

# European Rates Watch

## Bye bye DBRi

### Germany to close linker programme

After hours last night, Germany's Finanzagentur announced that:

"The Federal government has decided to withdraw from the market for inflation-linked bonds: From 2024, no further inflation-linked Federal securities will be issued, nor will already outstanding securities be reopened."

Press release, 22 November 2023

### Was the writing on the wall?

Germany has never seemed wholeheartedly enthusiastic about linkers, with fairly light annual issuance and a relatively small stock of issues – the four remaining lines have a notional value of €66bn and a market value of €80bn, representing only 14% of the Euro market. Perhaps the unwillingness to add new lines for the past few years, especially a reluctance to add a new 30y (with the longest now more like a 20y), was a clue.

### Why now?

It is likely that the experience of the last few years has led issuers to question the assumption that linkers are a good cyclical hedge. The conventional argument that inflation is high when the economy is strong and borrowers can better afford to pay, but weak when the economy is weak and public finances are thereby in poor shape, does not represent the recent inflationary experience well.

### Is this a trend?

Are there others that might be thinking about exiting? After Canada last year and now Germany, we must consider the possibility. And it is worth remembering that both Australia and Japan ceased issuance only to return to the market. Australia suspended its programme at a time of strong public finances, when it wanted to preserve volumes in its nominal issuance programme. For Japan, it was probably a deep suspicion of a product (then without a deflation floor) at a time of deflation and came after adverse basket changes that delivered much weaker than expected price data.

### Sweden gives reassurance with new programme

We have no hints that others will follow, but there are markets where the value-for-money of the product might be questioned. We have worried about Sweden, where 10y breakevens languish at 159bp, and public finances are in surplus. At such a breakeven level, there might be a concern about asymmetric upside risk to inflation that the borrower is not being compensated for. So we were reassured when the NDO announced last month that it would issue SEK9bn of linkers in the new fiscal year, alongside SEK60bn nominals. We think others are firmly committed, especially the remaining three Euro issuers – France, Italy and Spain. France, as the inaugural Euro issuer, seems here for the long haul, and for Italy, with a desire to maximise reach, the product diversification argument remains strong.

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Timestamp: 23 November 2023 04:53AM EST

23 November 2023

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## Market response

Longer term, the reduction in supply might prompt liquidity concerns in the market, and the street will be reluctant to be short German linkers if it worries it might struggle to get them back with no prospect of fresh issuance.

Near term, we'd expect this to create a bid for the market in general. Our core themes – that 5y5y real rates are attractive and that the 5s10s inflation curve should steepen – should benefit from the news, although we certainly were not expecting it.

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