14 September 2018

HSBC Global Research

DM Rates Ideas

Don't stop believing

FIXED INCOME
RATES

Global

- We turn tactically more bullish on US 10-year and Italian three-year bonds
- Growth uncertainty prompts us to receive long-end EUR swaps, while there is value in 4Y OAT ASW
- We see an RV opportunity in gilts, but in a directionally neutral fly: our strong bullish duration bias remains strong

Buy 10Y US Treasuries Page 3

10-year Treasuries offer value at the upper end of their 2018 range, as yield levels are limited by their linkage to Fed expectations.

Tactical long in 3Y Italy Page 5

Despite the recent rally, we still see tactical value in short-end BTPs. We expect a market-friendly budget, and the yield is still above our forecast equilibrium level.

Bullish EUR long-end via fly Page 7

As with the US, we think long-end EUR swap curves could flatten as Eurozone growth forecasts fall. Using receiver swaptions improves carry and adds protection.

Buy 4Y OAT on asset swap Page 9

France's short-end looks cheap after the recent recovery in global risk sentiment. We doubt this will be maintained while reinvestment flows turn supportive in October.

UK RV opportunity in the 10Y sector Page 11

The specific richness of UKT 4Q 27 offers a pure alpha opportunity via a micro-fly: we use a PCA weighting to maintain directional neutrality.

Table 1. Summary of views

Country	Bonds (duration)	10Y swap	10-30Y bond curve	10Y break-even	New trade ideas (this week)
US	Bullish	↓	Flatter	Mildly bearish	Buy 10Y UST
Euro core	Mildly bullish	↓	Neutral	Bearish	ASW 4Y OAT; 2-5-30Y EUR fly
Euro non-core	Mildly bullish		Neutral	Bearish	Buy 3Y BTP
UK	Mildly bullish	↓	Flatter	Mildly bearish	PCA-weighted 24-27-30Y fly
Japan	Mildly bullish	↔	Flatter	Neutral	
Canada	Mildly bullish	↓	Neutral	Mildly bearish	
Australia	Mildly bullish	↓	Flatter	Mildly bearish	
New Zealand	Mildly bullish	↓	Flatter	Neutral	

Source: HSBC. For trade recommendations see Table 12, page 21.

← Down ----------- yields ---------- Up →

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Buy 10-year UST

- **Upgrade to bullish vs mildly bullish:**10-year Treasury yields offer value when near the upper end of their 2018 range
- Yields increased this week on auction supply and position squaring ahead of 26 September FOMC meeting
- Risk of higher 10Y yields is limited by their linkage to Fed expectations: our long-term bullish rate view is unchanged

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Table 2. Buy cheap 10Y UST

Trade	Time horizon	Entry (date)	Target	Stop	3m C+R	Rationale	Risk
Buy T2.875 8/28	3mths	2.96% (13 Sep 18)	2.85%	3.1%	3bp	10-year is at upper end of recent range	Fed outlook turns more hawkish

Source: HSBC

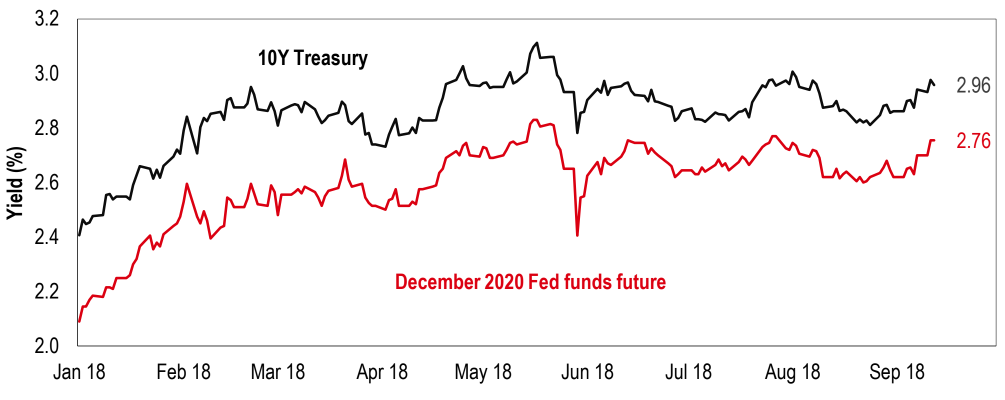
10Y Treasury cheap on increased risk aversion

The 10-year Treasury's yield has closely tracked investors' Fed tightening expectations. Figure 1 shows this linkage using the December 2020 Fed funds futures. Unless one expects a significantly more aggressive Fed outlook at the 26 September meeting, 10-year yields are likely to trade in their recent, narrow range. A tactical buy is appropriate at current levels given this view.

Long positions offer attractive risk vs reward given stable Fed funds expectations

The seasonal pattern for the 10-year yield also favours a tactical bullish view. Yields fell in eight of the past ten years from mid-September to month end. The exceptions were 2008, due to a bounce after Lehman's default, and 2017, when the 10-year yields started the month at the bottom end of their range and the Fed outlook turned from dovish to hawkish.

Figure 1. Treasury yields near upper end of range given Fed expectations

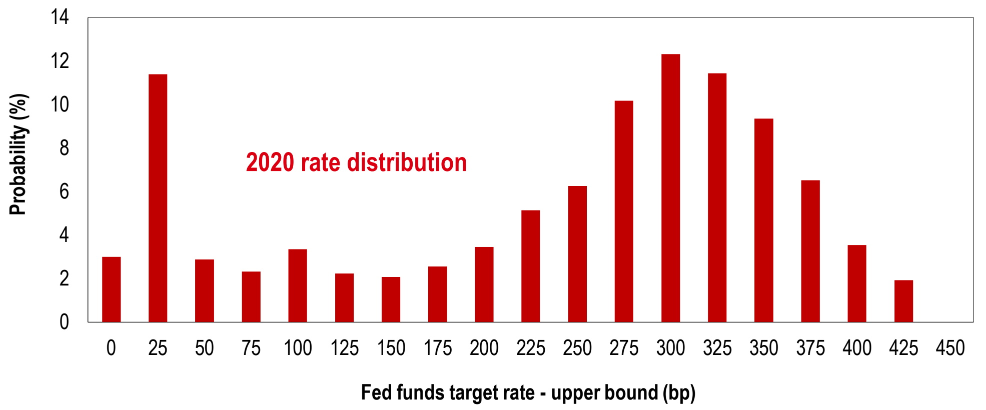


Source: HSBC, CME, Bloomberg

Fed rates survey shows consensus view for risk of lower rates

We maintain our long-term view that the fair value of the 10-year note is 2.3%. This expected value balances the risk of lower and higher yields. In contrast, most forecasters provide a single, most-likely yield scenario. That is appropriate for near-term trading views, but ignores the significant longer-term risks to the rate outlook. As an example of this, Figure 2 updates our calculation of the 2020 Fed funds distribution based on the July New York Federal Reserve's survey of market participants. The expected value for the funds rate upper bound is 2.37%. That is well below today's market implied level of 2.85%. The most likely value is 3.0%. The expected value for the consensus recognises a significant risk of lower rates in the future: their most likely forecast ignores it.

