

## Emerging Insight

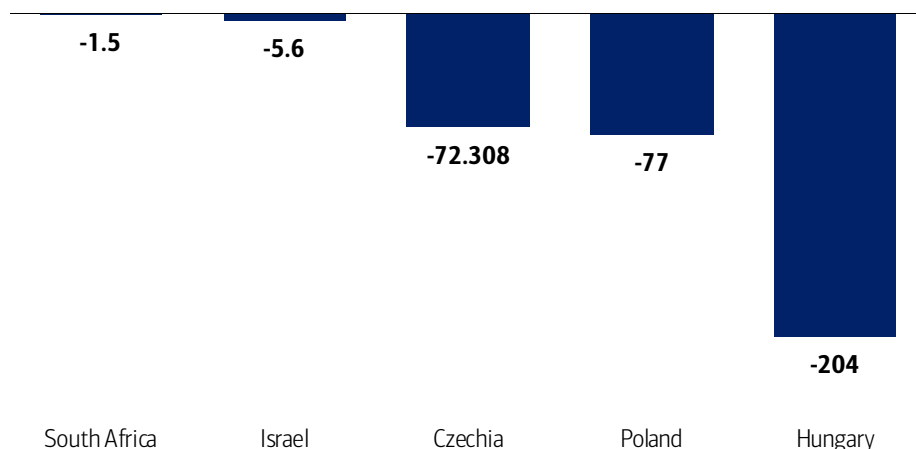
## EEMEA rates: receive, but be selective

## Key takeaways

- 1y swap is below interbank rates in all EEMEA countries => signal to receive. We like front-end receivers in SA and Israel.
- Too-early cuts priced in Czechia => pay 1y (Sep IMM). Receiver trades start c. 3m before the first cut (we expect it in Feb).
- Core rates should support 5y/10y in EEMEA: SA and Israeli curves to shift down with a steepening bias, but Czech curve up.

By **Mikhail. Liluashvili****Chart of the day: Our rule for receiving rates has been triggered in all EEMEA countries**

But we still need to be selective – we receive 1y1y in S, Africa and Israel, but pay 1y (Sep IMM) in Czechia



Source: Bloomberg, BofA Global Research

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## EEMEA: a receiver bias in rates

The 1y swap is below interbank rates in all EEMEA countries suggesting a receiver bias. We believe the best countries in which to receive rates right now are Israel and South Africa, as the market is not pricing in enough cuts relative to our forecast. We advocate a 1y payer (Sep IMM) in Czechia as the markets price in too-early cuts. In the case of Poland and Hungary, we do not have a strong view, but we have a receiver bias in Hungary.

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GEM Fixed Income Strategy & Economics  
Global

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## Abbreviations

EEMEA is Emerging Europe, Middle East and Africa

CEE is Central and Eastern Europe

NBH is National Bank of Hungary

SA is South Africa

NBP is National Bank of Poland

CDS is credit default swap

## 1y is below interbank rates in all EEMEA countries

Our Chart of the day shows that the 1y swap is now below the interbank rate in all EEMEA countries (we exclude Türkiye). This is usually a signal to receive front-end rates (see our report: [Emerging Insight: Front-end rates: the most inefficient market in EEMEA](#) 16 August 2022). However, when central banks are on hold for a prolonged period, receiver trades do not work in all circumstances and so we have to be selective.

## Valuations are supportive for receiving in SA and Israel

There are currently three groups of countries in EEMEA: (1) those in the middle of the easing cycle (just Hungary right now); (2) those that concluded their hiking cycles a long time ago (Poland and Czechia); and (3) those that ended the hiking cycle only recently (South Africa and Israel). For the valuations of front-end swaps in EEMEA, see Exhibit 1 through Exhibit 5.

