Global Fixed Income Markets Weekly

CBs unlikely to surprise, RV in focus

- **Overview:** Over the past couple of weeks, UK and US rates have rallied from their highs following US and UK downside CPI surprises and limited reaction to Trump's inauguration. We continue to see downside growth risks in the Euro area, while the unimpressive growth picture in UK has to be weighed against a stickier inflation backdrop. US exceptionalism is still there, but the economic impact of Trump policy shifts remains uncertain for now. This week, Norges Bank kept rates on hold and signaled a start of easing in March which remains our baseline. The BoJ hiked rates to 0.5% and guided for further hikes, although timing remains unclear (we foresee 2 additional hikes from BoJ this year). Fed, ECB and Riksbank meetings are scheduled next week. We expect a cut both from ECB and Riksbank while the Fed is expected to stay on hold until June.
- **Euro:** Hold long 10Y Germany. Keep longs in 10Y Spain vs. Germany, 7Y EU vs. Germany and 5Y NRW vs. Germany as strategic intra-EMU/€-SSA OW. Enter short 3Y France vs. Spain and 10s/30s Spain flattener vs. Italy. Keep short 9Y Portugal vs. Spain. Stay received 1Yx1Y €STR and in 6Mx1Y receiver spread (A-12.5/A-50) versus OTM payer. We favour Dec25/Jun26/Dec26 Euribor belly richener as a way to position for a slower ECB easing cycle/longer pause which also benefits from attractive slide on the curve. Enter tactical 2s/10s conditional bull flattener via 1M receivers which benefits from positive rate and volatility curve carry. Keep 10s/30s steepening bias; hold 2Yx2Y/10Yx10Y swap curve steepener and 10s/30s conditional bull steepener via 3M receivers; re-strike 5s/10s/30s conditional bull belly richener via 3M receivers. Take profit in long Jun25 ITM Euribor puts versus ITM SONIA puts. We have a medium term widening bias in Schatz spreads. We switch to a tactical widening bias in Bund spreads; enter Mar25 conditional Bund bull widener. Hold Bund/Buxl swap spread curve steepener. Stay short gamma; sell 3Mx2Y gamma and keep shorts in 1Yx1Y unhedged straddle. Take profit in short 3Mx30Y gamma with infrequent delta hedging.
- **UK:** Stay received Feb25 MPC OIS. Keep Aug25/Dec25 MPC OIS flattener. Neutral outright duration. Enter tactical 30s/50s gilt curve steepener. Focus on long end high coupon/low coupon pairs.
- **US:** We stay long 2-year Treasuries: the Fed retains a dovish bias, and we think valuations are a support. Longer out the curve, yields appear too high to their drivers, but we don't expect them to drop significantly, as the Fed's implicit focus on labor markets trumps inflation for now, supporting higher yields. Moreover, rising term premium should also prevent any significant decline. Hold 5s/10s flatteners as the curve remains too steep relative to the level of front end yields. We review November TIC data. Initiate 5Yx5Y inflation swaps shorts. We turn overweight $-SSAs on more favorable supply dynamics and valuations.Term premium is likely to continue drifting lower in the near-term - maintain exposure to flatter swap curves. Position for a structural increase in term premium in a selloff with weighted conditional 2s/7s/30s belly cheapening flies. Valuations point to rangebound spreads - unwind outright spread exposure. Term funding premium is biased lower, which supports steeper spread curves - initiate 7s/30s spread curve steepeners. Policy

See page 102 for analyst certification and important disclosures.

Rates Strategy

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uncertainty remains elevated - stay bullish on vol. Buy 1Yx10Y straddles paired with a long duration overlay and/or buy 1Yx10Y vs selling 10Yx10Y and 2Yx2Y straddles paired with a short duration overlay.

- **Japan:** The BoJ hiked the policy rate by 25bp as expected. We explore our views on duration, curve, swap spreads, and money markets. Keep 2s/10s JGB curve flatteners.
- **Australia & New Zealand:** Take profit on received Apr25 RBA-RBNZ meeting date spread; take profit on paid 5s/10s BBSW-SOFR; take profit on short ACGB Apr26 on ASW.

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Overview

CBs unlikely to surprise, RV in focus

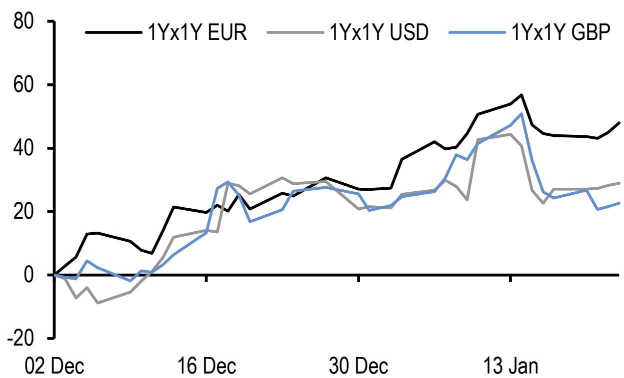
- **Over the past couple of weeks, UK and US rates have rallied from their highs following US and UK downside CPI surprises and limited reaction to Trump's inauguration. We continue to see downside growth risks in the Euro area, while the unimpressive growth picture in UK has to be weighed against a stickier inflation backdrop. US exceptionalism is still there, but the economic impact of Trump policy shifts remains uncertain for now. This week, Norges Bank kept rates on hold and signaled a start of easing in March which remains our baseline. The BoJ hiked rates to 0.5% and guided for further hikes, although timing remains unclear (we foresee 2 additional hikes from BoJ this year). Fed, ECB and Riksbank meetings are scheduled next week. We expect a cut both from ECB and Riksbank while the Fed is expected to stay on hold until June.**

Over the past couple of weeks, US and UK yields are lower and have mainly reversed their early January sell-off following decent downside surprises in UK and US CPI prints and further disappointments in UK macro releases (monthly GDP and retail sales) as well as some dovish Fed commentary (**Figure 1**). In fact, 10Y gilts saw their largest one day rally following the December CPI print (**Figure 2**). Euro area rate moves have been more modest amid lack of strong domestic catalysts. Market reaction to Trump's inauguration remained relatively contained as not much additional clarity was provided on possible universal tariffs or other macro policies relevant for rate markets, and lover the later part of this week, yields modestly sold-off given upside surprises in PMI prints across several jurisdictions.

We keep our strategy relatively unchanged and see limited value expressing views on the market impact of potential Trump policy announcements. We keep receiving 1Yx1Y ESTR and long 10Y Bunds on valuations and stay tactically received Feb25 MPC OIS. We enter tactical 2s/10s ESTR conditional bull flatteners via 1M receivers and in the UK enter tactical 30s/50s gilt curve steepeners. In intra-EMU, we enter tactical UW 3Y France vs. Spain and 10s/30s Spain flattener vs. Italy. In the US, we stay long 2Y USTs.

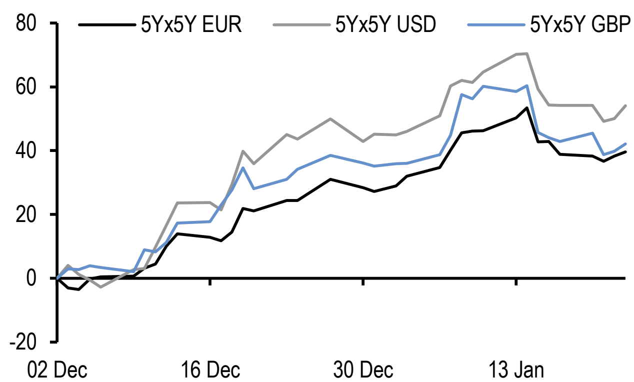
Figure 1: Over the past couple of weeks UK and US rates reversed the sell-off seen in early January

Cumulative change in in 1Yx1Y OIS rate in EUR, USD and GBP; since 1 December 2024; bp



Source: J.P. Morgan.

Cumulative change in in 5Yx5Y OIS rate in EUR, USD and GBP; since 1 December 2024; bp



Source: J.P. Morgan.

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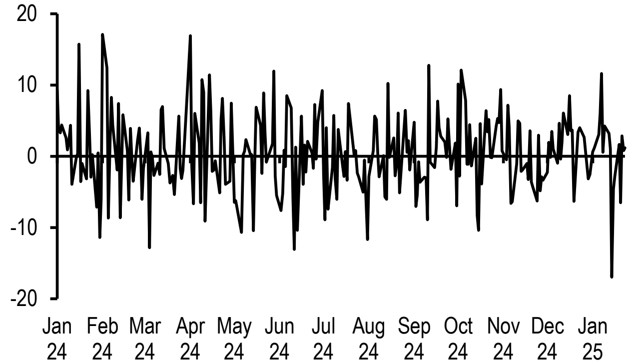
Figure 2: The move in 10Y gilts after the downside CPI surprise was the sharpest 1-day rally seen over the past year

Daily change in 10Y gilt yields; since Jan 2024; bp



Source: J.P. Morgan.

Macro update: downside risks in Euro area, caution in UK and continued policy uncertainty in US

Given the recent surprises in data releases, last week's update of the IMF growth forecasts and Trump's inauguration, we take stock of current J.P. Morgan macro forecasts and assess how they are tracking relative to official sources/forecasters' surveys.

In the **Euro area**, our economists' see growth remaining steady at 0.8%oya through both 2025 and 2026 amidst a backdrop of declining inflation. Our growth figures for the Euro area are weaker than both official forecasts and forecasters surveys, which are currently expecting a reasonable growth uptick in the region over the next two years (**Figure 3**). We believe that higher consumer spending and larger capex would be needed to justify such a pick-up in Euro area growth, which would be consistent with higher PMIs than what seen so far in our view. This weeks' increase in the January PMIs, although stronger than expected, is still consistent with a lower annualized growth rate this year (0.8% oya so far, according to our model. See *Euro area: PMI increased further at the start of the year, 24 January*). Although it is possible that consumption could firm from a fall in the (currently elevated) savings rate, this is not yet evidence in the data, whereas the ongoing fiscal and political concerns especially in France and Germany and trade/tariff uncertainty keep the balance of risks on Euro area growth tilted to the downside. We expect the ECB to proceed with another 25bp cut at next week's meeting in line with market pricing with likely non-committal guidance on the future easing path given elevated uncertainty especially around impact from US policy (see *ECB preview: Another 25bp cut, 24 January*). We continue to see ECB easing down to a modestly accommodative terminal rate of 1.75%, partly because we think that persistent trade uncertainty will keep growth below potential this year and partly because of the region's low inflation regime.

In the **UK**, our economists have recently revised growth forecasts down for 2024, given the disappointing November monthly GDP print, and up for 1H25, given expected support coming from upcoming government spending (see here). We believe that risks to UK growth remain nonetheless tilted to the downside relative to official forecasts given signs that private sector activity is weakening in response to higher taxes from the Budget as evidence in recent business surveys. For the UK, we believe that the downside risks to growth

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have to be weighed against a stickier wage and inflation backdrop relative to the Euro area. On the inflation front, our economists think that, despite the recent downside surprise on CPI, there are still several reasons that could pose upside risks to inflation, e.g. still elevated private sector wage growth, higher energy prices and the recent rise in survey-based measures of inflation expectations. We believe that in UK the recent activity prints support a rate cut in February, which is broadly in line with market pricing around 90% probability of a cut. Although we continue to call for 100bp cuts from BoE over 2025 vs. market pricing around 65bp, we remain cautious on UK duration for now. It still remains unclear whether the weak growth backdrop or high inflation will prove to be the more dominant factor this year.

Turning to the **US**, ahead of Trump's inauguration last week, the IMF notably revised up the US growth forecasts (2.7% for 2025 and 2.1% in 2026), widening the gap with the performance expected in other DM economies. Our economists continue to call for a similar divergence of US *vis a' vis* the rest of the world. However, we acknowledge that even after Trump's inauguration it is still hard to have clarity about potential Trump's policies, which makes it hard to gauge any specific macro impacts on the US and the global economy. US policy objectives remain conflicting: the growth supportive environment stemming from fiscal support and regulatory relief is counterbalanced by the likely effect of US tariffs on imports and immigration restrictions. Ultimately, the macro-outlook will depend on the (still unclear) policy mix being delivered when balancing these objectives. At next week's meeting, we continue to expect no Fed cut, in line with markets, and no mention of trade or other policy issues (see *US: The Fed in 2025, 24 January*). Our call for Fed remains for two further cuts in June and September for a total of 50bp cuts this year, which is close to current market expectations (around 40bp).

Figure 3: We see Euro area growth sticking at 0.8% through 2026 amid declining inflation, while in UK the unimpressive growth picture has to be weighed against a stickier inflation backdrop. US exceptionalism is still there, but the economic impact of Trump policies remains uncertain for now

GDP growth and Headline inflation forecasts for 2024,2025 and 2026; J.P. Morgan vs. official forecasts and forecasters surveys

		GDP growth			Headline inflation		
		JPM	Mean (Official)	Mean (Surveys)	JPM	Mean (Official)	Mean (Surveys)
Euro area	2024	0.8%	0.8%	0.8%	2.4%	2.4%	2.4%
	2025	0.8%	1.1%	1.0%	2.2%	2.1%	2.0%
	2026	0.8%	1.5%	1.2%	1.7%	1.9%	2.0%
UK	2024	0.8%	1.2%	0.9%	2.5%	2.7%	2.5%
	2025	0.7%	1.6%	1.4%	3.2%	2.4%	2.6%
	2026	0.9%	1.3%	1.5%	2.6%	2.1%	2.2%
US	2024	2.8%	2.7%	2.8%	3.0%	2.8%	3.0%
	2025	2.5%	2.3%	2.1%	2.7%	2.1%	2.5%
	2026	2.0%	2.1%	2.0%	2.2%	2.1%	2.6%

Source: IMF, European Commission, ECB, BoE, Fed, Consensus Economics, Bloomberg, J.P. Morgan. Note: Official forecasts include: IMF, European Commission and forecasts provided by the respective central bank. Survey forecasts include: Consensus Economics, Bloomberg Consensus.

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Central bank updates

On the central bank side, over the past couple of weeks, there have been several speeches from central bankers, especially at the Davos forum, along with meetings for Norges Bank and BoJ. Recent commentary from policymakers was on the margin tilted to the dovish side (**Figure 4**). Indeed, ECB members highlighted consensus (except Holzmann) around continuing with further gradual cuts, while keeping a data-dependent approach, as the growth outlook has weakened and they are not "overly concerned" over imported inflation from US policy. In UK, Taylor noted the recent negative developments in the data, while commentary from Fed indicated that there is still work to do to bring down inflation and that uncertainty remains high.

Figure 4: Over the past couple of weeks, there have been several speeches from central bankers, especially at the Davos forum, with a broadly dovish tone

Selected comments from Fed, BoE and ECB Members;

	Source	Date	Comment
Fed	Hammack	17-Jan	"We still have an inflation problem. We've made amazing progress on it, but we need to continue to finish the job."
Fed	Waller	16-Jan	"As long as the data comes in good on inflation or continues on that path, then I can certainly see rate cuts happening sooner than maybe the markets are pricing in." "If we make a lot of progress, you could do more [cuts]. If the data doesn't cooperate, then you're going to be back to two and going maybe even one, if we just get a lot of sticky inflation"
Fed	Barkin	15-Jan	"Inflation is coming down. But there's still work to do. I do still think we need to be restrictive to seal the final mile."
Fed	Williams	15-Jan	"The process of disinflation remains in train. But we are still not at our 2% goal." "The path for monetary policy will depend on the data. The economic outlook remains highly uncertain, especially around potential fiscal, trade, immigration, and regulatory policies."
Fed	Goolsbee	15-Jan	"If Congress and the president begin drafting policies that are going to raise prices, we've got to think about that. What will matter is the impact of policies taken as a whole, not some individual policy."
BoE	Taylor	17-Jan	"Right now, I think it makes sense to cut rates pre-emptively to take out a little insurance against this change in the balance of risks, given that our policy rate is still far above neutral and would still remain very restrictive" "There is a lot of uncertainty. The drift in the data recently has been more to the pessimistic side and we need to be very alert to directional risk both ways."
ECB	Holzmann	22-Jan	"Inflation gauges are still very strong. [...] There is danger of rate cut then hiking again." " [It would be better] to wait a bit more. I can be persuaded [on a rate cut] if there are good arguments."
ECB	Rehn	22-Jan	"It is important to maintain freedom of action in monetary policy decision-making. In future meetings – already next week – we should have more information about, for example, US trade policy and other decisions affecting the economy."
ECB	Villeroy	22-Jan	"On the European side I don't think that the inflationary effects [of US tariffs] will be that significant, so I would expect this disinflation process to go on."
ECB	Lagarde	22-Jan	"We are on this regular, gradual path. Disinflation is coming through." "Risk is to the downside when it comes to growth, and we'll have to be very attentive to the data." "We are not overly concerned by the export of inflation to Europe." "We do have that divergence, that has to do with a different economic setting at the moment between the U.S. and Europe."
ECB	Nagel	21-Jan	"This meeting-to-meeting approach worked pretty well and it should be the way forward for the next six months."
ECB	Guindos	15-Jan	"The policy trajectory is clear, and we expect to continue to further reduce the restrictiveness of monetary policy." "The high level of uncertainty calls for prudence. In particular, severe global trade frictions could increase the fragmentation of the world economy, uncertainty about fiscal policy and its present challenges could weigh on borrowing costs, and renewed geopolitical tensions could affect energy prices."

Source: Media Articles, J.P. Morgan.

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The delivery from Norges Bank last Thursday was broadly in line with both our and market expectations: the central bank kept policy rates on hold at 4.5% and left forward guidance unchanged, still guiding for a first ease in March (see *Norges Bank review: Easing cycle finally set to begin, 23 January*). The press conference was on the hawkish side with the discussion focused on tariffs, higher rates abroad and NOK weakness; the message on the currency was nonetheless offset by the NOK not even being mentioned in the statement for the first time in years. We still expect 100bp cuts over 2025 at quarterly pace starting in March, although risks are skewed towards fewer cuts. The BoJ hiked policy rate to 0.5%, in line with our forecast and consensus, and confirmed that they will continue to hike gradually, although Governor Ueda did not provide much guidance on the timing of the next move. Our economists (see here) continue to call for two rate hikes in 2025, at the June and December meetings, with the policy rate reaching 1% by year-end (vs. market pricing around 0.8% currently) and terminal at 1.25%. Given the likely sustained acceleration of inflation and the lingering yen depreciation pressure, the risk bias is shifting towards earlier moves.

Fed, ECB and Riksbank meetings are scheduled next week while the BoE meeting is coming up in early February. We present in **Figure 5**a summary of J.P. Morgan expectations and OIS market pricing across DM.

Figure 5: Our central bank call is broadly in line with market pricing for Fed and RBNZ, while elsewhere we are calling for more cuts than market pricing

Summary of the delivered central bank rate changes over the current policy cycle, J.P. Morgan call for next policy action and expectation of total policy rate changed in 2025 (J.P. Morgan forecast vs. OIS market pricing);

	Policy rate change over the current cycle						Next change		Expected policy rate changed in 2025			
									JPM forecast		OIS pricing	
	Start rate (%)	First change*	Last change	Current rate (%)	Total bp delivered	Delivered cuts	Central Bank Policy Bias	JPM forecast	Bp cuts	Rate end25	Bp cuts	Rate end25
US	5.25-5.50%	18 Sep 24 (-50bp)	7 Nov 24 (-25bp)	4.25-4.5%	-50	1 cut of 50bp	Easing	Jun 24 (-25bp)	-50	4.00%	-41	3.92%
Euro area**	4.00%	06 Jun 24 (-25bp)	17 Oct 24 (-25bp)	3.00%	-100	3 cuts of 25bp	Easing	Jan 24 (-25bp)	-125	1.75%	-80	2.12%
UK	5.25%	01 Aug 24 (-25bp)	7 Nov 24 (-25bp)	4.75%	-50	2 cuts of 25bp	Easing	Feb 25 (-25bp)	-100	3.50%	-65	4.05%
Japan	-0.10%	19 Mar 24 (+10bp)	23 Jan 25 (+25bp)	0.50%	60	1 hike of 10bp; 1 hike of 15bp; 1 hike of 25bp	Tightening	Jun 25 (+25bp)	75	1.00%	30	0.69%
Australia	-	-	7 Nov 23 (+25bp)	4.35%	-	-	On hold	Feb 25 (-25bp)	-100	3.35%	-53	3.77%
New Zealand	5.50%	14 Aug 24 (-25bp)	9 Oct 24 (-50bp)	4.25%	-125	1 cut of 25bp; 1 cut of 50bp	Easing	Feb 25 (-50bp)	-100	3.00%	-101	3.17%
Sweden	4.00%	07 May 24 (-25bp)	7 Nov 24 (-50bp)	2.50%	-150	3 cuts of 25bp; 1 cut of 50bp	Easing	Jan 25 (-25bp)	-75	1.75%	-69	1.81%
Norway	-	-	14 Dec 23 (+25bp)	4.50%	-	-	Easing	Mar 25 (-25bp)	-100	3.25%	-70	3.80%

Source: J.P. Morgan. Note: * Announcement date ** Deposit facility rate.

2025 issuance: net supply after QT flows to improve in US and UK, while the deterioration in Euro area is balanced by steady demand given attractive valuations

Supply has also remained at the forefront of DM rates discussions over the past weeks given the steepening move on fiscal/term premium concerns in US and UK as well as the heavy ongoing issuance frontloading at the start of the year. As discussed in our *2025 Global gov-*

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ernment issuance outlook, 16 January, our expectation is that 2025 net issuance will remain strong across most DM, although modestly lower than in 2024, with some heterogeneity across DM jurisdictions in terms of net issuance after central bank QT flows. Net issuance net of QT is expected to improve in US, where QT has slowed and will likely come to an end in 1Q25. In the UK, total gilt issuance net of redemptions and BoE QT is projected to remain historically high in FY25/26. In the Euro area, we forecast a deterioration in the 2025 supply vs. ECB flow dynamics as the increase in PEPP QT pace will more than offset the impact from lower net issuance. Nonetheless, we continue to hold a positive outlook on intra-EMU spreads over 2025 as we believe that the heavy net supply, including accelerating QT, will be met by a sustained demand for Euro govies, especially from foreigners, given our expectation that the ECB would deliver a sharper easing cycle vis-à-vis other DM central banks (see *Euro area government bond demand 2025 outlook, 19 November*). In line with our expectations, the heavy issuance frontloading of Euro sovereigns during January has so far been well digested by the market, especially owing to attractive valuations after the recent yield sell-off/spread widening (see *Euro Cash*). Most of the Euro sovereigns for which we had expected a syndicated deal in January have already come to the market and the deals have been met by strong demand as proven by the large order books and record deal sizes.

Japan flows update: continued net selling of French bonds in November

The recently published Japanese Balance of Payments data show that Japanese investors were marginal net buyers of foreign securities in November ($2.5bn net purchases) after being strong net sellers in the previous month (**Figure 6**). The majority of the November buying flows were concentrated in US ($7.5bn net purchases) similarly to what observed for most of 2024. Most of the net selling from Japanese investors in November was directed to Euro area bonds (€5.8bn). The net selling was focused on core Euro area countries, while there was a modest net buying directed towards the periphery. It is worth noting that Japanese investors have been net sellers of French debt securities over the past months amid the ongoing political noise in France since June: the net selling flows were initially quite muted except in July (€8.6bn net sales), but picked up in October and November with around €6-7bn net sales in both months.

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Figure 6: Japanese investors were marginal net buyers of foreign securities ($2.5bn net purchases) after being strong net sellers in October

Japanese net purchases of foreign bonds and notes by region; bn of domestic currency* ($bn for Total) per month

Period (bn local ccy)	Total ($bn)	US	Euro area								UK	Australia	China
			Total	Core**	Germany	France	Other core**	Periphery***	Italy	Spain			
2015	45.6	36.8	-1.8	-4.3	-5.7	1.2	0.2	2.5	0.7	1.5	-0.1	1.4	0.0
2016	182.2	111.7	30.0	27.0	-4.6	22.9	8.7	3.0	0.0	1.6	2.4	8.8	9.5
2017	-6.3	-19.3	1.0	-6.6	5.3	-11.2	-0.7	7.7	-0.5	4.7	-5.0	9.7	3.0
2018	92.1	-25.0	52.6	34.7	-6.4	22.8	18.3	17.9	0.6	8.8	9.7	8.8	14.4
2019	169.8	108.8	43.2	25.3	-15.3	34.3	6.4	17.8	2.9	9.0	-3.9	-0.9	40.9
2020	193.0	116.9	18.7	-6.2	-0.6	-8.3	2.7	24.9	16.4	5.8	4.2	42.6	35.9
2021	21.3	64.2	-6.9	-8.2	-5.0	-2.7	-0.4	1.2	-0.1	0.4	2.2	-18.2	18.3
2022	-177.6	-121.8	-28.7	-26.3	-8.1	-11.8	-6.4	-2.5	-1.7	-0.1	1.5	-3.9	-31.5
2023	137.8	149.9	-11.4	-7.4	1.4	-3.2	-5.7	-4.0	-0.6	-2.8	0.1	6.8	28.4
monthly avg. 2023	11.5	12.5	-0.9	-0.6	0.1	-0.3	-0.5	-0.3	-0.1	-0.2	0.0	0.6	2.4
Jan-24	17.4	23.0	0.7	1.4	2.1	-0.3	-0.4	-0.7	-0.1	0.0	0.0	-3.8	4.9
Feb-24	7.1	7.0	-1.3	-1.5	-0.5	-0.8	-0.3	0.2	-0.2	0.1	0.4	-0.2	6.3
Mar-24	2.8	9.2	-0.8	-0.6	0.1	-0.6	-0.1	-0.3	-0.6	0.8	-0.2	-2.1	5.6
Apr-24	-6.8	1.7	-0.3	1.2	0.2	1.9	-0.9	-1.5	-0.1	-0.9	-0.4	-2.2	6.2
May-24	19.9	22.7	0.1	-1.1	0.2	-1.0	-0.3	1.2	0.1	0.2	-0.5	-1.7	5.4
Jun-24	-23.8	-13.8	-11.5	-12.3	-7.2	-0.6	-4.5	0.7	-0.1	0.0	0.2	2.7	2.9
Jul-24	-12.0	8.1	-14.3	-13.0	-0.1	-8.6	-4.2	-1.3	-0.2	-1.2	0.4	0.5	1.0
Aug-24	51.0	41.7	3.4	2.0	2.2	-0.7	0.5	1.4	0.0	0.9	2.0	0.7	7.5
Sep-24	18.8	11.3	3.3	1.3	5.2	-3.1	-0.8	2.0	1.5	0.5	0.8	0.3	3.6
Oct-24	-28.1	-8.5	-15.7	-15.0	-5.3	-6.8	-2.9	-0.7	-2.5	-1.3	0.0	-1.7	0.5
Nov-24	2.5	7.5	-5.8	-8.0	1.7	-6.3	-3.4	2.1	1.6	0.0	0.4	-1.6	3.9
2024	48.7	109.9	-42.4	-45.4	-1.5	-26.8	-17.1	3.1	-0.7	-1.0	3.2	-9.0	47.8

Source: MOF, J.P. Morgan. Note: * Monthly flows converted to domestic currency at month average exchange rates. ** Austria, Belgium, Finland, Luxembourg and the Netherlands. *** Greece, Ireland, Italy, Portugal and Spain.

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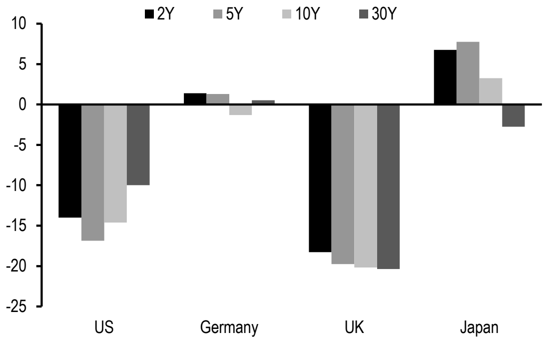
Figure 7: Over the past couple of weeks, US and UK yields are lower and have mainly reversed their early January sell-off following decent downside. Euro area rate moves have been more modest amid lack of strong domestic catalysts

Change in b/m yield since 10th January 2025 by region, bp



Source: J.P.Morgan.

Figure 8: UK and US CPI prints surprised to the downside. UK and Euro area PMIs were stronger than expected

Actual print vs. consensus expectations since 10th January 2025

	Surprise		
Region	**Upside**	**In line**	**Downside**
Euro area	PMI Mfg. & Comp.		Consumer Confidence PMI Serv.
US	Industrial Production PMI Mfg.		CPI Empire Mfg. Retail Sales PMI Serv. & Comp. U. Mich. Sentiment
UK	PMIs	ILO Unemployment Rate	CPI Monthly GDP Retail Sales Industrial Production GfK Consumer Conf.
Sweden		CPIF Unemployment rate	
Japan	Natl CPI		
Australia		Unemployment Rate	
New Zealand	CPI		

Source: Bloomberg Finance L.P.
Note: Jobless claims are reported as upside (downside) surprises if they are lower (higher) than consensus expectations. Inflation expectations are reported as upside (downside) surprises if they are higher (lower) than consensus.

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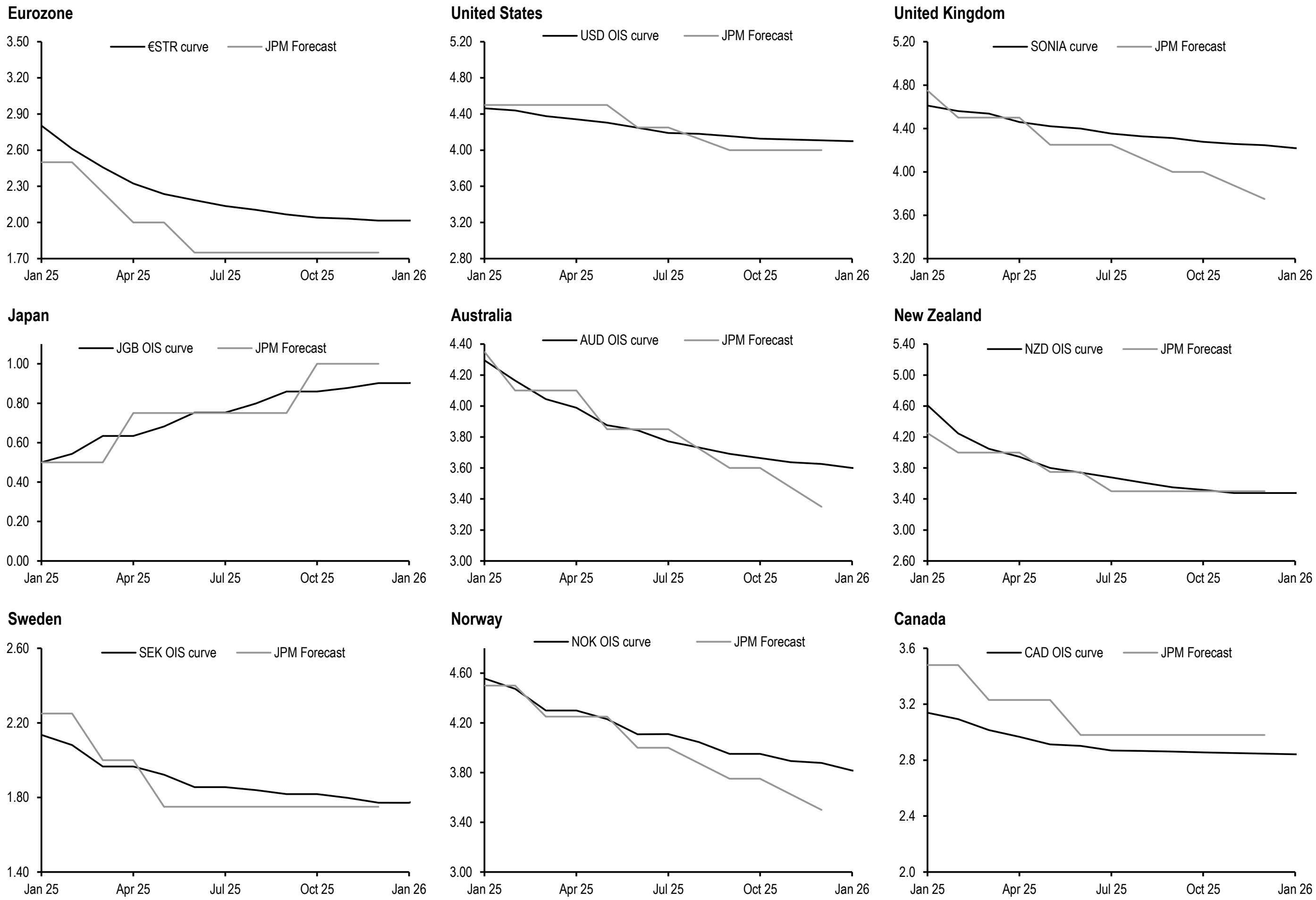
Figure 9: Central bank policy rate expectations inferred from money market rates

Central bank policy rate expectations (1M forward OIS rates starting at month end) and J.P. Morgan policy rates forecasts*, %



Source: J.P. Morgan.
* Adjusted for the differential between policy rates and O/N OIS rates. For USD OIS, adjusted for the differential between the O/N OIS rate and the upper bound of the Fed funds target range.
Levels as of COB 12th December 2024.

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Figure 10: Yield pick-up available via foreign bonds by country and investor currency, on a currency-hedged basis (3M rolling and maturity-matched hedges) and unhedged

Annualised yield pick-up* for euro-, yen-, US dollar- and sterling-based investors from foreign currency bonds vs. domestic bonds (German bonds for euro-based investors) of the same maturity, with no hedge, 3M rolling**and maturity-matched*** currency hedges; shaded regions for rolling and maturity-matched hedges show >1% yield pick-up (darkest shading), between 0.5% and 1%, and between 0% and 0.5% (lightest shading), %

EUR-based	US			Japan			UK			Australia			Sweden			Other Euro area^		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	France	Italy	Spain
2Y	2.09	0.33	0.08	-1.52	0.82	0.26	2.04	0.04	-0.05	1.71	-0.01	0.03	-0.22	0.16	-0.18	0.24	0.33	0.21
5Y	2.14	0.38	0.21	-1.43	0.91	0.35	1.98	-0.02	0.13	1.72	0.01	0.09	-0.21	0.18	-0.24	0.51	0.67	0.37
10Y	2.01	0.25	0.21	-1.34	1.00	0.41	2.08	0.09	0.37	1.91	0.19	-0.21	-0.19	0.20	-0.33	0.73	1.07	0.68
30Y	2.12	0.35	0.44	-0.56	1.78	0.85	2.32	0.32	0.61	2.20	0.49	0.21	-0.13	0.26	-0.26	1.01	1.42	1.04

^ Pickup relative to Germany

JPY-based	US			Germany			France			Italy			Spain			UK			Australia			Sweden		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	3.61	-0.49	-0.18	1.52	-0.82	-0.26	1.76	-0.58	-0.02	1.85	-0.49	0.07	1.73	-0.62	-0.05	3.56	-0.78	-0.31	3.23	-0.83	-0.39	1.30	-0.66	-0.44
5Y	3.57	-0.53	-0.13	1.43	-0.91	-0.35	1.94	-0.40	0.16	2.11	-0.23	0.32	1.80	-0.54	0.02	3.41	-0.93	-0.22	3.16	-0.90	-0.50	1.23	-0.73	-0.59
10Y	3.35	-0.75	-0.20	1.34	-1.00	-0.41	2.07	-0.27	0.33	2.40	0.06	0.66	2.02	-0.33	0.27	3.42	-0.92	-0.03	3.25	-0.81	-0.62	1.15	-0.81	-0.74
30Y	2.68	-1.43	0.05	0.56	-1.78	-0.39	1.57	-0.77	0.62	1.98	-0.36	1.03	1.60	-0.74	0.65	2.88	-1.46	0.23	2.77	-1.29	-0.18	0.43	-1.52	-0.65

USD-based	Japan			Germany			France			Italy			Spain			UK			Australia			Sweden		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	-3.61	0.49	0.18	-2.09	-0.33	-0.08	-1.85	-0.09	0.16	-1.76	0.00	0.25	-1.89	-0.12	0.12	-0.06	-0.29	-0.14	-0.38	-0.34	-0.22	-2.32	-0.17	-0.27
5Y	-3.57	0.53	0.13	-2.14	-0.38	-0.21	-1.63	0.13	0.29	-1.47	0.30	0.46	-1.77	-0.01	0.15	-0.16	-0.40	-0.09	-0.42	-0.37	-0.37	-2.35	-0.20	-0.45
10Y	-3.35	0.75	0.20	-2.01	-0.25	-0.21	-1.28	0.48	0.53	-0.95	0.82	0.86	-1.34	0.43	0.47	0.07	-0.17	0.17	-0.11	-0.06	-0.42	-2.20	-0.05	-0.53
30Y	-2.68	1.43	-0.05	-2.12	-0.35	-0.44	-1.11	0.66	0.57	-0.70	1.07	0.98	-1.08	0.69	0.60	0.20	-0.03	0.18	0.09	0.14	-0.23	-2.24	-0.09	-0.70

GBP-based	US			Germany			France			Italy			Spain			Japan			Australia			Sweden		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	0.06	0.29	0.14	-2.04	-0.04	0.05	-1.79	0.20	0.30	-1.71	0.29	0.38	-1.83	0.17	0.26	-3.56	0.78	0.31	-0.33	-0.05	-0.08	-2.26	0.12	-0.13
5Y	0.16	0.40	0.11	-1.98	0.02	-0.13	-1.47	0.53	0.38	-1.30	0.69	0.55	-1.61	0.39	0.24	-3.41	0.93	0.22	-0.25	0.03	-0.28	-2.18	0.20	-0.37
10Y	-0.07	0.17	-0.17	-2.08	-0.09	-0.37	-1.35	0.65	0.36	-1.01	0.98	0.70	-1.40	0.59	0.31	-3.42	0.92	0.03	-0.17	0.11	-0.59	-2.27	0.11	-0.70
30Y	-0.20	0.03	-0.18	-2.32	-0.32	-0.61	-1.31	0.69	0.40	-0.90	1.10	0.81	-1.28	0.72	0.43	-2.88	1.46	-0.23	-0.12	0.17	-0.41	-2.45	-0.06	-0.87

Source: J.P. Morgan. * Yield pick-up defined as foreign currency yield + hedge cost – domestic currency yield, using par govie curves (except Sweden, where we use benchmark bonds).** Cost of 3M rolling hedge defined as 3M FX cross-currency basis + domestic 3M swaprate (3s curve) – foreign-currency swaprate (3s curve).*** Cost of maturity-matched hedge defined as the maturity-matched FX cross-currency basis + domestic swaprate (3s curve) – foreign-currency swap rate (3s curve). Levels as at COB 23rd January 2025.

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Figure 11: Yield pick-up available via foreign bonds by country and investor currency, on a currency-hedged basis (3M rolling and maturity-matched hedges) and unhedged (EUR countries and SSA)

Annualised yield pick-up* for euro-, yen-, US dollar- and sterling-based investors from different Euro-based bonds of the same maturity, with no hedge, 3M rolling** and maturity-matched*** currency hedges; shaded regions for rolling and maturity-matched hedges show >1% yield pick-up (darkest shading), between 0.5% and 1%, and between 0% and 0.5% (lightest shading), %

EUR-based	Other Euro area^										
FX hedge:	France	Italy	Spain	Belgium	Netherlands	Austria	Finland	Ireland	EU	EIB	KfW
2Y	0.24	0.33	0.21	0.20	0.10	0.22	0.18	0.15	-0.22	-0.35	-0.33
5Y	#REF!	0.67	0.37	0.32	0.17	0.24	0.26	0.17	-0.09	-0.11	-0.14
10Y	0.73	1.07	0.68	0.57	0.21	0.46	0.44	0.30	0.31	0.18	0.13
30Y	1.01	1.42	1.04	0.90	0.15	0.43	0.44	0.35	0.80	0.29	-

^ Pickup relative to Germany

JPY-based	Germany			Belgium			Netherlands			Austria			Finland			Ireland			EU			EIB			KfW		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	1.52	-0.82	-0.26	1.72	-0.63	-0.06	1.62	-0.72	-0.16	1.74	-0.60	-0.04	1.71	-2.16	-1.59	1.67	-2.19	-1.63	1.86	-0.48	0.08	1.73	-0.61	-0.05	1.75	-0.59	-0.03
5Y	1.43	-0.91	-0.35	1.76	-0.58	-0.03	1.60	-0.74	-0.18	1.68	-0.66	-0.11	1.69	-1.97	-1.41	1.60	-2.06	-1.50	1.79	-0.55	0.01	1.77	-0.57	-0.01	1.75	-0.59	-0.04
10Y	1.34	-1.00	-0.41	1.90	-0.44	0.16	1.55	-0.79	-0.19	1.80	-0.54	0.06	1.77	-1.55	-0.95	1.64	-1.69	-1.09	1.85	-0.49	0.11	1.72	-0.62	-0.02	1.68	-0.67	-0.07
30Y	0.56	-1.78	-0.39	1.46	-0.88	0.52	0.71	-1.63	-0.24	0.99	-1.35	0.04	1.01	-1.34	0.06	0.91	-1.43	-0.04	1.37	-0.97	0.42	0.85	-1.49	-0.10	-	-	-

USD-based	Germany			Belgium			Netherlands			Austria			Finland			Ireland			EU			EIB			KfW		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	-2.09	-0.33	-0.08	-1.90	-0.13	0.11	-1.99	-0.23	0.02	-1.87	-0.11	0.14	-1.91	-0.14	0.10	-1.94	-0.18	0.07	-1.75	0.01	0.26	-1.88	-0.12	0.13	-1.86	-0.10	0.15
5Y	-2.14	-0.38	-0.21	-1.82	-0.05	0.11	-1.97	-0.21	-0.05	-1.90	-0.13	0.03	-1.88	-0.12	0.04	-1.97	-0.21	-0.05	-1.78	-0.02	0.15	-1.80	-0.04	0.12	-1.83	-0.06	0.10
10Y	-2.01	-0.25	-0.21	-1.45	0.31	0.36	-1.80	-0.04	0.01	-1.55	0.21	0.26	-1.58	0.18	0.23	-1.71	0.05	0.09	-1.50	0.26	0.31	-1.63	0.13	0.18	-1.68	0.09	0.13
30Y	-2.12	-0.35	-0.44	-1.21	0.55	0.46	-1.97	-0.20	-0.29	-1.69	0.08	-0.01	-1.67	0.09	0.01	-1.77	0.00	-0.09	-1.31	0.45	0.37	-1.83	-0.06	-0.15	-	-	-

GBP-based	Germany			Belgium			Netherlands			Austria			Finland			Ireland			EU			EIB			KfW		
FX hedge:	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched	None	Rolling	Maturity-matched
2Y	-2.04	-0.04	0.05	-1.84	0.16	0.25	-1.93	0.06	0.16	-1.82	0.18	0.27	-1.85	0.14	0.24	-1.89	0.11	0.21	-1.70	0.30	0.39	-1.83	0.17	0.26	-1.80	0.19	0.29
5Y	-1.98	0.02	-0.13	-1.65	0.34	0.20	-1.81	0.19	0.04	-1.73	0.26	0.12	-1.72	0.28	0.13	-1.81	0.19	0.04	-1.62	0.38	0.23	-1.64	0.36	0.21	-1.66	0.33	0.19
10Y	-2.08	-0.09	-0.37	-1.52	0.48	0.19	-1.87	0.13	-0.16	-1.62	0.38	0.09	-1.65	0.35	0.06	-1.78	0.21	-0.07	-1.57	0.43	0.14	-1.70	0.30	0.01	-1.74	0.25	-0.03
30Y	-2.32	-0.32	-0.61	-1.42	0.58	0.29	-2.17	-0.17	-0.46	-1.89	0.11	-0.18	-1.88	0.12	-0.17	-1.97	0.03	-0.26	-1.51	0.48	0.19	-2.03	-0.03	-0.32	0.00	-	-

Source: J.P. Morgan.
* Yield pick-up defined as foreign currency yield + hedge cost – domestic currency yield, using par govie curves (except Sweden, where we use benchmark bonds).
**Cost of 3M rolling hedge defined as 3M FX cross-currency basis + domestic 3M OIS rate – foreign currency OIS rate.
*** Cost of maturity-matched hedge defined as the maturity-matched FX cross-currency basis + domestic OIS rate – foreign-currency OIS rate.
Levels as of COB 23rd January 2025.