Figure 2. Probability distribution for Fed funds rate upper bound from July NY Fed survey



Source: HSBC, Federal Reserve Bank of New York

Fed's dot plot is priced into today's yields, risk to 10-year is a higher long-run dot…

The Fed's tightening guidance is priced into the Treasury yield curve, especially for the 10-year sector. Table 3 updates our analysis of the break-even Treasury yield curve for various Fed tightening scenarios. It assumes the Secured Overnight Funding Rate (SOFR) at a -10bp spread below the funds rate upper bound. The 10-year note's implied yield is below 3% for all but the last scenario. Our 5y5y forward analysis also sees limited risk for higher rates.

The risk for our 10-year view is a shift up in the Fed's longer-run dot. A move to 3.25%, +37bp above its current level, gives a 3.16% break-even 10-year yield. Although investors may indeed see higher yields before the Fed meeting, we do not expect a new high for the year in the coming weeks.

…but it takes a 3.25% longer-run dot to imply a break-even 10Y yield above 3%

Table 3. Break-even yields vs SOFR for Fed scenarios

	2yr	3yr	5yr	10yr
Yield curve on 9/11/2018	2.73%	2.80%	2.84%	2.95%
June dots, fastest hike path	2.93%	3.07%	3.01%	2.93%
June dots, slowest hike path	2.74%	2.96%	2.95%	2.90%
50bp per year to 3.00%	2.45%	2.64%	2.77%	2.87%
100bp/yr. to 3.0%	2.75%	2.83%	2.89%	2.93%
Dec 2018 stop at 2.5%	2.42%	2.43%	2.44%	2.45%
100bp per year to 3.25%	2.85%	2.99%	3.09%	3.16%

Source: HSBC, Bloomberg, Federal Reserve * Assumes SOFR 10bp below upper bound for funds rate

Tactically buy 3Y BTP

- HSBC's expectation of a relatively market-friendly budget looks more likely, but considerable uncertainty is still priced in
- The risk-off in EM is affecting Eurozone sovereign credit – but Italy trades over 100bp cheaper than that valuation suggests
- Our mildly bullish conviction reflects an end-of-year forecast that is 20bp below spot and 50bp below the forward

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Table 4. Buy 3Y BTP

Trade	Time horizon	Entry (date)	Target	Stop	3m C+R	Rationale	Risk
Buy BTPS 0.05% 4/21	3mths	1.25% (13 Sep 18)	0.60%	1.60%	+34bp	Market-friendly budget expected; uncertainty still priced in	Budget upset; Tria forced out

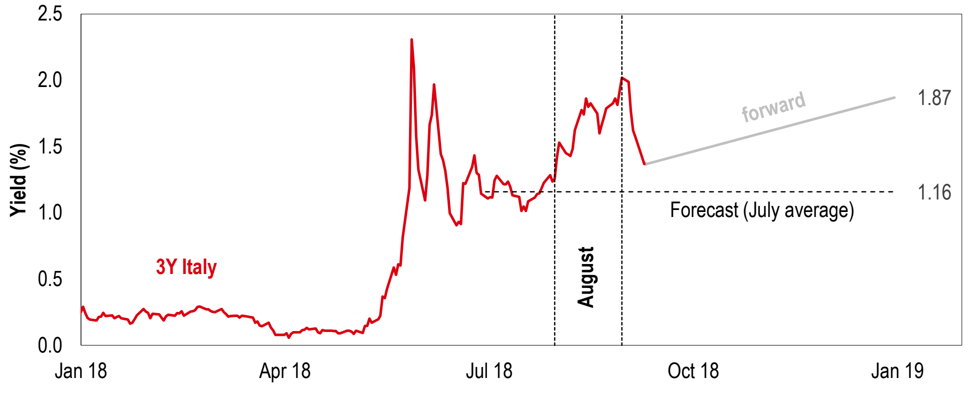
Source: HSBC

Rally driver

The market is coming round to our view that the budget deficit will not be excessive

We think the BTP rally could extend further, despite a 60bp fall in short-end yields. The move retraced August's weakness, which was driven by EM volatility during thin markets in the domestic holiday (see *DM Rates Ideas: TRYing times*, 17 August 2018). Our economists have long expected that the budget deficit would not be excessive (see *Italy's autumn budget*, 20 August) and September is seeing the market start to come round to this view. Although the market is once again being driven by the short end, three-year yields are still 20bp above the July average (which is also our EoY forecast, see Figure 3). Meanwhile, real money positioning is likely still underweight given the continued budget uncertainty, and we do not believe the majority of futures shorts have capitulated. Carry at the three-year point puts the forward 50bp higher than our EoY forecast; we increase our tactical conviction to mildly bullish to reflect this.

Figure 3. September retraced August: yields remain above equilibrium



Source: Bloomberg, HSBC. BVAL constant maturity yield used, forward level adjusted accordingly.

A local opportunity in a bearish risk environment

The other main concern is a global environment that is turning increasingly negative for risk assets (see *Fixed Income Asset Allocation: Inflection*, 5 September 2018). Given that Italy is now the focus of sovereign risk in the Eurozone, does this imply we should instead be selling into strength?

Italy still looks cheap, despite the global weakness of risk assets

We think not, because Italy is presently such an idiosyncratic risk. Sovereign credit valuations in the Eurozone are indeed affected by EM volatility (Figure 4), but, as we discussed in *Italy sovereign credit: bigger fish to fry* (12 September), Italy is trading so far from fair value that this can only explain at most 40bp of the move: Italy still looks cheap. EM volatility did cause temporary correlation to BTP yields in August (Figure 5), due to low liquidity and the lack of domestic news. This took yields higher in a parallel shift, but this behaviour came to an abrupt halt at the start of September as the move reversed.