In general, our policy rate forecast is more dovish than market pricing only in the third group (South Africa and Israel), where we think receiver traders should work better than in other EEMEA countries. We have a 1y1y receiver in Israel (current: 3.63, open: 3.53, target: 3.0, stop: 3.79). And we have also added a 1y1y receive in South Africa following the July central bank meeting (current: 7.97, open: 8.0, target: 7.5, stop: 8.3). For our original trading ideas, see reports below:

### BofA Global Research Reports

Title: Subtitle	Primary Author	Date Published
<a href="#">EM Alpha: Last hike + 1y swap below 3m Jibar = receive in South Africa</a>	Mikhail Liluashvili	21 July 2023
<a href="#">EM Alpha: Last hike + political risk likely peaked = receive front end in Israel</a>	Mikhail Liluashvili	19 July 2023

In Hungary, the market is already pricing in more cuts than we forecast. However, our studies of previous cutting and hiking cycles show that the market is likely to still under-price the number of cuts that the NBH will deliver. The 1y swap is highly correlated to the policy rate, implying that the market usually prices in more cuts as the NBH cuts (Exhibit 6).

## Czech and Poland price in too early or too many cuts

Czechia and Poland are the most interesting group. In both countries, our forecast is more hawkish than market pricing. In the case of Czechia, the key difference between our forecast and market pricing is the timing of cuts. We expect the first cut only in February, while the market prices in the first within three months (or even earlier). That is why we still like to pay 1y swap with September IMM (current: 6.07, open: 6.05, target: 6.55, stop: 5.80). For the original trading idea, see our report: [EM Alpha: Inflation is likely to be sticky: pay 1y swap in Czechia 12 June 2023](#)

In Poland, we expect only a very shallow cutting cycle (two 25bps cuts in September and October) as inflationary pressures are still strong. The market prices in a stronger and longer cutting cycle than we do. We stay away from any trades in Poland's front end given the divergence in valuations (that is why we do not receive) and the fact that we do not like to pay when the first cut is so close. The market price action might echo the situation in October 2014 when the NBP delivered 50bps cut, with receiver trades entered just before the cut not performing particularly well.

## Receivers work after the last hike...

Exhibit 7 through Exhibit 19 show all hiking cycles in EEMEA that were followed by a cuts, zooming in on the period between the two moves. In most EEMEA cutting cycles, receivers start shortly after the last hike, especially in South Africa. In some cases, like Hungary in 2006, the receiver trade starts earlier, but still performs well after the last

hike. In some cases, however, receiver trades started only a few months after the last hike, which is usually the case in Czechia. We think this is unlikely this time, as central banks have already delivered significant hikes, inflation is falling in EEMEA as the base effects are favourable for disinflation and the market narrative has shifted towards receiving.

In South Africa, a combination of a last hike and a 1y swap crossing the interbank rate from above were good signals for the receiver trades in the last two episodes when hiking cycles were over. This time is unlikely to be different, in our view.

#### ...and usually around 3-4 months before the first cut

Another time when receiver trades start/resume to perform well is around three to four months (or less) before the first cut. It is unusual for it to start earlier and normally an initial fall in swap rates (after the last hike) is followed by an increase if the central bank keeps the policy rate unchanged. We think this pattern has to do with negative carry of receiver positions, which become more and more negative if 1y and 2y swap yields fall without the central bank cutting rates. Exactly for this reason, market receiving in Czechia is premature, as we think the first cut will come only in February.

#### 5y and 10y should also be supported by core rates

Core rates are likely to be supportive for 5y and 10y parts of EEMEA curves (see Global Rates Weekly: Aye, Captain 21 July 2023). As a result, we expect the whole curve in Israel to shift down with a steepening bias. The situation is more nuanced in South Africa, as it has a credit component as well as an inflation premium in the belly and 10y part of the swap curve. We think the inflation premium as we define it (breakeven inflation minus core inflation and credit component (which we proxy using CDS)) should remain around current levels, also resulting in a downward shift in the SA curve with a steepening bias.

However, in the case of Czechia, repricing the front end towards our fair values also means that 5y and 10y swap rates should increase even with core rates falling. The beta of Czech 5y and 10y to the average of US and Eurozone rates is only 0.35, while the beta to the 2y swap is as high as 0.45. As a result, we also expect the Czech curve to flatten from here. We do not have strong views on Poland or Hungarian curves given uncertainty around their front ends.