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Figure 12: Current Global Rates trade recommendations

Changes are in bold and underlined

	Duration	Curve	Swap spreads	Swap spread curve	Gamma	Vega	Inflation	Cross-market
Euro area	Long 10Y Germany Receive 1Yx1Y €STR 6Mx1Y A-12/A-50 rec spread vs A+30 payer	Jun25/Jun27 Euribor bull steepeners 10s/30s bull steepener **<u>2s/10s bull flattener via 1M receivers</u>**	Widening bias **<u>Mar25 Bund bull widener</u>**	Bund/Buxl steepener	**<u>Short 3Mx2Y</u>** Sell 1Yx1Y unhedged straddle	Neutral	1Yx1Y/5Yx5Y HICP steepening bias Long 10Y EUR real yields Widening bias on 15Y+ OATei IOTA	Long 10Y Spain vs. Germany Short 9Y Portugal vs. Spain **<u>Short 3Y France vs. Spain</u>** **<u>10s/30s Spain flattener vs. Italy</u>** Long 5Y NRW vs. Germany Long 7Y EU vs. Germany
UK	Rec Feb25 MPC OIS Aug25/Dec25 MPC OIS flattener	**<u>30s/50s gilt curve steepener (UKT Jul54/Oct73)</u>**	MT 10Y swap spread narrower	Neutral	Buy A/A-50 receiver spread vs OTM payer		Neutral	
US	2Y duration longs	5s/10s UST curve flatteners 2Y fwd 5s/10s swap curve flatteners, hedged for short rates and fed expectations 3Y fwd 1s/5s swap curve steepeners vs 110% risk in 2Y fwd 1s/3s flatteners 2s/7s/30s weighted conditional belly cheapening fly	Neutral	5s/10s swap spread curve steepeners 7s/30s swap spread curve steepeners	Long 1Yx5Y Long 1Yx10Y paired w a long duration hedge		5Yx5Y inflation swap shorts	
Japan		2s/10s JGB curve flattener 1y1y vs. 2y1y steepener	10Y swap spread narrower					
Australia / New Zealand	Buyer of dips in the AUD front-end **<u>Rec NZD 1Yx1Y IRS</u>**		Hold NZGB Apr-33 on MMS					Receive NZD-AUD 1Yx1Y IRS at flat Hold NZ-US 2s/10s swap box flattener
Scandinavia	Receive Jun25 SEK FRA	Steepening bias	Neutral	Neutral			Neutral	Pay 2Yx1Y Stibor vs Nibor

Source: J.P. Morgan.

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Figure 13: 2025 trade performance summary

Hit rate* and average P/L** for all trades closed in 2025; bp of yield

		2025					
Region	Sector	#	pos	neg	flat	Hit rate	Avg. P/L
Euro Cash	Overall	2	2	-	-	100%	7
	Duration	-	-	-	-	-	-
	Curve	-	-	-	-	-	-
	Country selection / RV	1	1	-	-	100%	5
	SSA	1	1	-	-	100%	10
	Miscellaneous***	-	-	-	-	-	-
	Inflation	-	-	-	-	-	-
Euro Derivatives (swaps and spreads)	Overall	4	2	-	2	100%	5
	Duration	1	1	-	-	100%	5
	Curve	-	-	-	-	-	-
	Conditional curve / flies	2	-	-	2	-	0
	Swap Spreads	-	-	-	-	-	-
	Miscellaneous	1	1	-	-	100%	14
Euro Derivatives (options)	Overall	1	1	-	-	100%	180
	Options (outright)	1	1	-	-	100%	180
	Options (relative)	-	-	-	-	-	-
	Options (money market)	-	-	-	-	-	-
UK	Overall (ex. options)	-	-	-	-	-	-
	Duration	-	-	-	-	-	-
	Curve	-	-	-	-	-	-
	Swap spreads	-	-	-	-	-	-
	RV	-	-	-	-	-	-
	Conditional curve / flies	-	-	-	-	-	-
	SSA	-	-	-	-	-	-
	Inflation	-	-	-	-	-	-
	Miscellaneous	-	-	-	-	-	-
	Options	-	-	-	-	-	-
Scandinavia	Overall	-	-	-	-	-	-
	Duration	-	-	-	-	-	-
	Curve / Swap Spreads	-	-	-	-	-	-
	Country selection / RV	-	-	-	-	-	-
	Inflation	-	-	-	-	-	-
Japan	Overall (ex. options)	-	-	-	-	-	-
	Duration	-	-	-	-	-	-
	Curve	-	-	-	-	-	-
	Country selection / RV	-	-	-	-	-	-
	Swap Spreads	-	-	-	-	-	-
	FX Basis	-	-	-	-	-	-
	Inflation	-	-	-	-	-	-
	Miscellaneous	-	-	-	-	-	-
	Options	-	-	-	-	-	-
Australia and New Zealand	Overall (ex. options)	3	3	-	-	100%	6
	Duration	-	-	-	-	-	-
	Curve	-	-	-	-	-	-
	Country selection / RV	3	3	-	-	100%	6
	CDS	-	-	-	-	-	-
	Inflation	-	-	-	-	-	-
	Options	-	-	-	-	-	-

Source: J.P. Morgan.
* Hit rate defined as # positive trades / (total # trades - trades closed at flat).
** Avg. P/L across total # trades. Options trades are shown in bp of notional, except for money market trades which are shown in bp of yield and not included in avg P/L calculation.
***Until 2013, category was called CDS
Note: For individual trade performance data, please see Global Fixed Income Markets Weekly: Trade Statistics, Francis Diamond et al.

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Table 1: Highlights from recent publications with hyperlinks

	Recent publications	Date
Previous GFIMs	Global Fixed Income Markets Weekly: Not an easy start to the year	24-Jan
	Global Fixed Income Markets Weekly: Easy does it into year end	13-Dec
Global	Global SSA Jan25 Outlook	20-Jan
	2025 Global government issuance outlook	16-Jan
Europe	Intra-EMU RV update	24-Jan
	Cross currency basis 1Q25 Outlook: Stable bases with modest narrowing from technicals	23-Jan
	Term premia, European curves and UK rates: Stay long 1Yx1Y ESTR and long 10Y bunds, receive Feb25 MPC OIS	10-Jan
	Scandinavia monthly interest rate outlook: Long duration bias but selective cross market longs	09-Jan
	European rates update: Turn bullish on EUR duration but more cautious on GBP duration	07-Jan
	Euro area government issuance update 2025: higher QT flow to more than offset lower net issuance	06-Jan
	2025 Euro area rating analysis	06-Jan
	Global government bond activity chart pack	06-Nov
	European rates post US election	06-Nov
	European Client Survey	06-Nov
	UK budget: Larger tax rises, more investment, more borrowing	30-Oct
	Scandi monthly: External Risks	25-Oct
	2025 Euro area government issuance preview: Supply vs. ECB flow dynamics to modestly deteriorate vs. 2024 due to PEPP QT	07-Oct
	Going green in Europe: A green market dashboard for Euro area sovereigns, the UK and the EU	30-Sep
	Euro area government bonds demand update: Taking stock of early 2024 flows in EGBs	03-Sep
US	2025 Treasury supply outlook: Several means three	15-Nov
	US Rates Strategy post-election update	08-Nov
	Time flies: Reviewing the tenth annual Treasury market conference	26-Sep
	Highlighted Research: US Election Cross-Asset Views	04-Sep
	U.S. Bond Futures Rollover Outlook: September 2024 / December 2024	13-Aug
	Highlighted Research: US Elections Update	24-Jul
	Interest Rate Derivatives: Trading Principal Factor Volatility	10-Jul
Inflation	Monthly Inflation Outlook: Diverging drivers of front end inflation breakevens	16-Oct
	Monthly Inflation Outlook: Trade breakeven curves tactically, EUR real rates look attractive	26-Sep
	Inflation Markets Bitesize Series: SDR inflation swap flows 2Q24 update; HICP and RPI volumes decrease	05-Sep
Japan	JSDA JGB Transactions in November: Net buying by domestic banks continues	20-Dec
	Japan Rates Topics: Japan Flows in Pictures: September 2024	08-Oct
Australia & New Zealand	The Antipodean Strategist: Dragged along for the ride	24-Jan
	The Antipodean Strategist: Close front-end steepeners	17-Oct
2025 Outlooks	Global Fixed Income Markets 2025 Outlook: Exceptionalism and uncertainty driving cross-market divergences	26-Nov
	Global Inflation Outlook 2025: Cross-market divergence in breakevens	29-Nov

Source: J.P. Morgan

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Euro Cash

Focus on intra-EMU RV

- **German yields moved in +/-5bp tight range over the past two weeks with strong January flash PMI fully reversing the modest rally over the prior week**
- **We remain comfortable with our strategic OW duration stance and hold long 10Y Germany**
- **German curve: 2s/10s remains too steep; prefer outright OW duration instead of curve flatteners**
- **Maintain a constructive medium-term outlook on intra-EMU and €-SSA spreads; strong investor demand for record January supply vindicated our OW stance**
- **Hold OW 10Y Spain vs. Germany, OW 7Y EU vs. Germany and OW 5Y NRW vs. Germany**
- **Enter short 3Y France vs. Spain as a low-beta French political uncertainty hedge**
- **Initiate 10s/30s Spain flattener vs. Italy on attractive valuation and on expectation of extension trades in Spain**
- **Hold UW 9Y Portugal vs. Spain given still stretched OT valuations and increasing OT supply pressures in 2025**
- **Politics update in Austria, France, Germany, Ireland and Spain**
- **Supply: around €20bn of conventionals via auctions next week in Germany, the Netherlands and Italy; new 2Y Germany via auction**
- **Potential conventional syndications next week: 10Y and/or existing bond tap Austria (high), 30Y Germany (low), 15Y Italy (low)**

German yields have moved in +/-5bp tight range and are now broadly unchanged since our last publication two weeks ago (**Figure 14**). Cross-market, German yields sharply underperformed US and UK yields over the past two weeks. German yields followed US/UK yields lower with a low-beta post the US/UK inflation downside surprise around mid-January but almost fully reversed that move today after the upside surprise in January flash Euro area PMIs.

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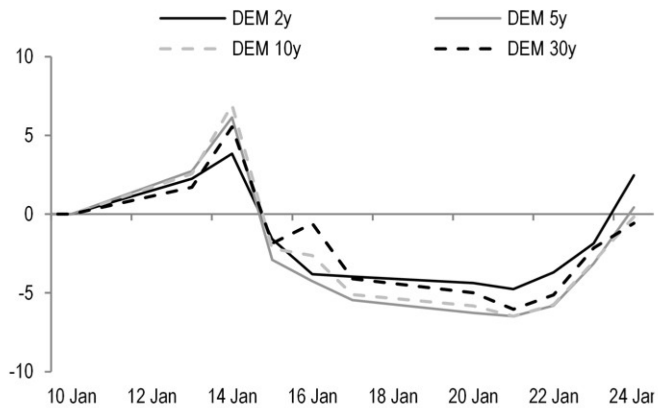
Figure 14: German yields have moved in +/-5bp tight range and are now broadly unchanged since our last publication two weeks ago

Cumulative change in German benchmark yields since 10 January 2025; bp



Source: J.P. Morgan

The focus now shifts to the ECB meeting on Thursday next week and we do not expect any significant surprises. As discussed by our economist in the *ECB preview*, the ECB is very likely to cut rates by 25bp to 2.75%. In terms of communication, we expect the ECB to stick to its guidance of data dependence, a meeting-by-meeting approach and no pre-commitment on the exact rate path. This will not prevent Lagarde from saying that the current baseline implies further cuts. But, this guidance will be non-committal and simply indicate broad direction on policy rates rather than clear visibility on the end point. Our economist continues to see a modestly accommodative terminal rate of 1.75% vs. current pricing of terminal above 2.10%.

As discussed in *Germany: Party programmes do not signal huge changes*, G, Fuzesi, 10 Jan, ahead of the Bundestag election on 23 February, polls continue to show the centre-right CDU/CSU leading at around 30%, followed by the right-wing AfD at ~20%, while centre-left SPD and the Greens are both around 15%. Centre-right FDP and Left Party would currently fall short of the 5% hurdle for the parliament, while polling for left-wing BSW has slipped towards 5%. As the CDU/CSU has currently ruled out any co-operation with right-wing AfD, and the political distance with the BSW is wide, only the centrist parties are left as potential partners. For now, a CDU/CSU coalition with the SPD or the Greens still looks most likely, but we see some chances of FDP joining a coalition with CDU/CSU and either SPD or Greens if it clears the 5% hurdle. Overall, party programmes look to address similar issues and do not largely deviate from recent policies. Given the high commitment in Germany towards sustainable public finances, absent a large economic shock we remain somewhat skeptical about large easing in German fiscal policy under a new government.

We remain comfortable with our strategic OW duration stance and hold long 10Y Germany. Despite the recent improvement in PMIs, Euro area growth (currently tracking 0.8%ar) still remains below potential (~1%ar) and also below ECB staff projections (1.2%ar for 1Q), and also the broad Euro area disinflation journey remains intact. We believe that risks are skewed to the dovish side as current pricing of terminal rate of slightly above 2.10% does not fully incorporate downside growth risks for the Euro area economy. The ECB is expected to take policy rates down to at least 2% whilst trade war/tariff uncertainty from US Trump policy remains a downside risk to Euro area growth and biases risks towards even lower depo rates (below neutral).

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The German curve is modestly flatter across 2-30Y over the past two weeks. **German curves in 2-10Y segment are still screening excessively steep in our fair value framework** (**Figure 15**). As discussed in our *2025 Outlook*, increased US or UK term premia pricing should have a limited immediate direct impact on Euro area term premia expectations, especially given ongoing gradual fiscal tightening expected across the region. Also, as discussed above we remain somewhat skeptical about a large easing in German fiscal policy under a new government. We, therefore, find the recent term premium repricing in German yields, in sympathy to the term premia linked steepening of US/UK curves, quite excessive and expect the cheapness to fully correct going forward. Interestingly the 2s/10s German curve modestly flattened in a bullish duration move, broadly in line with our view that near-term the 2s/10s German curve will likely bull flatten initially in order to correct excessive term premia pricing.

Figure 15: German curve segments with longer-leg in intermediate sector (5-10Y) are now screening excessively steep in our fair value framework but we prefer outright longs in 10Y

Statistics for various German curves over the last 3 years, 3M carry and slide on curve steepeners and statistics from 1-year regressions on 1Yx1Y €STR rate (%), ECB balance sheet as % of GDP; bp unless otherwise indicated

							Partial betas				
Curve	Last	Min	Max	Avg	%	R^2	1Yx1Y €STR (bp/%)	ECB Balance sheet (bp/1% GDP chg.)	Residual	3M C+S	Net mispricing*
2s/5s	11	-66	57	-14	73	89%	-20.9	-8.09	15.4	-7.4	-22.8
2s/10s	36	-79	88	-2	75	90%	-41.8	-9.63	22.7	-10.1	-32.8
2s/15s	56	-72	112	14	76	92%	-47.9	-10.17	21.3	-9.3	-30.6
2s/30s	56	-85	117	10	77	93%	-52.1	-10.45	21.5	-9.3	-30.8
5s/10s	25	-16	42	11	83	89%	-20.9	-1.53	7.4	-2.6	-10.0
5s/15s	45	-12	68	27	86	92%	-27.0	-2.07	5.9	-1.9	-7.8
5s/30s	45	-29	73	23	83	91%	-31.2	-2.36	6.1	-1.9	-8.0
10s/15s	20	1	27	16	72	69%	-6.1	-0.54	-1.5	0.8	2.2
10s/30s	21	-26	35	12	77	71%	-10.3	-0.83	-1.2	0.8	2.0

Note: We show 3M carry and slide on steepeners. Also a positive residual implies that the curve is too steep. Level as of 23 January 2025 COB.
* Net mispricing is shown for a steepening exposure and indicates expected P&L if residual corrects fully and carry is realized, all else equal. We take 3M carry and slide on steepeners and subtract the residual (as a positive residual implies that the curve is too steep)
Source: J.P. Morgan

Intra-EMU spreads

Intra-EMU spreads have broadly tightened across the board since our last publication two weeks ago, with Italian and French spreads tightening the most (**Figure 16**). The spread tightening over the past two weeks was quite impressive as it took place despite record issuance hitting the market and with ongoing yield volatility/choppiness. The strong investor demand witnessed at YTD syndications and intra-EMU spread tightening YTD has vindicated our view that heavy January supply will be well digested by the market.

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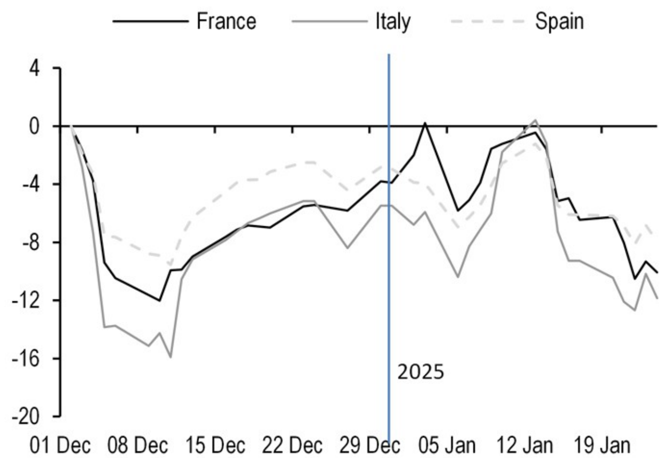
Figure 16: Intra-EMU spreads broadly tightened across the board over the past two weeks despite ongoing heavy supply

Evolution of selected 10Y spread vs. Germany since 1 December 2024; bp



Source: J.P. Morgan

Given the strong supply/demand backdrop, we remain comfortable with our constructive outlook on intra-EMU and €-SSA spreads. With full PEPP QT already started and expectation of ECB delivering a message of ongoing gradual easing, **we expect the ECB meeting next week to be uneventful and supportive for carry trading in intra-EMU/ €-SSA space**.

On *supply side*, Euro area DMOs started the year on a strong note, as expected, with record EGB issuance hitting markets in the first three weeks of a year (**Figure 17**). Euro area sovereigns have already raised around €136bn via conventional issuance in the first three full weeks of the year and we believe they are on track to issue close to the record €175bn they issued in January 2024. Anecdotal evidence suggests that YTD EGB syndications have registered strong investor demand and also syndicated bonds have on average performed well on curves post issuance. Also the broad strong intra-EMU market performance despite record issuance highlight strong investor appetite for EGBs, broadly in-line with our expectations (see *Euro area government bond demand 2025 outlook*).

On positioning, as per our latest client *survey*, 23 January, European real money investors maintained broadly unchanged their current OW exposure, which continues to remain close to the highest levels since early-2022 (just before the beginning of the ECB's tightening cycle) but still well below the OW exposure witnessed during the PEPP period (**Figure 18**).

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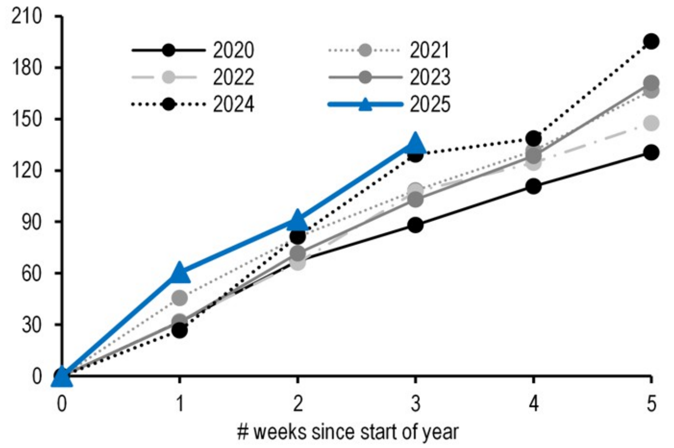
Figure 17: Euro area DMOs started the year on a strong note with record EGB issuance hitting markets in the first three full weeks of a year

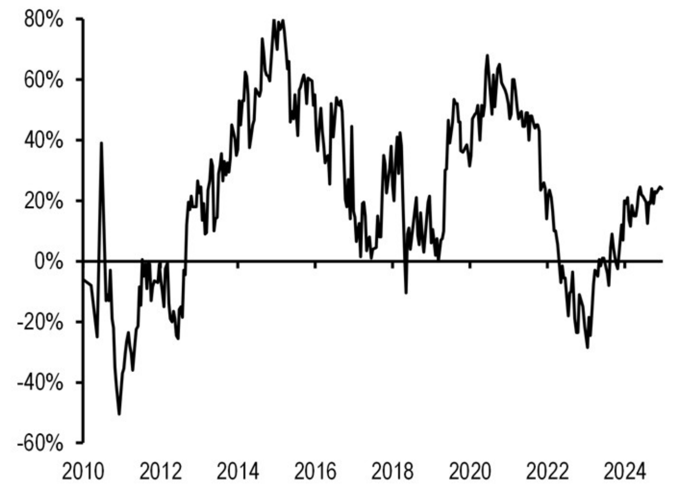
Cumulate EGB conventional issuance since the beginning of a year; €bn



Source: J.P. Morgan

Figure 18: European investors OW exposure remains close to the highest levels since early 2022, but is still well below the OW exposure witnessed during the PEPP period

Net exposure of Euro area investors to peripherals vs. core, %



Source: J.P. Morgan European Client Survey, 23 January

On politics, in *France*, as discussed in *France: the 2025 budget and debt challenges*, R. Brun-Aguerre & R. Balakrishnan, 17 January, the political situation remains fluid, with PM Bayrou surviving a confidence vote last week, and the government will target a deficit of 5.4% of GDP this year, higher than the Barnier's government target of 5.0%, and is still aiming for a 3% deficit in 2029. The higher deficit objective is due to the costly measures proposed by the opposition parties (RN and left-wing NFP coalition) which would need adopted by the Bayrou government for its survival. The Socialist party (centre-left) did not vote in favour of the motion of no confidence triggered by left-wing MPs, as Bayrou conceded on various measures the Socialist party wanted. This increases the odds that the 2025 budget will pass in the coming weeks, but political uncertainty remains high, with debates on the pension reform likely to be key for the government survival in the coming months. The risk of slippage relative to 5.4% is significant, and a potential new lower house election this year (the earliest Macron can call an election is in the summer) would add risks to the current governments' fiscal consolidation plans. Overall, **we maintain our cautious stance on France given our expectation that France will remain in a heightened state of political uncertainty over the coming months. In addition, no risk of a government shutdown and our still broadly constructive outlook for Euro rates outside France should help limit any material widening of French spreads on ongoing political noise**.

In *Austria*, right-wing FPÖ leader Kickl announced last week that an agreement has been reached with centre-right ÖVP on the federal budget, aiming to bring the country's 2025 projected deficit below 3% of GDP. In response to the fiscal consolidation plan, the European Commission confirmed at this stage it won't proceed with a proposal to open an Excessive Debt Procedure (EDP) for Austria. Although government negotiations might still take some time with no guarantee of success, the preliminary budget agreement marks a first step towards a possible FPO-ÖVP coalition. As things stands, such a coalition would be able to count on 108 seats (as a reminder, 92 seats are required to hold a majority at the parliament). An alternative scenario could see a snap election in the event the parties are unable to reach an agreement. FPÖ further increased in the polls since the elections, and currently stands at around 37%, up 10% vs. late September results (**Figure 19**), while ÖVP declined ~6%

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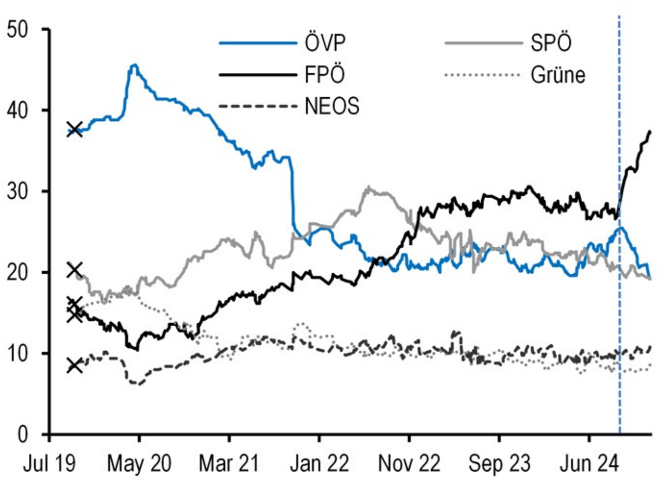
to around 19%, polling close to centre-left party SPÖ. **Overall, given the constructive fiscal stance taken by both FPÖ and OVP, and the need for the parties to converge towards a common agenda, we do not expect large policy divergences/surprises in the final coalition agreement, which should limit the magnitude of any political discount to be priced in Austrian markets**.

In *Ireland*, following the results of the general elections which took place on 29 November 2024, political parties Fianna Fáil (centre-right) and Fine Gael (centre-right), both part of the outgoing government coalition, reached an agreement to form a government coalition, together with a group of independent MPs. Micheál Martin, leader of Fianna Fáil , has been appointed as new Irish PM on Thursday with a total of 95 votes (88 seats are required for ensure majority). Overall, the presence of different parties in the coalition required to maintain a common agenda should limit any material political discount to be priced in Irish markets.

In *Spain*, as discussed in *Spain:New year, old political stalemates*, M. Monteiro, 16 Jan, despite the struggles faced by the minority government coalition led by PSOE (centre-left) and Sumar (left-wing), we believe the current administration is likely to remain in power for another year, with PM Sánchez (PSOE) insisting on staying in office until 2027. However, risks of a snap election in 2025 cannot be fully ruled out: looking at most recent polls, in the event of early elections, PP (centre-right) would most likely win most votes (currently polling at around ~33%), but would still fall short of an absolute majority (**Figure 20**). Post a snap-election we see potential for a PP-led government alongside Vox, if the two parties reconcile their differences on immigration. Overall, political instability is likely to persist in the near term. However, **we remain of the view that the Spanish economy will keep outperforming peers despite the ongoing political noise with limited risks to fiscal stability**.

Figure 19: Since elections took place in late September 2024, FPÖ further increased in the polls, while ÖVP support in the polls has declined

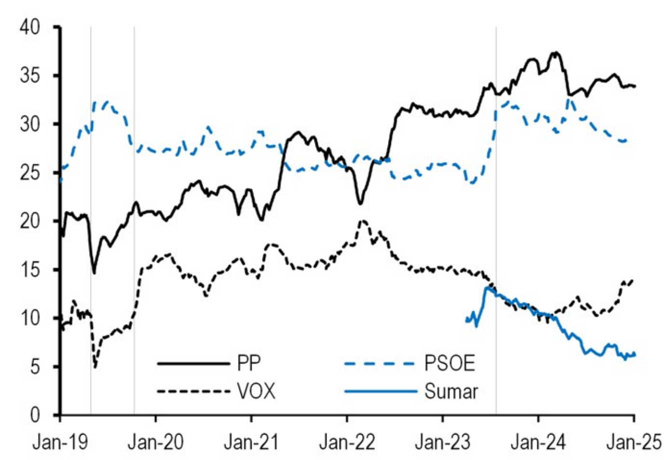
Austria polls since last elections in late September 2019; 5 polls moving average; %



Note: Blue dotted line representing 29 September 2024 general election results
Source: J.P.Morgan, *Wikipedia*

Figure 20: Most recent polls shows PP, in the event of early elections, would most likely win most votes, but would still fall short of an absolute majority

Spain national parliament polls since early January 2019; % vote share



Note: Vertical grey lines representing election dates
Source: Politico, J.P.Morgan

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Intra-EMU trading themes

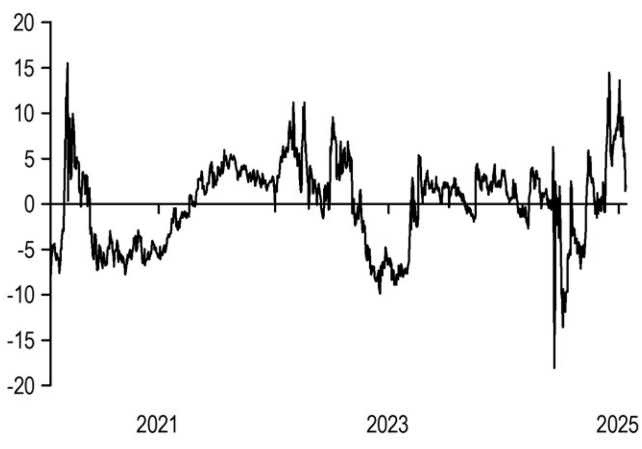
We hold OW 10Y Spain vs. Germany, OW 7Y EU vs. Germany and OW 5Y NRW vs. Germany as expressions of our strategic medium-term OW stance. We keep short 9Y Portugal vs. Spain given stretched valuations. Also, this week we added UW 3Y France vs. Spain and 10s/30s Spain flattener vs. Italy.

French spreads tightened sharply over the past two weeks given near-term constructive political developments and overall strong performance of intra-EMU spreads over the period. The recent tightening has almost fully corrected the cheapness of French spreads on our fair value model (**Figure 21**). In our view the cheapness reflected the political risk premia, which has now been fully removed.

As discussed in recent publications, we maintain a cautious stance on French spreads on expectation of ongoing political uncertainty with risks of some near-term potential noise coming from the current 2025 budget discussions. Therefore, given the limited political risk premia priced in French spreads we find it prudent to add low-beta political uncertainty hedge and recommend **entering tactical shorts in 3Y France vs. Spain**. On the French credit curve, the short-end outperformed sharply during the recent tightening move and we now find 3s/10s (3s/5s) credit curves vs. Germany trading excessively steep (**Figure 22**).The recent strong relative performance of short-end France has pushed 3Y France-Germany spread level (around 2-3bp) close to the lower-end of its range since the French snap election announcement last summer (-1bp to 10bp) (**Figure 23**). We, therefore, find short in 3Y France-Spain spread level attractive low-beta UW France proxy. The trade has modest negative carry (3M carry: -0.5bp).

Figure 21: The recent tightening has almost fully corrected the cheapness of French spreads on our fair value model

Residual from regressing 10Y France spread vs. Germany against 10Y wtd. peripheral spread vs. Germany (X1), 10Y Germany yield (X2) and 2024 France election dummy* (X3); past 5Y; bp

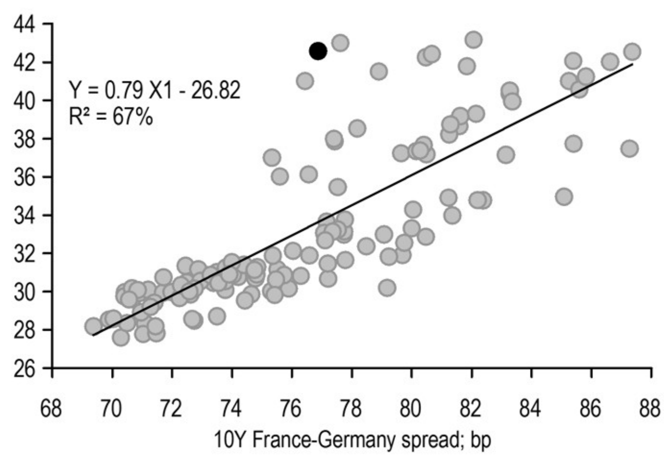


* Y = 0.18*X1 + 5.17*X2 + 29.1*X3 + 13.9; R-squared: 91%. The France 2024 election dummy variable is defined as 1 since 10 June 2024 and 0 before that as Macron called snap parliamentary elections on Sunday 9 June 2024

Source: J.P. Morgan

Figure 22: The 3s/10s French credit curves are trading excessively steep

3s/10s France-Germany box against 10Y France yield; bond specific; past 6M; bp



Source: J.P. Morgan

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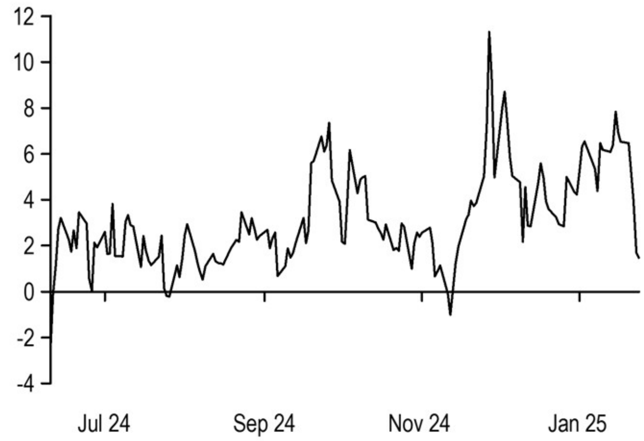
Figure 23: The recent strong relative outperformance has pushed 3Y France-Germany spread current level close to the lower-end of the their range since the French snap election call last summer: enter UW 3Y France vs. Spain

OAT Sep27 vs. Bono Oct27 yield; bp

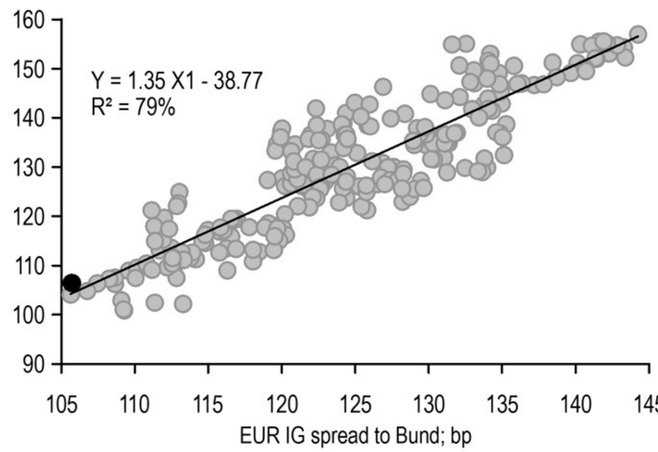


Source: J.P. Morgan

Italian spreads are still screening close to fair vs. other credit spreads as recent spread Italian tightening came along with broader credit tightening (**Figure 24**). We stay neutral on Italy and expect Italian spreads to be driven mainly by external risk-on/risk-off factors given lack of idiosyncratic domestic drivers. On the Italian credit curve, we find the intermediate sector modestly cheap and 3s/10s credit curve broadly fair vs. level of spreads. Further out, the 10s/30s box vs. Germany is still screening modestly flat vs. level of 10Y spreads (**Figure 25**). Also on supply front, we see high chance of the next Italy syndicate, possibly early February, to be in 10Y+ sector (likely 15Y). **We, therefore, maintain a 10s/30s Italy-Germany steepening bias given modestly flat valuations and potential supply pressures**.

Figure 24: Italian spreads are still screening close to fair vs. other credit spreads

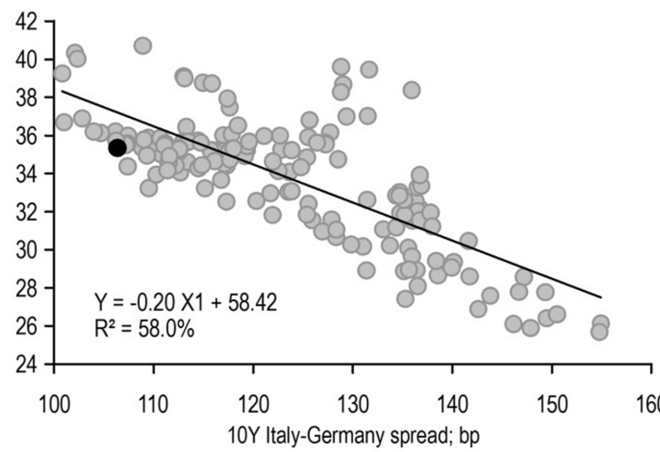
10Y Italy-Germany spread regressed against EUR IG spreads to Germany; par rates used; past 12M; bp



Source: J.P. Morgan

Figure 25: The 10s/30s Italy-Germany box is still screening modestly too flat vs. level of 10Y spreads

10s/30s Italy-Germany box regressed against 10Y Italy-Germany spread; past 6M; bp



Source: J.P. Morgan

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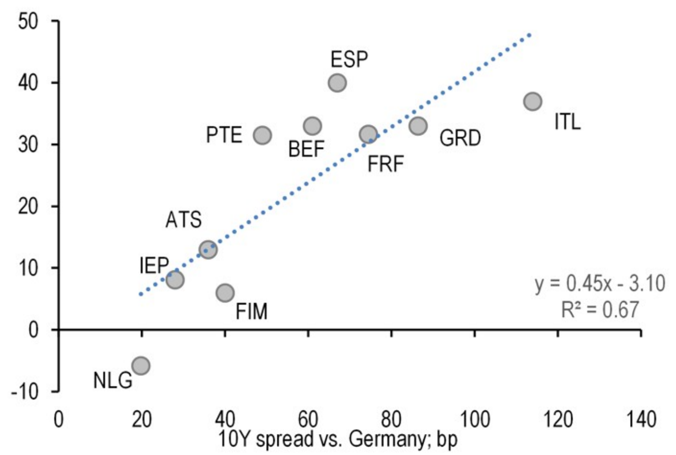
Spain remains our favourite pick for OW carry exposure in intra-EMU given strong fundamentals and limited political/fiscal noise compared to larger peers. **We hold long 10Y Spain vs. Germany (Bono Oct34 vs. Bund Aug34) as our benchmark OW**. On the credit curve, we note that Spanish (also Portuguese) 10s/30s boxes vs. Germany are trading excessively steep vs. their peers (**Figure 26**). Given our constructive spread outlook on Spain and expectation of search for carry environment could lead to investors extending down these steep credit curves. Therefore, we have a strategic flattening bias on 10s/30s Spain credit curve vs. Germany and vs. Italy.

We recommend entering 10s/30s Spain flattener vs. Italy (Bono Oct34/Oct54 flattener vs. BTP Feb35/Oct54). The 10s/30s Spain-Italy box has been negatively directional with level of 10Y Spain-Italy spread and is also trading modestly too steep (**Figure 27**). The box trade has modest positive carry (3M carry +0.7bp). On the supply side, we expect both Italy and Spain to syndicate a 10Y+ benchmark in coming weeks (likely 15Y in both jurisdictions), so expect limited impact on the box given offsetting pressures.

Figure 26: Spanish 10s/30s credit curve is trading excessively steep vs. their peers

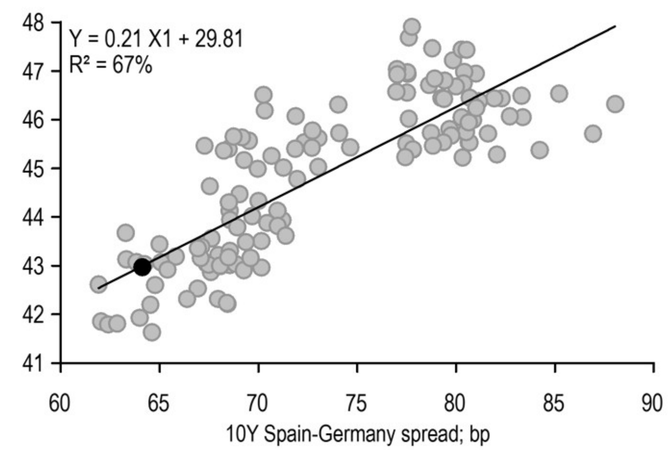
10s/30s box vs. Germany regressed against 10Y spread vs. Germany for selected Euro area sovereigns; bp



Source: J.P. Morgan

Figure 27: The 10s/30s Spanish credit curve has been positively directional with the level of 10Y spreads and is trading close to fair now

10s/30s Spain-Germany box regressed against 10Y Spain-Germany spread; bond specific; past 6M; bp



Source: J.P. Morgan

In Portugal, we still like UW 9Y vs. Spain (OT Oct34 vs. Bono Oct34) given still stretched OT valuations and increasing OT supply pressures in 2025. Portuguese bonds have been gradually underperforming vs. Spain over the past two weeks (**Figure 28**).

Core ex France spreads also tightened over the past two weeks, with the exception of Ireland where spreads modestly widened likely on increasing noise around potential Trump administration tax policy announcements. After the recent move we find core-ex France spreads are trading 2-3bp too tight on our fair value model (**Figure 29**). Netherlands remain our favorite carry pick in core ex France space.

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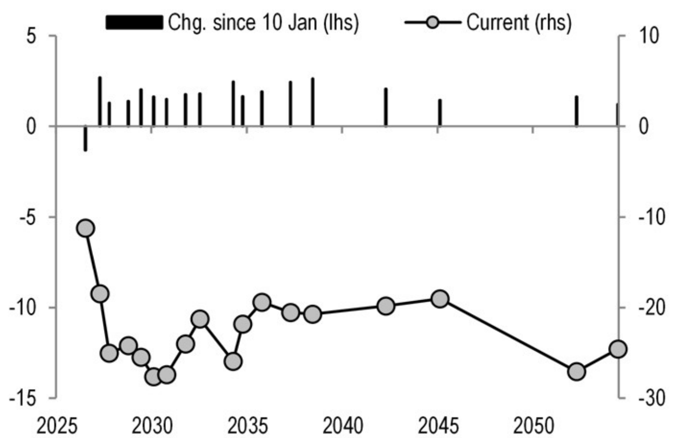
Figure 28: Portuguese bonds have been gradually underperforming vs. Spain over the past two weeks stay UW 9Y Portugal vs. Spain

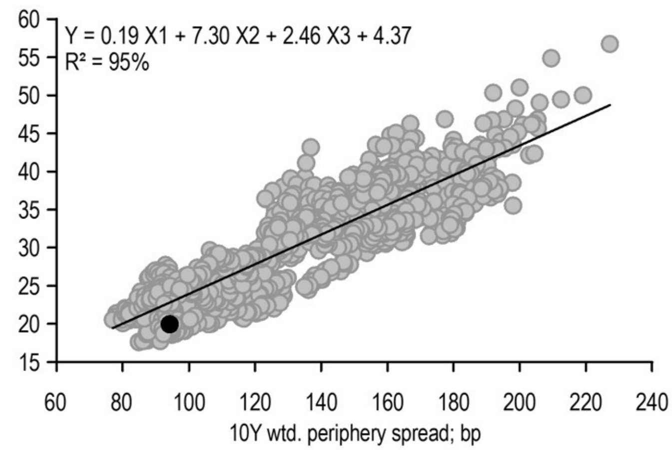
Portuguese bonds vs. interpolated Spanish z-spread curve; bp



Source: J.P. Morgan

Figure 29: Core-ex France spreads are trading 2-3bp too tight on our fair value model

10Y wtd. core spread vs. Germany regressed against 10Y wtd. peripheral spread vs. Germany (X1), 10Y Germany yield (X2) and 2024 France election dummy* (X3); past 5Y; bp



* The France 2024 election dummy variable is defined as 1 since 10 June 2024 and 0 before that as Macron called snap parliamentary elections on Sunday 9 June 2024
Source: J.P. Morgan

Irish bonds were the relative underperformer in intra-EMU space over the recent sessions, likely on increasing noise around Trump administration tax policy announcements. As we highlighted in our *2025 Outlook*, Irish spreads could show modest knee-jerk widening on any US trade/tax policy announcements. However, the devil will be in the details of any announcements and we see a strong chance that any such widening move will eventually reverse given a probable lack of substance and also given the strong Irish fiscal picture (primary balances, debt/GNI below 70% and cash balance of around €30bn).

In Austria, as discussed above the political developments have been constructive and supportive for a broadly positive medium term stance. On the Austrian credit curve, the 3s/10s box vs. Germany has corrected the excessive flatness we highlighted two weeks back (**Figure 30**). We see high chances of Austria launching a new 10Y benchmark along with potentially a tap of an existing bond via a joint syndication over the coming weeks and hence see room for further pressure on the 10Y sector until a syndication announcement.

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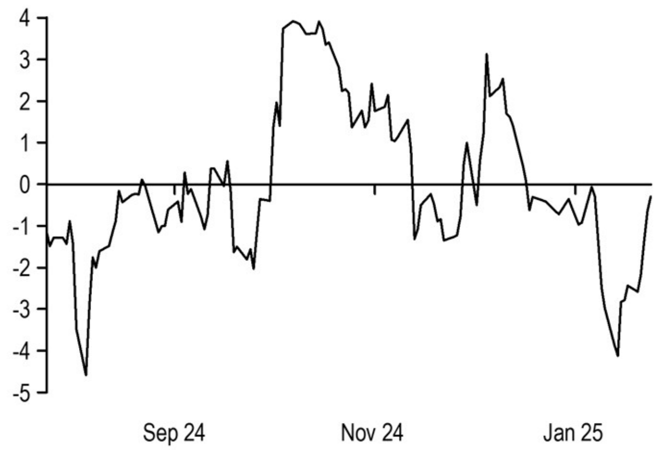
Figure 30: The 3s/10s Austria vs. Germany box has corrected the excessive flatness we highlighted two weeks ago

Residual from regressing 3s/10s Austria-Germany box against 10Y Austria-Germany spread*; bond specific; past 6M; bp



* 3s/10s = 0.99*10Y – 20.2; R-squared: 88%
Source: J.P. Morgan

We also published our latest *SSA Outlook* on 20 January. Key highlights are:

- **Over 2025, we remain broadly constructive on €-SSA** on attractive valuations, ongoing ECB easing supporting carry dynamics and expectation of ongoing demand offsetting supply/QT pressures.
- **We remain constructive on EU** valuations which we expect will gradually move towards Austria/Finland and eventually settle somewhere between Austria/Finland and the Netherlands, especially in sectors up to 10Y.
- **We entered OW 7Y EU vs. Germany (Figure 31) and 5Y NRW vs. Germany (Figure 32), and we also took profit on OW 5Y KfW vs. Germany**. We continue to remain cautious on French agencies, and remain constructive on Dutch agencies.
- On EU credit curves, intermediate sector looks attractive for OW. We have a 3s/10s and modest 10s/30s EU credit curve flattening bias.
- Looking at the NGEU supply cycle, we highlight a **strong richening dynamic around syndications, and decent cheapening dynamics going into auctions**.
- **On supply, we expect record issuance, modestly higher vs. 2024**, mainly due to ongoing heavy EU issuance. Our target for EU gross issuance is around €150-160bn vs. €138bn in 2024, and we expect 2025 EU net issuance to still decline vs. 2024 due to higher redemptions. 1H25 EU issuance expected to be ~€90bn.