Trading the long end is not worth the risk in our view

Why the three-year point? Two- and three-year BTPs have the highest carry. Trading the long end is not worth the risk, in our view, because expected profits are less and the carry much lower. Only the sub-five-year segment offers the potential to substantially outperform the market forwards.

Risks to the view

Our analysis assumes that the deficit will not be significantly above 2% GDP

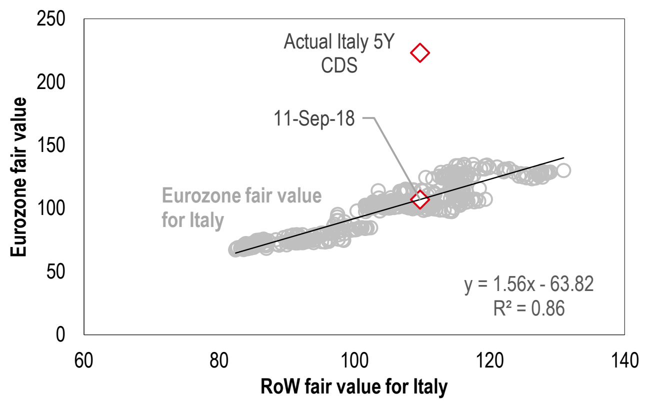
Any BTP trade at present should come with a health warning. The market remains volatile, and very sensitive to any headlines bearing on the budget, particularly if they question the position of Finance Minister Tria. Our analysis assumes that the budget deficit agreed will not come in significantly above 2% of GDP, in accordance with our economists' view. It also assumes the Finance Minister and Prime Minister remain in position. We set our stop level to allow for a volatile market: position sizes should reflect this. An acute EM crisis in the next month should also be expected to shock yields higher, even if the effect does not persist.

Closing time

Our bearish BTP flattener hit its stop on 10 September, and we close it for a loss. The speed of September's rally surprised us, although we had highlighted the risk of a short squeeze in September's *Fixed Income Asset Allocation*, and recommended the position be reviewed at the start of September when we initiated it.

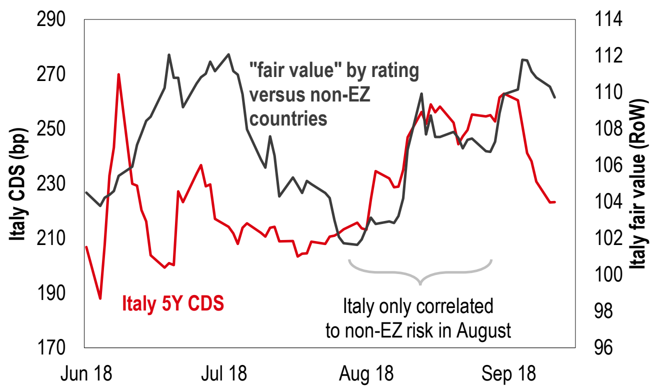
We take this opportunity to close our long five-year GGB position for a profit: EM weakness is, in our view, being reflected in its rising yield trend due to the overlap in investor base. We also take profit on our Spain CDS basis trade, which was 2bp away from its target.

Figure 4. Italy CDS is far above fair value



Source: Markit, Bloomberg, HSBC calculations

Figure 5. August's EM-led weakness was an anomaly



Source: Markit, Bloomberg, HSBC calculations

Bullish EUR long-end via fly

- Similar to the US, we think euro long-end curves can flatten amid recent macro developments and the ECB's economic projections…
- …however, carry is negative for flatteners: we prefer the fly instead
- Using receiver swaptions enhances carry profile and gives protection against near-term calendar-based binary risk events

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Table 5. Conditional EUR 2-5-30Y fly using receiver swaptions

Trade	Time horizon	Entry (date)	Target	Stop	3m C+R	Rationale	Risk
Buy 6M into 2Y and 6M into 30Y ATMF receiver swaptions and sell 6M into 5Y ATMF-7bp receiver swaption	6mths	0 cents (13 Sep 18)	30cents	-15cents	+2bp	Five-year to underperform amid long-end flattening	If ECB turns dovish with rate cut expectations

Source: HSBC

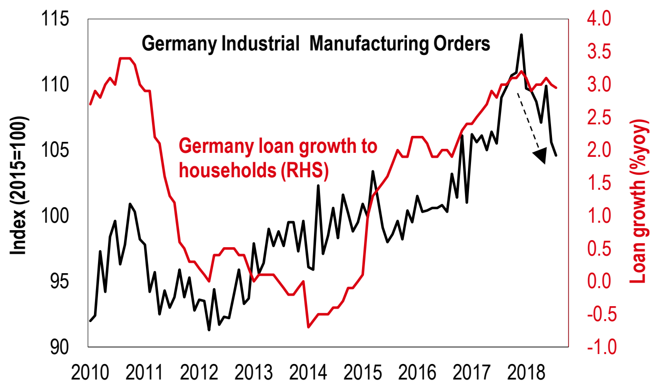
Liking longs

EUR curve flies that express long-end flattening bias look attractive

We like receiving the wings of euro fly trades that express a flattening bias in the five-year and above region. Euro curves have asymmetric risks of flattening in the five-year+ segment but investors will face the drag of negative carry to hold on to such positions. We think a good, limited risk, compromise is to look for fly trades via 2-5-30 year structures. As we have argued before, the five-year sector is again looking susceptible to any possible sell-off in core government curves, while slowing domestic macro-economic momentum, the peaking of loan growth in core nations (figure 6) and headwinds coming from EM nations suggest that markets may begin to lower long-term neutral rate expectations for the euro-area. Against this backdrop, holding flatteners has proven to be an attractive strategy but, when adjusting for carry, we find that fly structures are better suited, especially using receiver swaptions.

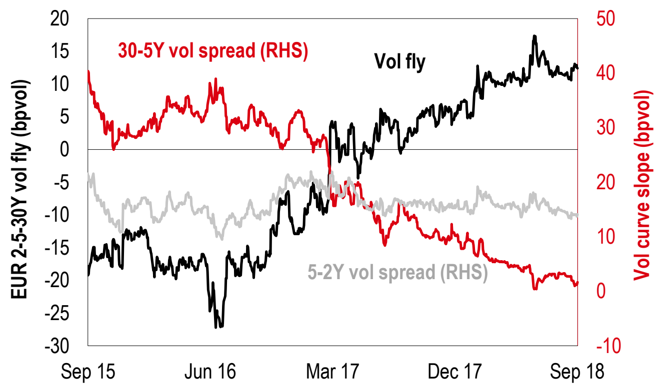
On the swaption vol grid, implied vol on five- to 10-year tails are near multi-year highs vs the short- and ultra-long end tails (figure 7). A vol overlay could be beneficial at this stage as, first, it improves the carry profile of the whole trade and, second, the trade is gamma positive, which means if realised vol picks up, the trade would generate positive returns.