#### Exhibit 1: Czechia – market pricing of the front end vs BofA

The market prices in too early cuts relative to our forecast

Swaps	Market Value	BofA expect.	Deviation	Carry	Roll	Total
1-year swap spot	6.42	6.99	0.58	-4.01	-15.90	-19.91
1-year swap September IMM	6.12	6.69	0.57	-	-16.64	-16.64
1-year swap December IMM	5.39	6.13	0.74	-	-18.30	-18.30
1-year swap March IMM	4.78	5.38	0.60	-	-14.51	-14.51
1Y1Y swap	4.13	4.62	0.49	-	-17.05	-17.05
2-year swap spot	5.39	6.01	0.62	-4.09	-11.72	-15.82
2-year swap September IMM	5.19	5.84	0.66	-	-13.01	-13.01
2-year swap December IMM	4.74	5.29	0.55	-	-13.13	-13.13
2-year swap March IMM	4.32	5.10	0.78	-	-11.28	-11.28

Source: Bloomberg, BofA Global Research estimates

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#### Exhibit 2: Hungary – market pricing of the front end vs BofA

The market prices too many cuts, but we are reluctant to pay

Swaps	Market Value	BofA expect.	Deviation	Carry	Roll	Total
1-year swap spot	12.64	12.76	0.12	-15.70	-43.74	-59.43
1-year swap September IMM	11.62	11.50	-0.12	-	-64.52	-64.52
1-year swap December IMM	9.89	9.73	-0.17	-	-49.04	-49.04
1-year swap March IMM	8.60	8.46	-0.14	-	-35.68	-35.68
1Y1Y swap	7.08	7.39	0.31	-	-28.10	-28.10
2-year swap spot	10.20	10.63	0.43	-16.64	-26.46	-43.11
2-year swap September IMM	9.53	10.24	0.71	-	-41.72	-41.72
2-year swap December IMM	8.44	8.76	0.32	-	-34.70	-34.70
2-year swap March IMM	7.58	8.26	0.67	-	-22.20	-22.20

Source: Bloomberg, BofA Global Research estimates

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**Exhibit 3: Poland – market pricing of the front end vs BofA**

Too many cuts are priced in, but we are too close to the first cut to pay

Swaps	Market Value	BofA expect.	Deviation	Carry	Roll	Total
1-year swap spot	6.07	6.54	0.47	-2.06	-6.67	-8.73
1-year swap September IMM	5.80	6.51	0.71	-	-19.13	-19.13
1-year swap December IMM	5.28	6.39	1.11	-	-14.95	-14.95
1-year swap March IMM	4.85	6.18	1.33	-	-11.04	-11.04
1Y1Y swap	4.35	5.93	1.59	-	-15.75	-15.75
2-year swap spot	5.30	6.36	1.07	-2.73	-7.72	-10.45
2-year swap September IMM	5.13	6.31	1.18	-	-11.41	-11.41
2-year swap December IMM	4.77	6.12	1.35	-	-11.28	-11.28
2-year swap March IMM	4.50	6.05	1.55	-	-7.25	-7.25

Source: Bloomberg, BofA Global Research estimates

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**Exhibit 5: South Africa – market pricing of the front end vs BofA**

We like to receive 1y1y

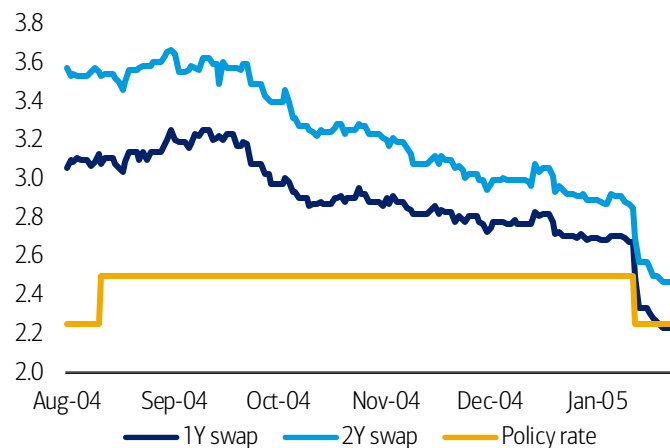
Swaps	Market Value	BofA exp.	Deviation	Carry	Roll	Total
1-year swap spot	8.45	8.40	-0.05	-3.57	0.65	-2.92
1-year swap September IMM	8.39	8.26	-0.13	-	-2.45	-2.45
1-year swap December IMM	8.29	8.05	-0.24	-	-3.67	-3.67
1-year swap March IMM	8.16	7.84	-0.32	-	-4.48	-4.48
1Y1Y swap	7.97	7.53	-0.45	-	-3.85	-3.85
2-year swap spot	8.22	7.96	-0.26	-2.87	-0.49	-3.36
2-year swap September IMM	8.19	7.83	-0.36	-	-1.40	-1.40
2-year swap December IMM	8.14	7.66	-0.48	-	-1.55	-1.55
2-year swap March IMM	8.09	7.49	-0.60	-	-1.63	-1.63

