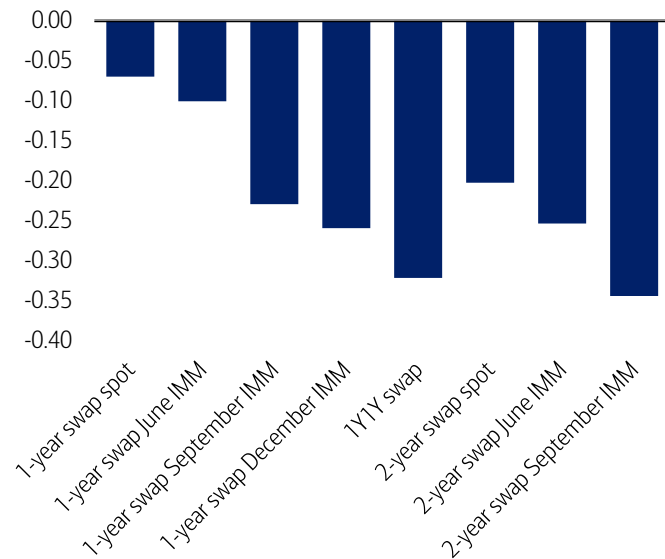
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Market pricing remains too hawkish relative to our forecast

The 1y1y remains the most mispriced part of the swap curve relative to our baseline forecast for the policy rate. It also offers the least negative carry and roll to receive rates. This is another reason to continue to receive the 1y1y swap in Israel.

Exhibit 5: 1y1y is most mispriced swap relative to our forecast

The chart shows our baseline forecast minus market forecasts

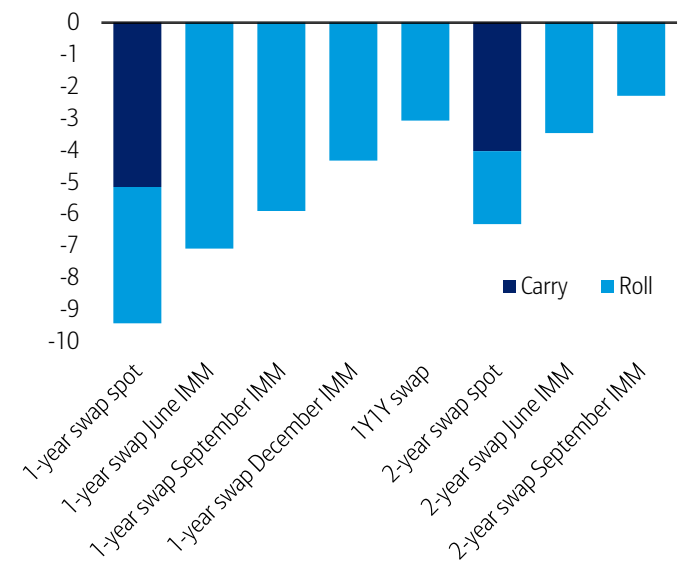


Source: Bloomberg, BofA Global Research

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Exhibit 6: 1y1y has the best carry and roll to receive

This is another reason why we still like to receive 1y1y



Source: Bloomberg, BofA Global Research

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Technical note on swaps net of carry and roll

We calculate 1y, 1y1y and 2y swaps net of carry and roll using Bloomberg curves. For 1y, 1y1y and 2y swaps, we calculate the price of a swap with a start date three months before the first cut. We track the price of this swap for 365 days for the 1y1y and 90 days for the 2y and 1y, after which we close the position and enter a fresh 1y1y, 2y or 1y swap.

News and Views

Brazil: IGP-M posted 0.52% mom deflation in February, as expected

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IGP-M posted -0.52% mom in February (from 0.07% in January), in line with market expectations. In yearly terms, it decelerated to -3.76% yoy (from -3.32% yoy). The deflationary result followed wholesale prices (-0.90% mom), with a sharp -2.19% mom deceleration in agricultural prices. Soybean (and derivatives), corn and iron ore were the largest contributors to the downside in the wholesale group. On the consumer side, inflation increased 0.53% mom, given acceleration in food inflation and diverse expenses.

- **To follow:** Downward pressure coming from commodities in wholesale prices should reach consumer inflation in the coming months.

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