Figure 6. German macro data look to have peaked



Source: HSBC, Bloomberg

Figure 7. Long-end vol cheapening is behind fly's performance



Source: HSBC, Bloomberg

Near the peak

EM volatility is a cause of concern for the ECB, more so than the Fed

With Italian uncertainty lingering in the background, it has never been easy to price the ECB's monetary tightening expectations. While the ECB's forward guidance has made the market crystallise the first 10bp of deposit hike in Q4 2019, time appears to be slipping away from the ECB Governing Council members as the euro-area could be nearing the peak of its cyclical recovery. External headwinds such as trade tensions and EM spill-over risks have weighed on export dynamics, while over the last few weeks domestic demand support is also waning, as evidenced in core countries' macro data (eg the latest loan creation and industrial production numbers, figure 6).

We think ECB policymakers may also have to be vigilant on Asian EM developments, more so than the Fed, because of the openness of the euro-area economy and European companies' exposure to Asia. EM Asia FX vol has shown greater negative correlation to euro-area equities than the US equivalents (figure 8).

Seeking asymmetry

ECB policy mistake could be played in the form of euro fly structures

Taking into account the macro backdrop, we think structural five- to 30-year flattening positions look good for the Eurozone as, even if markets were to re-price rate hike expectations back into the curves, it would be the five-year that might be affected the most. The main concern remains the deep negative carry associated with these positions.

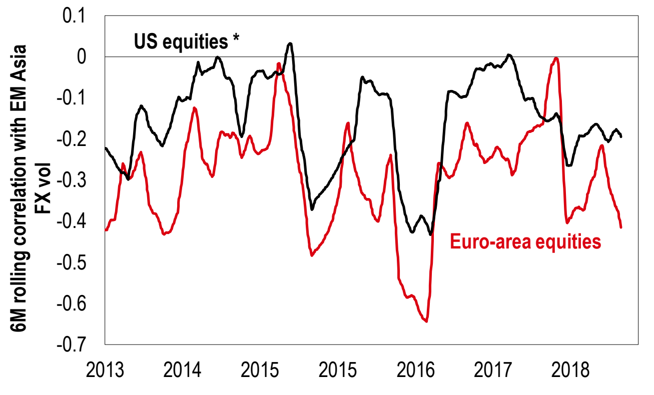
We think receiving the wings of the 2-5-30 year fly should closely mimic the performance of the long-dated slope as the front-end should remain anchored. This alternate expression is close to being non-directional (figure 9) and may bow out regardless of the direction of absolute rates. We like such asymmetric pay-off structures as, amid various politics-driven twists and turns, it may not yet be prudent to take an outright duration call based on pure macro-economic fundamentals.

Vol is your friend

Long-end vol has cheapened meaningfully and we look to buy them

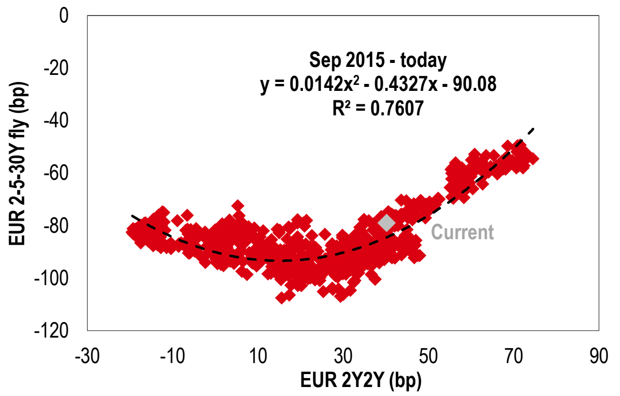
The euro vol surface has continued its softening tone across the grid but something that is quite interesting is the significant cheapening of long-end tails vs those in the belly of the curve. Vol fly spreads, centred around the five- to 10- year tails, have reached multi-year highs (figure 7). While we were positioned for such a dynamic to unfold in vega space (long swaption expiries), we are not sure how long these extreme valuations can be sustained in the gamma (short expiries) sector. Amid an eventual end to net QE purchases and long-end euro yields looking attractive from a macro perspective, realised volatility may inch higher on ultra-long tails. Moreover, we would want to have net long gamma exposure as overall realised rate volatility may move higher on macro calendar based events in the pipeline such as the Italian budget or the US mid-term elections. The 2-5-30 year fly using receiver swaptions is attractive as the trade strike carries positively and gives some protection if the five-year yield moves lower in an extreme risk-off event. A significant outperformance of the five-year sector is also the risk to the trade, which could materialise if there were a euro-centric market shock event, in which case investors may price out any rate hikes in the foreseeable future.

Figure 8. European equities more influenced by EM volatility



Source: HSBC, Bloomberg
* correlation of Daily changes of equity index level vs EM Asia FX vol. US: S&P500 Index, Europe: Stoxx Europe 600 Index

Figure 9. EUR fly is close to becoming non-directional



Source: HSBC, Bloomberg

Buy 4Y area France vs swaps

- The short-end of Eurozone core curves looks cheap versus swaps following a recent lift in global risk sentiment
- We see value in buying 4Y FRTR0 3/23 as geopolitical worries continue to linger
- Supply for France will be ongoing, but reinvestment flows will become heavily supportive in October

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Table 6. ASW 4Y FRTR0 3/23

Trade	Time horizon	Entry (date)	Target	Stop	3m C+R	Rationale	Risk
ASW FRTR0 3/23	3mths	-33bp (13 Sep 18)	-43bp	-28bp	Close to flat	France cheapened in ASW terms	Safe haven flows reversing significantly