Source: Bloomberg, BofA Global Research estimates

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**Exhibit 7: Czechia after the hiking cycle ending in 2004**

The receiver trade started around 4 months before the first cut



Source: Bloomberg, BofA Global Research

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**Exhibit 4: Israel – market pricing of the front end vs BofA**

We like to receive 1y1y

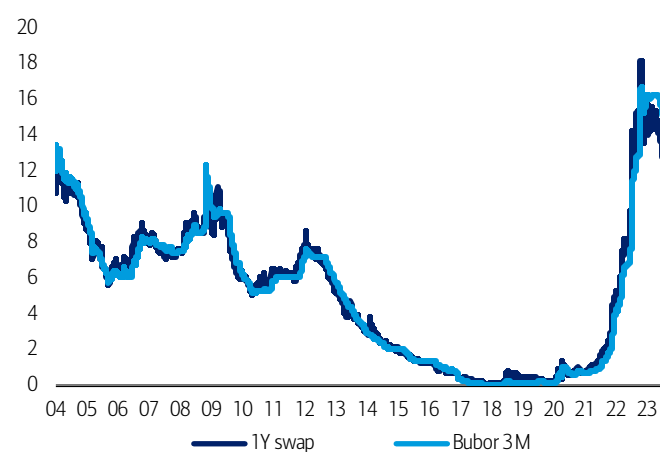
Swaps	Market Value	BofA expect.	Deviation	Carry	Roll	Total
1-year swap spot	4.74	4.65	-0.09	-2.40	-2.50	-4.90
1-year swap September IMM	4.61	4.45	-0.16	-	-7.17	-7.17
1-year swap December IMM	4.35	4.07	-0.28	-	-9.49	-9.49
1-year swap March IMM	4.04	3.63	-0.41	-	-9.69	-9.69
1Y1Y swap	3.62	3.06	-0.56	-	-9.89	-9.89
2-year swap spot	4.19	3.82	-0.37	-3.64	-3.92	-7.56
2-year swap September IMM	4.07	3.66	-0.41	-	-6.71	-6.71
2-year swap December IMM	3.86	3.38	-0.48	-	-7.40	-7.40
2-year swap March IMM	3.64	3.10	-0.55	-	-6.87	-6.87

Source: Bloomberg, BofA Global Research estimates

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**Exhibit 6: 1Y swap in Hungary vs 3M interbank rate**

1y swap follows the interbank rate very closely

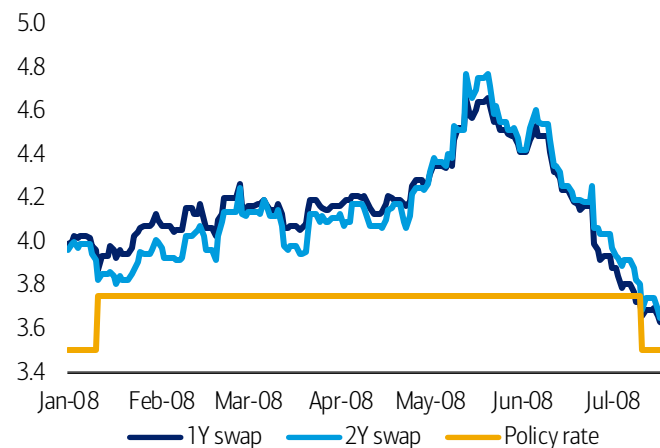


Source: Bloomberg, BofA Global Research

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**Exhibit 8: Czechia after the hiking cycle ending in 2008**