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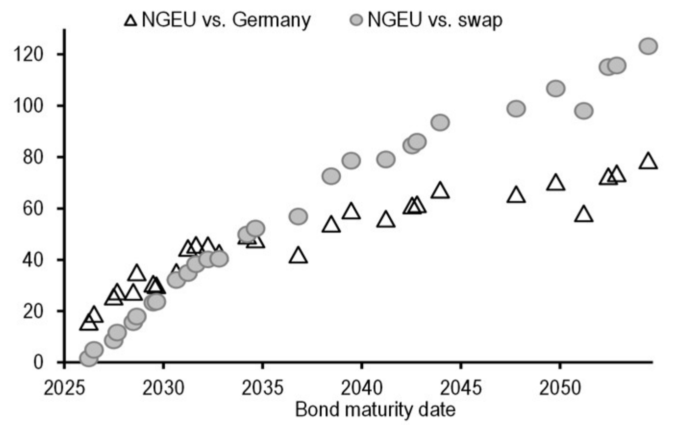
Figure 31: EU bonds trading ~40-50bp pick-up vs. Germany/swaps in 5-10Y sector are quite attractive

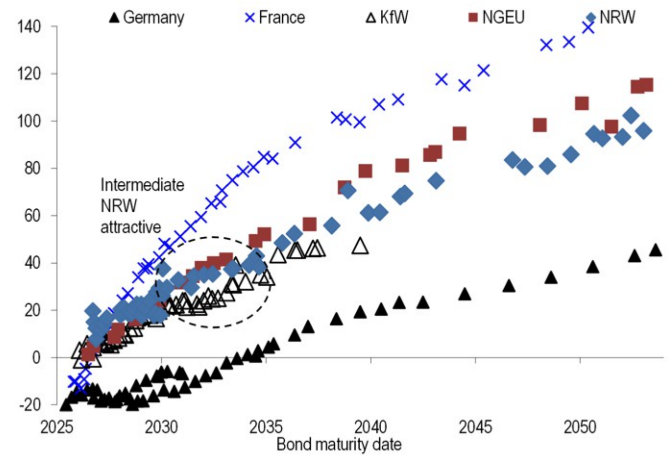
NGEU bonds vs. interpolated German and swap curves; bp



Source: J.P. Morgan

Figure 32: German regional (mainly) and agency bonds in intermediate sectors trading at 25bp+ pick-up over Germany are still attractive carry opportunities

Germany, France, EU, KfW and NRW ASW curves; bp



Source: J.P. Morgan

Issuance

We expect around €20bn of conventional bond supply next week (Figure 33), plus potential syndications. Conventional auctions are scheduled in Germany, the Netherlands and Italy (**Figure 34**).

The majority of syndications take place during the first quarter of the year, and in January in particular. **Figure 35** shows the list of syndications that took place in 1Q over the past few years and our expectations for 1Q25. So far, in the Eurozone, Belgium (new 10Y, €7.0bn), Finland (new 20Y, €3.0bn), France (new 15Y, €10.0bn), Greece (new 10Y, €4.0bn), Ireland (new 30Y, €3.0bn), Italy (new 10Y, €13.0bn and new 20Y green bond, €5.0bn), Portugal (new 10Y, €4.0bn) and Spain (new 10Y, €15.0bn) already came to the market with a syndicate in 2025. **Potential conventional syndications next week: 10Y and/or existing bond tap Austria (high), 30Y Germany (low), 15Y Italy (low)**.

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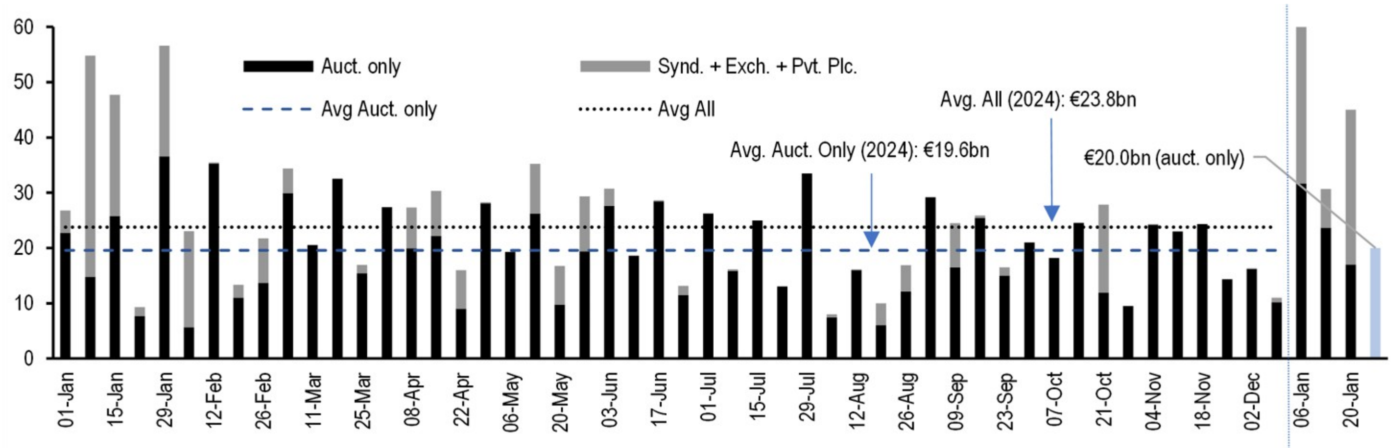
Figure 33: We expect around €20bn of conventional bond supply next week, plus potential syndications

Total Euro area conventional bond issuance weekly volume on trade date basis; black indicating total conventionals issued only via auctions; grey indicating conventionals issued via syndicate, exchanges and private placements; light blue indicating next week expected issuance volume (auction only); weekly basis since early 2024; €bn



Source: J.P. Morgan

Figure 34: Conventional auctions next week are scheduled in Germany, the Netherlands and Italy

Euro area conventional bond issuance calendar for the next two weeks; official announcements and J.P. Morgan forecast; peripheral supply highlighted in grey, green bonds are marked in green; €bn

		Issuer	Short	Medium	Long	Ultralong
	Jan	Austria		10Y and existing RAGB or green taps (synd.)		
	1Q	Italy				15Y synd.
	1Q	Germany				30Y synd.
Tue	28-Jan	Germany	Mar27 5.0			
Tue	28-Jan	Netherlands		Jan30 2.5		
Wed	29-Jan	Germany			Feb35 4.5	
Thu	30-Jan	Italy		4.0	3.5	
Tue	04-Feb	Austria			1.0	1.0
Thu	06-Feb	France			6.5	5.5
Thu	06-Feb	Finland		ORI (TBC)		
Thu	06-Feb	Spain	2.5	2.0		1.5
Fri	07-Feb	Belgium		ORI (TBC)		

Source: Debt Management Offices, J.P. Morgasnn

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Figure 35: 1Q is typically heavy in terms of syndicated deals

List of 1Q conventional syndicated deals by country; JPM forecasts for 1Q25 in *Italics*;

	1Q25	1Q24	1Q23	1Q22	1Q21
Austria	*10Y and existing RAGB or green tap in Jan*	5Y green tap & 10Y & 25Y green tap in Jan	10Y in Jan	7Y & 20Y tap & 50Y tap in Jan, 10Y in Mar	10Y in Jan
Belgium	10Y in Jan, *30Y in Feb*	10Y in Jan, 30Y in Feb	10Y in Jan, 30Y in Feb	10Y in Jan, 30Y in Feb	10Y in Jan, 50Y in Feb
Finland	20Y in Jan	30Y in Jan	15Y in Jan	20Y in Jan	30Y in Feb
France	15Y in Jan, *green 2049 tap in late 1Q/2Q*	25Y green in Jan, 30Y in Feb	30Y in Feb	-	50Y in Jan, 20Y Green in Mar
Germany	*30Y in 1Q*	30Y in Jan, 30Y tap in Mar	30Y tap in Feb	30Y tap in Mar	-
Greece	10Y in Jan	10Y in Jan	10Y in Jan, 5Y in Mar	10Y in Jan	10Y in Jan, 30Y in Mar
Ireland	30Y in Jan	10Y in Jan	20Y green in Jan	10Y in Jan	10Y in Jan
Italy	10Y and 20Y new green in Jan, *15Y over rest of 1Q*	7Y & 15Y & 30Y tap in Jan	20Y in Jan, 30Y in Feb	30Y in Jan	15Y in Jan, 10Y in Feb, 25Y Green in Mar
Netherlands	*10Y in Mar*	10Y in Feb	10Y in Feb	10Y in Feb	10Y in Feb
Portugal	10Y in Jan, *15Y late 1Q/2Q*	10Y in Jan	15Y in Jan	20Y in Jan	30Y in Feb
Spain	10Y in Jan, *15Y in Feb*	10Y in Jan, 30Y in Feb	10Y in Jan, 15Y in Feb	10Y in Jan, 30Y in Feb	10Y in Jan, 50Y in Feb

Source: DMOs, J.P. Morgan

New Schatz Mar27: expected to price at a benchmark discount of around 5-6bp

All new 2Y benchmarks issued since early 2012 have been priced at a discount relative to surrounding Bunds modestly higher than the benchmark discount of the old 2Y benchmark on the day before the auction (**Figure 36**). We expect the new Schatz Mar27 to follow this historical pattern and price at a benchmark discount of around 5-6bp on the German curve, modestly higher than the current 2Y benchmark of around 4.6bp.

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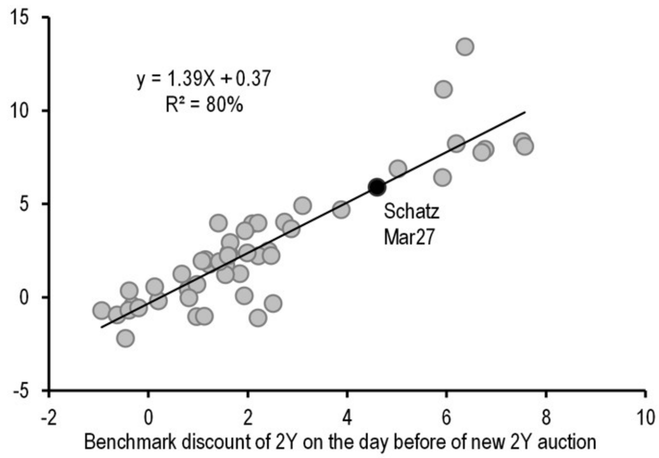
Figure 36: We expect the new Schatz Mar27 to price at a discount of around 5-6bp, modestly higher than the current level of 2Y benchmark discount

Benchmark discount* on new 2Y Schatz on the day auction regressed against benchmark discount on off-the-run 2Y Schatz the day before the auction; bp



* Benchmark discount is calculated as the difference between 2Y benchmark (Schatz) yield and interpolated yield calculated using surrounding Bunds
Source: J.P. Morgan

DSL Jan30: fair

The 7Y benchmark is currently trading with a benchmark discount of around 1.3bp on the Dutch curve relative to surrounding DSLs, broadly in line with the past 6M average 7Y benchmark discount (~1.6bp), broadly fair in our view.

Bund Feb35: dear

This will be the first tap of the recently issued new 10Y benchmark, which is currently trading with a benchmark roll (z-spread pick-up over the off-the-run Aug34) of 1.7bp, close to the lower-end of the past 12M benchmark roll trading range. The 10Y German benchmark roll has shown modest negative directionality to 5s/30s German swap spread curve over long history and the Bund Feb35 benchmark roll is dear based on that relationship (**Figure 37**).

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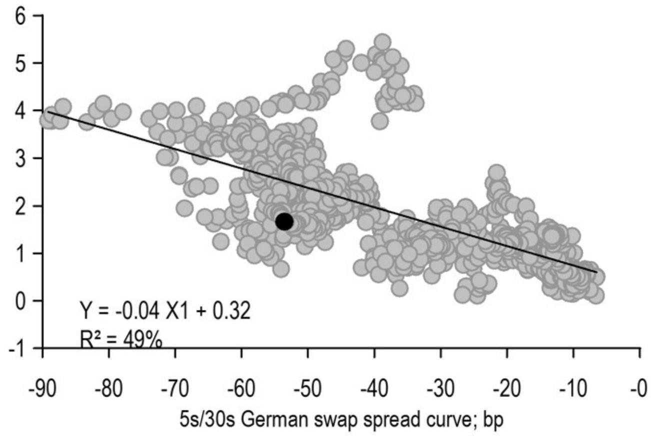
Figure 37: 10Y German benchmark-roll has shown modest negative directionality to 5s/30s German swap spread curve over long history and is now trading on the expensive side

10Y German benchmark roll (z-spread pick-up over off-the-run) regressed against 5s/30s Germany swap spread curve; past 5Y; bp



Source: J.P. Morgan

Italy auctions

On Thursday 30 January, we expect Italy to auction around €7-8bn of BTPs. They will tap of the 5Y benchmark (BTP Oct29). Given the recent syndicate of the new 10Y benchmark (BTP Aug35), we see decent chances of Italy tapping an off-the-run 10Y at this auction. The official announcement will be made on Monday evening, 27 January. The BTP Oct29 is currently trading with a benchmark discount of around 5.9bp relative to surrounding bonds, above the average benchmark discount observed since bond was first issued in late August 2024, and is cheap in our view.

Trade recommendations*

New trades

- **Enter short 3Y France vs. Spain**
  Enter short €25.0mn OAT Sep27 vs. long €24.5mn Bono Oct27 @ 2.5bp. 3M carry: -0.5bp and 3M slide: 0.5bp.
- **Enter 10s/30s Spain flattener vs. Italy**
  Enter long €25.0mn Bono Oct54 vs. short €53.1mn Bono Oct34 and short €27.1mn BTP Oct54 vs. long €54.0mn BTP Feb35 @ 0.5bp. 3M carry: 0.7bp and 3M slide: 0bp.

German trades

- **Keep long 10Y Germany**
  Keep long €50.0mn Bund Aug34 @ 2.55%; 3M carry: -1.1bp; 3M slide: 1.7bp; P&L since inception (07 Jan 2025): -10.1bp.

Country selection & RV trades

- **Keep long 10Y Spain vs. Germany**
  Keep long €50.0mn Bono Oct34 vs. short €46.9mn Bund Aug34 @ 64.7bp; 3M carry: 2.0bp; 3M slide: 0.4bp; P&L since inception (06 Jan 2025): 2.4bp.

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- **Keep short 9Y Portugal vs. Spain**
  Keep short €50.0mn OT Oct34 vs. long €49.7mn Bono Oct34 @ -22.0bp. 3M carry: 0.7bp and 3M slide: -0.6bp; P&L since inception (15 Nov 2024): 4.0bp.

SSA trades

- **Keep long 5Y NRW vs. Germany**
  Keep long €25.0mn NRW Jan30 vs. short €23.6 Bobl Apr30 @ 30.0bp, 3M carry: 2.0bp and 3M slide: 0bp. P&L since inception (20 Jan 2025): -0.5bp.
- **Keep long 7Y EU vs. Germany**
  Keep long €25mn EU Dec31 vs. short €27.7 Bund Aug31 @ 46.9bp, 3M carry: 1.7bp and 3M slide: 0.5bp. P&L since inception (20 Jan 2025): -0.4bp.

*Unless specified, all trades are priced as of 1PM on non-payroll Fridays and 2PM on payroll Fridays.

Trades closed over the past 12 months

TRADE	ENTRY	EXIT	P&L
DURATION			
Long 5Y Germany	21-Jul-23	19-Apr-24	-14.0
Long 5Y Germany	31-May-24	06-Jun-24	12.5
Long 5Y Germany	01-Jul-24	01-Aug-24	31.3
Long 2Y Germany	04-Oct-24	12-Dec-24	5.2
CURVE			
10s/15s Germany curve steepener	01-Mar-24	12-Jul-24	0.3
COUNTRY SELECTION/RELATIVE VALUE			
Long 10Y France vs. Germany	23-Jun-23	19-Jan-24	5.5
Long 10Y Belgium vs. France	01-Sep-23	19-Jan-24	2.2
10s/30s Italy flattener vs. Germany	05-Jan-24	19-Jan-24	1.5
Short 9Y Portugal vs Spain	08-Dec-23	26-Jan-24	3.0
Long 6Y Ireland vs. France	09-Jun-23	01-Mar-24	2.5
Long Bono Oct33 vs. 70% OAT Nov33 and 30%	26-Jan-24	01-Mar-24	3.5
Long 5Y Netherlands vs. France	22-Mar-24	05-Apr-24	3.0
Short 5Y Portugal vs. Spain	09-Feb-24	05-Apr-24	9.5
10s/30s France steepener vs. Germany	23-Feb-24	05-Apr-24	0.3
Long 10Y Ireland vs. France	15-Mar-24	05-Apr-24	0.0
10s/30s weighted Italy-Germany steepener (100'	15-Mar-24	10-May-24	4.2
30s/50s France steepener	02-Feb-24	31-May-24	-9.0
Long 10Y Ireland vs. Germany	05-Apr-24	31-May-24	7.3
Long 10Y Greece vs. Italy	03-Nov-23	16-Aug-24	-23.9
10s/30s Italy flattener vs. Germany	06-Sep-24	27-Sep-24	0.8
Long 10Y Spain vs. Germany	06-Sep-24	25-Oct-24	12.5
Short 10Y Portugal vs. the Netherlands	01-Nov-24	07-Nov-24	9.5
5s/10s France steepener vs. Germany	27-Sep-24	06-Jan-25	4.5

TRADE	ENTRY	EXIT	P&L
SSA			
Long 5Y EU vs Germany	05-Dec-23	07-Feb-24	6.0
Long 10Y KfW vs. Germany	11-Jan-24	23-Feb-24	10.0
Long 10Y EU vs. Germany	07-Feb-24	21-Mar-24	13.0
Long 5Y EU vs. swap	21-Mar-24	02-May-24	4.0
Long 7Y NRW vs. Germany	02-May-24	14-Jun-24	-10.0
Long 10Y EU vs. swap	02-May-24	10-Oct-24	-15.0
MISCELLANEOUS			
Long 5Y Italy CDS basis	19-Jan-24	27-Sep-24	3.5

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European Derivatives

Sell volatility as the waiting game continues

- **The ECB is expected to cut policy rates by 25bp next week, keep an easing bias, and continue to stress a data dependent approach**
- **The €STR curve is now pricing around 24bp, 73bp, and 87bp of cumulative easing by Jan25, Jun25, and Dec25 respectively with a terminal rate of around 2.15%, which is close to the recent highs**
- **We continue to find market pricing of the terminal rate to be too high reflecting the hawkish Fed shift and some modest improvement in Euro area macro data**
- **However, risks for Euro area economy remains tilted to the downside and we keep our front-end long duration bias; keep receiving 1Yx1Y €STR and hold 6Mx1Y receiver spread (A-12.5/A-50) vs OTM payer**
- **We favour Dec25/Jun26/Dec26 Euribor belly richener as a way to position for a slower ECB easing cycle/longer pause which also benefits from attractive slide on the curve**
- **Enter tactical 2s/10s conditional bull flattener via 1M receivers which benefits from positive rate and volatility curve carry**
- **Keep 10s/30s steepening bias; hold 2Yx2Y/10Yx10Y swap curve steepener and 10s/30s conditional bull steepener via 3M receivers; re-strike 5s/10s/30s conditional bull belly richener via 3M receivers**
- **On a cross market basis, take profit in long Jun25 ITM Euribor puts versus ITM SONIA puts; the cross market spread has compressed around 20bp over the last two weeks**
- **Swap spreads are exhibiting very low volatility over the past few days. We believe that volatility in swap spreads is likely to stay muted although short-term tactical drivers around valuations and swapped issuance point towards some rebound wider in spreads**
- **We have a medium term widening bias in Schatz spreads but do not find risk-reward attractive for outright wideners around current levels**
- **We have a tactical widening bias in Bund spreads given optically cheap levels and expected reduction in issuance; enter Mar25 conditional Bund bull widener**
- **Hold Bund/Buxl swap spread curve steepener with a medium term horizon**
- **Stay bearish on gamma; sell 3Mx2Y gamma as delivered volatility is likely to stay well below implieds**
- **Stay short 1Yx1Y unhedged straddles which offers wide breakeven ranges**
- **Further out the curve, take tactical profit in short 3Mx30Y straddles with infrequent delta hedging**

€STR forward yields have exhibited some volatility over the past two weeks but have overall remained in small range (**Figure 38**). Yields are overall lower since our last publication two weeks ago with some modest belly richening dynamic. The evolution of global and domestic macro has been the primary drivers of yields as expectations around the ECB terminal rate is largely unchanged. Anecdotal evidence suggests flows have been mixed with overall bias towards adding long duration and long-end curve steepening positions.

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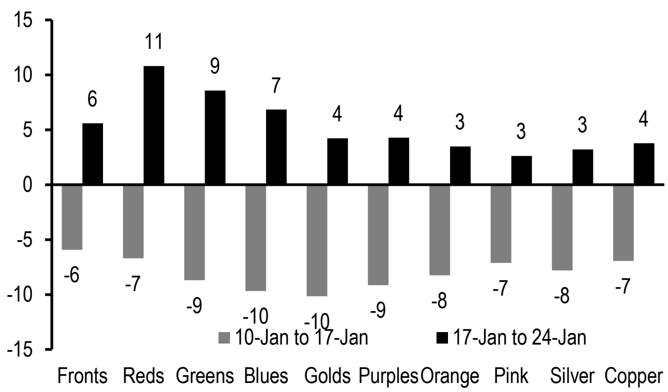
Figure 38: €STR yields have exhibited some volatility but are overall modestly lower with some richening of the belly of the curve

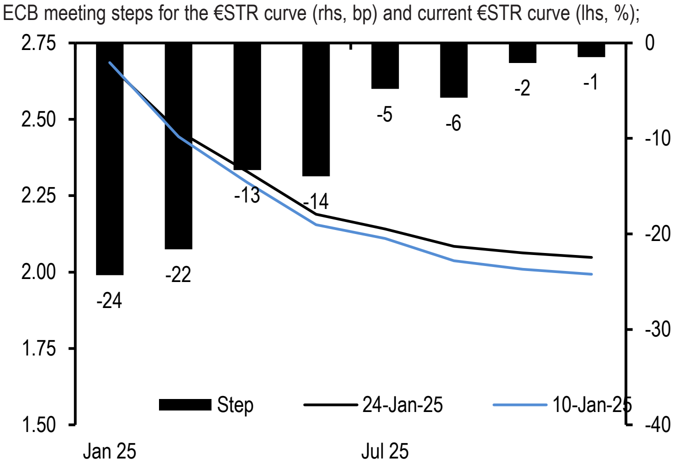
Change in various 1Y forward €STR yield; since 10th Jan 2025; bp



Source: J.P. Morgan.

Figure 39: The €STR curve is now pricing around 24bp, 73bp, and 87bp of cumulative cuts by January, June, and December ECB meetings with the terminal priced around 2.15%

ECB meeting steps for the €STR curve (rhs, bp) and current €STR curve (lhs, %);



Source: J.P. Morgan.

The ECB next week is unlikely to deliver any significant surprises. We expect them to cut policy rates by 25bp, maintain their easing bias, and stress the continued data dependent nature of their reaction function. The small rebound in the PMIs this week should be encouraging for the ECB and maintain their data dependency approach . The €STR curve is pricing around 24bp, 73bp, and 87bp of cumulative cuts by next week, June, and end-2025, respectively (**Figure 39**). The terminal rate is priced around 2.15% currently, which is close to the recent highs.

ECB commentary suggests that there appears to be a consensus to take policy rates down to 2% over the coming months although the pace still remains under debate (**Figure 40**). Most of the ECB board members agree on the maintaining the easing bias with gradual rate cuts to follow. We believe that the divergence amongst members might increase further once policy rates are cut to 2.5% over the next two meetings given the lack of visibility from the ECB on the exact level of the neutral policy rate. In this regard, the upcoming inflation data next week (the ECB will not have an indication of this going into the meeting next week) will be important in determining the speed of reaching 2%. As our economists have discussed, the disinflation trend is intact with core price pressures moderating over 2025 although the January print will see some start of year price resetting pressures. On a momentum basis (3m/3m saar), we expect core HICP to be at 2% already by 3Q25. We have a strong confidence that the ECB will continue easing rates every meeting until they reach 1.75% by September and this is driven by expectations of ongoing disinflation and sub-par growth, with downside risks to growth if the US imposes tariffs on Euro area imports.

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Figure 40: "Plausible consensus": ECB commentary suggests that there appears to be a consensus to ease further over the coming months

Selected excerpts from recent ECB commentary

	Source	Date	Comment
ECB	Holzmann	22-Jan	"Inflation gauges are still very strong. […] There is danger of rate cut then hiking again." " [It would be better] to wait a bit more. I can be persuaded [on a rate cut] if there are good arguments."
ECB	Rehn	22-Jan	"It is important to maintain freedom of action in monetary policy decision-making. In future meetings – already next week – we should have more information about, for example, US trade policy and other decisions affecting the economy."
ECB	Villeroy	22-Jan	"On the European side I don't think that the inflationary effects [of US tariffs] will be that significant, so I would expect this disinflation process to go on."
ECB	Lagarde	22-Jan	"We are on this regular, gradual path. Disinflation is coming through." "Risk is to the downside when it comes to growth, and we'll have to be very attentive to the data." "We are not overly concerned by the export of inflation to Europe." "We do have that divergence, that has to do with a different economic setting at the moment between the U.S. and Europe."
ECB	Nagel	21-Jan	"This meeting-to-meeting approach worked pretty well and it should be the way forward for the next six months."
ECB	Guindos	15-Jan	"The policy trajectory is clear, and we expect to continue to further reduce the restrictiveness of monetary policy."
	Villeroy	15-Jan	"If the retreat of inflation is confirmed in the coming quarters as we forecast, it makes sense to go toward this 2% rate by next summer without slowing the pace"
	Vujcic	13-Jan	"General, expectations of gradual, meeting-by-meeting cuts are justified by what we see in the data and in our projections." "We are not dependent on the Fed or any other central bank. So I can only say that from what I see now, the near-term expectations of the markets seem justified."
	Rehn	13-Jan	"I would say at the latest by midsummer, we should have left restrictive territory." "The ECB is not the 13th federal district of the Federal Reserve System. [...] Exchange rate has impact on inflaiton, it is not a policy target."
	Lane	13-Jan	"Probably more monetary easing is going to come in order to make sure the European economy grows." ECB has to find "a middle path" "being neither too aggressive nor too cautious." "We need to make sure that the economy does not grow too slowly, because then we face a new problem, which is that inflation might stabilize below the target."

Source: J.P. Morgan and ECB.

Current pricing of ECB terminal rate of around 2.15% is slightly higher than indicated in recent ECB communication. We believe valuations are cheap and continue to hold received positions in 1Yx1Y €STR. **First**, the €STR curve is currently closer to our "hawkish" scenario that we have discussed in our *2025 Outlook* to which we have ascribed a low probability of 10% (**Figure 41**). We think money market curve should be pricing some insurance against further deterioration of Euro area economy and risks emanating from potential US tariffs, although we have not incorporated this into our baseline forecast yet. Risks to growth remain tilted to the downside despite the small rebound in PMIs this week.

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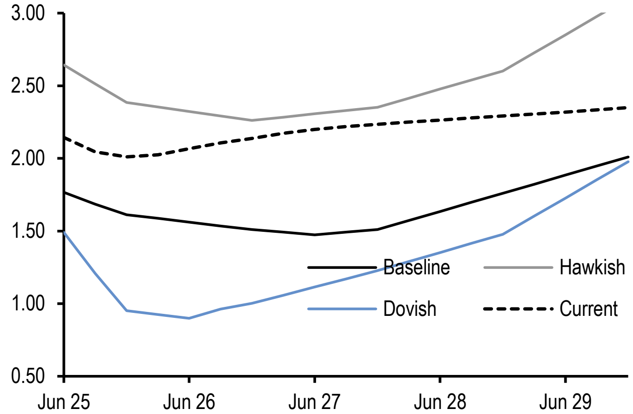
Figure 41: The €STR curve appears cheap against our ECB scenario analyses

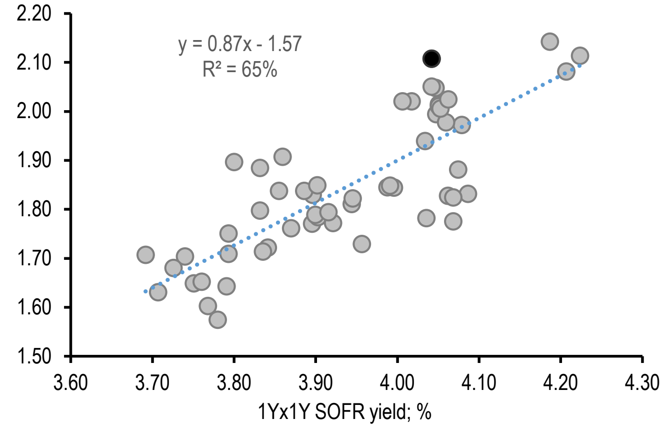
J.P.Morgan estimation of the evolution of the €STR curve under various ECB scenarios; %



Source: J.P. Morgan estimates.

Figure 42: €STR yields have cheapened as the Fed has shifted hawkish. We do not expect this dynamic to continue. 1Yx1Y €STR now appears too cheap versus SOFR; stay received 1Yx1Y €STR

1Yx1Y €STR yield regressed against 1Yx1Y SOFR yield; since 6th November; %



Second, to some extent the cheapness in €STR front-end yield is also a reflection of the hawkish Fed shift. Market participants have grappled with the idea that the ECB/Fed divergence is close to being fully priced and the ECB is unlikely to deliver additional significant easing (relative to current pricing) if the Fed turns hawkish further. Indeed, the relationship between 1Yx1Y €STR versus SOFR has been strong recently with €STR appear too cheap versus SOFR (**Figure 42**) on a relative basis. We remain of the view that macro fundamentals are likely to force the ECB to deviate from the Fed over the coming months as US exceptionalism continues on under the new administration whereas a weak backdrop in the Euro area keeps the ECB on an easing path. Thus, we continue to express long duration view at the front-end of the €STR curve via **receiving 1Yx1Y €STR and staying long 6Mx1Y receiver spread (A-12.5/A-50) versus OTM payer**.

Last GFIMs, we had highlighted that receiving the belly of the Dec25/Jun26/Dec26 Euribor fly is an attractive way to position for a slower ECB easing cycle. The fly has richened around 2bp over the past two weeks but still remains attractive on medium term considerations as it is still pricing the Dec25/Jun26 curve (itself at around 6bp) to be roughly only around 2bp flatter relative to Jun26/Dec26 (**Figure 43**). In the event of a slower easing cycle (say ECB cutting only at a quarterly pace and/or extending the easing cycle gradually towards mid-2026), we would expect the former curve to flatten relative to the latter and push the fly richer. We acknowledge that this fly has bullish duration flavour but highlight that the relationship has been rather weak over the past few months. Additionally, receiving the belly of the fly offers attractive positive slide on the curve.

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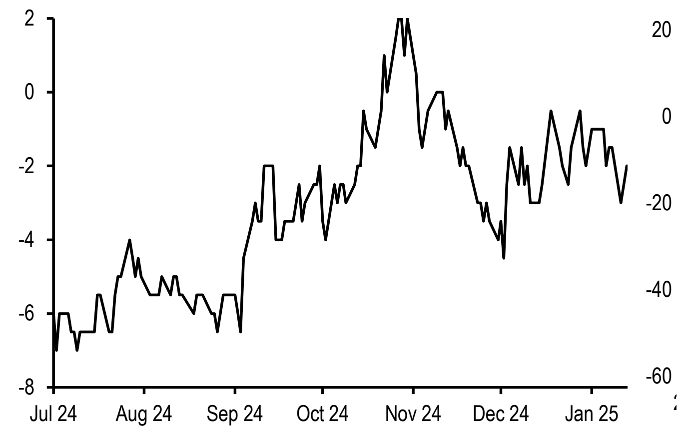
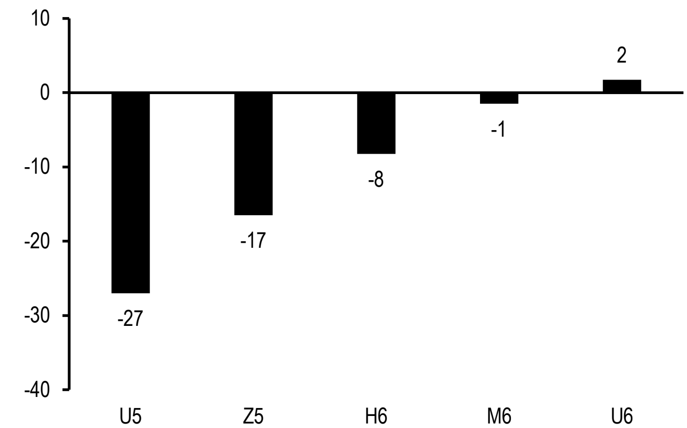
Figure 43: Receiving the belly of the Dec25/Jun26/Dec26 Euribor fly is still attractive to position for a longer/slower easing cycle with attractive positive slide on the curve

Dec25/Jun26/Dec26 Euribor 50:50 fly; past 6M; bp



Source: J.P. Morgan.

Various 50:50 1Y wide Euribor flies; bp



Source: J.P. Morgan.

Further out the curve, the 2s/10s swap curve has steepened over the past few weeks driven by higher yields and rising term premium considerations. We have a medium-term bias towards a steeper curve driven by lower front-end yields. However, we cannot fully discount the risk of some bull-flattening of the swap curve. This positive directionality would be in line with recent market moves where the curve has exhibited strong positive directionality versus yields and breaking away from the previous strong negative directionality (**Figure 44**). To this effect, **we recommend 2s/10s conditional bull flattener implemented via 1M receivers**. We use short maturity options due to the tactical nature of our flattening view. Flatteners benefit from positive rate curve carry (around 1bp over 1M) and also from positive volatility slide as 10Y implieds are trading cheaper relative to 2Y. This allows us to enter a premium neutral flattener at 0.5bp and 1.7bp better than forward and spot, respectively (see Trade Recommendations). The curve has exhibited a strong positive directionality versus yields recently whereas the options market is still pricing a negative directionality of the curve to yields.

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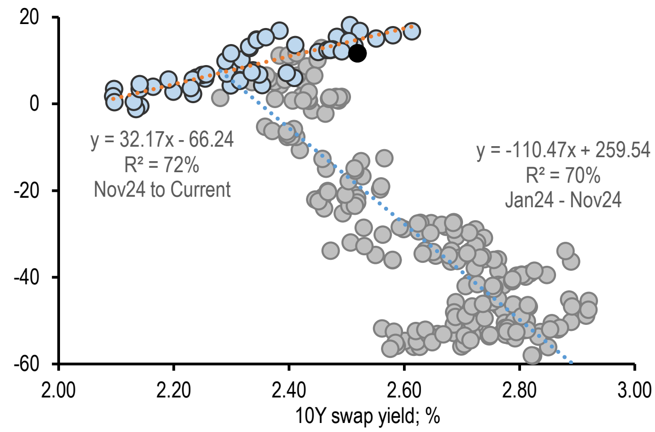
Figure 44: Enter 2s/10s tactical conditional bull flatteners via 1M receivers; the curve exhibits a strong positive directionality versus yields but this is not priced in the options market

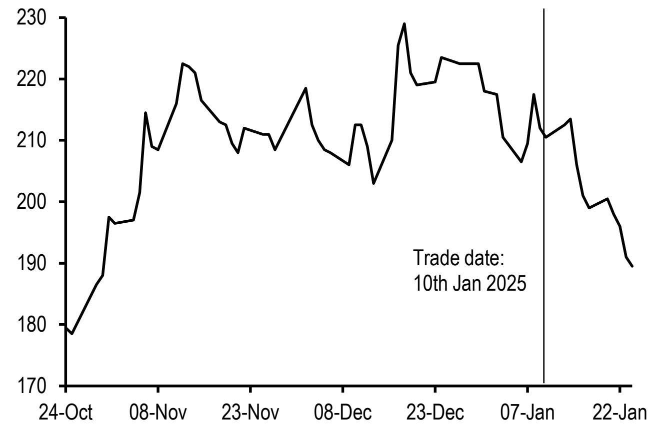
2s/10s swap curve regressed against 10Y yields; past 1Y; bp



Source: J.P. Morgan.

Figure 45: Take profit in short Dec25 SONIA put versus Euribor

Dec25 (SONIA-Euribor) yield spread; past 3M; bp



Source: J.P. Morgan.

Further out the curve, we continue to hold long-end steepening view via 10s/30s conditional bull steepener and outright 2Yx2Y/10Yx10Y swap curve steepener.

We also **re-strike our 5s/10s/30s conditional bull belly richeners into newer ATMF 3M receivers**. The recommended options are a few bps OTM and are likely to expire worthless at expiry (see *Trade Recommendations*).

Finally, on a cross market basis, we had recommended **selling ITM Dec25 SONIA puts versus Euribor**to position for a spread compression (SONIA outperformance versus Euribor) while benefitting from relatively volatility dynamics. The cross-market spread has tightened around 20bp over the past two weeks and we recommend **taking profit in the trade** (**Figure 45**).

Swap spreads

Since our last publication two weeks ago, German swap spreads have narrowed with a pronounced flattening of the Schatz/Buxl swap spread curve (**Figure 46**). The narrowing was driven by a combination of improvement in risk sentiment, relatively negative directionality of spreads to yield, continuation of strong swapped issuance activity, and heavy sovereign issuance. Anecdotal evidence suggests mixed flows at the ultra-long end of the curve and investors trading swap spreads around issuance.

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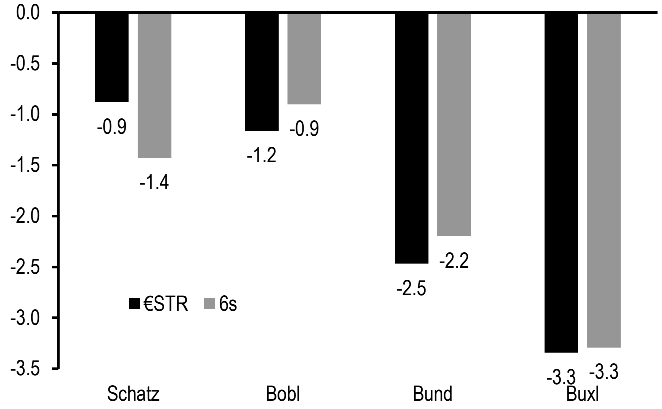
Figure 46: German swap spreads have narrowed further over the last two weeks with a pronounced flattening of the swap spread curve

Change in €STR and 6s Mar25 swap spread since 10th Jan 2025; bp

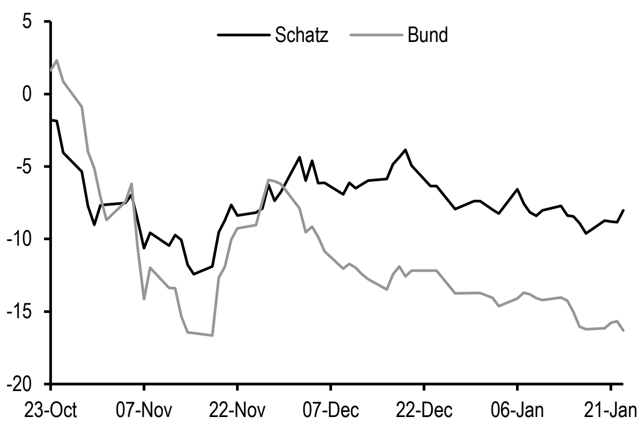


Source: J.P. Morgan.

Bund €STR spread is now close to its historical lows which was last tested in November even though the move has been gradual. Swap spreads have moved in tight ranges over the past few weeks with some flattening of the Schatz/Bund €STR swap spread curve (**Figure 47**). Swap spread volatility has dropped sharply over the last month with the 1M volatility at the lows seen over the past couple of years. **We believe that volatility in swap spreads is likely to stay muted although short-term factors around valuations and swapped issuance point towards some rebound wider in spreads**.

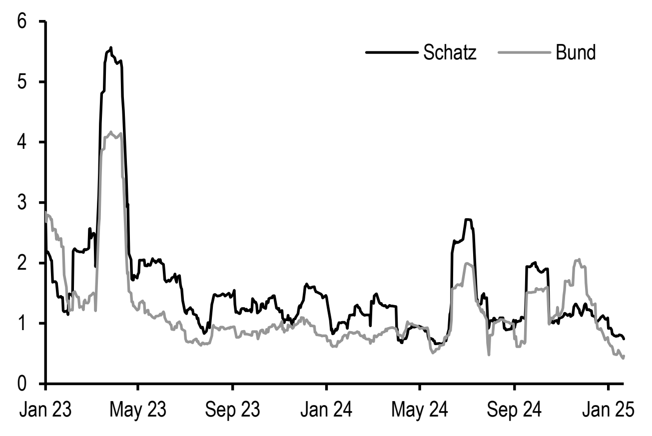
Figure 47: Bund swap spread has gradually retraced back towards its historical tight levels even though swap spread volatility has dropped towards the lows of the past couple of years – a dynamic that is likely to continue over the short term

Rolling front Schatz and Bund €STR swap spread; past 3M; bp



Source: J.P. Morgan.

Rolling 1M SD of front Schatz and Bund €STR swap spread; since 1 Jan 2023; bp/day



Source: J.P. Morgan.

Swap spreads have continued to exhibit a decent negative directionality versus yields since the US Presidential election (**Figure 48**). However, the beta is low around 10% and is low compared to historical averages.

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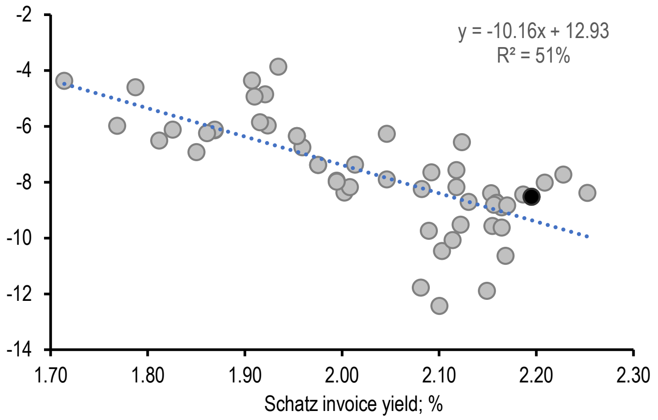
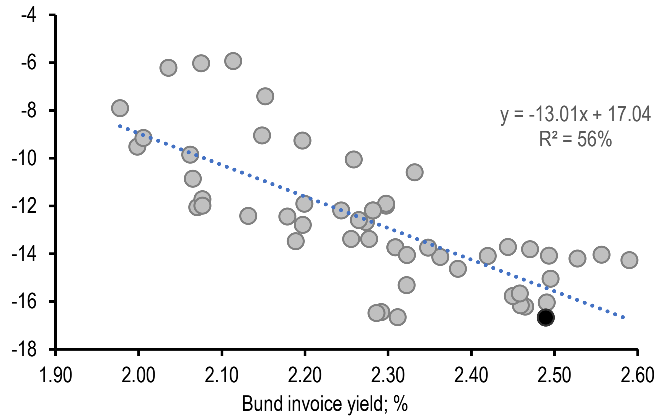
Figure 48: Swap spread directionality has resumed to being negative although the beta has been poor compared to historical levels

Schatz €STR swap spread regressed against Schatz invoice yield; since 6th Nov 2024; bp



Source: J.P. Morgan.