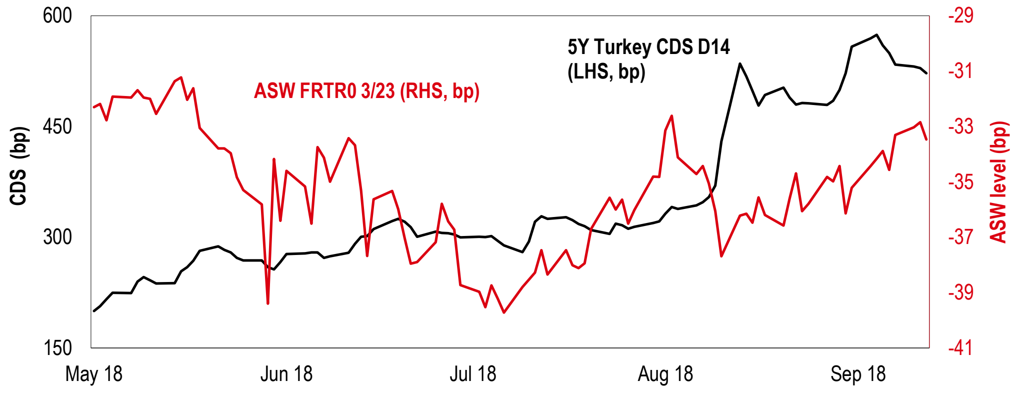
Source: HSBC

Cheapening in ASW terms is likely to be short-lived

Remain mildly bullish on core yields

The back-up in Eurozone high-rated yields since mid-August, in tandem with US Treasuries, is unlikely to be sustained, in our view. The market appears to be too sanguine even if market worries on the Italian budget turn out to be unfounded (page 5). Geopolitical risks continue to linger (see Figure 10) and the potential ramifications from the US trade tariff proposals remain unclear. Also, the tightening of monetary conditions (as highlighted in *FIAA*, 5 September 2018) reinforces our 'mildly bullish' view on core rates. We see the recent cheapening of short-end Eurozone core bonds vis-à-vis swaps as overdone and see value in entering an ASW position in the four-year sector of the French curve. At this maturity segment, we believe safe-haven flows outweigh the long-term fiscal challenges France is facing. Also, near-term outperformance of France is likely before the relatively large reinvestment flows from OAT issues in October.

Figure 10. ASW underperformance of 4Y OAT while EM challenges remain



Source: HSBC, Bloomberg

Closing our long-end RASW position

The cheapening of French bonds in ASW is set to reverse

We have been bearish on the long-end of France (*DMRI*, 13 July 2018) given the historically rich levels versus swaps in July combined with waning overseas demand and limited impact of a possible change in ECB reinvestment policy for the ultra long-end of the OAT curve. The trade has performed well and, as we see less potential for long-end OATs to cheapen further in ASW, we take profit on this position. Tactically, we believe the cheapening of French bonds in ASW is set to reverse, primarily at the belly of the curve.

The underperformance of French bonds versus swaps is consistent with the tightening of German swap spreads. This is illustrated in the strong relationship between the ASW level of FRTR0 3/23 and 10-year Bund spreads in a regression analysis (YTD, Figure 11, R-squared is 76%). The analysis shows this French bond is currently circa 2bp too cheap versus swaps. We believe there is more potential left given our short-term widening view on Bund spreads (*FIAA*, 5 September, page 29) and given the supportive cash-flows from OAT issues next month.

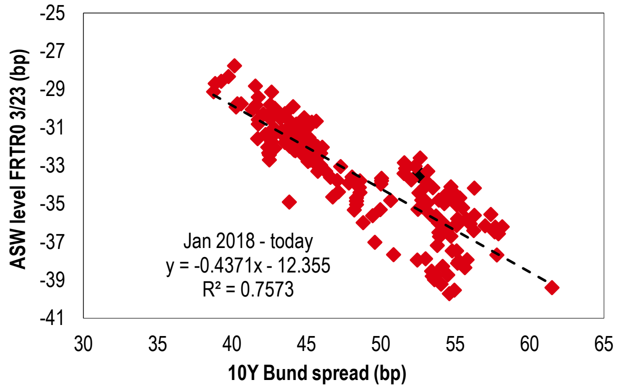
Supportive OAT cash-flows in October

Potential reinvestments likely to occur further out the curve

Gross issuance volumes from France will remain high in September-November, in our view (*SSAM*, 4 September 2018). However, large potential reinvestment flows due next month will offset this. Aggregate net Eurozone issuance is set to drop into negative territory (-EUR19bn in October), largely due to France (c-EUR8bn in October from cEUR19bn in September). Given the front-end is pinned down by the ECB's forward guidance and the low absolute yield levels, we believe reinvestments are likely to be focused at the belly of the French curve. FRTR0 3/23 is the off-the-run five-year French bond and was last re-opened in May. We believe direct supply pressure on the 2023 issue will be limited as a re-opening of this bond is unlikely at the next medium-term OAT auctions on 20 September.

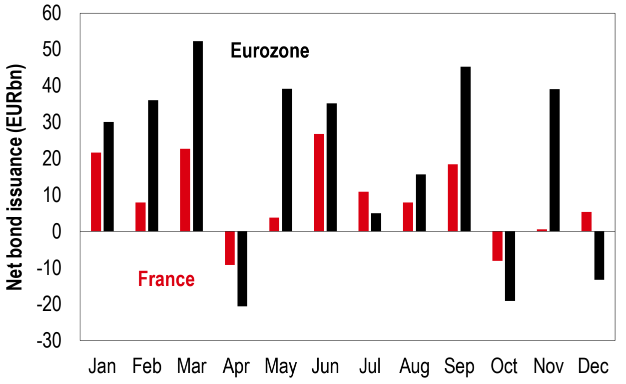
One of the French government's aims is to achieve a fiscal surplus in 2022. Our economists see this target as rather 'optimistic' (*European Economics Quarterly*, 10 July 2018). This is underlined by the recently lowered projections by the Finance Ministry (Bloomberg 12 September 2018). France's growth in 2019 is now projected at 1.7% of GDP (versus 1.9% previously) while next year's budget gap is estimated at 2.8% (0.4% wider than its previous estimate). We believe these setbacks are no surprises given the general weaker economic prospects across the Eurozone. Overall, we think French bonds are supported by the willingness of the French government to contain further fiscal slippage. In terms of main credit ratings reviews until end-2018, there are two planned, one from S&P (5 October) and one by Moody's (26 October). Of note is that Moody's changed the outlook on France's Aa2 rating to Positive from Stable on 4 May, partly triggered by the government's 'ambitious' reform programme.