The receiver trade started around 2 months before the first cut

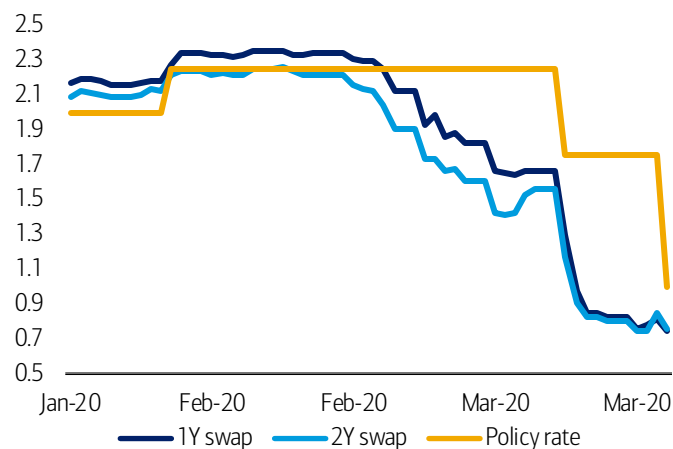


Source: Bloomberg, BofA Global Research

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**Exhibit 9: Czechia after the hiking cycle ending in 2020**

The receiver trade started less than a month before the first cut

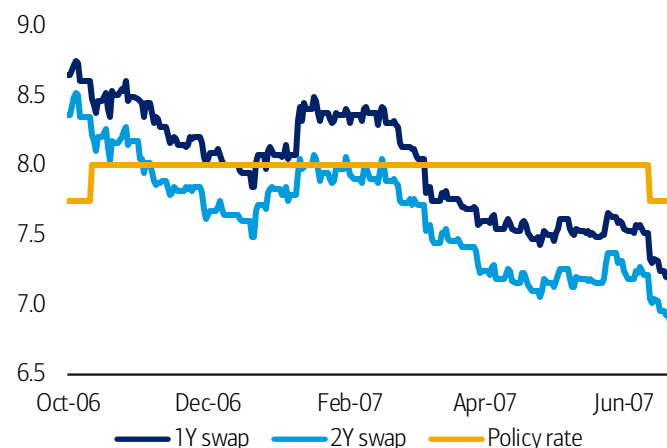


Source: Bloomberg, BofA Global Research

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**Exhibit 10: Hungary after the hiking cycle ending in 2006**

The receiver trade started before the last hike and resumed 4m before the first cut

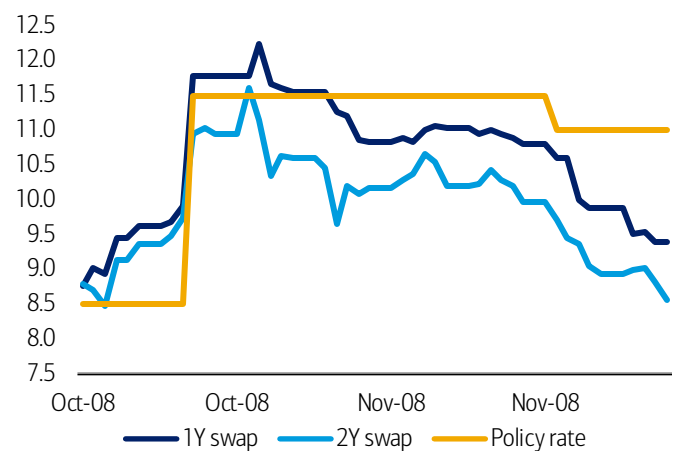


Source: Bloomberg, BofA Global Research

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**Exhibit 11: Hungary after the hiking cycle ending in 2008**

A receiver trade started shortly after the last hike

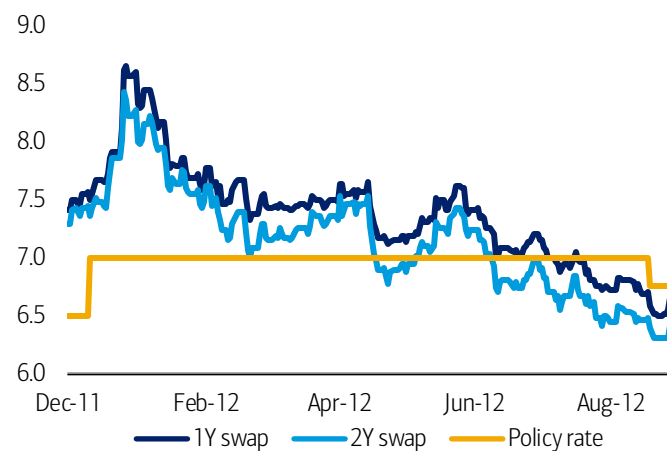


Source: Bloomberg, BofA Global Research

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**Exhibit 12: Hungary after the hiking cycle ending in 2011**