Bund €STR swap spread regressed against Bund invoice yield; since 6th Nov 2024; bp



Source: J.P. Morgan.

We now have a widening bias on swap spreads across the German curve; we essential maintain a widening view on Schatz and Buxl and switchinto a widening bias in Bund but with varying degree of conviction. While the widening view in Schatz and Buxl is more medium term in nature, the widening bias in Bund spreads is more tactical in nature. A couple of short-term factors support our overall view. **First**, the heavy January issuance season is now almost behind us. This dynamic coupled with rising concerns around term premium globally can explain some narrowing of spreads, especially at the intermediate and long-end of the curve. However, the main takeaway for us has been that demand for Euro govies has remained strong and will be sustained enough to absorb the heavy EGB supply (see *Overview*). Thus we believe that swap spreads can potentially unwind some of the issuance premium over the short term as supply slows down relatively; while gross issuance in January is likely to be around €160-170bn, it is projected to slow down to around €100-120bn in February and March. **Second**, to some extent German spreads are also reflecting concerns around potential easing of debt brake after the election. While we cannot fully rule this out over the medium term, we do not see this to be imminent in our baseline scenario and thus expect some short-term removal of this dynamic that is priced in the swap spread curve. **Third**, for Euro area multi-currency investors, owning US Treasuries over German bonds is not attractive anymore as the pickup is minimal (**Figure 49**). Against a backdrop of the ECB still easing and Euro area terminal rates potentially cheap, owning German duration is attractive. This is supportive of wider German swap spreads.

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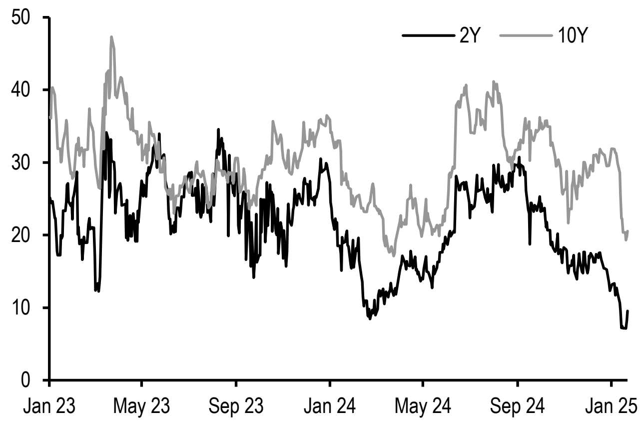
Figure 49: It is not attractive to buy USTs versus Germany at current levels. Against a backdrop of ECB continuing its easing cycle, we see demand for German bonds remaining robust over the coming months

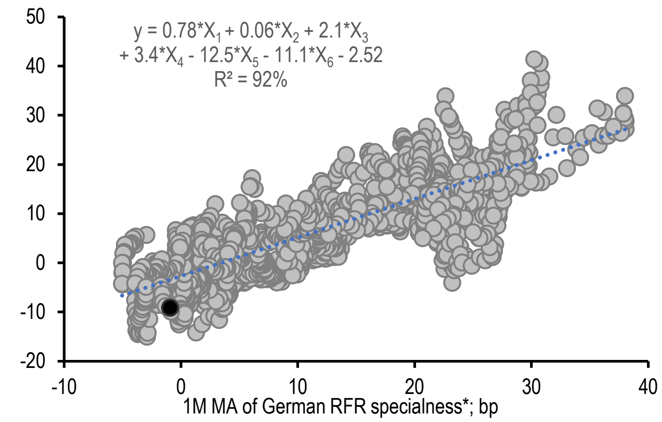
Pick up for EUR based investors from buying USTs versus Germany on a maturity matched FX hedging basis; since Jan 2023; bp



Source: J.P. Morgan.

Figure 50: We have a medium term widening bias in Schatz spreads but do not find risk-reward attractive for outright wideners around current levels and thus stay on the sidelines

Schatz swap spread regressed against *1)* German RFR richness to €STR (X_1), *2)* 1Yx1Y swap rate (X_2), *3)* 10Y BTP/Bund spread (X_3), *4)* rolling front Schatz implied volatility (X_4), *5)* Dummy for ECB Oct23 and TLTRO-III Sep24 repayment (X_5 and X_6); since 1 Jan 2015; bp



Source: J.P. Morgan.

At the front-end of the curve, we find Schatz swap spreads trading around 3bp too narrow versus fundamental drivers in our long-term fair value model (**Figure 50**). We have a medium-term bias towards Schatz swap spread widening to 0bp versus current level of around -9bp. On a short-term basis, we do not find risk-reward attractive for outright Schatz €STR wideners at -9bp and would consider entering wideners at around -11/-12bp.

In addition to the Govie supply related dynamics discussed above, our tactical widening bias in Bund spreads is also reflective of the seasonality of swapped issuance related dynamics after January. In **Figure 51**, we show the evolution of swapped issuance around year-end. Issuance this year has followed the script of the past years, on average, and risen in line with historical averages. Historically, these issuances peak towards the end of January before declining in February. An expected repeat of this seasonality this year is supportive of some Bund spread widening over the short-term. Additionally, as discussed above, Bund spreads are now close to their historical tight levels and appear optically too narrow.

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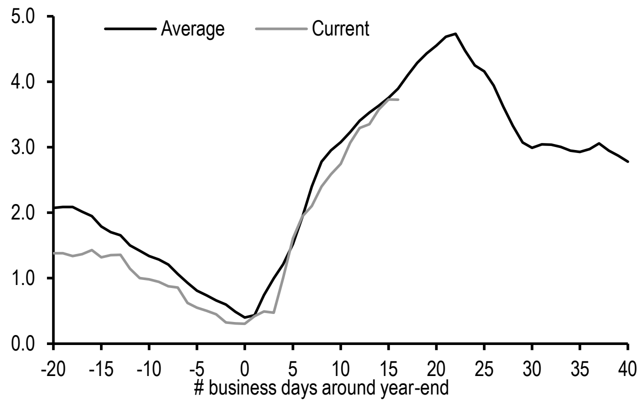
Figure 51: Swapped issuance has been largely in line with historical averages this year. These issuances tend to decline in February and an expected repeat of this seasonality is supportive of some tactical widening of Bund spreads

Average 1M MA of swapped issuance activity around year-end versus current; past 10Y; €bn/day



Source: J.P. Morgan and Dealogic.

Nevertheless, instead of outright wideners, **we recommend conditional Bund bull widener implemented via Mar25 calls/swaptions** (see Trade Recommendations). Bund implieds are priced around 8% above swaption implieds but Bund yields are delivering around 14% more relative to swaps over the recent past. As discussed above, swap spread directionality has been negative which is supportive of the trade given our bullish duration bias. However, we highlight that this trade is not necessarily a long duration proxy but is expected to perform as the yield curve unwinds some of the term premium priced in the curve.

To be sure, our medium term view calls for further narrowing of Bund spreads driven by structural receiving flows related to Bank related NII and mortgage based receiving flows. However, we believe that optically Bund spreads are now cheap and is likely to widen over the short-term, especially in a rally. On medium term considerations, we do not believe that USD spreads provide a template for how cheap German spreads can trade relative to swaps. Large negative USD swap spreads is primarily driven by high UST issuance. We believe that German deficit is unlikely to rise significantly given constitutional guard rails and thus fiscal dynamics should not result in a significant narrowing of German swap spreads.

Finally, at the ultra-long end of the curve, **we stay in Bund/Buxl swap spread curve steepener** that we had recommended in December. The spread curve has flattened around 3bp since inception but as we have discussed previously, we believe that tactical and medium term factors support a steeper swap spread curve.

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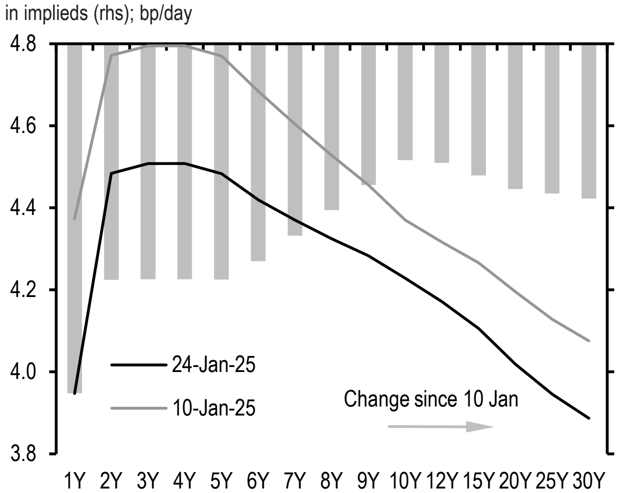
Volatility

Implied volatility declined across the curve with some steepening of the volatility curve across tails over the past two weeks. Gamma implieds have now declined close to the lows seen since the start of the tightening cycle in 1Q22 when uncertainty around the start, pace, and depth of the hiking cycle had pushed implieds significantly higher (**Figure 52**). Similarly, 1M delivered volatility has also declined, broadly in line with the "January effect" that we had discussed in our last publication. A large part of the current decline has been due to rising expectation of sticky ECB terminal rates and low delivered volatility. Anecdotal evidence suggests interest in short gamma positions on short tails (sub 2Y) and some systematic short gamma flows at the top-right of the gamma surface. Market liquidity, as proxied by Bund market depth, has increased sharply over the past few days and is close to the highs seen over the last few years (**Figure 53**). Notwithstanding the circularity, but this rise in market depth has also come along with a decline in volatility re-asserting the typical negative relationship that we expect between them.

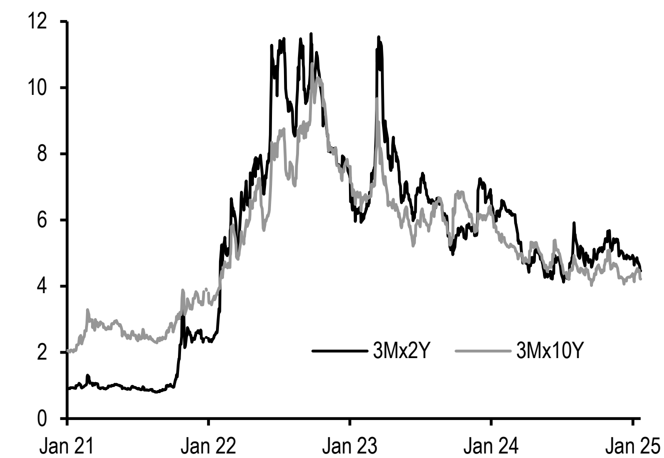
Figure 52: Implieds have declined across tails over the past two weeks with some steepening of the volatility curve across tails

3M expiry implied volatility on various tails, current and 1W ago (lhs) versus 1W change in implieds (rhs); bp/day



Source: J.P. Morgan.

3Mx2Y and 3Mx10Y implied volatility; since Jan 2021; bp/day



Source: J.P. Morgan.

Last week we had turned bearish on gamma across the curve and we keep that view. Several fundamental and technical factors continue to support short gamma positions over the coming weeks, especially at the front-end of the curve. Front-end yields had jumped sharply from their early December lows in the second half of December and early January, primarily driven by hawkish central bank delivery, term premium concerns, and the moves were exaggerated due to anecdotal unwinding of long duration positions in a illiquid year-end environment. However, yields have somewhat retraced from January highs and appear to have been settling down in a narrow range over the past few days. The rolling 2W range of 1Yx1Y €STR yield is now close to the lows since the start of the tightening cycle (**Figure 54**). Looking ahead, we do not see a strong catalyst that would break front-end yields out of their recent range with money market yields expected to only slowly grind lower over the coming months.

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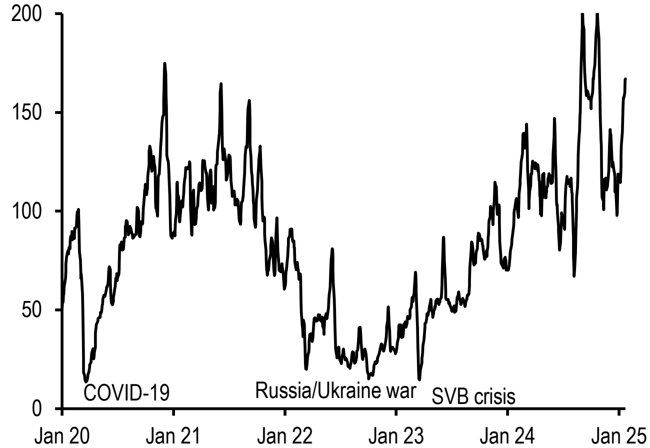
Figure 53: Market depth has rebounded sharply over the past few days and has aided in the decline of volatility

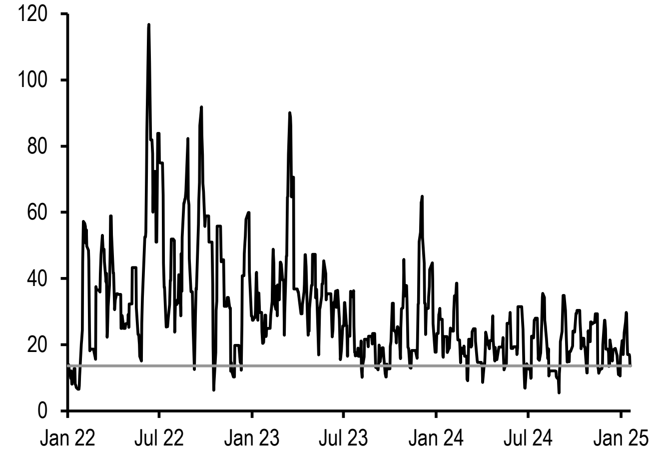
Rolling 1M MA of Bund market depth; since Jan 2020; €mn equivalent



Source: J.P. Morgan & Eurex.

Figure 54: Front-end yields have been in a narrow range over the recent past. We do not see any catalyst for them to breakout of the range either and thus favour short gamma positions

Rolling 2W range of 1Yx1Y €STR yield; since Jan 2022; bp

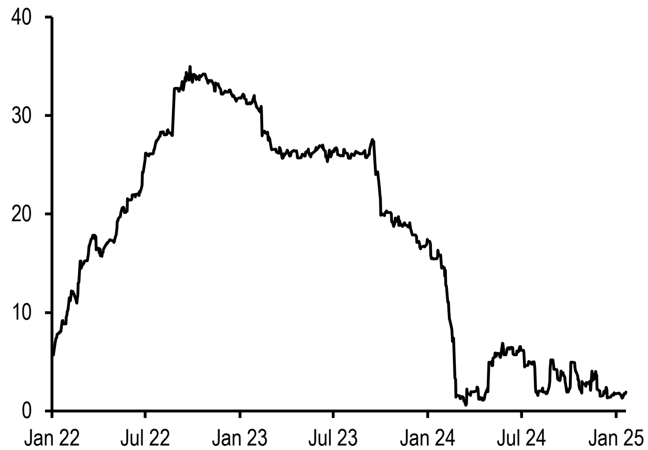


Source: J.P. Morgan.

Expected evolution of macro data in the Euro data warrants a lower terminal rate than is currently priced, in our view, but this is likely to be a slow and low volatility process. Indeed, ECB board members appear to be speaking largely in unison demonstrating large concensus for further decline in terminal rates (**Figure 55**).

Figure 55: ECB board members appear to be broadly in sync with each other thereby supporting lower volatility

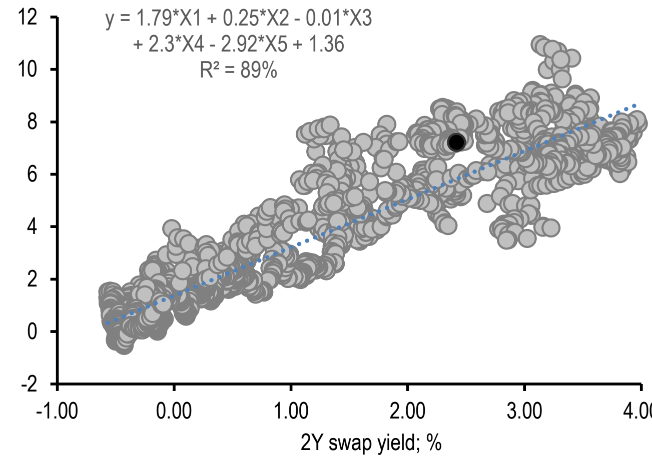
ECB hawk/dove divergence metric; since Jan 2022; bp/day



Source: J.P. Morgan & ECB.

Figure 56: Front-end implieds still appear marginally too rich versus fundamental drivers in our long-term fair value model

3Mx2Y implied vol regressed against *1)* 2Y swap yield (X_1), *2)* Euro Area HICP inflation (X_2), *3)*1W MA of Bund market depth* (X_3), *4)* ECB balance sheet (X_4) and ECB Dec 23 meeting dummy (X_5); since 1 Jan 2010; bp/day



Source: J.P. Morgan and Eurex.

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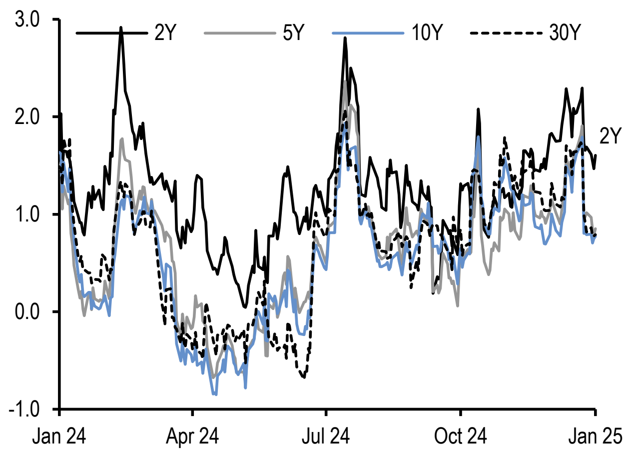
Overall, we believe that delivered volatility is likely to stay muted, especially when compared to *ex-ante*implieds. Implied volatility is now close to their recent lows and appear optically cheap as they have previously rebounded from current levels. However, we believe that implieds have room to decline but only modestly lower (vega P&L). Short gamma positions are likely to be profitable primarily from expected low delivered volatility over the coming few days (gamma P&L).

To this effect, we find shorts in front-end gamma attractive and **recommend selling 3Mx2Y gamma** (see Trade Recommendations). **First**, front-end implieds also appear too rich versus fundamental drivers in our long-term fair value model where we use underlying yield, inflation, market depth, and ECB balance sheet as primary drivers (**Figure 56**). Additionally, expected evolution of the underlying drivers supports some further modest decline in implieds over the coming weeks. We highlight that a similar regression shows that 3Mx10Y implieds are trading fair versus fundamental drivers.

Second, short gamma positions in 2Y benefit from attractive gamma characteristics with implied/delivered differential of around 1.5bp/day, which is the highest compared to longer tails which offer gamma carry of around 0.8bp/day (**Figure 57**).

Figure 57: Front-end short gamma positions are offering best gamma carry compared to other sector on the curve

3M expiry implied volatility – 1M delivered volatility of underlyswaps for 2Y, 5Y, 10Y, and 30Y tails; past 1Y; bp/day



Source: J.P. Morgan.

Third, current implied/delivered differential provides ample cushion and protection against jump risk. For instance, if we assume that 3Mx2Y implied volatility remains constant over the coming month at current levels of around 4.5bp/day and 2Y swap yields move in line with their current 3M delivered volatility (2.9bp/day), then 2Y yields need to jump 7bp six times over the next month to breakeven theta gains from a short gamma position, or with around 1/3rd frequency (**Figure 58**). Historically, 2Y yields have moved with a much lower frequency (around 5%) over the past few months. We do not see any near-term catalyst for front-end yields to jump significantly and have a strong conviction on the performance of short gamma positions over the coming weeks.

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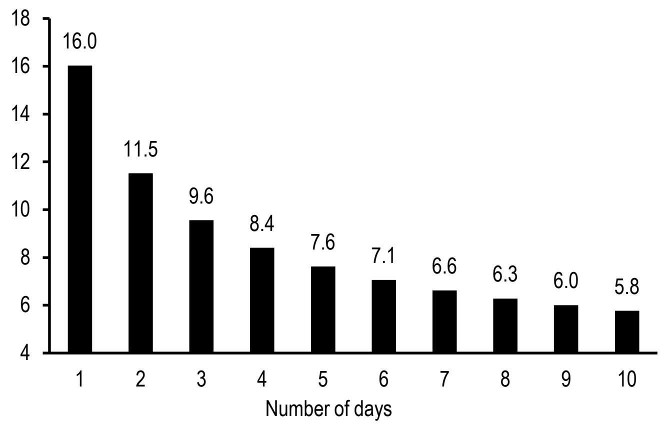
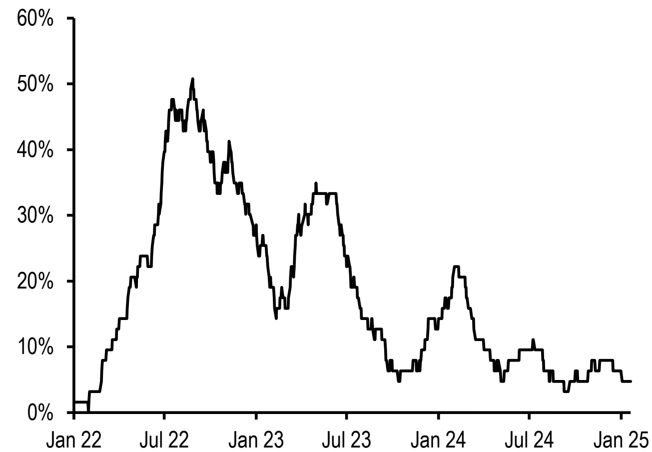
Figure 58: Current implied/delivered differential provides good cushion for short gamma positions in 2Y; jump risk has been relatively muted at the front-end over the recent months

Amount 2Y swap yield needs to jump on volatile days to breakeven theta gains from non-volatile days*; bp



Source: J.P. Morgan.
* We assume that implied volatility does not change over the next month (4.5bp/day). Delivered volatility on non-jump days is in line with current 1M delivered volatility of 2.9bp/day.

Rolling 3M jump frequency* of 2Y swap yield; since 1 Jan 2022; %



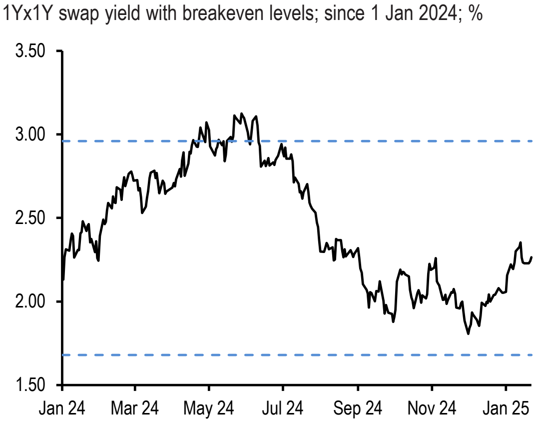
Source: J.P. Morgan.
* Jump days defined as days when 2Y yield moves in excess of 7bp.

On balance, we recommend selling 3Mx2Y gamma at 4.5bp/day with attractive gamma carry characteristics. Short-term risks to our trade could come from significantly weaker macro data which would warrant market pricing an aggressive easing cycle (not our baseline view) or unwind of short gamma positions. Additionally, already low level of implieds make them appear optically too cheap.

We also stay short 1Yx1Y unhedged straddles which still offer wide breakeven ranges (1.65%, 2.95%) (**Figure 59**). As we discussed in our previous publication, it will require a significant repricing of ECB easing expectations lower, consistent with an outright recession and the ECB pushing policy rates to 1%, for 1Y yields to breach this barrier. We ascribe almost negligible probability for ECB to start raising rates and thus find the upper breakeven to be safe as well.

Figure 59: Stay short 1Yx1Y unhedged straddles as a medium term trade

1Yx1Y swap yield with breakeven levels; since 1 Jan 2024; %



Source: J.P. Morgan.

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We **take tactical profit in our short 3Mx30Y gamma with infrequent delta hedging** which we had recommended in early November. Fixed strike implieds have declined around 0.4bp/day since inception. Underlying yields are around 10bp above strike which had greatly reduced the overall gamma exposure, as the underlying options are close to expiry (see*Trade Recommendations*).

Trade Recommendations

Swap curve

- **Enter 2s/10s conditional bull flattener via 1M receivers**
  Buy €100mn 2.53% 1Mx10Y receivers (ATMF strike 2.53%, notification date 24 Feb 2025, maturity date 26 Feb 2035) versus short €455.7mn 2.40% 1Mx2Y receivers (ATMF strike 2.405%, notification date 24 Feb 2025, maturity date 26 Feb 2027) to enter into a bull flattener at 13.3bp versus spot and forward curve at 11.6bp and 12.8bp, respectively; P&L since inception (10th Jan 2025);
- **Take profit in long Jun25 ITM Euribor puts versus SONIA**
  Close longs in 1000 98 Jun25 Euribor puts (ATMF strike 97.75) versus selling 838 95.9 Jun25 3M SONIA puts (ATMF strike 95.65) to take profit in a cross market bear narrower at 190bp versus entry level of 210bp ; P&L since inception (10th Jan 2025): 14cents;
- **Re-strike 5s/10s/30s conditional bull belly richener via 3M receivers**
  Buy €100mn 3Mx10Y 2.53% receivers (100% risk, ATMF strike 2.53%, notification date 24 Apr 2025, maturity date 28 Apr 2035) versus short €94.2mn 3Mx5Y 2.44% receivers (50% risk, ATMF strike 2.44%, notification date 24 Apr 2025, maturity date 28 Apr 2030) and €20.9mn 3Mx30Y 2.298% receivers (50% risk, ATMF strike 2.298%, notification date 24 Apr 2025, maturity date 28 Apr 2055) to enter a premium neutral conditional bull-belly richener at 31.7bp versus forward and spot spread of 31.7bp and 30.5bp, respectively;
  Close longs in €100mn 3Mx10Y 2.40% receivers (100% risk, ATMF strike 2.40%, notification date 3 Feb 2025, maturity date 5 Feb 2035) versus short €94.5mn 3Mx5Y 2.31% receivers (50% risk, ATMF strike 2.31%, notification date 3 Feb 2025, maturity date 5 Feb 2030) and €20.6mn 3Mx10Y 2.40% receivers (50% risk, ATMF strike 2.18%, notification date 3 Feb 2025, maturity date 5 Feb 2055) to close conditional bull-belly richener; P&L since inception (1st Nov 2024): 0bp of notional;
- **Stay received 1Yx1Y €STR**
  Keep received €100mn 1Yx1Y €STR (swap start date 9 Jan 2026, swap end date 11 Jan 2027) at 2.025% versus entry level of 1.975%; P&L since inception (7th Jan 2025): -5bp of yield;
- **Hold 10s/30s conditional bull steepener via 3M receivers**
  Buy €100mn 2.553% 3Mx10Y receivers (ATMF strike 2.573%, notification date 10 Apr 2025, maturity date 14 Apr 2035) versus short €41.9mn 2.338% 3Mx30Y receivers (ATMF strike 2.338%, notification date 10 Apr 2025, maturity date 14 Apr 2055) to remain in a bull steepener at -21.5bp versus spot and forward curve at -22.4bp and -30bp, respectively; P&L since inception (10th Jan 2025); -8bp of notional;
- **Keep 6Mx1Y receiver spread versus short OTM payer**
  Keep long €100mn 1.77%/1.39% 6Mx1Y receiver spread (notification date 12 Jun 2025, maturity date 16 Jun 2026) versus short €100mn 2.19% 6Mx1Y payer (ATMF+30bp); P&L since inception (12th Dec 2024): -14bp of notional;
- **Keep Jun25/Jun27 Euribor conditional bull steepener via Jun25 quarterly and 2Y midcurve calls**

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Keep long 1000 98 Jun25 3M Euribor calls (Jun25 Euribor futures at 98.05) versus short 1000 97.875 Jun25 2Y Euribor midcurve calls (Jun27 Euribor futures at 98.03) to remain in a bull steepener at 9.5bp versus entry level of 0bp; P&L since inception (25th Oct 2024): -6cents;

- **Keep 2Yx2Y/10Yx10Y swap curve steepener**
  Keep received €100mn 2Yx2Y swaps (swap start date 12 Nov 2026, swap maturity date 13 Nov 2028) versus paid €26.7mn 10Yx10Y swap (swap start date 13 Nov 2034, swap maturity date 14 Nov 2044) to remain in a swap curve steepener at 13.4bp versus entry level at 9bp; P&L since inception (8th Nov 2024): 1bp of yield;

Swap spreads

- **Enter Mar25 conditional Bund swap spread bull widener**
  Buy 1000 131.5 Mar25 Bund calls (ATM strike 131) versus selling €129.4mn 2.502% maturity matched receivers (notification date 21 Feb 2025, maturity date 15 Feb 2035) to enter into a premium neutral Bund bull widener at 1.2bp versus forward at -1.5bp;
- **Hold Mar25 Bund/Buxl swap spread curve steepener (vs 6s)**
  Stay short 1000 Mar25 Bund futures versus paying €135.2mn CTD matched maturity swap (swap start date 10th Mar 2025, swap end date 15th Feb 2034 vs 6s Euribor) (Bund spread narrower) versus buying 383 Mar25 Buxl futures versus paying €50.6mn CTD matched maturity swap (swap start date 10th Mar 2025, swap end date 15th Aug 2054 vs 6s Euribor) (Buxl spread widener) to remain in a swap spread curve steepener at -45.5bp versus entry level of -43bp; P&L since inception (13th Dec 2024): -2.5bp of yield;

Volatility

- **Sell 3Mx2Y gamma**
  Sell €100mn 2.38% 3Mx2Y (notification date 24 Apr 2025, maturity date 28 Apr 2027) at 4.5bp/day. This trade requires active delta hedging;
- **Stay short 1Yx1Y unhedged straddles**
  Stay short €100mn 2.323%1Yx1Y unhedged straddles (notification date 12 Jan 2026, maturity date 27 Jan 2027)at 58bp of notional verus entry level of 61bp of notional; P&L since inception (10th Jan 2025): 3 bp of notional;
- **Take profit in short 3Mx30Y gamma with infrequent delta hedging**
  Close short €100mn 2.18% 3Mx30Y straddles (notification date 6 Feb 2025, maturity date 10 Feb 2025) at 3.8bp/day versus entry level at 4.35bp/day. The trade requires infrequent delta hedging; we recommend delta hedging once every 10 days or if the total delta changes by 15%, whichever comes first); P&L since inception (15th Nov 2024): 180bp of notional;

* P/L for open trades calculated using Thursday's closes. New and closing trades are priced as of 1PM on non-payroll Fridays and 2PM on payroll Fridays.

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Trades closed over the past 12 months

TRADE	ENTRY	EXIT	P&L
DURATION			
Mar24 2Y Euribor midcurve call ladder	08-Dec-23	26-Jan-24	5.5
3Mx1Y payer spread	08-Dec-23	09-Feb-24	3.5
Mar24 Euribor put spread	14-Dec-24	23-Feb-24	6.0
Mar24 1Y Euribor midcurve call ladder	09-Feb-24	15-Mar-24	-5.0
Receive 1Yx1Y €STR	05-Jan-24	15-Mar-24	-53.0
Apr24 Euribor put spread	23-Feb-24	11-Apr-24	5.0
Jul24 Euribor put spread	11-Apr-24	31-May-24	4.0
Receive 1Yx1Y €STR	31-May-24	06-Jun-24	11.0
Receive 1Yx1Y €STR	07-Jun-24	13-Jun-24	17.0
Jun24 Euribor call ladder	07-Mar-24	14-Jun-24	-3.0
Receive 1Yx1Y €STR	01-Jul-24	12-Jul-24	19.0
Sep24 Euribor call ladder	14-Jun-24	01-Aug-24	6.5
1Yx5Y A/A-50 receiver spread vs A+50 payer	02-Feb-24	02-Aug-24	11.8
3Mx1Y A/A+15 payer spread	06-Jun-24	01-Jul-24	2.1
Aug24 1x2 Bund put spread	14-Jun-24	01-Jul-24	1.9
1Yx1Y A/A-50 receiver spread vs A+40 payer	16-Aug-24	06-Sep-24	10.0
Dec24 1Y Euribor midcurve call ladder	01-Aug-24	06-Sep-24	2.0
3Mx(1Yx1Y) 1x2 payer spread	02-Aug-24	12-Sep-24	2.0
1Yx1Y A/A-50 receiver spread vs A+40 payer	06-Sep-24	27-Sep-24	13.5
3Mx(1Yx1Y) 1x2 payer spread	12-Sep-24	08-Nov-24	3.0
Receive 1Yx1Y €STR	04-Oct-24	12-Dec-24	19.0
1Yx1Y A/A-50 receiver spread vs A+40 payer	27-Sep-24	12-Dec-24	5.0
3Mx(1Yx1Y) A/A+21 1x2 payer spread	08-Nov-24	10-Jan-25	4.5
CURVE			
1Y/1Yx1Y €STR flattener	12-Apr-24	14-Jun-24	1.5
Dec24/Dec25 Euribor curve flattener	12-Jul-24	01-Aug-24	14.0
2Yx2Y/10Yx10Y swap curve steepener	09-Feb-24	02-Aug-24	8.7
2Yx2Y/15Yx15Y swap curve steepener	02-Aug-24	12-Sep-24	9.0
3Mx(10s/30s) flattener hedged with long reds	20-Sep-24	04-Oct-24	2.5
1Yx1Y/5Yx5Y USD steepener vs EUR	20-Sep-24	04-Oct-24	-14.7
CONDITIONAL CURVE AND FLIES			
Mar25/Mar26 conditional bull steepener	05-Jan-24	15-Mar-24	0.0
3Mx(2s/10s) YCSO 1x2 floor spread	23-Feb-24	05-Apr-24	3.5
1Mx(5s/30s) conditional bear flattener	15-Mar-24	11-Apr-24	2.5
3Mx(3s/10s) conditional bear flattener	01-Mar-24	11-Apr-24	1.0
1Mx(5s/30s) conditional bear flattener	11-Apr-24	13-May-24	0.0
1Mx(5s/30s) conditional bear flattener	17-May-24	31-May-24	2.6
2s/5s/10s conditional bear belly cheapener	26-Apr-24	31-May-24	0.0
Jun25/Jun26 conditional bull steepener	01-Mar-24	14-Jun-24	0.0
10s/30s conditional bull steepener	14-Dec-24	14-Jun-24	0.0
2s/5s/10s conditional bull belly richener	22-Mar-24	22-Jun-24	0.0
1Mx(5s/30s) conditional bear flattener	31-May-24	01-Jul-24	0.0
Dec25/Dec26 conditional bull steepener	21-Jun-24	02-Aug-24	8.5

TRADE	ENTRY	EXIT	P&L
CONDITIONAL CURVE AND FLIES			
10s/30s conditional bull steepener	17-May-24	02-Aug-24	1.2
3Mx(2s/10s) YCSO 1x2 floor spread	19-Apr-24	02-Aug-24	-3.5
5s/30s conditional bull steepener	12-Sep-24	20-Sep-24	2.4
1Yx1Y/5Yx5Y bear flattener via 3M midcurves	21-Jun-24	20-Sep-24	0.0
2s/5s conditional bull steepener	12-Sep-24	27-Sep-24	1.5
2s/5s/10s conditional bull belly cheapener	02-Aug-24	27-Sep-24	1.9
Mar25/Mar26 conditional bull steepener	16-Aug-24	25-Oct-24	7.0
Jun25/Jun27 conditional bull steepener	04-Oct-24	25-Oct-24	6.0
10s/30s conditional bull steepener	04-Oct-24	03-Jan-25	0.0
5s/10s/30s conditional bull belly richener	01-Nov-24	24-Jan-25	0.0
SWAP SPREADS			
Mar24 Schatz/Bund swap spread curve flattener	08-Dec-23	23-Feb-24	-4.2
Mar24 Call spread	02-Feb-24	23-Feb-24	-1.5
10Yx20Y swap spread widener	05-Jan-24	08-Mar-24	-23.0
Jun24 Schatz €STR swap spread widener	23-Feb-24	12-Apr-24	4.1
Jun24 Schatz call spread	12-Apr-24	21-May-24	-5.0
Jun24 Bund bull widener	12-Apr-24	21-May-24	0.0
10Yx20Y swap spread widener (Jun24)	08-Mar-24	31-May-24	-17.0
Jun24 Schatz swap spread widener	17-May-24	31-May-24	0.3
Sep24 Schatz swap spread widener	31-May-24	13-Jun-24	6.6
Buy Sep24 Schatz call spread	13-Jun-24	14-Jun-24	1.0
10Yx20Y swap spread widener	31-May-24	14-Jun-24	7.0
Buy Sep24 Schatz call spread	14-Jun-24	01-Aug-24	1.2
Sep24 Schatz swap spread widener	12-Jul-24	02-Aug-24	2.2
Sep24 Bund bull widener	14-Jun-24	16-Aug-24	-10.0
Sep24 Schatz/Bund swap spread curve flattener	02-Aug-24	30-Aug-24	-1.0
Dec24 Schatz swap spread widener	30-Aug-24	18-Oct-24	-12.3
Dec24 Schatz/Bund swap spread curve flattener	27-Sep-24	18-Oct-24	0.2
Dec24 Schatz/Bund swap spread curve flattener	01-Nov-24	07-Nov-24	3.0
OPTIONS (OUTRIGHT)			
Sell 6Mx10Y unhedged straddle	05-Jan-24	26-Jan-24	75.0
Sell 6Mx30Y unhedged straddle	11-Apr-24	13-Jun-24	185.0
Sell 6Mx10Y unhedged straddle	02-Feb-24	14-Jun-24	185.0
Sell 3Mx2Y gamma - infrequent hedging	07-Jun-24	14-Jun-24	-7.0
Sell 3Mx30Y unhedged straddle	28-Jun-24	02-Aug-24	20.0
Sell 6Mx10Y unhedged straddle	30-Aug-24	04-Oct-24	35.0
Sell 3Mx30Y gamma - infrequent hedging	27-Sep-24	25-Oct-24	50.0
Sell 3Mx10Y GBP unhedged straddle	06-Sep-24	01-Nov-24	-147.0
Sell 3Mx30Y with infrequent delta hedging	06-Nov-24	24-Jan-25	180.0
OPTIONS (RELATIVE)			
1Yx1Y/1Yx10Y vol curve flatteners	26-Jan-24	15-Mar-24	1.0
1Yx1Y/1Yx10Y vol curve flatteners	12-Apr-24	31-May-24	0.0
3Mx2Y/3Mx10Y vol curve steepener	21-Jun-24	30-Aug-24	-2.0
3Mx10Y/3Mx30Y vol curve flattener	17-May-24	30-Aug-24	-2.0

Source: J.P. Morgan.

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Trades closed over the past 12 months

TRADE	ENTRY	EXIT	P&L
OPTIONS (MONEY MARKET)			
MISCELLANEOUS			
Pay 2Yx1Y €STR/SOFR basis	12-Jan-24	08-Mar-24	3.5
Buy 3Mx(1Yx1Y) ITM EUR receiver vs USD	15-Mar-24	05-Apr-24	7.4
Buy 3Mx10Y JPY payer spread vs EUR	15-Mar-24	12-Apr-24	2.9
Buy 3Mx(1Yx1Y) ITM EUR payer vs GBP	26-Apr-24	10-May-24	14.0
Buy 3Mx(5Yx5Y) OTM EUR receiver vs USD	17-Oct-24	01-Nov-24	4.9
Buy 1Yx10Y OTM GBP receiver vs USD	17-Oct-24	01-Nov-24	-3.5
Sell ITM Jun25 SONIA puts versus Euribor	10-Jan-25	24-Jan-25	14.0

Source: J.P. Morgan.

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United Kingdom

Awaiting US policy clarity, enter tactical 30s/50s gilt curve steepeners

- **Since our last GFIMS, gilt yields have rallied across the curve and cross-market have outperformed. Gilt yields remain strongly positively correlated with UST yields and the rally in UK yields has reduced some of the background media noise around UK fiscal concerns as 10Y and 30Y yields have fallen back to 4.65% and 5.20% respectively**
- **UK data this week overall sends a message of weak activity data, soft hiring but higher inflation and pricing pressures, which presents some challenges to the BoE's gradual easing stance. We expect the BoE will cut Bank Rate 25bp at the February meeting and continue to hold our received position in Feb25 MPC OIS into the meeting with 22bp of cuts priced**
- **We hold Aug25/Dec25 MPC OIS curve flatteners with the curve around -9bp. However, our conviction on the potential for ongoing BoE easing into 2H25 is weakening given the data is showing wage and price expectations rising and the Fed is expected to pause its easing cycle at the January meeting next week**
- **We expect 10Y gilt yields to exhibit ongoing strong positive directionality with 10Y USTs and despite the relative cheap valuations we remain cautious on outright duration**
- **From a relative valuation perspective, the 1Yx1Y/5Yx5Y SONIA curve remains 30bp too steep vs. front end rates, but we see limited potential for flattening given this relative steepness likely reflects USD curve dynamics with ongoing elevated term premia given uncertainty around Trump policy announcements. We stay neutral on the 2s/10s and 1Yx1Y/5Yx5Y SONIA curves**
- **We enter tactical 30s/50s gilt curve steepeners given relative valuations. The 30s/50s gilt curve is 6bp too flat vs. the level of 30Y yields and adjusting for convexity with the belly of the 10s/30s/50s gilt fly also cheap on a level and curve adjusted basis**
- **In micro RV space in the 20Y+ sector, looking at select high coupon/low coupon bonds we note the Dec49/Oct50 yield curve is fair value vs. 30s/50s and the Jan60/Oct61 yield curve a few bp too steep vs. 30s/50s gilt curve**

Since we published our last *GFIM*s two weeks ago gilt yields have rallied across the curve and are off their recent highs (**Figure 60**) and cross-market have outperformed vs. UST and particularly against Bunds. Gilt yields remain strongly positively correlated with UST yields (**Figure 61**) with the rally reflecting a combination of softer UK CPI and US CPI data as well as dovish comments from Fed Governor Waller. **The rally in UK yields has reduced some of the background media noise around UK fiscal concerns as 10Y and 30Y yields have fallen back to 4.65% and 5.20% respectively**. The UK's fiscal forecasts and fiscal policy remains sensitive to growth outturns and despite the recent rally in GBP yields we think the likelihood that growth undershoots the overly optimistic OBR growth forecasts will require a response from the government in terms of revising its fiscal projections and plans. However, we see limited potential for any change in the fiscal setting until the OBR forecast update on 26th March and we continue to expect **UK rate markets can continue to price UK term premia uncertainty against a backdrop of elevated US term premia given Trump policy uncertainty.**

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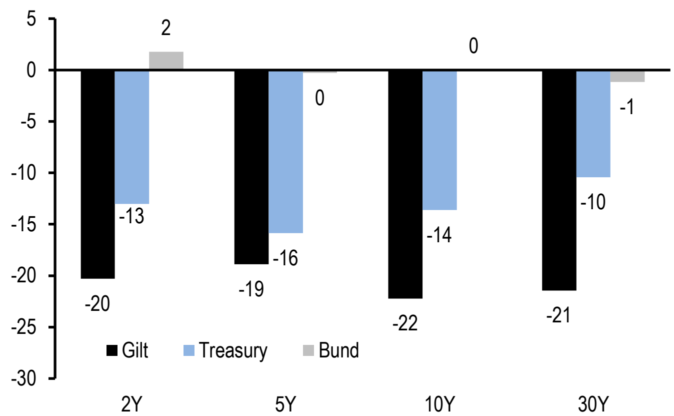
In our trade portfolio we see value in longs at the very front end of the MPC OIS curve and **continue to receive Feb25 MPC OIS** in addition to keeping Aug25/Dec25 MPC OIS flatteners. **We remain cautious on 10Y duration** and on the curve **enter tactical 30s/50s gilt curve steepeners** given relative valuations.

Figure 60: Gilt yields have rallied over the past couple of weeks with the curve moving broadly in parallel…

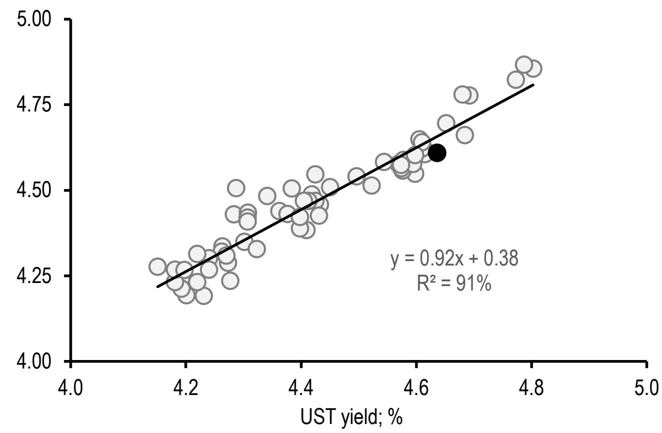
Change in benchmark yields since 10 Jan; bp



Source: J.P. Morgan.