Figure 11. ASW of 4Y OAT is cheap vs Bund spread



Source: HSBC, Bloomberg

Figure 12. Net French sovereign supply turns negative



Source: *SSA Monitor*, Table A3, 4 September 2018

RV opportunity in 10Y gilts

- Fade the specific richness of the UKT 4Q 27 gilt by selling it versus neighbouring bonds in a barbell structure
- We favour a PCA weighting on the trade since it enables us to minimise market directionality
- This leaves our recommended UK portfolio with a strong bullish duration bias, a view in which we have high conviction

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Table 7. Buy UKT 2T 24 and UKT 4T 30 vs UKT 4Q 27, PCA weighted (1.25:1.92:0.83)

Trade	Time horizon	Entry (date)	Target	Stop	2m C+R	Rationale	Risk
Buy UKT 2T 24 Sell UKT 4Q 27 Buy UKT 4T 30	3mths	-15bp (13 Sep 18)	0bp	-23bp	0bp	Rich UKT 4Q 27 relative to peers	The 10-year bond continues to richen due to CTD demand

Source: HSBC

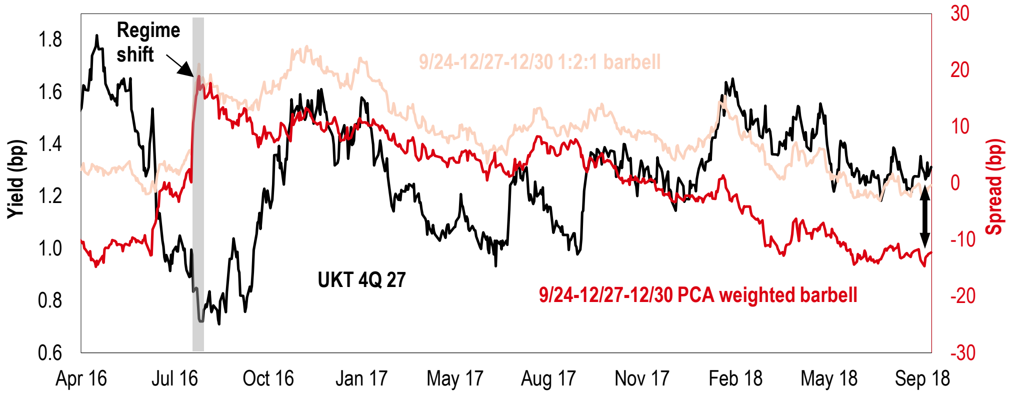
Picking up alpha in gilts

A few weeks ago, open interest in the long gilt futures contract rose to record highs, approaching a level of 1MM lots. While there has been a similar increase in open interest across other European and US futures contracts, it has been particularly pronounced in the UK. At the same time, the curve has continued to bow in, making the 10-year segment relatively expensive. We recommend selling this point vs neighbouring maturities in a PCA-weighted micro structure, thereby enabling us to preserve the strong bullish duration bias in our portfolio.

UKT 4Q 27 is still rich, even after we account for its "special" status as the CTD

Our CUTE algorithm flags the UKT 4Q 27 as the most expensive bond in the sub 20-year sector, while UKT 2T 24, UKT 5 25 and UKT 4Q 32 are relatively cheap. This is the case even after accounting for the special status of UKT 4Q 27 (due to it being the CTD in the futures basket). Figure 13 shows the UKT 9/24-12/27-12/30 barbell over the last three years. There is a clear directional link between the barbell spread and the level of yields when we use a weighting of 1:2:1.

Figure 13. Too low curvature around the 10-year area



Source: HSBC

But, we also note that there was a regime shift in August 2016, when the BoE announced further QE which therefore prompted the market to differentiate between new and old bonds, depending on their distance from the 70% purchase limit. A regression of the UKT 9/24-12/27-12/30 spread vs the level of yields in this recent regime shows that the curvature is currently about 10bp too low.

Minimise market directionality via PCA weighting

PCA weighting removes bearish exposure inherent with 1:2:1 structure

However, it is worth emphasising that a simple 1:2:1 weighting would give the trade a directionally bearish exposure. That is, the fly should perform better in a rising yield environment. Given gilt yields are towards the top of the recent range, and our structural (and tactical) duration bias is to be bullish, we favour implementing the trade in a PCA-weighted structure (Figure 13, red line). So, in order to minimise any market directionality, we are buying 125K of UKT 2T 24 and 83K of UKT 4T 30, versus 192K UKT 4Q 27. Effectively, investors need to buy more PV01 in the wings relative to what is sold in the belly.

Bullish duration bias remains strongly intact

Higher wage numbers were flattered by favourable base effects…and may not last

As 10-year gilt yields move back up towards the top of the range, we struggle to find a compelling reason why they should break out to the upside. In the latest *Fixed Income Asset Allocation*, (5 September 2018), we highlighted some of the growing risks to the global outlook as the slow-motion transition to risk aversion continues. Meanwhile, when we are looking for reasons to be more optimistic, we still cannot find them domestically either. This week's headline rise in pay growth might have left some hoping that the Phillips Curve is finally working again. But we remain unconvinced. The latest numbers were *flattered by base effects*: and if average weekly earnings continue to rise by GBP1 every month for the rest of the year (in line with the average so far this year), then 3m/yr wage growth will edge back below 2.5% once the weakness of July 2017 falls out of the annual comparison (Figure 14). If real wages fail to accelerate, this will make it difficult for consumers to continue to drive growth now the boost from the World Cup and good weather has ended.

UKT 4Q 27 could cheapen in spite of its CTD status

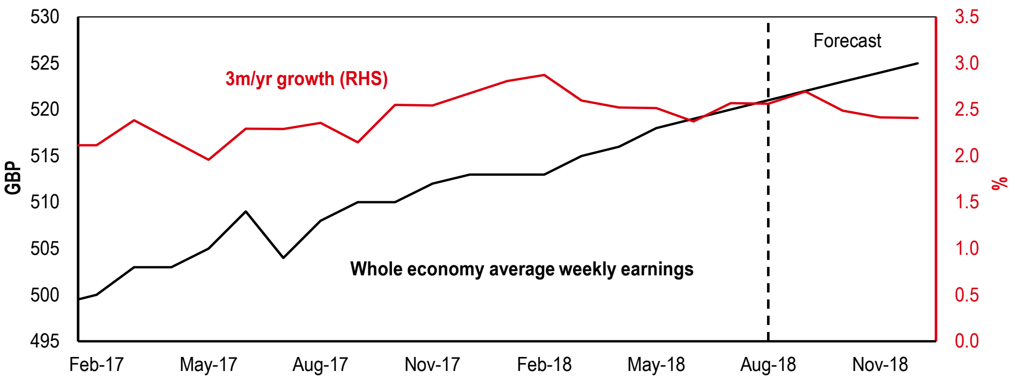
Change in CTD status triggers relative cheapening

The risk is that UKT 4Q 27 remains expensive because of its CTD status, which could be maintained up until March 2019. However, this should not necessarily be the case. We have looked at how previous 3 CTDs (UKT 2 25, UKT 5 25 and UKT 3T 21) have performed in their final six months – and then the first three months – after losing CTD status. We find that the CTD starts to cheapen a few months prior to the bond losing its status, and the cheapening then continues for a few months afterwards. For UKT 2 25 and UKT 5 25, the relative cheapening (clean off directional/slope) was evident: we estimate it at about 5bp over that nine-month period.