Again a receiver trade started shortly after the last hike

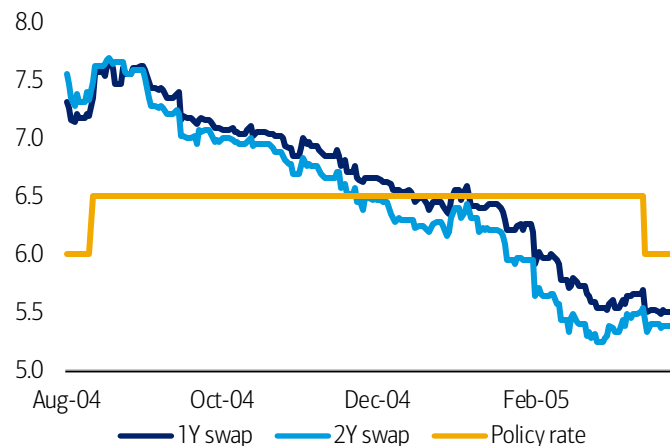


Source: Bloomberg, BofA Global Research

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**Exhibit 13: Poland after the hiking cycle ending in 2004**

A receiver trade started shortly after the last hike

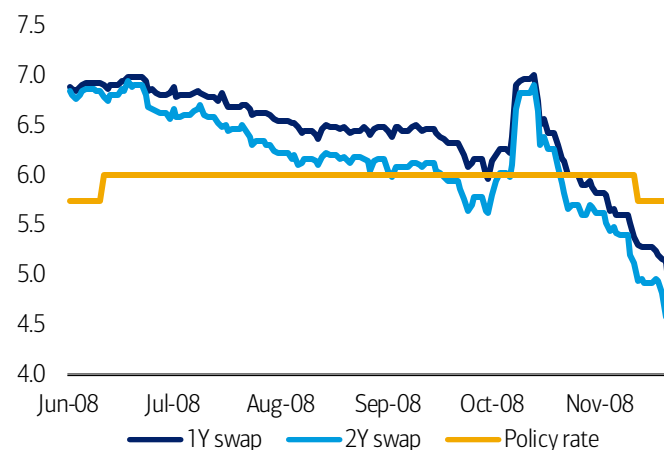


Source: Bloomberg, BofA Global Research

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**Exhibit 14: Poland after the hiking cycle ending in 2008**

A receiver trade started after the last hike and resumed a month before the first cut

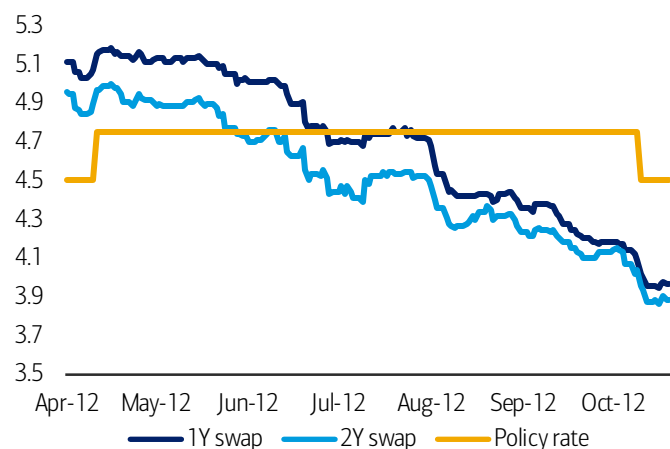


Source: Bloomberg, BofA Global Research

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**Exhibit 15: Poland after the hiking cycle ending in 2012**