Figure 61: …and the directionality between 10Y gilts and 10Y USTs has remained strong

10Y gilt yield regressed against 10Y UST yield; past 3M; bp



Source: J.P. Morgan.

UK data this week overall sends a message of weak activity data, soft hiring but higher inflation and pricing pressures, which presents some challenges to the BoE's gradual easing stance. The labour market report showed a move up in the ILO U/R to 4.4% in the three months to November, although the survey continues to suffer data reliability issues, whilst private sector earnings growth surprised to the upside which combined with an upward revision to October data leaves underlying pay growth in the private sector running at 7.3% on a 3m/3m annualised basis. Pay is on track to come in above the BoE's 4Q forecast of 5.1% and although there is volatility in the data the unexpected strength in wages may signal some degree of caution for the BoE. The flash composite PMI surprised modestly to the upside but the overall level still signals weak private sector activity, although we do expect an additional boost to GDP from higher government consumption as monthly public finances data show a clear increase in spending on public services, suggesting this strength will eventually show up more clearly in the GDP data. Both the PMI and the Gfk surveys signal negative business sentiment is also spreading to the consumer but with significant increases in the pricing components of both of these surveys.

We feel comfortable that the BoE will cut Bank Rate 25bp at the February meeting given the current easing stance and guidance around gradual easing alongside evidence of a softening trend in the BoE's supercore measure of services inflation. Around 22bp of easing are priced for the meeting next month and we continue **to hold our received position in Feb25 MPC OIS into the meeting**. **We also hold Aug25/Dec25 MPC OIS curve flatteners** with the curve around -9bp (**Figure 62**) given we still expect the BoE to ease once a quarter over 2025. However, our conviction on the potential for ongoing BoE easing into 2H25 is weakening given the data is showing wage and price expectations rising and the Fed is expected to pause its easing cycle at the January meeting next week. Although the very front end of the SONIA curve i.e. 1Y SONIA has exhibited a weaker positive directionality with 1Y SOFR we think the Fed pause can result in increased stickiness in the front end of the SONIA curve pricing quarterly pace of BoE easing **and we think absent a deteri-**

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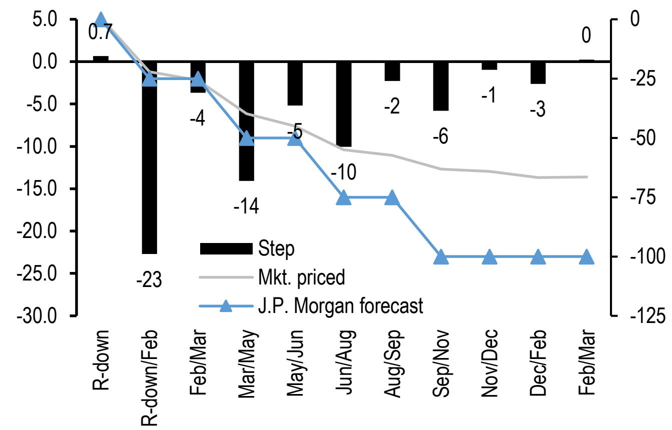
oration in the UK inflation and wage data then cumulative BoE easing priced by the end of 2025 will likely be stuck in a 60-70bp range (65bp of cuts priced currently).

Figure 62: We continue to receive Feb25 MPC OIS and hold Aug/Dec MPC OIS curve flatteners

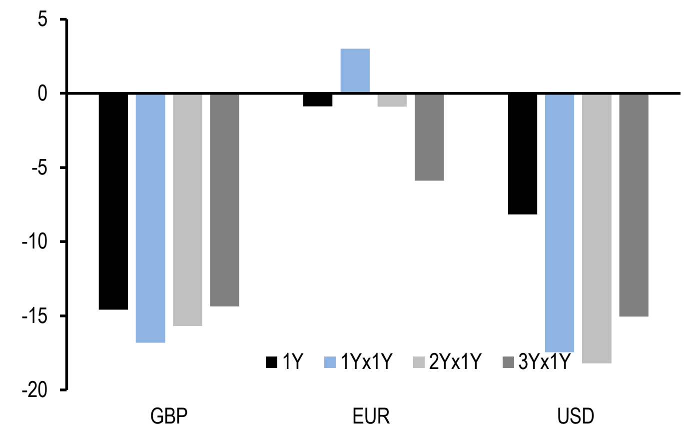
MPC OIS meeting date steps (LHS) cumulative easing priced and JPM BoE forecast (RHS); bp



Source: J.P. Morgan.

Figure 63: 1Yx1Y SONIA has rallied 15bp over the past two weeks in line with moves in 1Yx1Y SOFR

Change in GBP, EUR and USD OIS rates since 10 Jan; bp

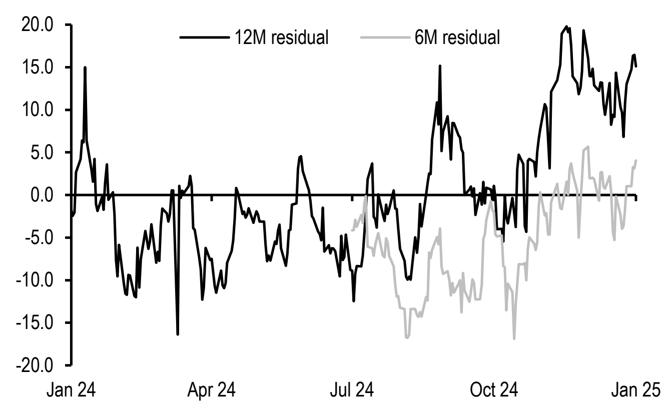


Source: J.P. Morgan.

1Yx1Y SONIA has rallied 15bp over the past two weeks with forwards in the short end of the SONIA curve all moving broadly in parallel and 1Yx1Y SONIA has broadly matched the 17bp rally in 1Yx1Y SOFR (**Figure 63**). From a fundamental valuation perspective**, 1Yx1Y SONIA is around 20bp cheap vs. our baseline BoE easing scenario but we see limited value in long positions at current levels**(1Yx1Y SONIA at 4.10%) given uncertainty over how much easing the BoE can deliver in 2025 against a backdrop of a Fed shifting to pause until 2Q25.

Figure 64: The relative cheapness of 10Y gilts vs. high frequency drivers has partially corrected

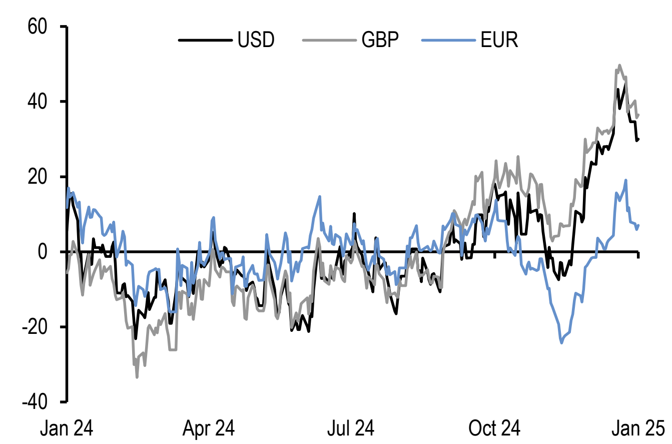
Residual from regressing* 10Y gilt yield vs. 10Y UST and 2Yx1Y SONIA – 2Yx1Y SOFR spread; residuals over past 6M and past 12M; bp



12M residual. 10Y gilt = 1.25 * 10Y UST + 0.97 * (2Yx1Y SONIA – 2Yx1Y SOFR) – 1.19. R-squ: 89%, std. error: 8bp
6M residual. 10Y gilt = 1.12 * 10Y UST + 0.49 * (2Yx1Y SONIA – 2Yx1Y SOFR) – 0.55. R-squ: 96%, std. error: 6bp
Source: J.P. Morgan.

Figure 65: The excessive term premia driven steepness of 1Yx1Y/5Yx5Y SONIA curve has partly corrected although the curve remains 30bp too steep on a relative basis

Residuals from regressing* 1Yx1Y/5Yx5Y USD, GBP and EUR OIS curves vs. the respective 1Yx1Y OIS rate; past 12M; bp 12M; bp



*1Yx1Y/5Yx5Y SOFR = - 0.57 * 1Yx1Y SOFR + 2.1. R-squ: 83%
1Yx1Y/5Yx5Y SONIA = - 0.68 * 1Yx1Y SONIA + 2.4. R-squ: 60%
1Yx1Y/5Yx5Y ESTR = - 0.73 * 1Yx1Y ESTR + 1.9. R-squ: 92%
Source: J.P. Morgan.

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10Y gilts have rallied 20bp over the past two weeks and have modestly outperformed 10Y USTs and more substantially outperformed 10Y Bunds given the reversal in recent bearish momentum softer December inflation data in both the UK and the US Despite the recent rally, the relative cheapness in 10Y gilts on our high frequency model has only modestly declined given the gilt rally predominantly reflects the rally in 10Y UST. 10Y gilts look over 15bp cheap on our high frequency valuation model vs. 10Y UST and the 2Yx1Y SONIA – 2Yx1Y SOFR spread (**Figure 64**). However, on a short 6M regression horizon the relative cheapness is much smaller at just under 5bp, reflecting the reduced partial beta of 10Y gilts vs. 2Yx1Y SONIA – 2Yx1Y SOFR spread over the past 6M. We see limited scope for the BoE to deliver a dovish surprise at the February MPC meeting and don't expect chancellor Reeves to make any significant fiscal or budget related announcements before the OBR presents its updated fiscal forecasts towards the end of March. The media noise around the UK's fiscal position has died down given the rally in yields but ultimately the UK government still faces a challenge to its fiscal forecasts from growth that will undershoot OBR forecasts. **We expect 10Y gilt yields to exhibit ongoing strong positive directionality with 10Y USTs and despite the relative cheap valuations we remain cautious on outright duration.**

On the curve, we highlighted in our last *GFIM*s that 2s/10s and 1Yx1Y/5Yx5Y GBP curves were trading too steep on an adjusted basis vs. the level of front-end yields. Over the past couple of weeks, the 2s/10s SONIA curve is broadly unchanged and has traded in a 6bp range with 1Yx1Y/5Yx5Y SONIA 3bp steeper whilst trading in a 10bp range. Given this, and with intermediate yields rallying over the past couple of weeks the excessive steepness of the 1Yx1Y/5Yx5Y SONIA curve vs. the level of 1Yx1Y SONIA yields has partially corrected, **although the 1Yx1Y/5Yx5Y SONIA curve remains 30bp too steep vs. 1Yx1Y SONIA on a regression basis** (**Figure 65**). In addition, as we had discussed a couple of weeks ago the bear steepening dynamic of the GBP curve seen in early January was mainly a reflection of the USD curve steepening and pricing of increased term premia. Similarly, the modest relative flattening in 1Yx1Y/5Yx5Y SONIA recently is also driven by global factors given the simultaneous relative flattening in the 1Yx1Y/5Yx5Y SOFR and 1Yx1Y/5Yx5Y ESTR curves over the past few weeks. Although from a relative valuation perspective the 1Yx1Y/5Yx5Y SONIA curve looks too steep vs. front end rates, we expect the dynamic of the 1Yx1Y/5Yx5Y USD can continue to be the main driver of the 1Yx1Y/5Yx5Y SONIA curve. We expect the USD curve to continue to reflect increased term premia given there is still uncertainty around Trump policy announcements and their potential macro implications. **We stay neutral on the 2s/10s and 1Yx1Y/5Yx5Y SONIA curves**.

Further out, the 10s/30s curve has been broadly range trading over the past month and is a few bp flatter than its 6M average. From a relative valuation standpoint, **the 10s/30s gilt curve is now 1bp too flat vs. the level of front-end yields, 30Y rates and the 10s/30s UST curve** (**Figure 66**), having traded 3bp too steep a couple of weeks ago.

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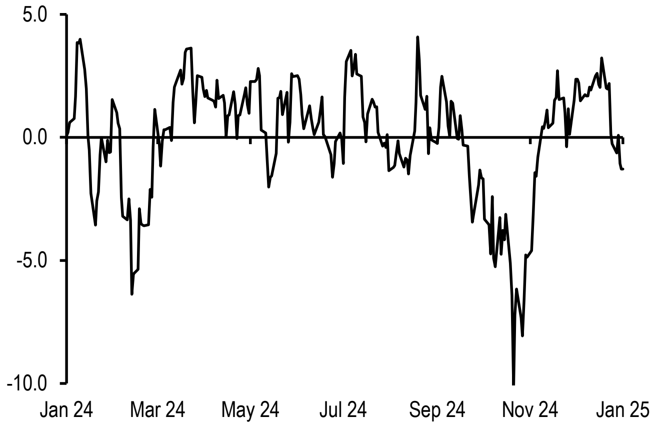
Figure 66: The 10s/30s gilt curve looks modestly too flat vs. high frequency drivers

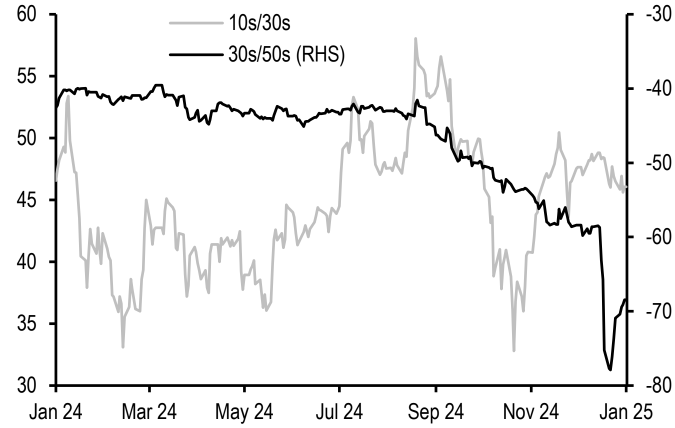
Residual* from regressing 10s/30s gilt curve vs. 30Y yield, 1Yx1Y SONIA and 10s/30s UST curve; past 12M; bp



*10s/30s gilt = 0.06 * 30Y UK – 0.14 * 1Yx1Y SONIA + 0.2 * 10s/30s UST + 0.8. R-squ: 76%, std. error: 3bp
Source: J.P. Morgan.

Figure 67: The 30s/50s gilt curve flattened materially during the early-January sell-off in yields

10s/30s and 30s/50s gilt curves; bp



Source: J.P. Morgan.

At the ultra-long end of the curve, the significant sharp flattening in 30s/50s gilt curve alongside the large outperformance of low coupon gilts vs. adjacent high coupon gilts in the 20Y+ sector has been in focus. The 30s/50s gilt curve has generally exhibited low correlation and beta to the 10s/30s gilt curve over the past few months and the sharp sell-off in yields during the first couple of weeks of January drove a significant flattening and further inversion of 30s/50s. The 30s/50s gilt curve flattened 20bp from 7 January – 14 January as 30Y yields rose 25bp before partially retracing over the past week (**Figure 67**). From a relative valuation standpoint, the 30s/50s curve has exhibited strong negative directionality with the level of 30Y yields (i.e. flattens in a sell-off) and we note **that despite the recent re-steepening the 30s/50s gilt curve looks around 8bp too flat vs. the level of 30Y yields and adjusting for our estimated value of 50Y bond convexity** (**Figure 68**). We also note that this cheapness of the 30Y sector on the gilt curve can also be seen in the 10s/30s/50s gilt fly which is trading 7bp cheap on a level- and curve-adjusted basis on a 12M regression (**Figure 69**).

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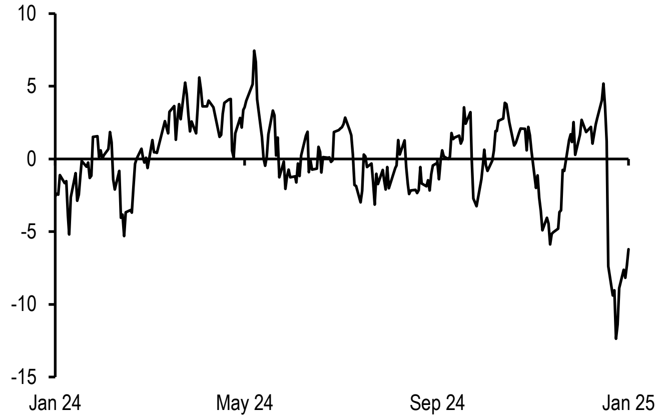
Figure 68: The 30s/50s gilt curve is 6bp too flat vs. the level of 30Y yields and adjusting for convexity. We enter tactical 30s/50s gilt curve steepeners…

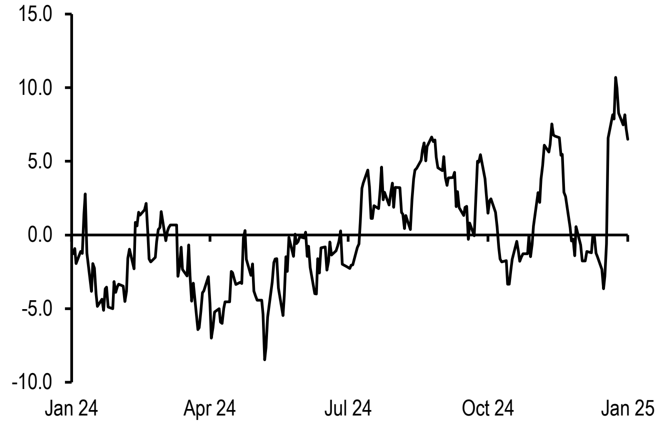
Residual* from regressing 30s/50s gilt curve vs. level of 30Y gilt yield and implied value of 50Y convexity; past 12M; bp



*30s/50s = -25.2 * 30Y yield + 0.63 * value of 50Y convexity + 62.85. R-squ: 85%, std. error: 3bp
Source: J.P. Morgan.

Figure 69: …with the belly of the 10s/30s/50s gilt fly also cheap on a level and curve adjusted basis

Residual* from regressing 10s/30s/50s gilt fly (50:50) vs. 30Y yields and 10s/50s gilt curve; past 12M; bp



*10s/30s/50s gilt fly = 0.26 * 30Y yield + 0.37 * 10s/50s gilt curve – 0.76. R-squ: 57%, std. error: 4bp
Source: J.P. Morgan.

We acknowledged that reduced liquidity and position squaring in micro high coupon/low coupon bond curves in the 20Y sector has likely exacerbated the relative flatness of the 30s/50s curve. In addition, there is very limited supply of ultra-long end gilts given end user demand has shifted inwards from the ultra-long sector. However, despite these technical factors **from a relative valuations standpoint we recommend entering tactical 30s/50s gilt curve steepeners** (gilt Jul54/Oct73) at around the -69bp level.

In micro curve space, the sell-off in yields and flattening in 30s/50s also resulted in low coupon bonds outperforming neighbouring high coupon bonds given convexity effects, with the gilt 4.25% Dec49/0.625% Oct50 and 4.0% Jan60/0.5% Oct61 micro curves showing a similar substantial flattening dynamic in the first couple of weeks of January (**Figure 70**) to the large flattening in the 30s/50s gilt curve. Both these micro high coupon/low coupon curves have exhibited strong positive directionality with the 30s/50s curve and we note that from a relative valuation standpoint the Dec49/Oct50 micro curve is fair value vs. 30s/50s whilst the Jan60/Oct61 micro yield curve is a few bp too steep vs. 30s/50s (**Figure 71**). Given this, and the anecdotal skew to demand in 0.5% gilt 2061, particularly from retail-type investors, **we prefer 30s/50s gilt curve steepeners rather than micro Jan60/Oct61 gilt curve steepeners.**

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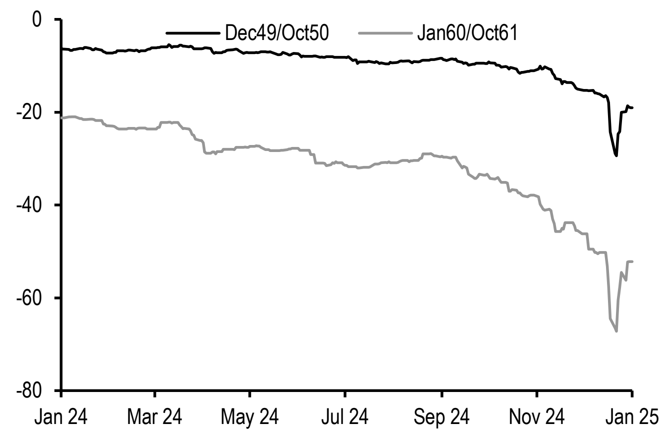
Figure 70: The sell-off in yields also drove outperformance of low coupon vs. neighbouring high coupon bonds in the 20Y+ sector

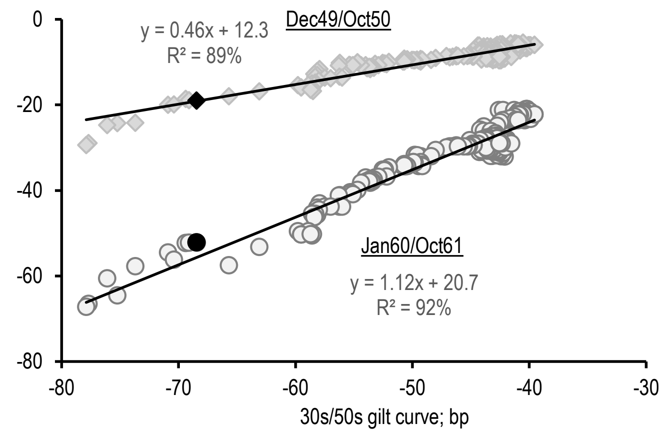
Dec49/Oct50 and Jan60/Oct61 gilt yield curves; bp



Source: J.P. Morgan.

Figure 71: …with Dec49/Oct50 yield curve fair value vs. 30s/50s and the Jan60/Oct61 yield curve a few bp too steep vs. 30s/50s gilt curve

Dec49/Oct50 and Jan60/Oct61 gilt yield curves regressed against 30s/50s yield curve; past 12M; bp



Source: J.P. Morgan.

Trade recommendations

New Trades

- **Enter 30s/50s gilt steepeners (Jul54/Oct73)**
  Buy £16.3mn of UKT Jul54 and sell £25mn of UKT Oct73 @-69bp. 3M C+S is 0.4bp.

Existing Trades

- **Keep receiving Feb25 MPC OIS**
  Receive £150mn Feb25 MPC OIS @448bp. P/L since inception is 5bp (recommended 10 Jan)
- **Keep Aug25/Dec25 MPC OIS flattener**
  Keep receiving €150mn Dec25 MPC OIS vs. paying £150mn Aug25 MPC OIS at -8.75bp. P/L since incpetion is -3bp (recommended 7 Jan)
- **Stay long gilt Mar27 on ASW basis**
  Buy £50mn gilt 3.75% Mar27 on ASW basis@ 15.1bp. P/L since inception is -6.1bp (recommended 12 Jul)
- **Keep long 1Yx5Y A/A-50bp receiver spread versus short OTM payer**
  Keep long £100mn 3.35%/2.85% 1Yx5Y receiver spread (notification date 22 Sep 2025, maturity date 22 Sep 2030) versus short£100mn 3.865% 1Yx5Y payer at -147bp of notional with ATMF 1Yx5Y rate at 3.88% versus entry level at close to flat premium. P/L since inception is -147bp of notional (recommended 20 Sep).

*All existing trades priced as of 1pm UK 24th Jan 2024, except for those done via options, which are as of Thursday COB.

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Trades closed over the past 12 months

TRADE	ENTRY	EXIT	P&L
DURATION			
Rec 1Yx1Y SONIA	19-Jan-24	01-Feb-24	11
Pay May24 MPC OIS	22-Mar-24	05-Apr-24	3
Long 10Y gilt	31-May-24	06-Jun-24	19
long 1Q51 vs short gilt 0FE50 (equinotional)	31-May-24	14-Jun-24	5
Rec Sep24 MPC OIS	19-Jul-24	01-Aug-24	9
Long 5Y gilt	27-Sep-24	30-Oct-24	-43
CURVE			
10s/30s gilt curve flattener	02-Feb-24	09-Feb-24	8
H4/U4 3M SONIA flattener	19-Jan-24	08-Mar-24	-31
5Yx5Y/15Yx15Y curve steepener	01-Mar-24	22-Mar-24	-4
10s20s gilt curve flattener	08-Mar-24	05-Apr-24	7
Aug24/Nov24 MPC OIS curve flatteners	23-Feb-24	26-Apr-24	-11
10s/30s gilt steepener (UKT Jan34 vs UKT Oct53)	12-Apr-24	17-May-24	-2
1Yx1Yx1Y SONIA flattener	05-Apr-24	14-Jun-24	2
10s30s gilt flattener	14-Jun-24	19-Jul-24	-2
ronts/reds (3Mx1Y/15Mx1Y)SONIA curve flattener	12-Jul-24	16-Aug-24	5
5s30s SONIA steepener	16-Aug-24	19-Sep-24	7
H5/H7 3M SONIA futures flattener	06-Nov-24	08-Nov-24	13
SWAP SPREADS			
UKT Sep34 swap spread narrower	13-Sep-24	04-Oct-24	3

TRADE	ENTRY	EXIT	P&L
RELATIVE VALUE			
short gilt 3T38 vs long gilt 4Q39 (equinotional)	19-Jan-24	01-Mar-24	2
Long belly Jan34/Mar36/Sep39 cash&duration ntrl fly	15-Mar-24	10-May-24	1
short Jan32/Jan38/Oct41 gilt fly (Cash and dur neutral)	01-Mar-24	16-Aug-24	-5
Receive belly 2s5s10s SONIA fly (50:50)	30-Aug-24	13-Sep-24	2
Buy belly 10s/30s/50s gilt fly (50:50)	27-Sep-24	25-Oct-24	2
Pay belly Mar25/May25/Jun25 fly 50:50	13-Sep-24	13-Dec-24	2
Short belly 4Q36/4Q40/3H45 (cash-and-duration neutral)	11-Oct-24	13-Dec-24	-1
MISCELLANEOUS			
Receive 5Yx5Y SONIA vs. 5Yx5Y SOFR	05-Jul-24	16-Aug-24	-14
Long 10Y gilt vs 10Y Bund	18-Oct-24	30-Oct-24	-8
SSA			
CONDITIONAL CURVE AND FLIES			
OPTIONS			
Buy 3Mx5Y GBP vs USD	21-Mar-24	12-Apr-24	20.0
BuyJun24 SONIA call ladder	26-Jan-24	17-May-24	0.5
Sell 1Yx30Y A-50 delta hedged straddle	26-Apr-24	17-May-24	45.0
Buy Sep24 SONIA call ladder	17-May-24	07-Jun-24	1.0
Sell 6Mx30Y unhedged straddles	17-May-24	07-Jun-24	55.0
Sell 3Mx10Y GBP vs USD	17-May-24	21-Jun-24	20.0
Sell 6Mx10Y unhedged straddle	17-May-24	21-Jun-24	145.0
Buy Sep24 SONIA call ladder	07-Jun-24	30-Aug-24	3.0
Short 3Mx2Y gamma	21-Jun-24	30-Aug-24	16.0

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Treasuries

Meet the new boss, same as the old boss

- Yields have retreated from their local highs and the curve bullishly flattened over the last two weeks
- We continue to think the front end offers value: markets are not pricing another full 25bp ease until summer, the Fed retains an asymmetrically dovish bias, and valuations should act as a soft ceiling: stay long 2-year Treasuries
- Intermediate and long-end Treasuries have lagged, with yields remaining near 12-month highs and too high after adjusting for market-based Fed policy, growth, and inflation expectations…
- ...However, with the Fed unduly focused on its labor market mandate and term premium biased higher, we do not expect long-end yields to retrace materially lower
- Locally, the 5s/10s curve remains too steep given front-end rate levels: maintain 5s/10s flatteners
- Foreign investors net sold $16bn of long-term Treasuries in November, the largest month of net selling since October 2021, with this activity concentrated among investors domiciled in the Cayman Islands, whereas European remain pervasive net buyers

Market views

Yields have declined since our last publication two weeks ago, but the path has not been a straight line. Concerns over hawkish risks faded last week, as core CPI rose 0.23% in December (consensus: 0.3%), and coupled with the details from PPI imply core PCE rose 0.19% over the month (see *US: A little bit softer now for December core CPI*, Michael Hanson, 1/15/25), allaying some hawkish fears after the December employment data. Turning to Fedspeak, Governor Waller suggested room for further easing as early as March, discussed the possibility of 3 to 4 cuts this year, and said that "if the data doesn't cooperate, then you're going to be back to two, maybe even one if we just get a lot of sticky inflation." Finally, Treasury Secretary nominee Bessent focused on narrowing the deficit via reduced spending, and did not comment on the maturity structure of Treasury's debt. Given this backdrop, 10-year yields at one point earlier this week had fallen 25bp from their local peak just two weeks ago.

However, yields retraced higher over the second half of this week, with much of the move coming on Thursday, after President Trump appeared virtually at the World Economic Forum in Davos, pressing OPEC to "bring down the cost of oil" and stating he will "demand that interest rates drop immediately," and the last leg of curve steepening seemed to occur after these comments alongside a widening in TIPS breakevens. Over the last two weeks, 2-, 5-, 10-, and 30-year yields have declined 12bp, 16bp, 15bp, and 12bp, respectively, outperforming all other DM government bond markets except for the UK over the period (**Figure 72**).

Looking ahead, the FOMC meeting looms large next week, but is unlikely to be a major market-moving event. The December FOMC statement and inter-meeting commentary from officials indicate a Committee that is ready to slow the pace of easing and pause at the next meeting. Indeed, money markets have taken a clear signal as well: OIS forwards are pricing in just 6bp of easing over 1Q25 and are not pricing a full 25bp ease until the July meeting (**Figure 73**). With Fedspeak moving more hawkish in recent months, there is a risk Chair Powell could take a more cautious tone over rate cuts in his prepared remarks, but with

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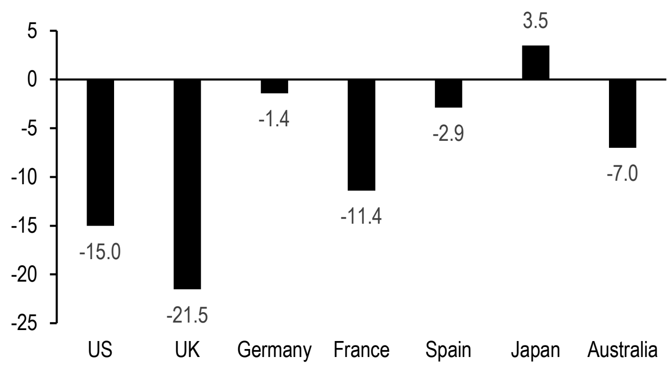
two more sets of employment and CPI data before the March FOMC meeting, we do not expect a strong shift in guidance (see *US: The Fed in 2025*, Michael Feroli, 1/24/25). Thus, with the Fed's reaction function still asymmetrically dovish, choosing between an extended hold or shallow cuts, we would expect Fed expectations to remain relatively stable, and this should leave front-end Treasuries well supported as well, sitting just 6bp below the Fed funds effective rate. **Accordingly, we continue to recommend longs in 2-year Treasuries.**

Figure 72: Yields declined across most of the DM, and the US outperformed all markets save for the UK

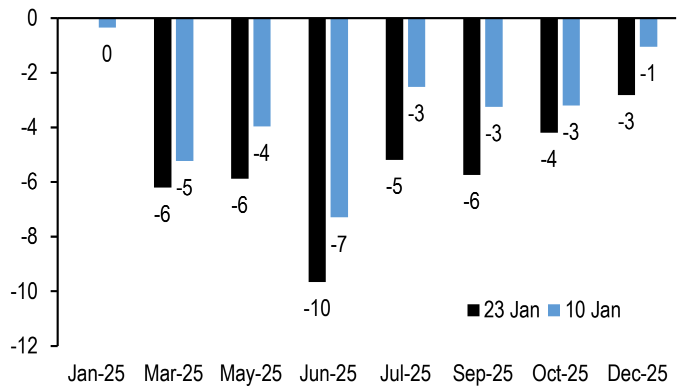
Changes in 10-year DM government bond yields, 1/10/25-1/24/25; bp



Source: J.P. Morgan

Figure 73: OIS forwards are not pricing another full 25bp cut until late-summer

Change in Fed funds effective rate implied by FOMC meeting date OIS forwards, 1/10/25 vs. 1/24/25; bp



Source: J.P. Morgan

Moving longer out the curve, though the long end has recovered from its local yield highs earlier this month, it has lagged the rally at the front end, which one would naturally expect in an easing regime. However, it's notable that in the 10-year sector and beyond, yields are in the 90th percentile and above of their 12-month ranges, and within 10-15bp of their highs (**Figure 74**). Moreover, even with this latest rally, valuations appear cheap as well: 10-year yields continue to trade 40bp too high after controlling for the market's medium-term Fed policy, inflation, and growth expectations, and the size of the Fed's balance sheet, a gap of more than 2 standard deviations (**Figure 75**). **At least optically, this would make the case for extending duration, particularly if the Fed is on hold through mid-year, as we have forecast.**

Figure 74: Long-end yields remain closer to their yearly highs...

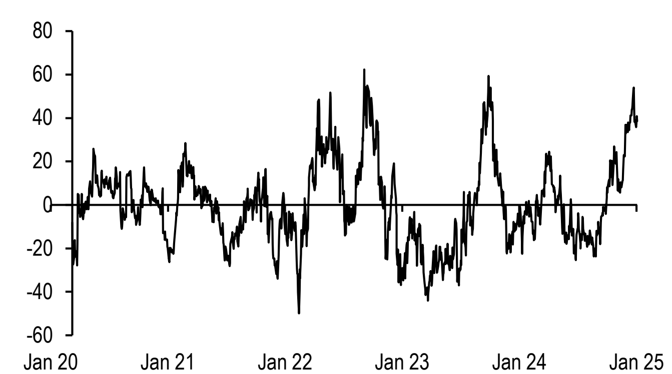
Current levels, YTD changes, and 12-month statistics for on-the-run Treasuries; % unless otherwise indicated

Tenor	Last	YTD chg (bp)	12m low	12m high	12m avg	%
2y	4.270	2.0	3.52	5.04	4.38	38%
3y	4.328	4.6	3.41	4.88	4.24	54%
5y	4.427	3.7	3.40	4.72	4.16	80%
7y	4.527	3.9	3.50	4.72	4.20	88%
10y	4.622	4.6	3.62	4.80	4.24	94%
20y	4.915	5.9	4.00	5.07	4.54	96%
30y	4.848	6.6	3.94	4.99	4.45	97%

Source: J.P. Morgan

Figure 75: ...and appear 40bp high in our valuation framework...

Residual of J.P. Morgan 10-year Treasury yield fair value model residual*; bp



*10-year Treasury yields regressed on 3m3m OIS rates (%), 5y5y seasonally-adjusted TIPS breakevens (%), J.P. Morgan U.S. Forecast Revision Index (%), Fed forward guidance (months), and Fed B/S as share of the US economy (%). Regression over the last 5 years: R-squared = 98.1%, SE = 19.3bp
Source: J.P. Morgan, Federal Reserve

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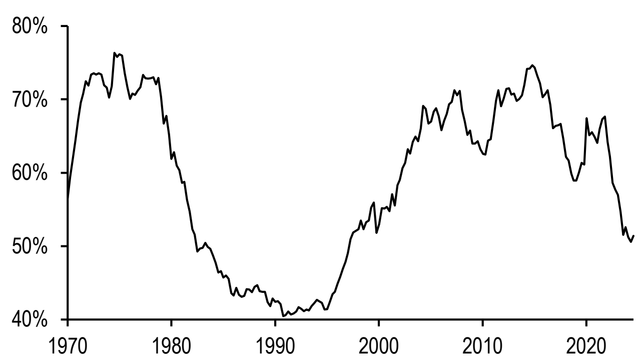
However, we remain reticent to add duration in longer-duration Treasuries, for a number of reasons. First, the Fed's reaction function makes it challenging to add long-duration securities here. We think the Fed's words and actions underscore a desire to not bring the expansion to a premature end, thus implicitly elevating the labor market side of its mandate over its inflation target. This should keep growth and inflation expectations elevated, even if the Fed does resume cutting later this year, thus justifying higher yields than persisted even in 4Q24. **Second**, our fair-value framework does not incorporate an independent variable for term premium, and it's our view that term premium is structurally biased higher over time as the composition of ownership for risk-free assets continues to pivot away from price-insensitive hands like the Fed, foreign official institutions, and US banks, and toward more price sensitive hands, while the Treasury market continues to grow rapidly (**Figure 76**). Just as term premium was depressed earlier this century as the pace of demand from these investors outpaced the growth of the Treasury market, we believe the reversal of these trends supports higher term premium, making it more challenging for yields to converge with their model-implied fair value.

Figure 76: ...but the shifting tide of Treasury demand challenge the notion yields can reverse significantly lower...

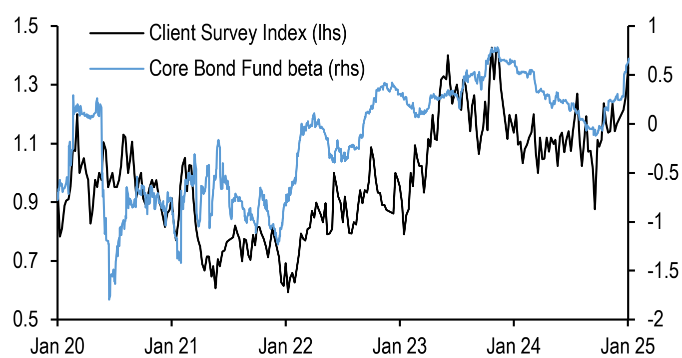
SOMA, US commercial bank, and foreign combined share of marketable Treasury debt outstanding; %



Source: Federal Reserve Z.1

Figure 77: ...and our Treasury Client Survey and core bond betas have both reached their longest levels since December 2023, amid the "immaculate disinflation"

J.P. Morgan Treasury Client Survey Index (lhs) versus Partial beta with respect to 10-year US Treasury yields in our model for active bond fund excess returns**



*(longs + neutrals)/(shorts + neutrals)
** The core bond fund index is comprised of the 20 largest (by assets under management) actively-managed US core bond funds. Model is a 3-month regression of daily excess returns on the bond fund index versus daily changes in 1) 10-year US Treasury yields, 2) 5s/30s Treasury curve, 3) JULI spread to Treasury, 4) MBS Production coupon Treasury OAS, and 5) 3Mx10Y swaption volatility
Source: J.P. Morgan, Bloomberg Finance L.P.

Third, it's notable that investor positions have extended in recent weeks. Our latest *Treasury Client Survey* has moved to its longest levels since December 2023 and is now 3 standard deviations longer than the prior 1-year average. Similarly, our core bond fund index beta to 10-year Treasuries has also risen sharply: three months ago it showed actively managed core bond funds were underweight duration, but now are as overweight as they were in late-2023, when yields peaked at 5% (**Figure 77**). Certainly, it seems that active investors have added duration as yields have retraced to their highest levels in over a year, but we have found that the Treasury Client Survey Index can be contrarian in nature, as sharp deviations from recent averages can predict contrarian moves in yields over the next 4-6 weeks (see *Survey says: Using the Treasury Client Survey to predict rates moves*, 7/21/23). Indeed, with both of these measures now reaching extremely long levels, this would indicate some risk that yields could move higher over the coming weeks if these longs are liquidated. For this reason, we don't feel comfortable extending duration out the curve.

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However, locally, it appears the bearish steepening of the curve has been excessive. Figure 78 shows a number of curve pairs regressed on the level of 2-year yields over the last 12 months. The figure shows that front-end yields, a proxy for medium-term Fed expectations, account for much of the variation of many curve pairs, particularly those that are wider in nature. It also shows that most of these curves have diverged significantly from the level of front-end yields over the last month, and now appear considerably steep on this basis. **In particular, 5s/10s appears more than 2 standard deviations too steep given the level of 2-year yields over this horizon, and we continue to recommend 5s/10s flatteners to fade this aggressive steepening tactically, and to also hedge our front-end longs.**

Figure 78: Most broad curves appear too steep given the level of front-end yields, and we think 5s/10s flatteners tactically offer value

Statistics for various Treasury curves regressed on 2-year yields; bp unless otherwise indicated

Curve	Level	R-squared	Beta	Residual	Z-score	3m C+R
3s/10s	29.4	65.3%	-37.6	24.5	2.3	-0.4
3s/20s	58.7	79.0%	-50.2	22.8	2.3	0.9
3s/30s	52.0	79.2%	-53.7	25.0	2.4	-0.1
5s/7s	10.0	72.4%	-9.1	4.8	2.2	0.3
5s/10s	19.6	84.0%	-21.3	8.4	2.4	-0.9
5s/30s	42.1	90.1%	-37.4	8.9	1.9	-0.5
7s/10s	9.6	84.5%	-12.2	3.5	1.8	-1.2
7s/20s	38.8	88.7%	-24.9	1.8	0.5	0.1
7s/30s	32.1	88.7%	-28.3	4.1	1.1	-0.8
10s/20s	29.2	78.9%	-12.7	-1.7	-0.7	1.3
10s/30s	22.5	84.6%	-16.1	0.6	0.2	0.3

Source: J.P. Morgan

November TIC update

Last Friday Treasury released its monthly TIC data, showing foreign investors net sold $16bn long-term Treasuries in November, the first month of net selling since July 2023 and the largest since October 2021. Private investors net sold $15bn, including $570mn from International and Regional Organizations (IROs), compared to net buying of $92bn in October. Foreign official investors net sold $1bn of long-term Treasuries, after adding $14bn the month prior (**Figure 79**).

Geographically, Euro-area investors remained the most prominent buyers of long-term Treasuries, purchasing $14bn in November, with activity concentrated in Belgium, France, and the Netherlands (**Figure 80**). Demand from the Euro-area remains robust as Treasury valuations look somewhat attractive for Euro-funded investors on a FX-hedged yield basis. Oil exporting countries added $5.8bn Treasuries over the month, almost completely concentrated among investors domiciled in the UAE. Conversely, investors in the Cayman Islands shed $22bn Treasuries in November, close to unwinding the large purchases made in September. As a reminder, we tend to think of flows from this country as largely reflecting hedge fund demand and the large net selling could reflect levered clients positioning for higher yields following the election results. Finally investors domiciled in Japan net sold $9bn Treasuries, and have offloaded roughly $57bn YTD in 2024 through November, with more timely data from the MoF indicating net selling pressure continued into December (see *Japan Rates Topics: Japan Flows in Pictures*, Takafumi Yamawaki, 1/14/25).

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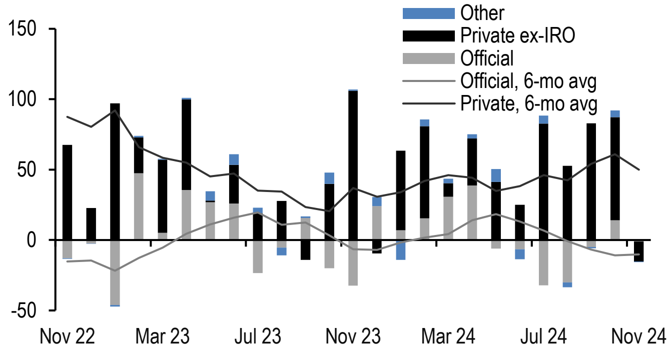
Figure 79: Foreign investors on net sold $16bn of long-term Treasuries in November, the most since October 2021...