Considering the conditions in the repo market

When implementing these sorts of relative value trades, it is important to consider repo conditions. Any repo richness in UKT 4Q 27 has been limited so far, with the bond trading special by a few basis points. Those who like the view but are wary about the potential for a repo squeeze might consider implementing this idea via UKT 9/24-7/27-12/30 barbell, i.e. avoiding UKT 4Q 27.

Figure 14. Headline rise in wage growth may not last



Source: ONS, HSBC forecasts Note: forecasts are a purely illustrative scenario where average weekly earnings rise by GBP1 every month until the end of the year (consistent with the average increases seen so far this year

Supply outlook

- Gross Eurozone supply is estimated at cEUR25bn in the next week
- Bonds from Italy and Finland will redeem for cEUR11bn and EUR5bn respectively
- Belgium re-opens four OLO bonds, including the 29- and 39-year issues

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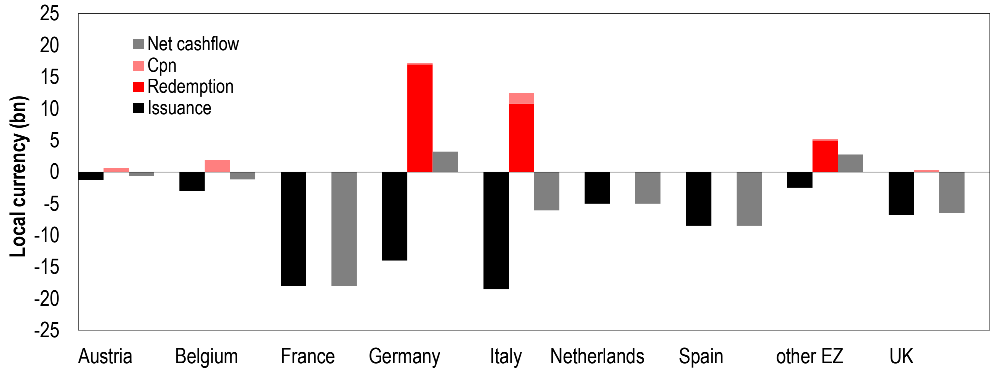
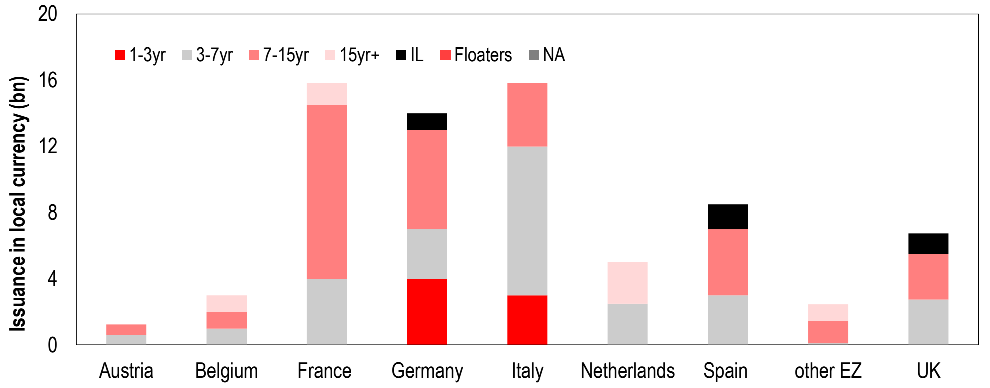
Figure 15: Issuance, redemption, and coupon cash-flows for the weeks ahead (17 September 2018 to 12 October 2018)



Note: Numbers are in local currency bn. Other EZ constitute Portugal, Finland, Slovakia, Slovenia and Ireland
Source: Official debt agency website(s), HSBC and central bank websites

Figure 16: Auctions (split in maturity segments) for the weeks ahead (17 September 2018 to 12 October 2018)



Note: Numbers are in local currency bn. Other EZ constitute Portugal, Finland, Slovakia, Slovenia and Ireland
Source: Official debt agency website(s), HSBC and central bank websites