A receiver trade started immediately after the last hike

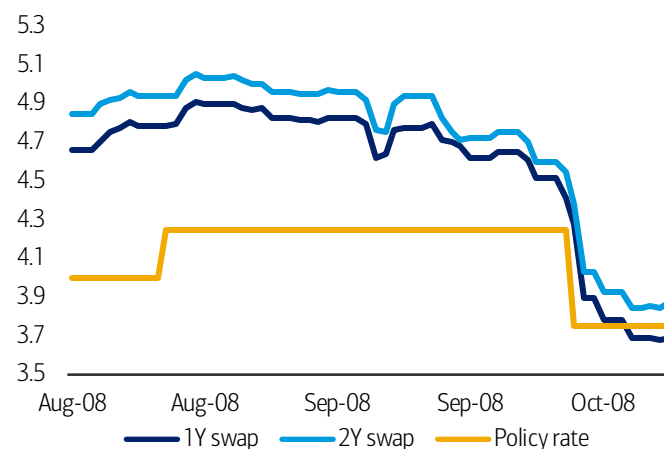


Source: Bloomberg, BofA Global Research

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**Exhibit 16: Israel after the hiking cycle ending in 2008**

The main receiver trade started around 1 month before the first cut

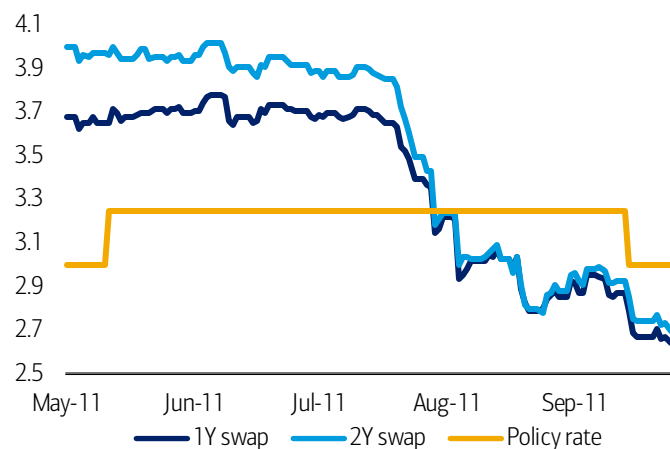


Source: Bloomberg, BofA Global Research

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**Exhibit 17: Israel after the hiking cycle ending in 2011**

The main receiver trade started 2 month before the first cut

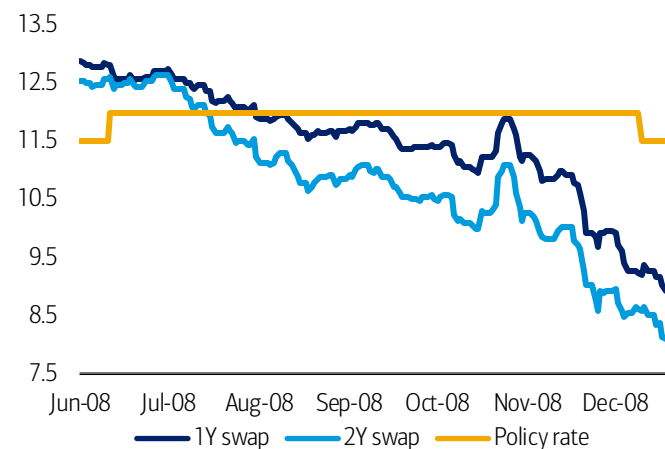


Source: Bloomberg, BofA Global Research

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**Exhibit 18: South Africa after the hiking cycle ending in 2008**

The receiver trade started after the last hike

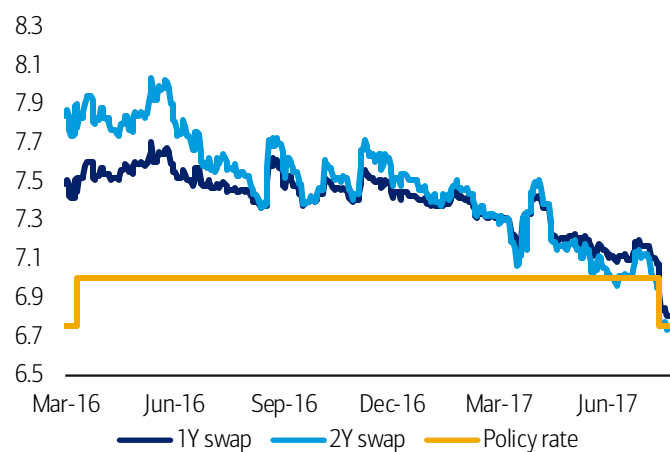


Source: Bloomberg, BofA Global Research

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**Exhibit 19: South Africa after the hiking cycle ending in 2016**

The first leg of a receiver trade started after the last hike



Source: Bloomberg, BofA Global Research

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