Total net sales of long-term Treasuries by US residents by sector and 6-mo. moving average; $bn



Source: Treasury International Capital System

Figure 80: ... with selling pressure emanating from Japan and the Cayman Islands

Net sales of long-term Treasuries by US residents from Sept - Nov 2024 by region as well as cumulative net sales year-to-date; $bn

Region	Nov-24	Oct-24	Sep-24	YTD 2024
Euro Area†	13.6	5.6	60.9	172.0
Oil Exporters*	5.8	3.7	3.2	34.2
EM ex-China**	4.0	6.3	7.2	83.4
Ireland	2.5	-1.9	-0.7	13.9
UK	-1.4	11.3	-0.6	52.3
China	-4.1	3.1	-12.4	-91.1
Japan	-9.0	5.2	-28.7	-57.2
Cayman Islands	-21.7	-0.1	23.7	74.2

Source: Treasury International Capital System
*Oil exporters include all OPEC members (excluding Equatorial Guinea & Angola) and also include Bahrain, Indonesia & Oman
**EM ex-China includes Russia, Brazil, African countries, Taiwan (China), South Korea and Mexico
† Euro area include Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, Spain

Trade recommendations

- **Maintain 2-year Treasury longs**

- Stay long 100% risk, or $272mn notional of T 4.25% Nov-26s
- (*US Fixed Income Markets Weekly*, 12/20/24: P/L since inception: 3.3bp)

- **Maintain 5s/10s flatteners**

- Stay short $115mn notional of T 4.375% Dec-29s
- Stay long 100% risk, or $66.2mn notional of T 4.25% Nov-34s
- (*US Fixed Income Markets Weekly*, 1/10/25: P/L since inception: -1.7bp)

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Figure 81: Closed trades in last 12 months
P/L reported in bp of yield unless otherwise indicated

TRADE	ENTRY	EXIT	P/L
Duration			
30-year duration shorts	12/15/23	01/04/24	10.9
5-year duration longs	01/19/24	02/01/24	25.3
5-year duration longs	02/09/24	03/07/24	3.3
Equi-notional 2s/5s flatteners	05/31/24	06/06/24	16.0
5-year duration shorts	06/14/24	07/01/24	21.9
30% 2-year duration short	07/12/24	07/31/24	-1.8
2-year duration longs	11/15/24	12/02/24	7.1
Curve			
2s/5s flatteners	12/08/23	05/17/24	6.0
5s/30s steepener	11/22/23	09/06/24	26.4
3s/5s steepener	09/04/24	09/06/24	3.1
3s/30s steepener	09/06/24	09/18/24	0.2
3s/20s steepener	09/27/24	10/04/24	-18.3
10s/30s steepeners	11/15/24	12/18/24	-1.2
Relative value			
2.75% Aug-32/ 3.5% Feb-39 steepeners	01/10/24	01/26/24	5.2
20s/ old 30s flatteners	02/15/24	05/10/24	-2.6
100:97 weighted 3.75% Apr-26/ 4.625% Sep-26 flatteners	04/12/24	05/17/24	2.2
100:95 weighted 4% Feb-28 / 4% Feb-30 steepeners	02/23/24	05/31/24	-6.6
50:50 weighted 3s/5s/7s belly-richening buterflies	03/15/24	06/14/24	2.1
100:98 weighted 4.75% Feb 37s / 4.5% Aug 39s steepeners	06/14/24	07/12/24	2.6
100:95 weighted 0.625% Jul-26s / 1.25% Dec-26s steepeners	07/12/24	08/14/24	1.5
2.375% May-51s / 4.25% Feb-54s steepener	11/15/24	01/06/25	1.6
Term premium			
75:6 weighted 5s/10s/30s belly-cheapening butterfly	09/29/23	11/06/24	8.5
64:11 weighted 3s/10s/30s belly-cheapening butterfly	11/26/24	12/20/24	8.3
Number of positive trades			18
Number of negative trades			5
Hit rate			78%
Aggregate P/L			121.7

Source: J.P. Morgan

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Interest Rate Derivatives

DISP-play time

- Expectations of easing have risen following softer inflation data, helping to push yields lower. But thanks to falling term premium, swap curves anchored in the front end are not much steeper. Going forward, term premium remains likely to drift lower in the near term, and we recommend maintaining tactical exposure to swap curve flatteners hedged for Fed expectations. But the longer term direction of travel for term premium remains upward. One way to position for a structural increase in term premium, while mitigating the risk of a tactical decline, is to seek conditional long exposure to term premium in a selloff …
- … underweight the belly of a 2s/7s/30s swap yield butterfly conditionally in a selloff, using 3M expiry payer swaptions. Given that the butterfly is positively correlated to term premium, and given that term premium is now perhaps the dominant driver of yield levels, such a trade offers a way to gain conditional long exposure to term premium when it is rising. Entry levels are attractive as well, as current swaption implied volatilities permit slight premium intake at construction
- Term funding premium is likely tactically biased lower as well, causing us to maintain our expectation of steeper swap spread curves - initiate 7s30s swap spread curve steepeners. But with maturity matched swap spreads now close to fair value in most sectors, we turn neutral on outright swap spread positions
- Policy uncertainty remains significant, and the FOMC meeting, employment data and cabinet appointments all lie ahead, bringing potential for higher event risk and volatility - we stay bullish on volatility. Long tails are attractive as well, as valuations remain cheap in long tails - buy 1Yx10Y swaption volatility and received fixed in 1Yx10Y to hedge the rate exposure
- On a relative basis, we recommend buying 1Yx10Y swaption volatility versus selling 10Yx10Y volatility, while selling 2Yx2Y swaption straddles and paying fixed in 2Yx2Y swaps to hedge the directional exposure to volatility as well as rates

DISP-play time

In the two weeks since our last publication, a lot has happened in the United States, from the inauguration of President Trump and the start of confirmations of his cabinet to former Treasury Secretary Yellen sending a letter to Congressional leadership informing that a "debt issuance suspension period (DISP) will begin on Tuesday" and that Treasury would start using extraordinary measures effective Tuesday (1/21). However, economic data was rather light, with CPI last week being the important event, which came in softer-than-expected. Core CPI rose 0.22% in December, below consensus, implying core PCE rose 0.19% over the month (see A little bit softer now for December core CPI, M. Hanson, 1/15/2025). Initial claims this week rose, but remain near their lowest levels (see Claims send uncertain message on LA fire payroll drag, A. Reinhart, 1/23/2025). Next week, of course, brings the FOMC meeting, where we expect a pause, in line with the markets, and expect Chair Powell to keep the possibility of action at the March meeting open (The Fed in 2025, M. Feroli, 1/24/2025).

All in all, expectations of easing have risen following the softer inflation data and swap yields have declined, led by the front end. Year-end forward OIS rates are also lower by ~15bp, and 3- to 5- year yields are lower by a similar amount. But what is noteworthy is the

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lack of steepening in swap curves anchored in the front end. For instance, the 2s/10s curve is essentially flat despite the decline in forward OIS rates (**Figure 1**). This reflects the offsetting impacts from increased easing expectations on the one hand, and a decline in term premium on the other hand. The widely followed ACM model term premium in the 10-year sector has declined by over 10bp over the same period.

Figure 1: In the past two weeks, yields are lower along with ACM term premium, while swap yield curves anchored in the long end have steepened

Selected statistics for benchmark swap yields (%), 10Y ACM term premium* (%), and swap yield curves (bp), 1/10/2025 - 1/24/2025

	Start	Change	End	Min	Mean	Max
2Y	4.24	-0.13	4.11	4.10	4.16	4.25
3Y	4.25	-0.15	4.10	4.09	4.15	4.27
5Y	4.27	-0.15	4.12	4.09	4.16	4.30
7Y	4.27	-0.14	4.13	4.10	4.18	4.31
10Y	4.28	-0.13	4.16	4.12	4.20	4.33
20Y	4.29	-0.10	4.19	4.16	4.23	4.33
30Y	4.11	-0.09	4.03	3.99	4.06	4.15
10Y ACM TP	0.65	-0.10	0.55	0.47	0.58	0.68
2s/5s	3	-2	1	-4	1	1
2s/10s	5	0	5	-1	4	9
2s/30s	-12	4	-8	-14	-10	-7
5s/10s	2	2	4	2	3	5
5s/30s	-15	6	-9	-15	-10	-7
10s/30s	-17	4	-13	-17	-14	-11

*Current ACM term premium value as of 1/23/2025
Source: J.P. Morgan., Federal Reserve Board of New York

The recent decline in term premium is not unexpected. In our publication two weeks ago (see Strong Jobs Report, Mike Drop) we had highlighted both the increased significance of term premium as a factor in driving yield curves, and our tactical bias towards lower term premium. Looking ahead, a further retracement in term premium remains a possibility (given how quickly and how much term premium rose in late December), and **we recommend maintaining exposure to trades designed to gain efficient exposure to such a decline**. **But that being said, the longer term direction of travel for term premium remains upward, given the anticipated trends in UST supply and price-insensitive demand** (see *Treasuries*). This raises an interesting question - is there a way an investor can position for the expected longer term rise in term premium, while also guarding against the near prospect of likely further declines in term premium?

One way to do this is via conditional bearish trades that are positively exposed to term premium. Increases in term premium would translate into higher yields, and it is thus no surprise that intermediate maturity yields are well correlated to term premium metrics (**Figure 2**). Indeed, as Fed expectations have become more stable and flat, term premium will likely be the more dominant driver of yield levels in the near term. **Separately**, a 2s/7s/30s (50:65 weighted) swap yield butterfly spread is well (and positively) correlated to term premium (**Figure 3**). Putting these two observations together, a conditional 2s/7s/30s weighted belly cheapening butterfly in a selloff may be thought of as an indirect way to gain conditional long exposure to term premium when term premium is rising. **Lastly**, current implied volatility levels permit the construction of such a trade at a slight premium intake, making

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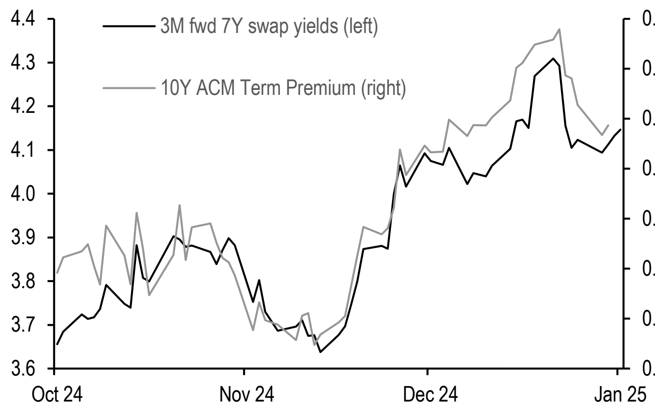
this trade attractive. Therefore, **we recommend this trade** (see Trade recommendations).

Figure 2: Term premium has become perhaps the dominant driver of yield levels in the belly ...

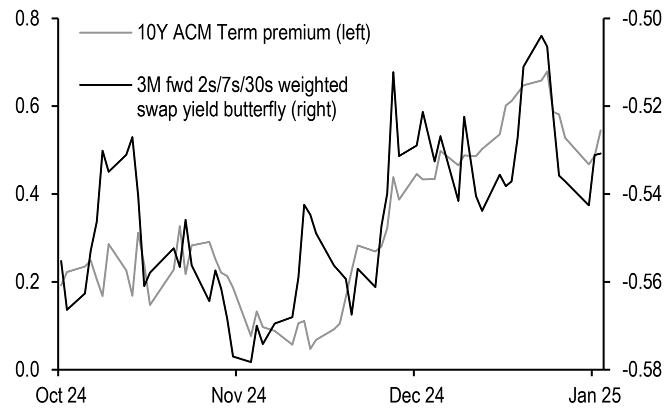
3M fwd 7Y swap yields (%, left) vs. 10Y ACM Term Premium (%, right); past 3M



Source: J.P. Morgan., Federal Reserve Board of New York

Figure 3: ... and the 50:65 weighted 2s/7s/30s swap yield butterfly spread has been well correlated to term premium, which means that the conditional belly cheapening trades in a selloff may be thought of as a conditional long-term-premium trade

10Y ACM Term Premium (%, left) vs 3M fwd 2s/7s/30s (50:65 weighted) swap yield butterfly (%, right); past 3M



Source: J.P. Morgan., Federal Reserve Board of New York

Swap spreads

In the two weeks since our last publication, swap spreads widened initially post strong bank earnings last week but have narrowed this past week until Friday, where they widened again. In the front end, this week's narrowing has mostly negated the widening from the prior week, and spreads are slightly narrower, while in the long end the recent narrowing has been modest and spreads remain wider over the period (**Figure 4**). All in all, spreads are flat to narrow in the front end and are wider in the belly and the long end and the swap spread curve is steeper overall. Term funding premium (TFP) has also declined in the past two weeks from its highs, while zero duration spreads (ZDS) have remained relatively stable. (As a quick reminder, on any given day we can regress maturity matched swap spreads in all the benchmark tenors versus modified duration of the corresponding bonds. We define zero-duration-spreads as the intercept from this regression, and we define term funding premium as the negative of the slope. Viewing swap spreads through the lens of these two summary metrics of the term structure offers many advantages. For more details, see Term Funding Premium and the Term Structure of SOFR Swap Spreads.)

This week's move in spreads likely reflects a combination of valuations as well as the effects of a decline in TFP. In our last publication (Strong Jobs Report, Mike Drop), we had noted that in the short term TFP could be biased lower which could cause longer maturity swap spreads to outperform shorter maturity spreads, which is indeed what happened over the past two weeks. At the same time, after last week's moves, spreads in shorter maturities had widened to above our mid-year targets. Thus, **we see this week's move as consistent with a correction towards fair value, in addition to reflecting the consequences of a decline in TFP**.

Looking ahead, valuations remain within 1bp of fair value (**Figure 5**) **in the near-term as well as remaining close to our mid-year targets.** This means that in our view, swap spreads are likely to remain rangebound without a clear directional bias. As a result, **we turn**

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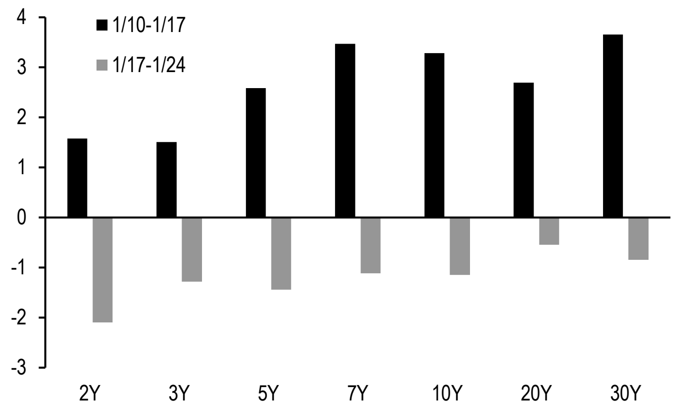
neutral on swap spreads on an outright basis and recommend unwinding narrowing exposure (see Trade recommendations).

Figure 4: In the past two weeks, swap spreads widened initially post strong bank earnings but have narrowed this past week

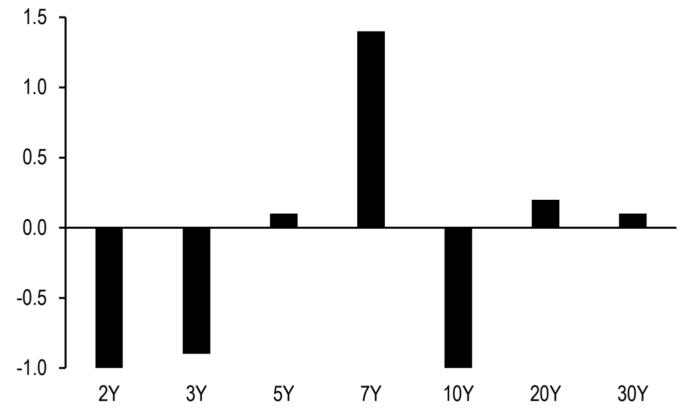
Weekly change in benchmark maturity matched SOFR swap spreads (1/10-1/17 and 1/17-1/24); bp



Source: J.P. Morgan.

Figure 5: Valuations remain mostly fair as well as close to our mid-year targets

Residual from our fair value model* for maturity matched SOFR swap spreads, 1/23/2024; bp



* Fair values are computed by adding our Term structure baseline swap spread values and our swap spread deviation relative to the term structure of swap spreads across each sector (see Term Funding Premium and the Term Structure of SOFR Swap Spreads for details)
Source: J.P. Morgan.

On the other hand, TFP remains modestly above our mid-year targets and we continue to expect further declines in the short run. **One development that could support such narrowing relates to the likely upcoming decline in the TGA balance**. Treasury Secretary Yellen announced the start of extraordinary measures as part of by-now-familiar actions that the Treasury takes when the debt ceiling has been reached (or the debt ceiling suspension period has ended). Such actions include intra-governmental deferrals and other accounting maneuvers. But another step is the steady decline in Treasury's cash balance (the TGA). As is well known, Treasury maintains a large cash balance as a buffer against unexpected operational disruptions (such as natural disasters) which could result in a temporary loss of market access. But this buffer tends to be drawn down when the ceiling is binding. Such a decline in the TGA would temporarily create lighter-than-usual supply, which could help bias TFP lower in the short term. **This leaves us with our spread curve steepening bias intact and we recommend initiating exposure to 7s30s swap spread curve steepeners** (see Trade recommendations).

Options

Implieds declined across the surface since our last publication, and most of the decline was fueled by a softer-than-expected CPI and the subsequent decline in yields. Shorter expiries led the decline as 6Mx2Y declined by about 0.4 bp/day while 2Yx2Y declined by about only 0.1 bp/day (**Figure 6**). Most of the decline in implieds can be explained by the decline in yields and vol-rate relationship. But as Figure 6 also shows, 30-year tails underperformed what would have been expected under the vol-rate relationship and declined in excess of it, while 2Y expiries generally outperformed.

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Figure 6: In the past two weeks, the decline in implieds can be explained by the decline in yields and the vol-rate relationship

Swaption implied volatility as of 1/10 and 1/24, change over the two weeks (bp/day), percent yield vol (%), change in the respective ATMF yields (%), expected change* (bp/day) and excess change (bp/day) **

	Start	Chg	End	Percent yield vol	Chg in ATMF yields	Expected Chg	Excess Chg
6Mx2Y	6.83	-0.43	6.39	25.6	-0.17	-0.27	-0.16
6Mx5Y	6.77	-0.24	6.53	25.2	-0.16	-0.25	0.01
6Mx10Y	6.47	-0.31	6.16	23.9	-0.13	-0.20	-0.11
6Mx30Y	5.89	-0.34	5.55	22.8	-0.09	-0.13	-0.21
1Yx2Y	7.18	-0.32	6.86	26.8	-0.19	-0.31	-0.01
1Yx5Y	6.79	-0.15	6.64	25.2	-0.16	-0.25	0.10
1Yx10Y	6.49	-0.22	6.27	23.9	-0.13	-0.19	-0.03
1Yx30Y	5.89	-0.22	5.67	22.8	-0.09	-0.13	-0.10
2Yx2Y	7.11	-0.14	6.97	26.3	-0.18	-0.30	0.16
2Yx5Y	6.73	-0.09	6.64	24.9	-0.15	-0.23	0.14
2Yx10Y	6.44	-0.14	6.30	23.6	-0.12	-0.18	0.03
2Yx30Y	5.85	-0.15	5.70	22.8	-0.08	-0.12	-0.03

*Expected change is calculated based as percent yield vol (as of 1/10) times change in ATMF yields over the two weeks divided by square root of 251
**Excess change is calculated as the difference between actual change and excess change
Source: J.P. Morgan.

Looking ahead, we maintain our bullish stance on volatility in the near-term. **One**, policy uncertainty continues to be elevated. As regular readers are no doubt aware, we infer a probability density function from the prices of call and put options on Z5 SOFR futures, and then decompose that implied density function as we weighted combination of Normal distributions (each of which can be identified with a particular policy rate scenario). Doing so transforms the information contained in the probability density function into weights that are associated with policy outcomes, which is much more intuitive. As **Figure 7** shows, **there continues to be a wide range of scenarios carrying significant weights, including scenarios with cuts of varying magnitudes and even a scenario corresponding to the resumption of hikes**. Such a lack of concentration in the weights is indicative of policy uncertainty. **This implies a high degree of data dependency until more data provides corroboration of any specific policy path, which, in turn implies higher "jump risk" and higher delivered volatility**. **Two,** we are about to enter a period of high event risk, with the FOMC meeting, NFP and cabinet appointment confirmations. All of this could point to high delivered volatility in the near-term.

Finally, despite the retracement in the residuals from our fair value framework, implieds continue to appear cheap to fair value, especially in longer tails (**Figure 8**). **Negative residuals, coupled with elevated policy uncertainty which can pressure implieds higher than what our fair value may suggest, keep us bullish on volatility for a little longer**, despite the decline in implieds in the past two weeks. Therefore, **we recommend a bullish stance on volatility, and recommend expressing this in the 1Yx10Y sector currently**. **Given the vol-rate correlation** (1Yx10Y implied volatility tends to move by 0.25bp/day per 100bp move in the underlying forward rate), **we recommend hedging the rate exposure with a suitably weighted receive-fixed position in 1Yx10Y forward swaps** (see Trade recommendations).

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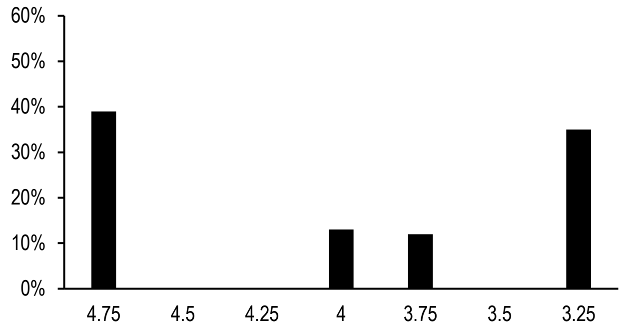
Figure 7: Policy uncertainty continues to be elevated, with deep cuts as well as the resumption of hikes carrying similar weights in the implied probability distribution

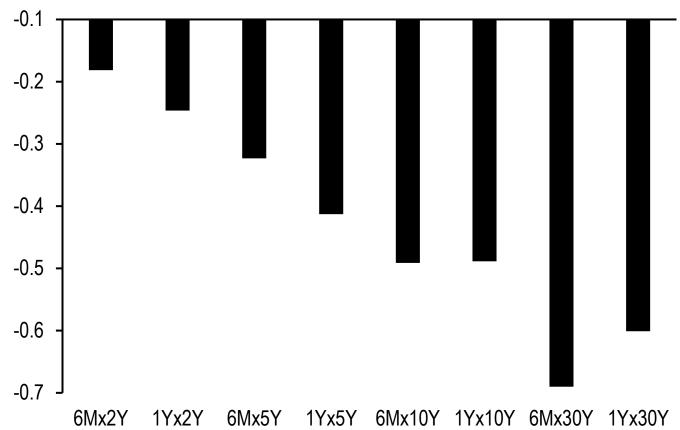
Weights on year-end 2025 policy rate scenarios representing a range of different Fed Fund outcomes, as calculated from a decomposition of the implied probability distribution associated with Dec 2025 SOFR futures*; 1/21/2025



* We enumerate a list of scenario-specific Normal distributions with fixed standard deviations and means that are separated by 25bp, and then require the implied distribution to be a weighted combination of these individual distributions. The weights are then solved for, by fitting to the observed prices of calls and puts at various different strikes. For more details of our approach, see What's the rush?
Source: J.P. Morgan.

Figure 8: Implieds continue to appear cheap to fair value, especially in longer tails

Residual from our fair value* model for selected swaption implied volatility structures, 1/23/2025; bp/day



* For details on our fair value framework for swaption implied volatility, see Interest Rate Derivatives 2025 Outlook
Source: J.P. Morgan.

On a relative basis, we recommend buying the expiry curve (which we define as 1Yx10Y minus 10Yx10Y), **hedged with a 65% vega weighted short in 2Yx2Y swaption straddles, and also adding a short duration overlay buy paying a suitable amount in 2Yx2Y forward swaps**. As seen in **Figure 9**, this expiry curve has been well explained by one volatility and one rate factor over the past three years - the 2Yx2Y implied vol and he 2Yx2Y forward swap yield respectively. Adjusted for these factors, the expiry curve has been fairly mean-reverting, and is currently at cheap levels relative to history (**Figure 10**). Therefore, **we recommend buying 1Yx10Y swaption volatility versus selling equal vega risk in the 10Yx10Y, selling 65% of the vega risk in 2Yx2Y to hedge the directional exposure to level of volatility, and paying fixed in a suitably weighted amount in 2Yx2Y forward swaps to hedge the directional exposure to rates** (see Trade recommendations).

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Figure 9: 1Yx10Y - 10Yx10Y volatility curve has been well explained by 2Yx2Y volatility and 2Yx2Y forward swap yields …

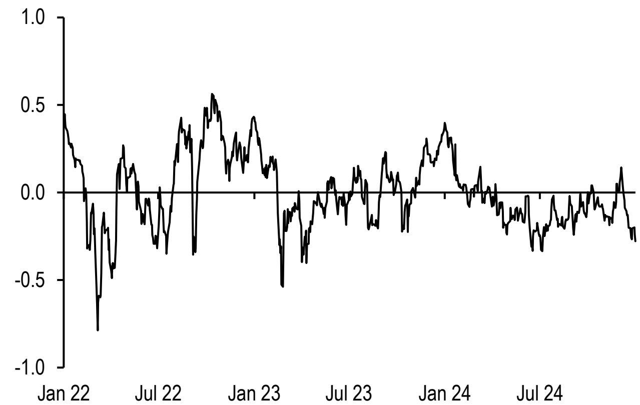
Regression statistics* (coefficients, T-stats, R-squared, residual, and standard error) for 1Yx10Y minus 10Yx10Y volatility curve versus 2Yx2Y implied volatility (bp/day) and 2Yx2Y swap yields (%) as well as current values of 2Yx2Y implied vol (bp/day) and 2Yx2Y swap yields (%), current as of 1/23/2025

	Coefficient	T-statistic	Current
Intercept	-2.72	-34.8	
2Yx2Y Vol	0.69	73.5	6.98
2Yx2Y Swap Yield	-0.25	-18.3	4.11
R-squared	88%		
Std. Err.	0.21		
Residual	-0.28		

*Regression period is for the past 3 years
Source: J.P. Morgan.

Figure 10: … and adjusted for these two factors, the volatility curve has been relatively mean-reverting and currently looks mispriced

Residual from regressing* 1Yx10Y minus 10Yx10Y versus 2Yx2Y vol as well as the 2Yx2Y swap yield (1Yx10Y vol minus 10Yx10Y vol minus 0.688*2Yx2Y vol plus 0.25*2Yx2Y swap yields), past 3 years; bp/day



*Regression details are detailed in the previous exhibit
Source: J.P. Morgan.

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Trading Recommendations

- **Initiate 2s/7s/30s (0.50:-1.0:0.65 weighted) belly cheapening butterfly in a selloff to conditionally position for a rise in term premium**
  The longer term direction of term premium remains upward, and a conditional belly cheapening butterfly allows for a convenient way to gain exposure to higher term premium while guarding against the near prospect of a likely further decline in term premium. Increases in term premium will likely translate into higher yields, and we anticipate term premium to be a dominant driver of yields in the near term. Lastly, the weighted fly has been positively correlated to term premium and can be constructed at a slight premium intake at the forwards
  -Sell $158.5mn notional 3Mx2Y payer swaptions. (Notification date: 2025-04-24, swap tenor: 2Y, ATMF: 4.069%, strike: 4.069%, spot premium: 35.0bp per notional, forward premium: 35.4bp per notional, bpvol at inception: 5.91bp/day). Buy $100mn notional 3Mx7Y payer swaptions. (Notification date: 2025-04-24, swap tenor: 7Y, ATMF: 4.124%, strike: 4.124%, spot premium: 117.4bp per notional, forward premium: 118.7bp per notional, bpvol at inception: 6.24bp/day). Sell $22.9mn notional 3Mx30Y payer swaptions. (Notification date: 2025-04-24, swap tenor: 30Y, ATMF: 4.017%, strike: 4.017%, spot premium: 288.8bp per notional, forward premium: 292.0bp per notional, bpvol at inception: 5.42bp/day).
  -This trade was constructed with a slight premium intake at inception
- **Initiate 7s/30s swap spread curve steepeners**
  We remain biased towards modest declines in Term funding premium in the near term, which is supported by the likely drawdown in the TGA balance, which could would temporarily create lighter-than-usual supply dynamics. A decline in TFP supports a spread curve steepening bias and valuations support a steeper 7s/30s swap spread curve
  -Receive fixed in 4.5% Dec 31 2031 maturity matched SOFR swap spreads. Sell $100mn notional of the 4.5% Dec 31 2031 (yield: 4.527%, PVBP: $588.4/bp per mn notional), and receive fixed in $98.3mn notional of a maturity matched SOFR swap (coupon: 4.13%, PVBP: $598.7/bp per mn notional) at a swap spread of -39.7bp.
  -Pay fixed in 4.25% Aug 15 2054 maturity matched SOFR swap spreads. Buy $40.5mn notional of the 4.25% Aug 15 2054 (yield: 4.854%, PVBP: $1453.7/bp per mn notional), and pay fixed in $34.6mn notional of a maturity matched SOFR swap (coupon: 4.037%, PVBP: $1699.1/bp per mn notional) at a swap spread of -81.7bp.
- **Buy 1Yx10Y swaption straddles paired with a receive-fixed swap overlay to hedge against a decrease in implieds due to lower yields**
  Implieds continue to appear cheap to fair value, especially in longer tails. Negative residuals, coupled with elevated policy uncertainty keep us bullish on volatility, despite the recent decline in implieds. Also, given vol-rate correlation, we recommend hedging the rate exposure with a suitably weighted receive-fixed position in 1Yx10Y forward swaps.
  -Buy $100mn notional 1Yx10Y ATMF swaption straddles. (Notification date: 2026-01-26, swap tenor: 10Y, ATMF: 4.165%, strike: 4.165%, spot premium: 622.8bp per notional, forward premium: 649.2bp per notional, bpvol at inception: 6.33bp/day). This trade assumes active delta hedging every business day.
  -In addition, receive-fixed in $3.2mn notional of a 01/24/26x10Y SOFR swap at a yield of 4.162% (PVBP: $777.7/bp per mn notional). Swap notional is calculated assuming a beta of 0.25 bp/day per 100bp move in the forward.
- **Buy 1Yx10Y straddles versus 10Yx10Y straddles, hedged with a 65% vega weighted short in 2Yx2Y swaption straddles, and add a short duration overlay buy paying**

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a suitable amount in 2Yx2Y forward swaps
This expiry curve has been well explained by 2Yx2Y vols and 2Yx2Y rates over the past three years. Adjusted for these factors, the expiry curve has been fairly mean-reverting, and is currently at cheap levels relative to history
-Buy $100mn notional 1Yx10Y ATMF swaption straddles. (Notification date: 2026-01-26, swap tenor: 10Y, ATMF: 4.165%, strike: 4.165%, spot premium: 616.6bp per notional, forward premium: 643.0bp per notional, bpvol at inception: 6.27bp/day).
-Sell $46.2mn notional 10Yx10Y ATMF swaption straddles. (Notification date: 2035-01-24, swap tenor: 10Y, ATMF: 4.247%, strike: 4.247%, spot premium: 1150.0bp per notional, forward premium: 1746.2bp per notional, bpvol at inception: 5.4bp/day).
-Sell $203.8mn notional 2Yx2Y ATMF swaption straddles. (Notification date: 2027-01-25, swap tenor: 2Y, ATMF: 4.106%, strike: 4.106%, spot premium: 218.7bp per notional, forward premium: 237.4bp per notional, bpvol at inception: 6.97bp/day). This trade assumes active delta hedging every business day.
-In addition, pay-fixed in $13.5mn notional of a 01/24/27x2Y SOFR swap at a yield of 4.108% (PVBP: $182.2/bp per mn notional). Swap notional is calculated assuming a beta of 0.25 bp/day per 100bp move in the forward.

- **Unwind 5Y maturity matched swap spread narrowers**
  Valuations point to rangebound spreads in the near term, and as a result we turn neutral on outright spread exposure. We recommend unwinding this trade at a loss of 2.4bp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Maintain 5s/10s maturity matched swap spread curve steepeners**
  P/L on this trade is currently 0bp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Maintain 2Y forward 5s10s curve flatteners paired with a 10% short in SOFR H5 futures and a 20% long in SOFR H6 futures**
  P/L on this trade is currently -0.7bp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Maintain 3Y forward 1s/5s swap curve steepeners paired with 110% of the risk in 2Y forward 1s/3s swap curve flatteners**
  P/L on this trade is currently 1bp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Maintain longs in 1Yx5Y swaption straddles**
  P/L on this trade is currently -3abp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Continue to overweight 1Yx5Y straddles versus a gamma-neutral amount of 1Yx10Y straddles**
  P/L on this trade is currently 0.5abp. For original trade write up, see Fixed Income Markets Weekly 2025-01-10.
- **Maintain longs in the belly of a 6M forward 5s/10s/30s swap yield curve butterfly (-0.5:1.0:-0.5 weighted)**
  P/L on this trade is currently -0.4bp. For original trade write up, see Fixed Income Markets Weekly 2024-12-20.

Closed trades over the past 12 months

P/L reported in bp of yield for swap spread, yield curve and misc. trades, and in annualized bp of volatility for option trades, unless otherwise specified

Note: trades reflect Thursday COB levels, and unwinds reflect Friday COB levels

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Trade	Entry	Exit	P/L
Spreads and basis			
Pay in 1.375% Nov '31 maturity matched swap spreads paired with 5% risk in 5s/10s OTR Treasury curve steepeners	1/10/2024	1/26/2024	2.4
Initiate 5s/30s swap spread curve flatteners	12/15/2023	2/2/2024	3.8
Initiate swap spread narrowers in the 30Y sector	1/5/2024	2/2/2024	0.2
Maintain a widening bias on swap spreads in the belly but switch to the 2.625% Feb 2029 issue	1/19/2024	2/23/2024	2.4
Maintain a widening bias on swap spreads in the belly using the 2.625% Feb 2029 issue, but hedge the narrowing risk from higher implied volatility with a long in 2Yx2Y swaption straddles	1/19/2024	2/23/2024	2.7
Initiate 2s/5s (100:60 weighted) maturity matched swap spread curve steepeners	1/26/2024	2/23/2024	(3.3)
Pay-fixed in 2.125% May '26 maturity matched swap spreads	3/15/2024	3/22/2024	3.6
Pay-fixed in 1.875% Jul '26 maturity matched swap spreads	3/22/2024	4/5/2024	3.4
Initiate 20s/30s 1.33:1 wtd maturity matched spread curve steepeners hedged with a 30% risk weighted 20s/30s steepener, but use an equi-notional blend of the Nov 53s and Aug 53s to create a synthetic approximate par bond in the 30Y leg	2/23/2024	4/12/2024	(2.5)
Initiate 30Y swap spread wideners	3/15/2024	4/12/2024	(0.1)
Pay in 4% Jan '27 maturity matched swap spreads	4/5/2024	4/26/2024	2.2
Initiate 10Y swap spread wideners using the Nov '33 issue	3/8/2024	5/17/2024	0.9
Initiate exposure to a steeper 7s/10s 1:0.75 weighted swap spread curve, and we recommend implementing the 7Y narrower leg with TYM4 invoice spreads	5/10/2024	5/28/2024	0.3
Initiate 1:0.9 risk weighted 20s/30s maturity matched swap spread curve steepeners	5/31/2024	6/14/2024	3.9
Initiate 5s/10s off-the-run swap spread curve steepeners (100:60 weighted)	3/8/2024	7/12/2024	(4.7)
Initiate 7s/10s swap spread curve steepeners paired with 25% risk in a 7s/10s UST curve steepener	3/22/2024	7/12/2024	(0.2)
Pay in Feb 2037 maturity matched swap spreads versus receiving in USU4 invoice spreads	6/14/2024	7/12/2024	0.8
Buy Feb 37s versus selling USU4 Futures	6/14/2024	7/12/2024	2.7
Pay-fixed in 1.875 Feb 2027 maturity matched swap spreads	4/26/2024	7/26/2024	(5.9)
Initiate 5s/30s spread curve flatteners	5/3/2024	7/26/2024	5.1
Pay-fixed in 4% Feb 2034 maturity matched swap spreads	5/17/2024	7/26/2024	(6.7)
Initiate 10s/30s swap spread curve flatteners	7/26/2024	8/2/2024	(0.8)
Initiate TU/TY invoice spread curve flatteners (1:0.35 weighted)	6/7/2024	8/23/2024	(6.3)
Pay-fixed in 4.625% Feb '26 maturity matched swap spreads	5/31/2024	9/6/2024	0.3
Pay-fixed in 4.375% Aug '28 maturity matched swap spreads	5/31/2024	9/6/2024	(1.8)
Initiate 10Y swap spread narrowers	8/16/2024	9/6/2024	2.5
Initiate 3s/7s swap spread curve flatteners	8/16/2024	9/6/2024	1.4
Initiate 0.875% June 2026 / 0.875% September 2026 swap spread curve flatteners	8/16/2024	9/6/2024	1.3
Initiate 5s/30s swap spread curve flatteners	8/23/2024	9/6/2024	(0.3)
Initiate 7s/20s weighted swap spread curve steepeners	8/23/2024	9/20/2024	3.8
Initiate 100:80 weighted 20s/30s maturity matched swap spread curve flatteners	9/6/2024	9/20/2024	2.3
Initiate 7s/10s maturity matched swap spread curve steepeners	9/27/2024	10/4/2024	0.0
Initiate 1:0.75 risk weighted 7s/10s maturity matched swap spread curve steepeners	5/31/2024	10/18/2024	0.8
Initiate 2s/3s maturity matched swap spread curve flatteners	9/20/2024	11/1/2024	0.0
Initiate 3s/30s maturity matched swap spread curve flatteners	10/4/2024	11/1/2024	(2.1)
Initiate 2s/30s maturity matched swap spread curve flatteners	11/7/2024	11/15/2024	1.7
Initiate 5Y maturity matched swap spread narrowers	1/10/2025	1/24/2025	(2.4)

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Duration and curve	Entry	Exit	P/L
Initiate 3Mx1Y / Greens weighted flattener (1:0.8 weighted) paired with 80% risk in a 3M forward 2s/10s swap curve steepener	01/05/24	01/26/24	2.9
Initiate U5/M6 SOFR futures curve flatteners paired with 110% of the risk in Z5/U6 3M SOFR futures curve steepeners	12/15/23	02/02/24	1.6
Buy the belly of a 35:65 weighted H5/H6/Z6 3M SOFR futures butterfly	12/15/23	02/02/24	1.9
Initiate 1Yx2Y / 3Mx30Y swap yield curve steepeners paired with 65% risk in a Reds / 10Yx5Y swap yield curve flattener	01/19/24	02/02/24	1.1
Receive fixed in the belly of a 6M forward 2s/7s/30s swap butterfly (40:69 weighted)	01/19/24	02/02/24	0.1
Initiate conditional exposure to a composite flattener in a selloff by buying 3Mx2Y payer swaptions (100% risk) versus selling 3Mx5Y and 3Mx30Y payer swaptions (24% and 100% risk respectively)	02/02/24	02/23/24	14.3
Buy H5 and Z5 3M SOFR futures contracts (30:100 weighted) versus selling U4 3M SOFR futures contracts (100% risk weight) and pay-fixed in 6M forward 10Y swaps (40% risk weight)	02/09/24	02/23/24	5.8
Initiate exposure to rising term premium by selling the belly of a 35/65 weighted 3M forward 5s/10s/15s butterfly	12/08/23	03/08/24	(1.5)
Initiate SFRM5 / Blues flatteners paired with a 110% risk weighted 3M forward 2s/10s steepener	03/01/24	03/22/24	3.3
Initiate 3M forward 3s/20s swap curve steepeners, paired with 85% of the risk in a SFRM5 / 3Mx10Y curve flattener	03/08/24	04/05/24	3.2
Initiate 2Y forward 2s/5s swap curve steepeners paired with 40% risk in 3M forward 2s/5s flatteners	01/26/24	04/12/24	(11.4)
Initiate conditional exposure to a flatter 2s/5s swap yield curve in a selloff using 3M expiry payer swaptions	03/22/24	04/12/24	5.2
Initiate conditional exposure to a flatter 18M/5Y swap yield curve in a selloff using 6M expiry payer swaptions	04/05/24	04/12/24	3.1
Initiate conditional exposure to a flatter 1s/5s swap yield curve in a selloff using 3M expiry payer swaptions	02/23/24	04/26/24	(9.4)
Initiate 1Y forward 2s/5s swap curve flatteners, paired with weighted longs in H5 and H6 3M SOFR futures (20% and 10% respectively)	03/22/24	04/26/24	(9.5)
Initiate SFRM5 / 3Mx5Y flattener, hedged with a 20% risk weighted long in Reds	04/05/24	04/26/24	(5.0)
Initiate 5th/9th SOFR futures curve flatteners hedged with a risk weighted amount 2Y forward 2s/5s swap curve steepeners	04/12/24	05/03/24	3.0
Receive in the belly of a 0.625/1.0/0.375 weighted 3M forward 2s/7s/20s swap butterfly, with an additional 15% risk weighted long in June 2024 3M SOFR futures	02/23/24	05/17/24	2.7
Initiate 3M forward 2s/3s swap curve flatteners hedged with a 14% risk weighted long in the M4 3M SOFR futures	02/23/24	05/17/24	0.4
Initiate 3M forward 5s/15s swap curve flatteners paired with 70% risk in a 2Y forward 2s/20s swap curve steepener	03/22/24	05/17/24	2.8
Buy the belly of a 2s/5s/15s weighted swap butterfly (50:50 weighted)	04/12/24	05/17/24	2.4
Initiate 3M forward 1s/3s swap curve flatteners, hedged with a 65% risk weighted long in the 3Mx3M sector and a 25% risk weighted short in the 15Mx3M sector	05/03/24	05/17/24	2.1
Buy the belly of a U5/M6/H7 SOFR Futures butterfly (-0.37:1:-0.63 risk weighted)	03/01/24	05/31/24	(0.7)
Initiate a Greens/Blues steepener paired with 55% of the risk in a SFRM5 / 3Mx5Y swap curve flattener	03/15/24	05/31/24	2.2
Buy the belly of a Z5/U6/H7 3M SOFR futures butterfly (-0.33:1.0:-0.67 risk weighted)	04/19/24	05/31/24	1.8
Initiate 12Mx3M / 3Mx10Y flatteners, paired with 33% risk in a 3Mx2Y receive fixed swap	05/17/24	06/06/24	5.7
Initiate 3M fwd 3s/15s flatteners paired with 85% risk in 2Y fwd 3s/30s steepeners	05/17/24	06/06/24	4.5
Initiate 3Mx1Y / 2Yx1Y forward swap curve flatteners as a bullish proxy	05/31/24	06/06/24	11.5
Initiate 3Mx1Y / 2Yx1Y swap curve flatteners paired with 45% risk-weighted pay-fixed positions in 3Mx5Y swaps	05/31/24	06/06/24	0.0
Initiate conditional exposure to a flatter 1s/2s swap yield curve in a rally using 1Y expiry receiver swaptions	04/05/24	06/14/24	4.0
Initiate Z5/U6 SOFR futures flatteners paired with H6/Z6 SOFR futures steepeners (0.85:1 risk weighted)	03/01/24	07/12/24	1.8
Initiate conditional exposure to a steeper 10s/20s swap yield curve in a selloff using 9M expiry payer swaptions	03/15/24	07/12/24	4.0
Initiate 3M forward 10s/15s swap curve steepeners paired with 25% risk in 3M forward 3s/7s flatteners	04/26/24	07/12/24	3.5
Initiate 3M forward 10s/30s steepeners (1:1.5 risk weighted) paired with M5/Z5 3M SOFR futures flatteners	06/07/24	07/12/24	2.9
Initiate 15Mx3M / 1YX1Y forward swap curve flatteners, paired with 20% of the risk in a long in 18Mx3M and a 24% risk weighted short in 3Mx5Y forward swaps	05/03/24	08/02/24	(1.3)
Receive in 3Mx3Y and 3Mx5Y swaps versus paying in 3Yx1Y and 12Mx3M swaps	06/14/24	08/02/24	(8.8)
Initiate a synthetic 6M forward 2s/10s swap curve steepener, constructed by replacing the 2Y leg with a 6Mx3M / 18Mx3M flattener	07/12/24	08/02/24	(28.9)
Initiate a synthetic 3M forward 5s/30s swap curve steepener, constructed by replacing the 5Y leg with a 3Mx3M / 3Mx2Y flattener	07/26/24	08/02/24	(18.1)
Initiate conditional exposure to a flatter 1s/2s swap yield curve in a rally using 6M expiry receiver swaptions	07/26/24	08/02/24	(8.8)
Initiate conditional exposure to a flatter 1s/7s swap yield curve in a selloff using 6M expiry payer swaptions	07/12/24	10/04/24	(6.6)
Initiate conditional exposure to a flatter 1s/3s swap yield curve in a selloff using 3M expiry payer swaptions	09/13/24	10/04/24	0.4
Initiate Greens / 3Mx15Y flatteners (0.9:1.0 weighted)	09/20/24	10/04/24	6.1
Initiate conditional exposure to a flatter 1s/5s swap yield curve (100:102 weighted) in a selloff using 3M expiry payer swaptions	09/20/24	10/04/24	11.0
Initiate conditional exposure to a steeper 2s/10s curve in a rally using 3M expiry receiver swaptions, financed by selling 24% risk-weighted receiver swaptions on 7-year tails	09/13/24	12/13/24	(0.9)
Initiate 2Y forward 5s/30s swap yield curve steepeners, paired with a 25% risk weighted short in 3Mx7Y swaps	11/15/24	12/13/24	1.0
Initiate 1s/10s conditional bear flatteners using 3M expiry payer swaptions	12/13/24	01/10/25	(14.9)
Initiate 10s/30s swap curve steepeners paired with a 16% weighted shorts in 2s	12/13/24	01/10/25	0.8
Initiate 10s/30s conditional bull steepeners financed by selling 9% of the risk in 6Mx2Y receiver swaptions	12/20/24	01/10/25	0.7

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Options	Entry	Exit	P/L
Initiate long gamma exposure in the 1Yx10Y sector	12/08/23	02/23/24	(2.1)
Initiate long exposure to 2Yx2Y volatility with a suitably weighted short in July Fed funds futures to hedge the downside risk from a fall in Fed-easing expectations	01/05/24	02/23/24	2.6
Overweight 2Yx2Y swaption straddles versus a vega-neutral amount of 5Yx5Y swaption straddles	01/19/24	02/23/24	3.2
Overweight 6Mx10Y swaption straddles versus selling 110% of the vega risk in 1Yx10Y swaption straddles	01/26/24	02/23/24	1.3
Buy 6Mx10Y straddles	03/01/24	03/08/24	(6.6)
Initiate longs in 6Mx10Y swaption implied volatility, delta hedged daily	03/15/24	03/22/24	(5.1)
Overweight 6Mx2Y swaption straddles versus a theta-neutral amount of 6Mx5Y swaption straddles	01/19/24	04/12/24	(8.8)
Sell 2Yx30Y swaption volatility versus buying 50% of the vega risk in 2Yx2Y swaption volatility , and pay fixed in 2Yx 10Y swaps to neutralize the bullish bias in this trade	02/23/24	04/12/24	1.5
Buy 6Mx10Y volatility versus 6M forward 6Mx10Y volatility, synthetically constructed via suitably weighted 1Yx10Y and 6Mx10Y swaptions	04/05/24	04/12/24	3.2
Buy 2Yx5Y swaption straddles on a delta hedged basis	04/12/24	04/19/24	1.0
Sell 6Mx10Y straddles on a delta hedged basis	04/26/24	05/03/24	3.1
Sell 6Mx15Y straddles on a delta hedged basis	05/03/24	05/10/24	(1.6)
Sell 1Yx2Y volatility versus buying a theta neutral amount of 1Yx5Y volatility	05/17/24	06/06/24	0.6
Initiate Fronts/Green curve flatteners, paired with delta hedged long volatility positions in the 1Yx10Y swaption sector	05/31/24	06/06/24	5.6
Initiate exposure to long curve volatility by buying 6Mx2Y and 6Mx10Y straddles (41:60 vega weighted) versus selling 6Mx5Y straddles	12/08/23	06/07/24	1.1
Buy 2Yx5Y swaption straddles on a delta hedged basis, versus 6Mx1Y / 18Mx1Y flatteners	06/07/24	06/14/24	3.6
Initiate outright shorts in 3Yx30Y swaption implied volatility, but delta hedge monthly or if rates move by over 25bp in either direction since the last delta hedge	03/08/24	07/12/24	(5.0)
Buy 1Yx30Y volatility versus 1Y forward 1Yx30Y volatility, synthetically constructed via suitably weighted 2Yx30Y and 1Yx30Y swaptions	03/15/24	07/12/24	(2.5)
Buy 65% risk weighted 1Yx10Y swaption volatility versus selling 1Y forward 2Yx10Y swaption volatility, synthetically constructed via suitably weighted 1Yx10Y and 3Yx10Y swaptions	04/12/24	07/12/24	(4.4)
Sell 6Mx10Y swaption straddles on a delta hedged basis, paired with a short position in Greens	06/14/24	07/12/24	2.2
Buy 1Yx5Y straddles versus selling vega-neutral amount of 5Yx5Y straddles	07/12/24	08/02/24	4.7
Buy A+100 1Yx5Y payer swaptions and sell A-100 1Yx5Y receiver swaptions, delta-hedged daily, to position for a correction in skew	04/19/24	08/23/24	(8.5)
Buy 6Mx5Y swaption straddles versus selling 150% of the vega risk in 6Mx30Y straddles	07/12/24	09/13/24	2.2
Initiate longs in 6Mx5Y swaption implied volatility on an outright basis, delta hedged daily	08/02/24	09/13/24	(8.5)
Overweight 6Mx5Y and 6Mx30Y swaption volatility (vega weights of 0.32 and 0.76, respectively) versus selling 6Mx10Y swaption volatility	04/05/24	10/04/24	(1.2)
Buy 3Yx3Y versus selling 10Yx10Y swaption straddles	09/06/24	10/04/24	(5.6)
Buy 1Yx10Y swaption straddles on a delta hedged basis coupled with a weighted long in S&P 500 futures	09/13/24	10/04/24	1.2
Overweight 1Yx10Y straddles versus a gamma-neutral amount of 1Yx15Y straddles	05/03/24	10/18/24	(2.1)
Buy 1Yx3Y versus selling 105% of the vega risk in 1Yx10Y swaption straddles	09/20/24	10/18/24	(0.2)
Sell 6Mx10Y straddles versus buying 130% of the vega weight in 6Mx30Y straddles	09/27/24	10/18/24	(0.3)
Buy 6Mx2Y swaption volatility versus selling a carry-neutral amount of 6Mx5Y swaption volatility	09/27/24	10/18/24	0.7
Sell 6Mx10Y straddles on a delta-hedged basis	10/04/24	10/18/24	(1.5)
Buy 6Mx2Y straddles on a delta-hedged basis	10/04/24	11/01/24	2.5
Buy 3Mx10Y straddles on a delta-hedged basis	11/01/24	11/15/24	(13.8)
Buy 65% risk weighted 1Yx10Y swaption volatility versus selling 1Y forward 2Yx10Y swaption volatility, synthetically constructed via suitably weighted 1Yx10Y and 3Yx10Y swaptions	10/18/24	01/10/25	(4.8)
Sell 1Yx5Y swaption straddles versus buying a theta-neutral amount of 1Yx30Y swaption straddles	12/13/24	01/10/25	(1.5)
Treasury Futures	**Entry**	**Exit**	**P/L**
WN calendar spreads narrowers	2/13/2024	2/23/2024	(0.7)
UXY calendar spreads narrowers	2/13/2024	2/23/2024	(0.8)
TU calendar spreads narrowers	2/13/2024	2/23/2024	(0.3)
Sell the 4.75% Nov 2053 WNM4 basis, versus buying payer swaptions	3/8/2024	4/12/2024	1.0
Initiate calendar spread wideners in US Futures	5/17/2024	5/28/2024	(3.0)
Initiate calendar spread narrowers in UXY Futures	5/17/2024	5/28/2024	0.4
Initiate calendar spread narrowers in FV futures	5/17/2024	5/28/2024	1.0
Initiate calendar spread wideners in US Futures	8/16/2024	8/23/2024	(0.8)
Initiate calendar spread narrowers in FV Futures	8/16/2024	8/23/2024	(0.1)
Buy the USZ4 factor-weighted CTD basis	9/13/2024	9/20/2024	2.4
Buy the WNZ4 factor-weighted CTD basis	9/13/2024	9/20/2024	1.0
Initiate calendar spread narrowers in FV futures	11/15/2024	11/25/2024	0.0
Initiate calendar spread wideners in US futures	11/15/2024	11/25/2024	0.0
Buy the FVH5 factor weighted CTD basis with repo termed out to 3/3/2025	11/15/2024	12/13/2024	2.8
Buy the USH5 factor weighted CTD basis with repo termed out to 3/3/2025	11/15/2024	1/10/2025	0.7
Total number of trades			**136**
Number of winners			**84**
Hit rate			**62%**

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Recent Weeklies	
10-Jan-25	Strong Jobs Report, Mike Drop
20-Dec-24	It's beginning to look a lot like a pause
13-Dec-24	Twelve voters voting
15-Nov-24	It's an easing cycle, not an easy cycle
08-Nov-24	Elephant spirits
01-Nov-24	Purple rain
25-Oct-24	Déjà vu awaits in funding markets
18-Oct-24	Counting down to November
04-Oct-24	Strong data, tighter liquidity conditions and rising geopolitical risk
27-Sep-24	Waiting Game
20-Sep-24	From Dovish Pause to Hawkish Easing
13-Sep-24	Schrodinger's Cut
06-Sep-24	Rates, unlike the economy, are not yet in "equipoise"
23-Aug-24	False Fall
16-Aug-24	Hopscotch
2-Aug-24	Powell sees the data, markets see one data point
26-Jul-24	Joie de Louvre
12-Jul-24	The Evitable Conflict
14-Jun-24	Pardon my French
07-Jun-24	The BOC and ECB begin a game of BOCCE-Ball, likely without the Fed for now
31-May-24	The planets, if not the stars, are aligning
17-May-24	Another brick in the vol
10-May-24	The election enters the hearts and minds of options traders
3-May-24	R2-P2
26-Apr-24	Perfectly priced to patience
19-Apr-24	Should I stay or should I go?
12-Apr-24	A hairpin bend on the road to easing
5-Apr-24	Shaken, not stirred
22-Mar-24	The Fed, walking a tightrope, finds better balance
15-Mar-24	(P)PI day
08-Mar-24	The sun is the same, in a relative way, but vol is lower
01-Mar-24	Governor Vol-ler moves the market
23-Fed-24	What's the rush?
09-Feb-24	Soft landings, TouchdoWNs, and Safety in the End Zone
02-Feb-24	When it rains, it pours
26-Jan-24	All eyes on Washington

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Outlooks	
26-Nov-24	Interest Rate Derivatives 2025 Outlook: Nobody said it was easy
28-Jun-24	Interest Rate Derivatives 2024 Mid-Year Outlook: Waiting for someone or something to show you the way
Recent Special Topic Pieces	
08-Nov-24	US bond futures rollover outlook: December 2024 / March 2025
13-Aug-24	US bond futures rollover outlook: September 2024 / December 2024
10-Jul-24	Trading Principal Factor Volatility
15-May-24	US bond futures rollover outlook: June 2024 / September 2024
29-Apr-24	Term Funding Premium and the Term Structure of SOFR Swap Spreads
13-Feb-24	US bond futures rollover outlook: March 2024 / June 2024

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Japan

January MPM: BoJ raised the policy rate by 25bp—What's next?

- **The BoJ decided to raise the policy rate by 25bp to around 0.50%, as universally expected.**
- **Many investors seem to anticipate the next rate hike to occur in approximately six months, which helps reduce near-term policy risks and provides an opportunity to buy duration. In our view, the recent fast-paced curve flattening partly reflects these expectations.**
- **On duration, we believe it is prudent to maintain a neutral stance for now. Given the current market narrative, the potential for JPY rates to rise measurably seems limited in the near term, particularly at the longer end of the curve. We expect the front end of the curve to be less supported. Conversely, we believe the long and super-long sectors will attract demand from domestic end-buyers.**
- **From a valuation perspective, our fair-value models suggest that the 2- and 5-year JGB yields are slightly too high after accounting for their fundamental drivers. In contrast, the 10-year JGB yield appears to be more or less in line with its drivers.**
- **The main risk to our duration view is that it is in line with a widely held one, and the current narrative around duration is similar to what we observed leading up to and shortly after the March 2024 MPM.**
- **On the curve, we believe that some segments have flattened too rapidly, and the market may be overdone. However, given the positioning of both domestic and international investors, along with strong flattening momentum, we prefer not to fade this trend at the moment. We explore the 2s/10s and 10s/30s JGB curves.**
- **Swap spreads have stabilized after a meaningful narrowing earlier this month. Our valuation metrics indicate that front-end swap spreads remain too narrow relative to their fundamental drivers, but with uncertainty around collateral dynamics in the near term, we choose to stay on the sidelines for now. We provide an update on *Gengaku Sochi*.**
- **In the plumbing space, the BoJ announced that no new loan disbursements will be made after June 30 under the Fund-Provisioning Measure to Stimulate Bank Lending. We share an estimated maturity schedule.**
- **From a collateral demand perspective, we think that there is a reasonable likelihood that collateral such as T-bills will become somewhat richer around March and June, as last-minute demand to secure cheap funding may arise. However, after June, the announcement indicates a clear trend towards cheaper collateral over time. We anticipate 3-month T-bills to stabilize around OIS-15bp before further richening into March. We anticipate that TONAR will continue to trade slightly below IOER and expect GC/TONAR to remain tight.**
- **Last but not least, we briefly explore what the latest rate hike may mean for deposit betas and dynamics.**

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January MPM

BoJ hiked by 25bp, as universally expected

At the January Monetary Policy Meeting (MPM), the BoJ decided to raise the policy rate by 25bp to around 0.50%, as universally expected. Effective January 27, the BoJ will raise IOER to 0.50% and the basic loan rate to 0.75%. Additionally, the BoJ announced that no new loan disbursements will be made after June 30 under the Fund-Provisioning Measure to Stimulate Bank Lending (more on this later). In the Outlook Report, the BoJ revised its core and BoJ core inflation forecasts upward, now expecting inflation to remain at or above 2% throughout the forecast period, with potential upside risks. The market viewed it as hawkish, driving JPY rates higher in the afternoon session.

At the press conference, all eyes were on the pace and timing of future rate hikes and the terminal rate. However, Governor Ueda stated that decisions would depend on economic conditions, inflation, and financial stability. Regarding the terminal rate, he noted that there is no change in the BoJ's view of the neutral rate, which remains between 1.0% and 2.5% in nominal terms. When asked if the BoJ might fall behind the curve, Governor Ueda responded that the BoJ is not "seriously" behind. Market participants perceived the press conference as less hawkish than the Outlook Report, resulting in a 10+ sen rally in JGB futures at one point during the evening session.

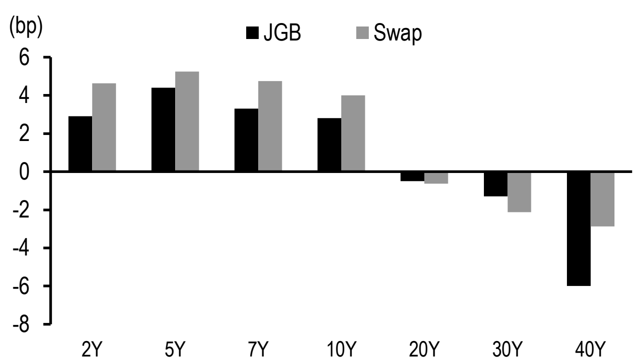
We remain neutral on duration

Following recent communications from Governor Ueda and Deputy Governor Himino, and extensive coverage by major media outlets, the market had already turned its attention to a rate hike following the January MPM. Many investors seem to anticipate the next rate hike to occur in approximately six months, which helps reduce near-term policy risks and provides an opportunity to buy duration. In our view, the recent fast-paced curve flattening partly reflects these expectations (**Figure 82**). OIS pricing indicates that the next 25bp hike is not fully priced in until the December MPM (**Figure 83**). However, considering the BoJ's approach, we believe there is limited interest to pay BoJ dates at this time.

Our economics team continues to expect two additional rate hikes this year, at the June and December meetings, with the policy rate reaching 1% by year-end. However, given the recent resurgence of inflation and pressures from yen depreciation, they believe the risk bias is shifting towards earlier rate hikes.

Figure 82: JGB and swap curves twist flattened this week...

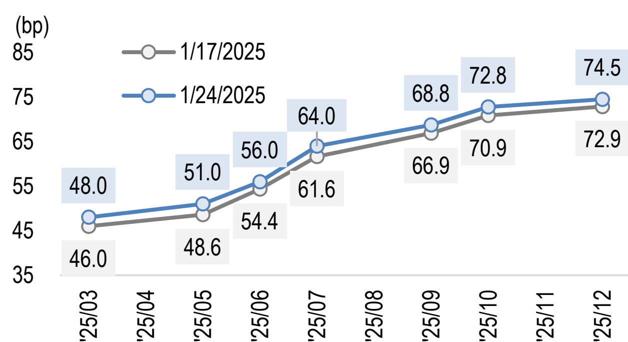
Change in yields between January 17 and January 24 (bp)



Source: J.P. Morgan, Bloomberg Finance L.P.

Figure 83: ...while OIS pricing moved little this week

BoJ policy rate outlook based on OIS market expectations (TONAR)



Source: J.P. Morgan.

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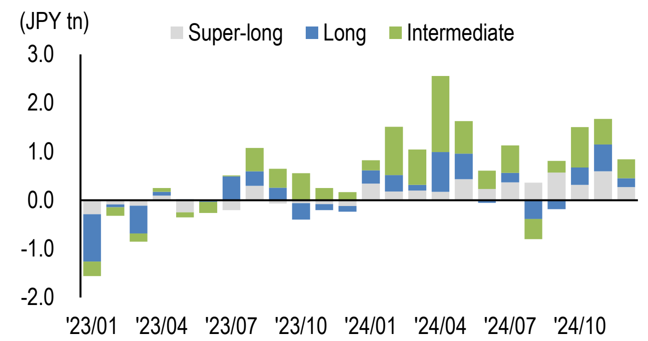
On duration, we believe it is prudent to maintain a neutral stance for now. Given the current market narrative, the potential for JPY rates to rise measurably seems limited in the near term, particularly at the longer end of the curve. Unless there is a continued global bond sell-off and/or a sustained depreciation of the yen, we anticipate some time before another major repricing of yields occurs. Additionally, recent JSDA transaction data indicates ongoing dip-buying of JGBs by domestic investors, especially regional financial institutions (**Figure 84**). **Considering potential policy repricing risks, we expect the front end of the curve to be less supported. Conversely, we believe the long and super-long sectors will attract demand from domestic end-buyers**.

From a valuation perspective, our fair-value models suggest that the 2- and 5-year JGB yields are slightly too high after accounting for their fundamental drivers. In contrast, the 10-year JGB yield appears to be more or less in line with its drivers (**Figure 85**). Although the 30-year yield seems low, we believe this level can be justified from a curve perspective, as we will discuss later.

The main risk to our view is that it is in line with a widely held one, and the current narrative around duration is similar to what we observed leading up to and shortly after the March 2024 MPM. However, contrary to market expectations at that time, JPY rates continued to rise until the July 2024 MPM, driven by a global bond sell-off and a USD/JPY-led repricing of OIS expectations. Needless to say, we are now at a different stage in the hiking cycle, with r* and the terminal rate (wherever they may be) being closer than they were last March. That said, we believe it is prudent to avoid chasing a rally.

Figure 84: We believe the long and super-long sectors will attract demand from domestic end-buyers

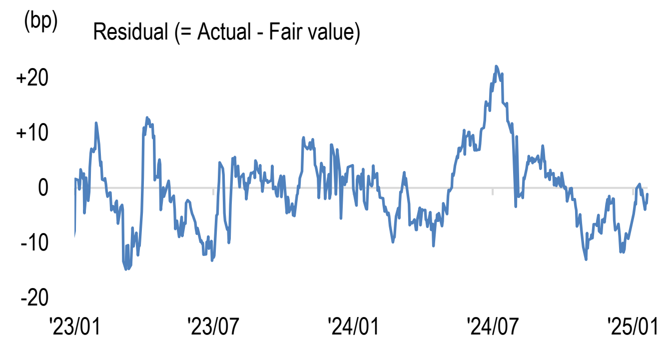
Net buying of JGBs by regional financial institutions in each sector (JPY tn)



Source: JSDA, J.P. Morgan.

Figure 85: Our fair-value model indicates that the 10-year JGB yield is aligned with its fundamental drivers

Residual of our 10-year JGB model* (bp)



Source: BoJ, MoF, Bloomberg Finance L.P., J.P. Morgan estimates.
*10-year JGB yields regressed on 3Mx3M JPY OIS (%), 10-year Treasury yields (%), and BoJ share of the three most recently issued 10-year JGBs outstanding (%); regression over the last 2 years. R-squared = 91.3%, S.E. = 7.0bp.

Shifting gears to the curve, we believe that some segments of the curve have flattened too rapidly, and the market may be overdone. However, given the positioning of both domestic and international investors, along with strong flattening momentum, **we prefer not to fade this trend at the moment**.

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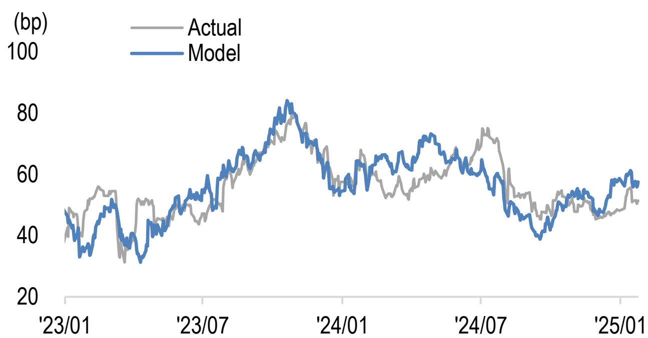
By sector, we find the 2s/10s and 5s/10s JGB curves to be too flat, though the market might want to test local lows in the near term (**Figure 86**). In contrast, the 10s/30s JGB curve appears consistent with historical trends (**Figure 87**). Overall, we believe the risk balance leans towards underperformance in the belly. However, considering that the near-term supply-demand headwind from *Gengaku Sochi* is likely behind us, we will wait for a more opportune moment to reshuffle our trades.

Figure 86: In our view, the 2s/10s JGB curve is starting to look too flat

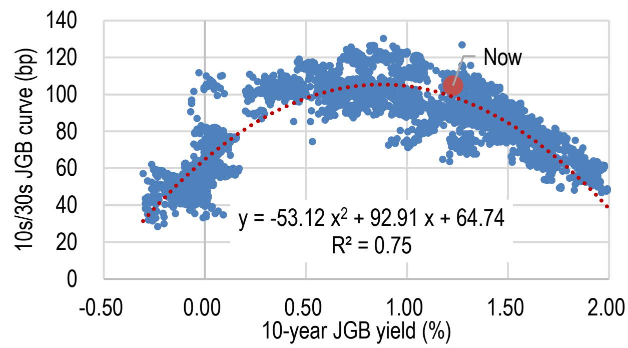
2s/10s JGB curve: Actual vs. Model (bp)



Source: J.P. Morgan estimates.
* 2-year JGB yields regressed on 3Mx3M JPY OIS (%); regression over the last 2 years. R-squared = 95.0%, S.E. = 4.9bp.
** See Figure 5 for 10-year JGB yield model specifications.

Figure 87: 10s/30s JGB curve appears consistent with historical trends

10s/30 JGB curve (bp) vs. 10-year JGB yield (%) over the last 20 years*



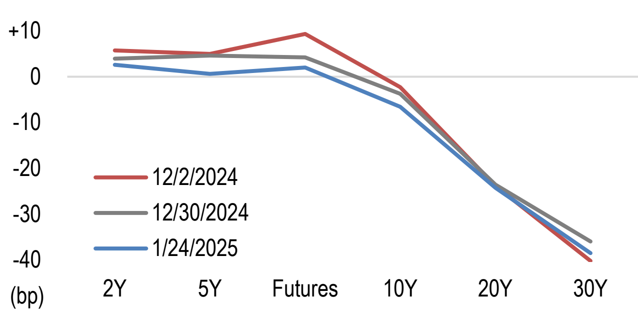
Source: J.P. Morgan.
* Excluding February 2022-July 2023 as we judge YCC was binding, resulting in curve distortions.

Swap spreads: Things are starting to stabilize here

Swap spreads have stabilized after a meaningful narrowing in the front to the belly of the curve earlier this month (**Figure 88**). Our valuation metrics indicate that front-end swap spreads remain too narrow relative to their fundamental drivers (**Figure 89**). However, as discussed in the plumbing section, **with uncertainty around collateral dynamics in the near term, we choose to stay on the sidelines for now**.

Figure 88: Swap spreads have stabilized after a meaningful narrowing

Matched-maturity swap spread of on-the-run bonds (bp)



Source: J.P. Morgan.

Figure 89: Front-end swap spreads continue to look too narrow

Swap spreads by tenor: Actual vs. Model (as of January 24) (bp; %)

(bp)	Actual	Model	Residual	R2	S.E.
2-year	2.6	6.0	-3.4	84%	2.0
5-year	0.6	8.4	-7.8	78%	2.8
10-year	-6.5	4.2	-10.8	71%	6.6
20-year	-24.2	-21.7	-2.6	72%	5.2

Source: BoJ, MoF, JSDA, Bloomberg Finance L.P., J.P. Morgan estimates.
* 2-year swap spread regressed on 3-month GC/OIS, 2-year Treasury yield, and BoJ Rinban in the 1-3 year sector as a share of monthly auction.
** 5-year swap spread regressed on 3-month GC/OIS, 5-year Treasury yield, and BoJ Rinban in the 3-5 year sector as a share of monthly auction.
*** 10-year swap spread regressed on 3-month GC/OIS, 10-year Treasury yield, and BoJ Rinban in the 5-10 year sector as a share of monthly auction.
**** 20-year swap spread regressed on regionals' super-long JGB purchases, LCH-JSCC clearing spreads, 20-year Treasury yield, and BoJ Rinban in the 10-25 year sector as a share of monthly auction.
***** All in monthly averages; regression over the last 3 years.

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Separately, *Gengaku Sochi*—a permanent buyout of a bond from the BoJ—has become a focal point for those who trade the belly of the curve (see here for *Gengaku Sochi* 101). On January 16, the BoJ announced it would consider requests for *Gengaku* of CTDs to enhance JGB market liquidity until the free float of CTDs reaches around JPY1.2tn, about three times the average physical delivery settlement. Since the free float of JB366 exceeds this threshold, we anticipate a slowdown in the pace of *Gengaku* in the near term (**Figure 90**). However, there remains approximately JPY625bn of capacity for *Gengaku* in JB367 and JB368, which could impact the supply-demand balance in the future. We maintain a narrowing bias in the 7- to 10-year sector.

Figure 90: Since the free float of JB366 exceeds the JPY1.2tn threshold, we anticipate a slowdown in the pace of *Gengaku* in the near term

Various statistics for CTDs (BoJ holdings as of January 20*) (JPY bn; %)

(JPY bn)	Total Outstanding	BoJ Holdings	Free Float	*Gengaku* room	BoJ share (%)
JB366	9,002	7,776	1,226	-26	86%
JB367	8,475	7,580	894	306	89%
JB368	8,946	8,075	871	329	90%
JB369	8,446	7,463	984	216	88%
JB370	8,471	6,814	1,657	-457	80%
JB371	9,020	5,737	3,283	-2,083	64%
JB372	8,569	5,383	3,186	-1,986	63%

Source: Bloomberg Finance L.P., J.P. Morgan estimates.
* We assume that *Gengaku Sochi* that occurred on January 21 was for JB366, and we have adjusted the BoJ's holdings accordingly.
** *Gengaku* room is calculated assuming the JPY1.2tn limit.

Plumbing: Analyzing the implications of the sunset of the Fund-Provisioning Measure to Stimulate Bank Lending in June

The BoJ's announcement to cease extending new loans under the Fund-Provisioning Measure to Stimulate Bank Lending (the Measure) requires us to assess its impact on collateral demand and reserve dynamics.

Figure 91: Banks could roll over approximately JPY10tn in 2H25, if desired

Estimated maturity schedule of major funds-provisioning measures (JPY bn)

(JPY bn)	FSO (ex. 2-week)	Disaster areas	Climate change	Foundations for econ. growth	Stimulate bank lending	Total
1Q25	0	35	4,727	679	6,450	11,891
2Q25	0	18	0	502	9,414	9,935
3Q25	0	28	7,236	264	14,911	22,440
4Q25	0	6	0	246	5,397	5,649
1Q26	0	0	0	792	3,888	4,680
2Q26	0	0	0	316	4,627	4,943
3Q26	0	0	0	0	3,059	3,059
4Q26	0	0	0	0	3,671	3,671
1Q27	0	0	0	0	7,826	7,826
2Q27	0	0	0	0	5,946	5,946
3Q27	0	0	0	0	3,545	3,545
4Q27	0	0	0	0	5,109	5,109
1Q28	4,002	0	0	0	9,851	13,853
2Q28	0	0	0	0	0	0
3Q28	1,001	0	0	0	0	1,001
4Q28	2,001	0	0	0	0	2,001
Est. total	7,004	86	11,963	2,801	83,694	105,547
Actual	7,004	86	11,963	2,402	79,549	101,004
Actual - Est.	0	0	0	-399	-4,145	-4,544

Estimated values overstate due to prepayments

Source: BoJ, J.P. Morgan.
* See the description under Figure 9 of this report on how we estimate.

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As of the end of December, the outstanding balance of the Measure was JPY79.5tn, with an estimated maturity schedule shown in Figure 91. Before the Measure concludes in June, operations are scheduled for March and June. While the maximum amount of newly disbursed loans depends on each counterparty's lending activity, **we estimate that banks can likely borrow around JPY5tn in *new* loans in both March and June**. The BoJ will allow counterparties to roll over up to 50% of the amount of loans maturing between July and December into one-year loans. **Our back-of-the-envelope calculations suggest that banks could roll over approximately JPY10tn in 2H25, if desired**. By the end of 2026, the outstanding balance of the Measure is expected to decrease to around JPY30tn, less than 40% of its current level.

From a collateral demand perspective, we think that there is a reasonable likelihood that collateral such as T-bills will become somewhat richer around March and June, as last-minute demand to secure relatively cheap term funding may arise. However, beyond June, the announcement indicates a clear trend towards cheaper collateral over time. We anticipate greater cheapening pressure on T-bills and coupon JGBs, as other types of collateral posted to the BoJ have limited use in the private repo market (**Figure 92**).

On reserves dynamics, we expect ongoing QT to drain around JPY30tn in reserves this year. Between July and December, at minimum, an additional JPY10tn is expected to drain due to the maturity of the Measure. Although the pace of liquidity drain is set to accelerate and be substantial, we believe we are still far from a point where liquidity drain pressures funding rates. The turnover ratio of current account balances (settlement via BoJ current accounts / total current account balances) should remain low (**Figure 93**). **We foresee a continued environment of abundant liquidity**, where banks primarily engage in money markets for arbitrage transactions rather than meeting intraday cash needs.

Figure 92: Starting in 2H25, we anticipate greater cheapening pressure on T-bills and coupon JGBs, as other types of collateral posted to the BoJ have limited use

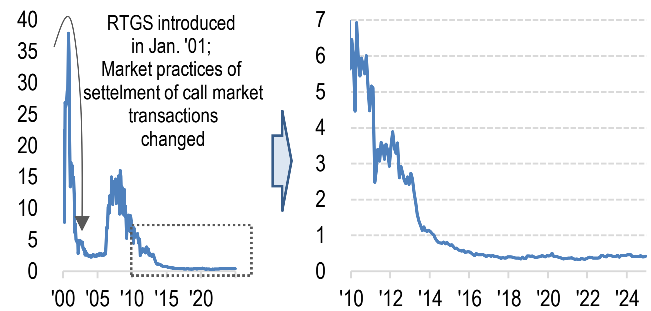
As of December 2024: Collateral posted to the BoJ (JPY bn)

(JPY bn)	Face value	Collateral value
Loans on deeds to the government	31,355	30,390
Beneficial interests of a trust in housing loans	44,434	26,660
JGBs	26,192	24,159
Municipal bonds	23,736	22,258
FILP agency bonds	9,664	8,730
Loans on deeds to companies	5,910	5,126
Govt.-guaranteed bonds	5,352	5,106
Corporate bonds	5,142	4,842
T-bills	4,552	4,500
All other	8,244	7,512
Total	164,580	139,283

Source: BoJ, J.P. Morgan.

Figure 93: We foresee a continued environment of abundant liquidity, where banks primarily engage in money markets for arbitrage transactions rather than meeting intraday cash needs

Turnover ratio of current account balance (= settlement via BoJ current accounts / total current account balance)



Source: BoJ, J.P. Morgan.

In summary, T-bills have become cheaper relative to OIS over recent weeks. Specifically, 3-month T-bills have cheapened to below OIS-10bp due to the JPY9tn maturity wall of FSOs this month, likely reducing collateral demand. With FSO maturities now behind us, T-bills have resumed richening, closing at around OIS-15bp today (**Figure 94**). Based on our supply-demand expectations for 1H25, **we anticipate 3-month T-bills to stabilize around OIS-15bp before richening into March. However, in 2H25, we expect them to gradually cheapen**.

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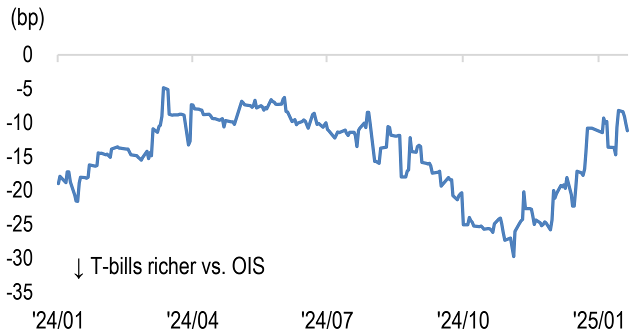
We anticipate that TONAR will continue to trade slightly below IOER and expect GC/TONAR to remain tight, as it has since the rate hike in July last year (**Figure 95**). Over the long term, we believe GC will likely cheapen as collateral gradually returns to private hands.

Figure 94: We anticipate 3-month T-bills to stabilize around OIS-15bp before richening into March

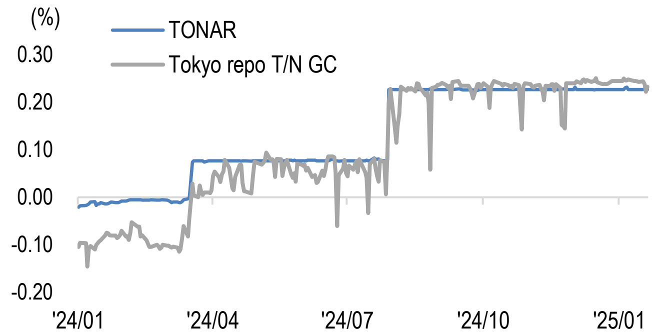
Spread between 3-month T-bills minus matched-maturity OIS (bp)



Source: Bloomberg Finance L.P., J.P. Morgan.

Figure 95: We anticipate that TONAR will continue to trade slightly below IOER and expect GC/TONAR to remain tight

TONAR and T/N Tokyo repo rate (%)



Source: BoJ, JSDA, J.P. Morgan.

Last but not least, developments around deposit betas are likely to garner attention. After today's rate hike, two mega banks have announced an increase in the rate on ordinary deposits from 0.10% to 0.20%, resulting in both marginal and cumulative betas of around 40% (**Figure 96**).

From an Interest Rate Risk on the Banking Book (IRRBB) perspective, rising deposit betas suggest that as interest rates rise, the present value (PV) of fixed-rate assets decreases, while the PV of liabilities, primarily deposits, may not decrease as much. This could potentially reduce banks' willingness to take on duration risk over the medium term (see here).

Additionally, higher interest rates have led to changes in deposit trends (**Figure 97**). If deposits shift from demand deposits to time deposits, the duration of bank liabilities may shorten somewhat. Lastly, from a plumbing perspective, as the policy rate increases, participants who are not eligible for IOER remuneration might seek cash equivalents with a higher policy beta. With many banks expected to announce new deposit rates in the coming weeks, we will closely monitor these developments.

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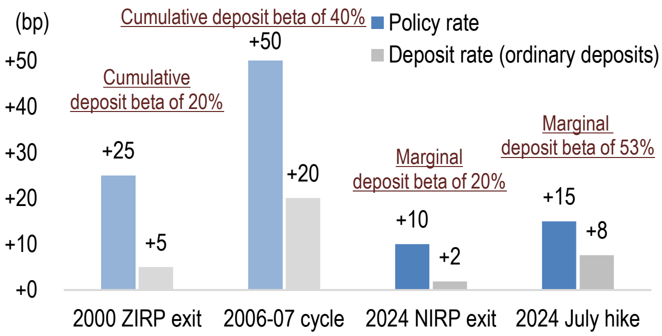
Figure 96: After today's rate hike, two mega banks have announced an increase in the rate on ordinary deposits from 0.10% to 0.20%, resulting in both marginal and cumulative betas of around 40%

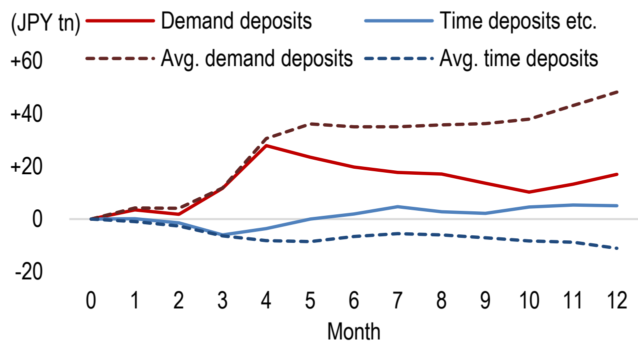
Deposit betas of ordinary deposits (bp; %)



Source: BoJ, J.P. Morgan estimates.

Figure 97: Higher interest rates have led to changes in deposit trends

Cumulative change in the outstanding balance of demand and time deposits in 2024 compared to the average over the past three years (JPY tn) (0 = December of the previous year)



Source: BoJ, J.P. Morgan.
* Averages are based on the 2021-2023 data.

Trade recommendations

- **1y1y vs. 2y1y steepener**
  Pay 2Y1Y swap @0.826% vs. Receive 1Y1Y swap @ 0.750%. P/L since inception is +2.1bp (recommended: 22 November 2024)
- **30Y swap spread narrower**
  Receive 30Y swap (JSCC) @ 1.848% vs. Short 30Y JX84 (maturity: 20 September 2054) @ 2.251%. P/L since inception is -2.0bp (recommended: 22 November 2024)
- **10Y swap spread narrower**
  Receive 10Y swap (JSCC) @ 0.940% vs. Short 10Y JB375 (maturity: 20 June 2034) @ 0.960%. P/L since inception is +2.8bp (recommended: 2 August 2024)
- **2s/10s JGB curve flattener**
  Long JPY10.0bn of 10Y JB374 (maturity: 20 March 2034) @ 0.860% vs. Short JPY48.5bn of 2Y JN459 (maturity: 1 April 2026) @ 0.275%. P/L since inception is +0.5bp (recommended: 12 April 2024)

Figure 98: Closed trades in last 12 months

P/L reported in bp of yield unless otherwise indicated

TRADE	ENTRY	EXIT	P&L
DURATION			
Receive 1Yx1Y swap (JSCC)	15-Sep-23	5-Jan-24	7
Short 7Y JGB	23-Jan-24	26-Jan-24	7
Short 2Y JGB	19-Jan-24	2-Feb-24	4
Pay 1M OIS	15-Mar-24	19-Mar-24	4
Tactically long 30Y JGB	12-Apr-24	10-May-24	-6
Pay 1Yx1Y swap (JSCC)	9-Aug-24	30-Aug-24	6
CURVE			
2s/10s JGB curve steepener	20-Nov-23	19-Jan-24	1
10s/30s JGB curve steepeners	30-May-24	2-Aug-24	15
SWAP SPREADS			
5Y swap spread narrower (JSCC)	26-Oct-23	19-Jan-24	3
10Y swap spread narrower	19-Jan-24	15-Mar-24	12
2Y swap spread narrower	19-Mar-24	6-Sep-24	4

Source: J.P. Morgan.

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Australia & New Zealand

Dragged along for the ride

- **Next week's CPI report in Australia should consolidate the case for a first RBA cut in February**
- **Though 1H25 pricing in AUD has been anchored by approaching cuts, the curve beyond has been high-beta to the US sell-off of recent months**
- **The net result is steep forward shape, and the AUD 3-5Y sector appears broadly cheap vs surrounds given domestic fundamentals of a relatively gradual, shallow easing cycle ahead**
- **The AUD 2-5Y sector should also be high beta to a global rally, given performance on the way up; receive AUD 3Yx1Y IRS which is above 4%**
- **NZ 4Q CPI was in line with expectations, near the middle of the target band**
- **Core eased further and slipped below the mid-point in 2H24**
- **The NZIER business survey suggested some cyclical stabilization, but this is yet to be borne out in hard data**
- **Inflation is still drifting lower and growth has been concerningly weak, so we expect the RBNZ to follow through with another 50bp cut next meeting**
- **Maintain the 2s/10s NZD-USD swap box flattener, as 5Yx5Y NZD is still very elevated relative to cyclical performance and assessment of neutral**
- **Trade portfolio: Receive AUD 3Yx1Y IRS. Close the received position in the April RBA-RBNZ OIS meeting date spread; hold the NZD 2s/10s-US 2s/10s swap box flattener.**

AUD Strategy Update: 3-5Y sector looking cheap

Over the last month, domestic policy has again taken a back seat to global factors in driving AUD yields. Local developments are broadly playing to script in that the RBA delivered the pivot in December (Figure 99) as predicted by the data trajectory, and the 4Q CPI data next week should confirm a first rate cut for the cycle in February. Nevertheless, AUD under-performed on the largely US-driven sell-off (Figure 100), until US CPI.

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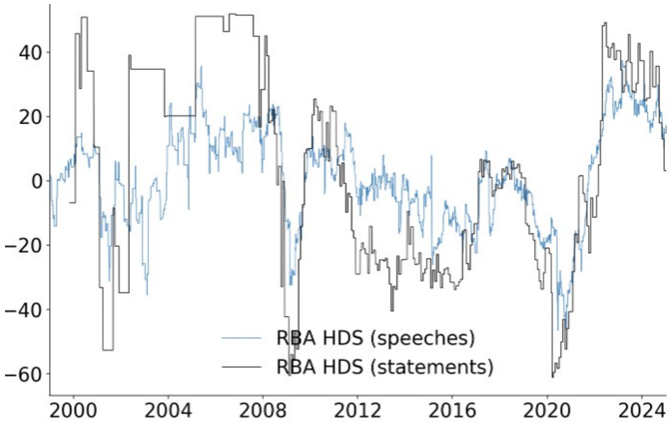
Figure 99: The RBA Hawk Dove Score dropped sharply with the December policy meeting/statement

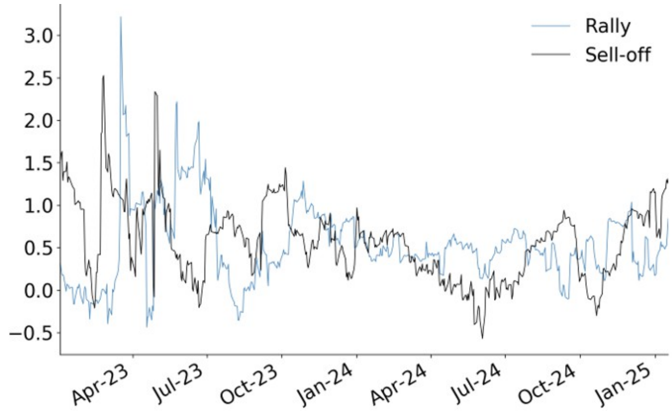
RBA Hawk Dove Score for speeches, statements



Source: J.P. Morgan.

Figure 100: AUD 3Y yields have been high-beta to the US sell-off

ACGB 3Y yields, rolling beta to UST2Y conditional on sell-offs/rallies

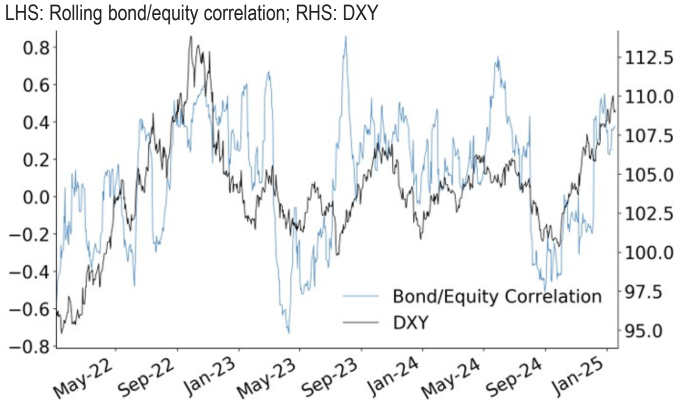


Betas calculated on daily yield changes, samples partitioned for UST overnight rally or sell-off.
Source: J.P. Morgan.

In playing this dynamic, the main contrast to 2024 is that we see less scope for relative monetary policy as a driver for AUD spreads in 2025, with the Fed and RBA to deliver similar magnitudes of easing this year. The directional question is then harder to sidestep, but the DM fixed income complex is looking cheap again, with inflation risk premia back at their peaks (Figure 101), and so unlikely to fully realize. This gives us a bullish outlook for the front-end of the AUD curve.

Figure 101: Perceived inflation risk has returned over the last few months, helping drive real yields and the dollar; these appear to be decent levels to fade vis a vis outright yields

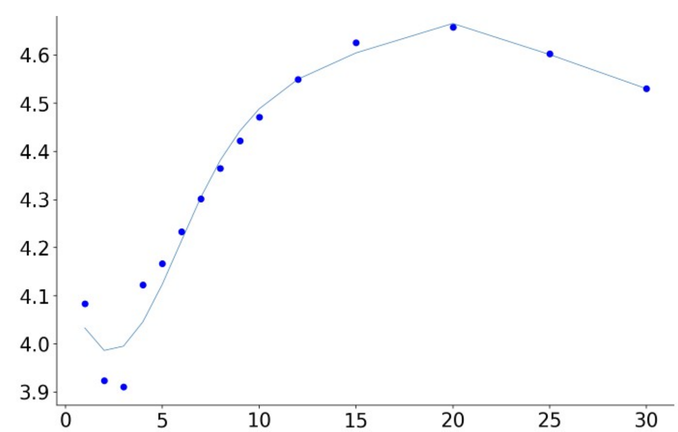
LHS: Rolling bond/equity correlation; RHS: DXY



Source: J.P. Morgan.

Figure 102: ...rate cuts dominate the 1Y sector, but forward-shape beyond is very steep in the context of gradual, relatively shallow cuts...

AUD IRS curve, actual and fitted spline (%)



Source: J.P. Morgan.

Further, one would have thought an RBA easing cycle motivated by lower inflation, and stable (below-trend) growth, rather than significantly rising unemployment, should support a gradual easing path. But, while February OIS pricing has held solid at 60%-70% probability of a cut, curves in AUD steepened through the sell-off, suggesting deleveraging has driven yields through the belly. The pronounced V-shape in the AUD curve (Figure 102) is exacerbated when a global sell-off occurs in the context of near-term RBA cuts: 3Y futures are the liquidity instrument, and will cheapen relatively more, if the front year of the curve is

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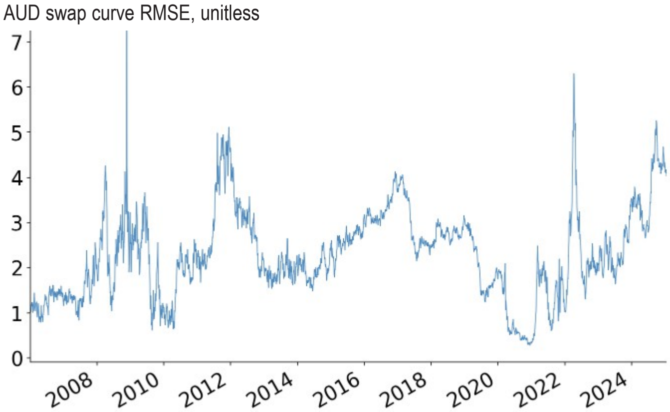
anchored by local policy.

Figure 103: … this complex term structure puts AUD swap curve RMSE near historical extremes

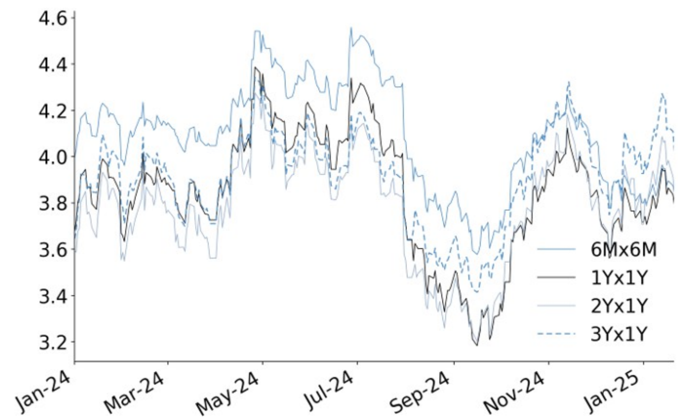
AUD swap curve RMSE, unitless



Root mean squared error (RMSE) of AUD swap curve from 3M to 30Y, relative to a more sparsely fitted curve.
Source: J.P. Morgan.

Figure 104: AUD 3Yx1Y IRS is above 4%, having lagged on the more recent rally

AUD IRS forwards, %



Source: J.P. Morgan.

The implied dislocation is relatively extreme in a historical context, as shown by RMSE through the swap curve (Figure 103). This is most easily resolved by a rally and out-performance in the belly. Similarly, 3Y futures at 40bp under cash is quite skinny compared to history when cuts are expected imminently. On a global rally we would also expect AUD front-end curve spreads to be biased flatter from 1s/2s out to 5Y. Receive AUD 3Yx1Y IRS, which is particularly elevated at over 4%, having lagged the last week's rally (Figure 104).

Relatedly, we look for dips in 3Y EFP to pay, an expression we expect will trade bullishly. Swap-futures mismatch already embeds some of this directionality, and has been exacerbated on a global sell-off for reasons stated above. 3Y swap spreads should then widen if RBA easing is stretched deeper out into the curve. The same holds for term spreads on a long-end rally given the extent to which the fiscal largesse/excess supply theme has translated into AUD, where it is less applicable (see our global government issuance outlook).

AUD Funding Update: A wider front-end than peers

The year-end passed uneventfully for Antipodean basis markets. Beyond the very front-end, the AUD/USD (BBSW-SOFR) cross-currency curve is relatively unchanged in month-ago terms. Still, this does represent some drift vs other basis markets where the sub-1Y segment has narrowed more considerably. The six month tenor in BBSW-SOFR for example has diverged from PC1 of the comparable EUR, JPY and GBP curves (Figure 105) for a few months now. Monetary policy dynamics can account for some of this in Yen, though even leaving that aside, there remain idiosyncratic factors pinning the AUD short-end at relatively wide levels.

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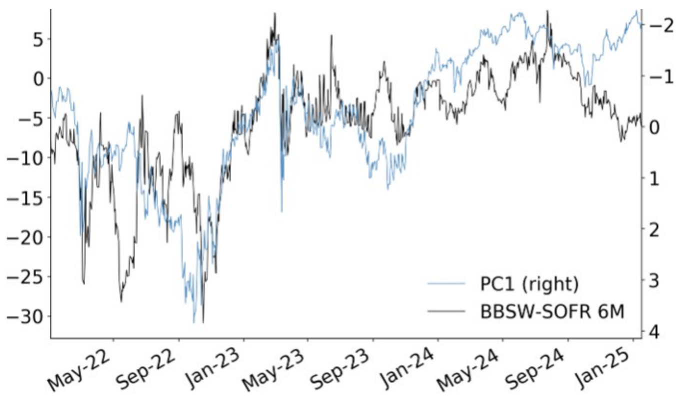
Figure 105: 6M BBSW-SOFR has held at wider levels than other DM basis markets of late

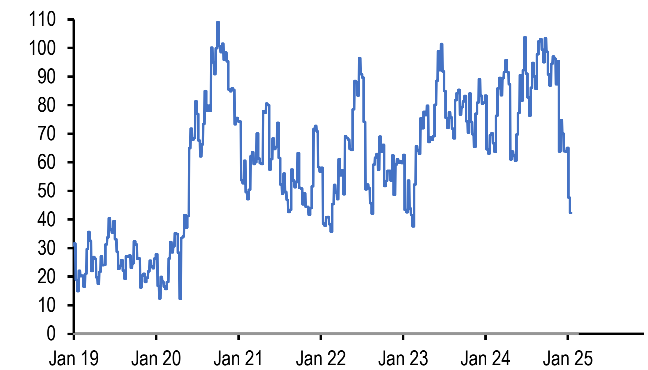
LHS: BBSW-SOFR 6M basis (Bp); RHS: PC1 of EUR, GBP and JPY 6M bases (Unitless)



Source: J.P. Morgan.

Figure 106: After a period of steady accumulation, government deposit balances dropped sharply in January on seasonal factors, injecting >AUD 30bn of temporary liquidity

Government deposit balances at the RBA, AUD bn



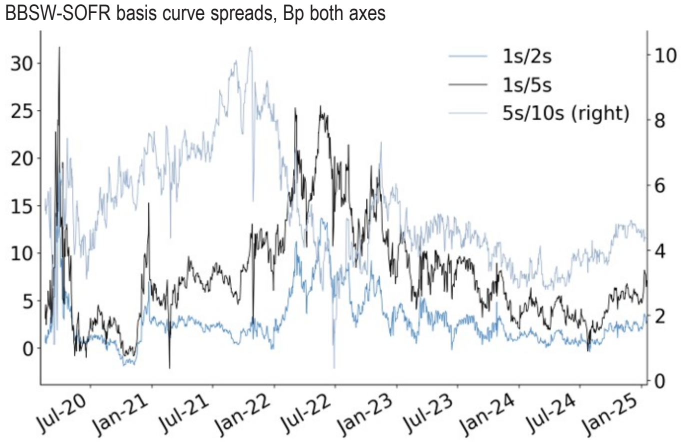
Source: RBA, J.P. Morgan.

Overnight liquidity has recently (but temporarily) increased due to seasonal drawdown in the government's deposit balance (Figure 106), which helps cap FX/OIS near-term. At the same time, AUD FRA-OIS has traded structurally wider since the RBA's TFF facility matured, reflecting banks' terming of domestic issuance beyond 3m. With the RBA delivering unlimited allotment in sub-1m repo, there are now greater system-level term premia for uncollateralized vs collateralized lending, which is a front-end widener for AUD basis.

In our 2025 Outlook we were expecting a steeper AUD cross-currency curve (Figure 107) with banks' term issuance requirements increasing further around the 5Y sector, with sub-1Y to stayed anchored on the liquidity factors outlined above. We have also been positioned for 5s/10s steepening and maintained this tactically into Kanga issuance season on anticipation of related receiving activity around the 5Y sector. These flows have largely played out now however (Figure 108) and so should be waning as an influence from here.

Figure 107: Front-end curve spreads have steepened but mostly due to 1Y; despite a strong Kanga season 5s/10s failed to steepen on net...

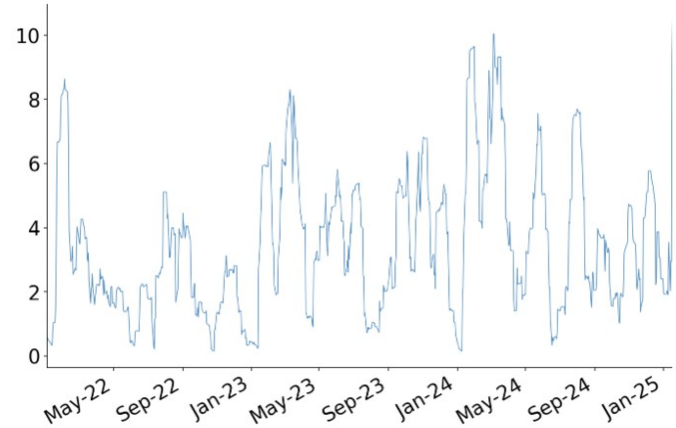
BBSW-SOFR basis curve spreads, Bp both axes



Source: J.P. Morgan.

Figure 108: ... Kanga flows have exceeded their prior January peak and should be waning in influence for the belly of the curve

Rolling 1m debt issuance, foreign entities issuing in AUD ccy



Excludes callables and convertibles.
Source: J.P. Morgan, Bloomberg Finance L.P.

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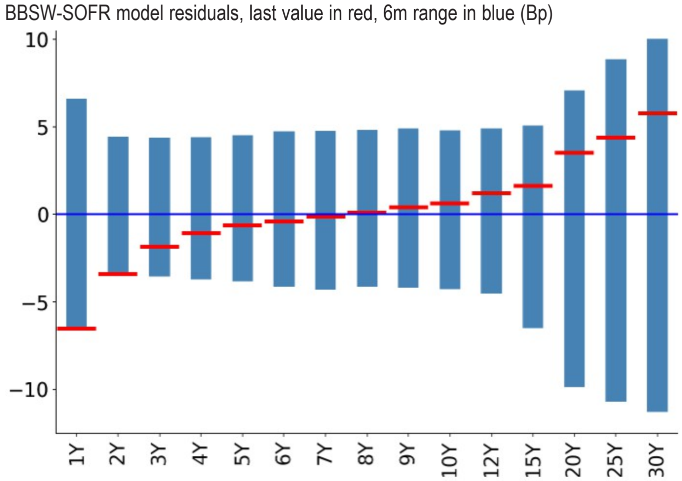
Models based on issuance flows, liquidity and other basis markets are flagging the belly as closer to fairly valued now, with a flattening bias in terms of relative residuals (Figure 109), so we are turning more neutral at these levels. Close the paid position in 5s/10s BBSW-SOFR curve. The longer-end has historically been harder to value given structural imbalance of flows. Over time however, we anticipate the tenor of offshore issuance by domestic entities to lengthen given the changing complexion of national funding requirements leans more toward large infrastructure-like names, and potentially state governments, with longer duration assets to fund. This should be a source of trend dis-inversion in the typically very negative AUD long-end (Figure 110).

Figure 109: Given narrower levels offshore and benign credit conditions, models are now showing the belly of the AUD curve as fair, and sub-3Y biased higher

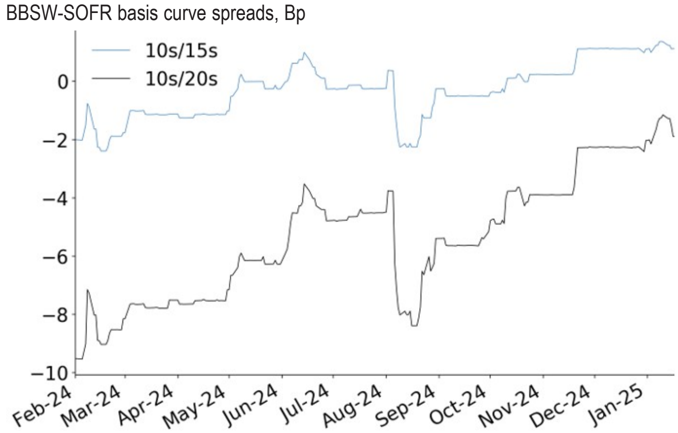
BBSW-SOFR model residuals, last value in red, 6m range in blue (Bp)



Separate models estimated on each curve point, of the form: basis = f(PC1, PC2 of JPY, EUR, GBP basis, JPM JULI bank credit index, JACI Index of offshore issuance by AUD entities, rolling 1M offshore and Kanga issuance, RBA ES balances).
Source: J.P. Morgan.

Figure 110: The deep-end has structurally lacked outbound (payside) flow, but shifts in the composition of domestics' offshore borrowing should drive trend dis-inversion

BBSW-SOFR basis curve spreads, Bp



Source: J.P. Morgan.

NZ Strategy Update: CPI keeps the easing cycle on track

New Zealand's 4Q CPI data were well-behaved, in line with JPM/consensus expectations at 0.5%q/q. The annual rate stayed at 2.2%oya, near the middle of the RBNZ's 1-3% target midpoint. This is a tenth above the staff forecast from the November MPS, though the details on core and the more cyclical components offset that, and suggest further deceleration ahead. The suite of trimmed mean measures printed mostly at 0.4%q/q, slipping below the target midpoint in annualized terms over 2H24 (Figure 111). Non-tradables inflation, something of a weathervane for domestic market hawkishness on inflation, was below normal and below market/RBNZ expectations at 0.7%q/q. Measures of breadth, showing the proportion of items annualizing above 2%, 3% and 4%, are back at 2019/pre-pandemic norms. Most proxies for pricing intentions and spare capacity suggest further falls in annual inflation to the lower half of the target band in 2025.

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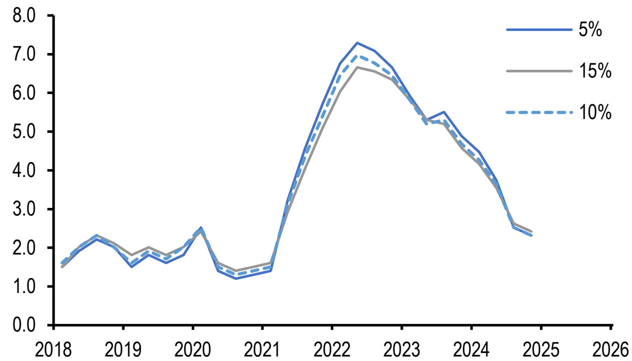
Figure 111: Core inflation in NZ is inside the target band and trending lower

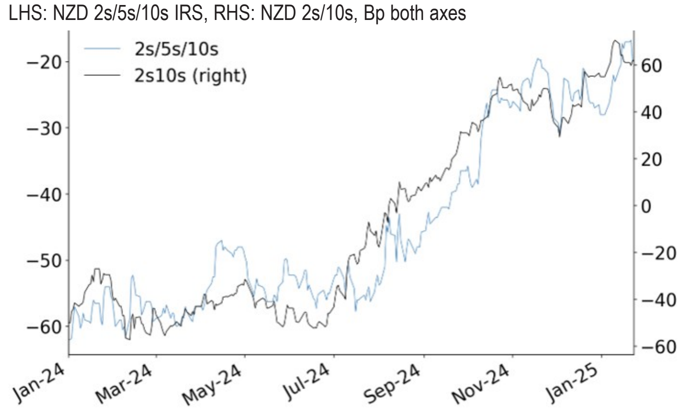
Trimmed mean CPI (%oya), by % of trim



Source: Stats NZ, J.P. Morgan.

Figure 112: The NZD belly is cheaper despite no new policy news, poor GDP data and in-line inflation

LHS: NZD 2s/5s/10s IRS, RHS: NZD 2s/10s, Bp both axes



Source: J.P. Morgan.

NZ rates have sold off on net over January, largely following US. A less-bad NZIER business survey for 4Q gave the turning point narrative a bit more gusto, but the hard data are some way from following suit: the last GDP report was ugly and showed more of the deterioration to be recent, such that the need for policy traction is now a bit more urgent. Meanwhile, inflation is still slowing, removing any constraint on the RBNZ to do more. The committee is unlikely to feel it has enough traction yet as average mortgage rates haven't fallen much from the peak, so we still expect a 50bp easing in February before shifting down to 25bp pace.

We use the opportunity to take a small profit on the paid Apr-25 RBNZ OIS vs received Apr-25 RBA OIS position. Maintain the NZD 2s/10s - US 2s/10s swap box flattener: NZD 5Yx5Y (4.65%) remains very high compared to assessments of long-run neutral (sub-3%). The belly of the NZ curve has underperformed on the sell-off too (Figure 112), which suggests significant potential to participate in a rally.

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Summary of main views

Duration	Curve	Swap spreads	Swap spread curve	Inflation	Cross-market
Buyer of dips in the AUD front-end	AUD 3s/10s curve to realize flatter than forwards, 5Y to outperform	Hold NZGB Apr-33 on MMS	Fade narrowing in AUD 3Y EFP	Long bias front-end ACGBi BEI vs US	Receive NZD-AUD 1Yx1Y IRS at flat
Rec NZD 1Yx1Y IRS					Hold NZ-US 2s/10s swap box flattener

Trade recommendations

- **Receive AUD 3Yx1Y IRS**
  Receive 25K DV01 AUD 3Y IRS (Q-Q) at 4.065%
- **Close the received position in the Apr '25 RBA-RBNZ OIS meeting date spread**
  Receive 25K DV01 Apr-25 RBA OIS at 3.67%, pay 25K DV01 Apr-25 RBNZ OIS at 4.25%, a spread of -57.4bp. Closed at -55.7bp. P/L since inception (Nov 14): +2.7bp
- **Hold an NZD-USD 2s/10s swap box flattener**
  Receive 25K DV01 NZD 2s/10s IRS curve at +42.3 bp, pay 25K DV01 USD 2s/10s swap (SFR) curve at -14.0bp, a box spread of +59.2bp. P/L since inception (Nov 14): -2.9bp
- **Long NZGB Apr-33s vs MMS**
  Buy 25K DV01 NZGB Apr-33 MMS at a spread of +32.0bp. P/L since inception (Nov 14): -10.1bp
- **Close the paid position in 5s/10s AUD-USD (BBSW-SOFR) basis**
  Pay 25K DV01 10Y BBSW-SOFR basis at +9.6bp, receive 25K DV01 5Y BBSW-SOFR basis at +6.0bp, a spread of +3.6bp. P/L since inception (Sep 26): +0.7bp
- **Close the short in ACGB Apr-2026s on ASW**
  Sell 25K DV01 ACGB Apr-2026s on ASW, at a spread of -12.9bp. P/L since inception (5 Sep): +13.5bp
- **Receive NZD 1Yx1Y IRS**
  Sell 25K DV01 NZD 1Yx1Y IRS at 3.39. P/L since inception (19 Dec): -9.0bp

Note: One star (*): high-conviction trade and no star: moderate-conviction trade. Closed trades marked as at submission, existing trades marked as of the close of business (Sydney) on 22 January 2024.

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Forecasts

	Current	Mar-25	Jun-25	Sep-25	Dec-25
United States					
Fed Funds	4.50	4.25	4.00	3.75	3.75
2-year note	4.28	4.00	3.75	3.65	3.80
10-year note	4.59	4.40	4.25	4.10	4.25
2s10s curve (bps)	31	40	50	45	45
Australia					
RBA cash rate	4.35	4.10	3.85	3.60	3.35
90-day rate	4.33	3.95	3.70	3.45	3.45
3-year yield	3.93	3.80	3.60	3.50	3.50
10-year yield	4.46	4.40	4.20	4.10	4.10
3-year swap spread (bps)	-2	5	5	10	10
10-year swap spread (bps)	-2	5	5	5	5
3s10s curve (bps)	53	60	60	60	60
AUS-US 10-year spread (bps)	-13	0	-5	0	-15
New Zealand					
RBNZ OCR	4.25	3.75	3.50	3.25	3.25
90-day rate	4.05	3.75	3.40	3.40	3.40
2-year bond	3.70	3.60	3.40	3.30	3.20
10-year bond	4.59	4.30	4.10	4.00	3.90
2s10s swap curve	62	65	70	70	70
NZ-US 10-year spread	0	-10	-15	-10	-35
Foreign Exchange					
AUD/USD	0.63	0.62	0.65	0.67	0.69
NZD/USD	0.57	0.56	0.58	0.59	0.60
EUR/USD	1.04	0.99	1.03	1.05	1.08
USD/JPY	156	152	151	149	148
AUD/JPY	97.6	94.2	98.2	99.8	102.1
NZD/JPY	88.2	85.1	87.6	87.9	88.8
AUD/NZD	1.11	1.11	1.12	1.14	1.15

Source: J.P. Morgan. Current values are from Bloomberg Finance L.P.

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Trades closed last 12M

TRADE	ENTRY	EXIT	P&L
DURATION			
Receive NZD 1Yx1Y IRS	08-Jun-23	02-Nov-23	-6.9
Pay Dec-23 RBA OIS	08-Nov-23	06-Dec-23	-3.0
Receive Aug '24 RBNZ OIS	08-Nov-23	14-Dec-23	42.4
Receive Aug '24 RBNZ OIS	29-Feb-24	11-Jul-24	-2.2
Receive NZD 2Yx1Y IRS	21-Mar-24	18-Jul-24	36.1
Receive AUD 1Yx1Y IRS	18-Jul-24	01-Aug-24	31.0
Receive August '24 RBNZ OIS	01-Aug-24	15-Aug-24	11.4
Pay 2Y NZD IRS	26-Sep-24	17-Oct-24	2.3
Pay Feb 2025 RBNZ OIS	17-Oct-24	24-Oct-24	0.0
Receive AUD 6Mx6M OIS	24-Oct-24	12-Dec-24	24.4
CURVE			
Sell belly of ACGB Nov-25/Apr-26/Sep-26 fly	22-Jun-23	03-Aug-23	0.6
Receive belly of NZD 2s/3s/10s IRS fly	23-Mar-23	02-Nov-23	33.8
Sell ACGB 3s/10s futures curve	25-Oct-23	08-Nov-23	3.5
Receive belly of AUD 3s/5s/10s IRS fly	22-Feb-24	26-Apr-24	-4.2
AUD IRU4/U5 bill flattener	13-Jun-24	18-Jul-24	10.0
Pay NZD 2s/5s IRS curve	18-Jul-24	01-Aug-24	4.2
Paid belly of NZD 2s/5s/10s IRS fly	01-Aug-24	12-Sep-24	11.4
Paid AUD 1s/2s IRS spread	29-Aug-24	17-Oct-24	6.9
Paid Nov '24/Feb '25 RBNZ OIS spread	15-Aug-24	16-Oct-24	5.0
Received Feb '25 RBNZ OIS/NZD 2Y IRS spread	24-Oct-24	12-Dec-24	13.0
COUNTRY SELECTION/RELATIVE VALUE			
AUD 3s/10s EFP box flattener	16-May-23	17-Aug-23	1.0
Receive 12M BBSW-SOFR basis	13-Apr-23	08-Nov-23	0.9
Long NZGB Apr-33 vs UST 3 3/8 May-33	13-Jul-23	08-Nov-23	21.7
Sell ACGB Sep-26 vs receiving 3Y OIS	12-Oct-23	18-Jan-24	4.3
Paid 1s/5s BBSW-SOFR basis	20-Jul-23	22-Feb-24	-7.6
Paid 1s/2s BKBM-SOFR basis	08-Nov-23	22-Feb-24	-2.0
Long IRU4 vs SFRU4	25-Oct-23	22-Feb-24	42.0
Paid AUD 1Yx1Y IRS, received 1Yx1Y SFR	21-Mar-24	11-Apr-24	-36.0
Paid May '24 RBA OIS, received Apr '24 RBNZ OIS	18-Jan-24	11-Apr-24	-1.6
NZD-AUD 2s/5s IRS box steepener	22-Jun-23	11-Apr-24	6.6
Own TCV Nov-2034s on ASW	07-Mar-24	18-Apr-24	0.0
Pay AUD 10Y EFP	04-Apr-24	26-Apr-24	1.0
Pay the belly of AUD 1s/2s/3s IRS	14-Dec-23	09-May-24	5.1
Pay the AUD-USD 2s/5s/10s spread (IRS-SFR)	07-May-24	13-Jun-24	4.4
Receive the NZD-AUD 1Yx1Y IRS spread	09-May-24	27-Jun-24	15.6
Own NZGB Apr-2033s on ASW	18-Jan-24	29-Aug-24	-4.8
Long TCV Nov 2034 vs ACGB May 2034	09-May-24	24-Oct-24	7.6
Receive AUD-USD 5Yx5Y (IRS-SFR) spread	15-Aug-24	24-Oct-24	-7.9
Sell ACGB Apr-26s on ASW	05-Sep-24	25-Jan-25	13.5
Paid 5s/10s BBSW-SOFR basis	26-Sep-24	25-Jan-25	0.7
Receive Apr '25 RBA-RBNZ OIS spread	14-Nov-24	23-Jan-25	2.7
INFLATION			
Long 2025 ACGBi BEI	14-Sep-23	26-Oct-23	11.3
Long 2025 ACGBi BEI	06-Dec-23	25-Sep-24	-52.

Source: J.P. Morgan. Note: Past performance is not indicative of future results.

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Interest rate forecasts

		24-Jan	Mar-25	Jun-25	Sep-25	Dec-25	YTD chg. (bp)
US	Fed funds	4.25-4.50	4.25-4.50	4.00-4.25	3.75-4.00	3.75-4.00	-
	SOFR	4.30	4.30	4.05	3.85	3.85	-
	2Y bmk yield	4.26	4.25	4.10	3.85	3.95	0
	5Y bmk yield	4.43	4.45	4.35	4.15	4.25	6
	10Y bmk yield	4.63	4.70	4.60	4.45	4.55	9
	30Y bmk yield	4.86	4.90	4.80	4.75	4.80	10
	2s/10s bmk curve	38	45	50	60	60	8
	10s/30s bmk curve	23	20	20	30	25	1
	2s/30s bmk curve	61	65	70	90	85	10
Euro area	Refi rate	3.15	2.65	2.15	1.90	1.90	-
	Depo rate	3.00	2.50	2.00	1.75	1.75	-
	3M Euribor	2.64	2.50	2.00	1.75	1.75	-4
	2Y bmk yield	2.29	1.85	1.65	1.65	1.70	22
	5Y bmk yield	2.38	1.90	1.75	1.80	1.90	25
	10Y bmk yield	2.57	2.10	1.95	2.00	2.05	23
	30Y bmk yield	2.79	2.40	2.30	2.35	2.40	22
	2s/10s bmk curve	29	25	30	35	35	1
	10s/30s bmk curve	22	30	35	35	35	-1
	2s/30s bmk curve	50	55	65	70	70	0
vs. 6s	2Y swap spread	12	17	20	21	22	0
	5Y swap spread	5	11	10	9	8	-3
	10Y swap spread	-5	-6	-7	-8	-9	-4
	30Y swap spread	-49	-41	-37	-34	-30	-6
10Y spread to Germany (curve adj.)	Austria	36	43	45	40	40	-6
	Belgium	60	52	55	50	50	-1
	Finland	39	43	45	40	40	-7
	France	74	70	75	70	65	-9
	Greece	85	85	90	85	80	-1
	Ireland	28	30	30	30	30	1
	Italy	115	125	130	125	125	-1
	Netherlands	20	25	25	25	25	-3
	Portugal	48	55	55	55	55	0
	Spain	66	65	70	65	65	-3
	Wtd. peri. spread	94	99	104	99	99	-2
	EU	48	50	50	45	45	-6

		24-Jan	Mar-25	Jun-25	Sep-25	Dec-25	YTD chg. (bp)
UK	Base rate	4.75	4.50	4.25	4.00	3.75	-
	2Y bmk yield	4.36	4.20	4.10	3.95	3.90	-6
	5Y bmk yield	4.35	4.15	4.10	4.05	4.00	-2
	10Y bmk yield	4.64	4.25	4.20	4.15	4.10	5
	30Y bmk yield	5.20	4.75	4.70	4.70	4.65	6
	2s/10s bmk curve	28	5	10	20	20	11
	10s/30s bmk curve	56	50	50	55	55	1
	2s/30s bmk curve	85	55	60	75	75	12
vs. SONIA	2Y swap spread	-15	-15	-15	-15	-15	-2
	5Y swap spread	-27	-31	-33	-35	-38	1
	10Y swap spread	-53	-50	-52	-55	-57	-2
	30Y swap spread	-88	-80	-85	-87	-90	1
Japan	Policy rate	0.50	0.50	0.75	0.75	1.00	-
	2Y bmk yield	0.71	0.65	0.85	0.90	1.10	11
	5Y bmk yield	0.90	0.80	1.00	1.05	1.25	16
	10Y bmk yield	1.23	1.15	1.35	1.35	1.50	14
	20Y bmk yield	1.90	1.95	2.10	2.10	2.25	2
	30Y bmk yield	2.27	2.35	2.45	2.45	2.55	-1
	2s/10s bmk curve	52	50	50	45	40	2
	10s/30s bmk curve	105	120	110	110	105	-15
	2s/30s bmk curve	156	170	160	155	145	-12
Australia	Cash rate	4.35	4.10	3.85	3.60	3.35	-
	3Y bmk yield	3.91	3.80	3.50	3.40	3.40	1
	10Y bmk yield	4.46	4.40	4.10	4.00	4.00	1
New Zealand	Cash rate	4.25	4.00	3.75	3.50	3.50	-
	2Y bmk yield	3.68	3.60	3.50	3.50	3.60	8
	10Y bmk yield	4.63	4.30	4.20	4.20	4.30	8
Sweden	Repo rate	2.50	2.00	1.75	1.75	1.75	-
	2-year govt	2.01	1.60	1.45	1.50	1.60	-3
	10-year govt	2.34	1.90	1.85	2.00	2.10	-4
Norway	Depo rate	4.50	4.25	4.00	3.75	3.50	-
	2-year govt	3.89	3.50	3.20	3.00	2.80	0
	10-year govt	3.74	3.60	3.35	3.20	3.10	-9

* Levels as of 2:00pm London time.

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Fact sheet / Sovereign ratings

	GDP* (bn) 2025	GDP growth (oya, %) 2025	Inflation** (oya, %) 2025	Budget balance*** (% of GDP) 2025	Prim. Balance (% of GDP) 2025	Gross debt (% of GDP) 2025	Curr. acc. bal. (% of GDP) 2025	GDPpc (EU15=100) 2025	Unempl. Rate (%) Latest
Austria	506	1.0	2.1	-3.7	-2.2	81	1.5	118	5.0
Belgium	642	1.2	2.9	-4.9	-2.6	105	0.3	116	5.8
Cyprus	35	2.8	2.1	2.7	3.8	61	-8.4	80	4.4
Finland	287	1.5	2.0	-3.0	-1.5	85	-0.9	109	8.9
France	2,990	0.8	1.9	-5.3	-2.7	115	-0.3	93	7.2
Germany	4,437	0.7	2.1	-2.0	-0.9	63	6.8	112	6.1
Greece	250	2.3	2.4	-0.1	2.9	147	-7.5	51	9.0
Ireland	556	4.0	1.9	1.4	2.0	38	9.7	218	4.2
Italy	2,241	1.0	1.9	-3.4	0.5	138	1.2	81	6.1
Netherlands	1,183	1.6	2.4	-1.9	-1.1	44	11.1	140	3.7
Portugal	295	1.9	2.1	0.4	2.5	93	0.6	59	6.7
Slovenia	71	2.5	3.2	-2.1	-0.7	64	2.9	71	10.8
Spain	1,667	2.3	2.2	-2.6	-0.1	101	4.5	72	11.2
Euro area	15,669	1.3	2.1	-2.9	-0.9	90	3.6	95	6.3
US	30,397	2.1	2.0	-7.4	-2.6	124	-3.3	176	4.1
UK	2,917	1.4	2.4	-4.4	-2.3	104	-3.0	108	4.4
Japan	658	1.1	2.0	-3.0	-2.9	249	3.6	67	2.5
Australia	2,803	2.3	3.1	-1.3	-	35	-1.4	-	4.0
New Zealand	440	1.7	2.2	-3.1	-	43	-4.7	-	4.8
Norway	5,510	1.1	3.2	11.0	8.3	43	12.5	178	2.0
Sweden	6,576	1.9	1.6	-1.4	-0.3	35	7.9	116	8.0

*In billions of local currency except for Japan which is in ¥trillions
**HICP; National index if not available
*** Net lending (+) or net borrowing (-)
Source: EC European Economic Forecast Autumn 2024, Ameco, CBO, OBR, IMF, National Treasury Offices and National Statistics Offices.

Sovereign rating

	S&P		Moody's		Fitch		DBRS	
Austria	AA+	POS	Aa1		AA+	NEG	AAA	
Belgium	AA		Aa3	NEG	AA-	NEG	AA	
Cyprus	A-		A3		A-		BBB high	POS
Finland	AA+		Aa1		AA+	NEG	AA high	
France	AA-		Aa3		AA-	NEG	AA high	
Germany	AAA		Aaa		AAA		AAA	
Greece	BBB-	POS	Ba1	POS	BBB-		BBB low	POS
Ireland	AA	POS	Aa3	POS	AA		AA	
Italy	BBB		Baa3		BBB	POS	BBB high	POS
Netherlands	AAA		Aaa		AAA		AAA	
Portugal	A-	POS	A3		A-	POS	A high	
Slovenia	AA-	POS	A3	POS	A		A high	POS
Spain	A		Baa1	POS	A-	POS	A high	
US	AA+		Aaa	NEG	AA+		AAA	
UK	AA		Aa3		AA-		AA	
Japan	A+		A1		A		A high	
Australia	AAA		Aaa		AAA		AAA	
New Zealand	AAA		Aaa		AA+		-	
Sweden	AAA		Aaa		AAA		AAA	
Norway	AAA		Aaa		AAA		AAA	
Switzerland	AAA		Aaa		AAA		AAA	

Source: S&P, Moody's, Fitch, DBRS and Bloomberg Notes: Grey highlight represents below IG; "*" represents under watch. NEG - negative outlook, POS – positive outlook, DEV - developing outlook, blank represents stable outlook. Rules for a country to be excluded from an IG index are as follows: 1) J.P. Morgan's EMU IG index requires any 1 of 3 credit ratings (S&P's, Moody's, Fitch) to be below IG. 2) Bloomberg AGG requires 2 of the above 3 credit ratings to be below IG. 3) FTSE WGBI requires both S&P and Moody's rating to be below IG.

Eurozone rating action calendar

	AT	BE	CY	FI	FR	GE	GR	IE	IT	NL	PO	SL	SP	UK
24-Jan-25		D								F				
31-Jan-25						S								
07-Feb-25		F↓		F↓										
14-Feb-25	S↑							M↑						
21-Feb-25	M													
28-Feb-25					S	F				M, D	S↑			F
07-Mar-25							D↑							
14-Mar-25					F↓		M↑	D			F↑		S	
21-Mar-25			D↑	D	D			S↑						
28-Mar-25													M↑	
04-Apr-25									F↑			F		
11-Apr-25		M↓			M				S			M↑	F↑	S
18-Apr-25							S↑		D↑	S				
25-Apr-25		S		S										
02-May-25														
09-May-25						M		F						
16-May-25			S				F				M			D
23-May-25			M, F						M			D↑		M
30-May-25					S	D							D	
06-Jun-25	F↓, D											S↑		
13-Jun-25		F↓		M		S								
20-Jun-25														
27-Jun-25														
04-Jul-25														
11-Jul-25						F								
18-Jul-25										F	D			
25-Jul-25		D		F↓										

Source: S&P , Moody's, Fitch, DBR
Legend: "S": S&P, "M": Moody's, "F": Fitch, "D": DBRS, "↓" - negative outlook, "↑" – positive outlook; "*" – under watch.

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Global Market Movers

27 January	28 January	29 January	30 January	31 January
Germany IFO bus. survey (10:00am) Jan Retail sales (8:00am) Dec **Belgium** BNB bus. conf. (3:00pm) Jan **United Kingdom** CBI growth indicator (12:01am) Jan CBI services sector survey (12:01am) Jan **United States** New home sales (10:00am) Dec 650,000 Dallas Fed manufacturing (10:30am) Jan **Japan** Coincident CI final (2:00pm) Nov **Sweden** Trade balance (8:00am) Dec **China** PMI mfg. (NBS) (9:30am) Dec	**Euro area** ECB bank lending survey (10:00am) 4Q **France** INSEE cons. conf. (8:45am) Jan **United States** Durable goods prelim (8:30am) Dec -0.1% Ex. transportation -0.1% S&P/Case-Shiller HPI (9:00am) Nov FHFA HPI (9:00am) Nov Richmond Fed survey (10:00am) Jan Consumer confidence (10:00am) Jan 106.0 **Japan** Corporate service prices (8:50am) Dec **Norway** Retail sales (8:00am) Dec **Australia** NAB business confidence (11:30am) Dec *Holiday: China*	**Italy** ISAE cons. & bus. conf. (10:00am) Jan **Spain** GDP prelim (9:00am) 4Q **United Kingdom** IDR pay settlements (7:00am) Jan **United States** Advance economic indicators (8:30am) Nov Trade balance -$105.5bn Wholesale inventories 0.1% Retail inventories 0.0% **Japan** Consumer sentiment (2:00pm) Jan 36.4 **Sweden** GDP quarterly indicator (8:00am) 4Q 1.1%oya GDP monthly indicator (8:00am) Dec Household lending (8:00am) Dec Riksbank rate announcement (9:30am) Jan Repo rate: 2.25% **Australia** CPI (11:30am) 4Q	**Euro area** GDP flash (11:00am) 4Q Unemployment rate (11:00am) Dec EC cons. Conf. final (11:00am) Jan ECB rate announcement (2:15pm) **Germany** GDP prelim (8:00am) 4Q **France** GDP prelim (7:30am) 4Q Cons. of mfg goods (7:30am) **Italy** GDP prelim (10:00am) 4Q **Spain** HICP & CPI flash (9:00am) Jan **United Kingdom** Net lending to individuals (9:30am) M4 & M4 lending final (9:30am) **United States** Initial claims (8:30am) w/e Jan 25 230,000 Real GDP (8:30am) 4Q advance 2.75% Pending home sales (10:00am) Dec -2.0% **Sweden** Retail sales (8:00am) Dec Wage stats (8:00am) Nov Economic Tendency survey (9:00am) Jan **Norway** Credit indicator growth (8:00am) Dec **New Zealand** Trade balance (10:45am) Dec NBNZ business confidence (1:00pm) Jan *Holiday: China*	**Euro area** ECB survey of professional forecasters (10:00am) **Germany** Employment (9:55am) Jan Unemployment (9:55am) Jan HICP & CPI flash (2:00pm) Jan **France** HICP & CPI flash (8:45am) Jan PPI (8:45am) Dec **Italy** PPI (11:00am) Dec **United Kingdom** Lloyds business barometer (12:01am) Jan Nationwide HPI (8:00am) Jan **United States** Employment cost index (8:30am) 4Q 0.9% Personal income (8:30am) Dec 0.4% Real consumption 0.3% Core PCE deflator 0.19% (2.8%) Fed Governor Bowman speaks(8:30am) **Japan** Job offers to applicants ratio (8:30am) Dec 1.26 Unemployment rate (8:30am) Dec 2.5 % Tokyo core CPI (8:30am) Jan Ex. fresh food 2.7 %oya Ex. fresh food and energy 1.9 %oya IP prelim (8:50am) Dec 0.0 %m/m, sa Total retail sales (8:50am) Dec -1.4 %m/m, sa Housing starts (2:00pm) Dec 2.7 %oya **Norway** Labor directorate unemployment (8:00am) Jan Unemployment rate: 2.1%, sa **Australia** PPI (11:30am) 3Q Pvt. sector credit (11:30am) Dec **China** PMI Mfg. (9:45am) Jan

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03 February	04 February	05 February	06 February	07 February
Euro area PMI Mfg final (10:00am) Jan HICP flash (11:00am) Jan **Germany** PMI Mfg final (9:55am) Jan **France** PMI Mfg final (9:50am) Jan **Italy** PMI Mfg final (9:45am) Jan HICP & CPI flash (11:00am) Jan **Spain** PMI Mfg final (9:15am) Jan **United Kingdom** PMI Mfg final (9:30am) Jan **United States** Manufacturing PMI (9:45am) Jan final Construction spending (10:00am) Dec ISM manufacturing (10:00am) Jan Light vehicle sales Jan **Japan** PMI manufacturing final (9:30am) Jan **Sweden** PMI (8:30am) Jan **Norway** PMI Mfg (10:00am) Jan *Holiday: China*	**Euro area** MFI interest rates (10:00am) Dec **France** Monthly budget situation (8:45am) Dec **United States** Factory orders (10:00am) Jan Durable goods (10:00am) Jan JOLTS (10:00am) Dec **Sweden** Riksbank monetary policy minutes (9:30am) Jan	**Euro area** PMI Serv. & Cmp final (10:00am) Jan PPI (11:00am) Dec **Germany** PMI Serv. & Cmp final (9:55am) Jan **France** Industrial production (8:45am) Dec PMI Serv. & Cmp final (9:50am) Jan **Italy** PMI Serv. & Cmp final (9:45am) Jan **Spain** PMI Serv. & Cmp final (9:15am) **United Kingdom** PMI Services final (9:30am) Jan New car regs (9:30am) Jan **United States** ADP employment (8:15am) Jan International trade (8:30am) Dec Services PMI (9:45am) Jan final ISM services (10:00am) Jan **Japan** Employers' survey (8:30am) Dec PMI services final (9:30am) Jan **Sweden** Services PMI (8:30am) Jan	**Euro area** Retail sales (11:00am) Dec **Germany** Mfg orders (8:00am) Dec **United Kingdom** PMI Construction (9:30am) Jan MPC rate announcement and asset purchase target (12:00pm) Jan Decision maker panel survey (2:00pm) Jan **United States** Initial claims (8:30am) w/e Feb 1 Productivity and costs prelim (8:30am) 4Q **Sweden** CPI prelim (8:00am) Jan	**Germany** Industrial production (8:00am) Dec Foreign trade (8:00am) Dec **France** Foreign trade (8:45am) Dec **United Kingdom** Halifax HPI (7:00am) Jan **United States** Employment (8:30am) Jan Consumer sentiment (10:00am) Feb preliminary Wholesale trade (10:00am) Dec Consumer credit (3:00pm) Dec **Japan** All household spending (8:30am) Dec Coincident CI prelim (2:00pm) Dec Consumption activity index (2:00pm) Dec **Sweden** Budget Balance (8:00am) Jan **Norway** IP Mfg (8:00am) Dec **China** Foreign Exchange Reserves Jan

Selective list as of 24 January 2025. Forecasts are m/m, nsa, unless stated & times are local. Telephone your J.P. Morgan representative for an update/more details.
Highlighted data are scheduled for release on or after the date shown. Times shown are local.

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	Overweight (buy)	Marketweight (hold)	Underweight (sell)
Global Sovereign Research Universe*	11%	79%	11%
IB clients**	86%	50%	71%

***Please note that the percentages may not add to 100% because of rounding.**
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