Events Calendar

Date	Country	Segment	Details	Ticker	Amount	Previous auction Date	B/C ratio	Yield (%)
Week 17 September-21 September								
17 Sep	Belgium	5Y	**Re-opening of five-year OLO**	**BGB0.2 10/23**	2.00-3.00e	**18-Jun**	**2.3x**	**0.00**
	Belgium	10Y	**Re-opening of 10-year OLO**	**BGB0.8 6/28**		**23-Jul**	**2.7x**	**0.69**
	Belgium	29Y	**Re-opening of 29-year OLO**	**BGB1.6 6/47**		**18-Jun**	**1.7x**	**1.70**
	Belgium	39Y	**Re-opening of 39-year OLO**	**BGB2.25 6/57**		**23-Apr**	**1.7x**	**1.82**
	Slovakia	5Y	**Re-opening of 5-year SLOVGB**	**SLOVGB0 11/23**	**0.10**	**18-Jun**	**2.6x**	**0.42**
	Slovakia	10Y	**Re-opening of 10-year SLOVGB**	**SLOVGB1 6/28**	**0.10**	**5-Jun**		**1.02**
	Finland*		**Redemption**	**RFGB1.125 9/18**	**5.00**			
	Italy*		**Redemption**	**BTPS1.7 9/18**	**10.76**			
18 Sep	Germany	2Y	**Re-opening of two-year Schatz**	**BKO0 9/20**	**4.00**	**21 Aug**	**1.6x**	**-0.61**
19 Sep	Germany	10Y	**Re-opening of 10-year Bund**	**DBR0.25 8/28**	**3.00**	**22 Aug**	**1.2x**	**0.33**
20 Sep	Italy		*Details of 25 September CTZ/BTPei auctions*					
	France	-	**Medium-end and IL bond auction(s)**		8.50-9.50e			
	Spain	-	**SPGB auction(s)**		3.00-4.00e			
	UK	10Y	**Re-opening of 10-year gilt**	**UKT1.625 10/28**	**2.75**	**8 Aug**	**2.2x**	**1.46**
Week 24 September-28 September								
24 Sep	Italy		*Details of 27 September medium/long-end BTP auctions*					
25 Sep	Austria		*Details of 2 October RAGB auctions*					
	Italy	-	**CTZ/BTPei auctions planned**		3.00-3.50e			
	Netherlands	6Y	**Re-opening of six-year NETHER**	**NETHER0 1/24**	**2.50e**	**12 Jun**		**0.09**
	UK	IL	**Re-opening of 30-year IL gilt** *(Amount on 18 September)*	**UKTI0.125 8/48**	1.00-1.25e	**24 Apr**	**2.2x**	**-1.41**
26 Sep	Germany	5Y	**Re-opening of five-year Bobl**	**OBL0 10/23**	**3.00**	**29 Aug**	**2.0x**	**-0.18**
27 Sep	Italy	-	**BTP and CCT auction(s)**		5.00-6.00e			
28 Sep	France		*Details of 4 October long-term OAT auctions*					
	Spain		*Details of 4 October SPGB(ei) auctions*					
Week 1 October-5 October								
2 Oct	Austria	-	**RAGB auction(s)**		1.00-1.25e			
4 Oct	Spain	-	**SPGB(ei) auction(s)**		4.00-4.50e			
	France	-	**Long-end OAT auction(s) planned**		8.00-8.50e			
5 Oct	UK	6Y	**Re-opening of six-year gilt**	**UKT1 4/24**	2.50-2.75e	**6 Sep**	**1.9x**	**1.11**
Week 8 October-12 October								
8 Oct	Italy		*Details of 11 October medium/long-end BTP auctions*					
9 Oct	Germany	IL	**ILBundei auction planned**		0.75-1.00e			
	Netherlands	-	**NETHER auction(s) expected**		2.25-2.50e			
10 Oct	Germany	10Y	**Re-opening of 10-year Bund**	**DBR0.25 8/28**	**3.00**			
11 Oct	Ireland	-	**IRISH bond auction(s)**		1.00-1.25e			
	Italy	-	**BTPS auction(s) planned**		8.75-9.00e			
12 Oct	Germany		**Redemption**	**OBL1 10/18**	**17.00**			
	Spain		*Details of 18 October SPGB auction(s)*					
	France		*Details of 18 October short-end and IL bond auction(s)*					
2018 Syndication expectations								
Q3/Q4	Italy	30Y	**BTP syndication possible**					
	UK	53Y	**Syndicated re-opening of 53-year conventional gilt (October)**	**UKT1.625 10/71**				
	Ireland		**First Green bond planned**					

Bold: Announced Colour Key: **Auction / Syndication** **Cash-flow** **CB purchases** **NEW bonds**

Note: Amount in national currency bn; 'e' – denotes estimate; b/c = bid to cover ratio; For taps, prev b/c ratio for that bond auction is given. For new bond auctions, prev b/c ratio of the last similar maturity bond auction is given.
Source: HSBC, official debt agency and central bank websites
* denotes redemption on 15 September which is a Saturday

Table 8: Weekly supply, coupon and redemption flows per segment for the upcoming four weeks (Eurozone) in EURbn

		SUPPLY (A)							REDEMPTIONS (B)						Net Supply (A+B)	COUPONS (C)						Total CashFlows (B+C)	Net Flows (A+B+C)
Week comm.	Maturity (yr)	1-3	3-7	7-15	15+	IL	Total Cash	BPV*	1-3	3-7	7-15	15+	IL	Total		1-3	3-7	7-15	15+	IL	Total		
Austria	17-Sep-18																		0.6		0.6	0.6	0.6
	24-Sep-18																						
	01-Oct-18		(0.6)	(0.7)			(1.3)	1.3M							(1.3)								(1.3)
	08-Oct-18																						
	Total		(0.6)	(0.7)			(1.3)	1.3M							(1.3)				0.6		0.6	0.6	(0.6)
Belgium	17-Sep-18		(1.0)	(1.0)	(1.0)		(3.0)	4.0M							(3.0)								(3.0)
	24-Sep-18																0.4	1.5			1.9	1.9	1.9
	01-Oct-18																						
	08-Oct-18																						
	Total		(1.0)	(1.0)	(1.0)		(3.0)	4.0M							(3.0)		0.4	1.5			1.9	1.9	(1.1)
France	17-Sep-18		(4.0)	(4.0)		(1.5)	(9.5)	5.4M							(9.5)								(9.5)
	24-Sep-18																						
	01-Oct-18			(6.5)	(2.0)		(8.5)	12.0M							(8.5)								(8.5)
	08-Oct-18																						
	Total		(4.0)	(10.5)	(2.0)	(1.5)	(18.0)	17.4M							(18.0)								(18.0)
Germany	17-Sep-18	(4.0)		(3.0)			(7.0)	3.7M							(7.0)								(7.0)
	24-Sep-18		(3.0)				(3.0)	1.6M							(3.0)								(3.0)
	01-Oct-18																						
	08-Oct-18			(3.0)		(1.0)	(4.0)	5.3M		17.0				17.0	13.0		0.2				0.2	17.2	13.2
	Total	(4.0)	(3.0)	(6.0)		(1.0)	(14.0)	10.6M		17.0				17.0	3.0		0.2				0.2	17.2	3.2
Italy	17-Sep-18												10.8	10.8	10.8		0.2			1.4	1.6	12.3	12.3
	24-Sep-18		(6.0)	(2.0)		(1.5)	(9.5)	4.0M							(9.5)								(9.5)
	01-Oct-18																0.1				0.1	0.1	0.1
	08-Oct-18	(3.0)	(3.0)	(3.0)			(9.0)	4.7M							(9.0)					0.0	0.0	0.0	(9.0)
	Total	(3.0)	(9.0)	(5.0)		(1.5)	(18.5)	8.7M					10.8	10.8	(7.7)		0.3			1.4	1.7	12.5	(6.0)
Netherlands	17-Sep-18																						
	24-Sep-18		(2.5)				(2.5)	1.3M							(2.5)								(2.5)
	01-Oct-18																						
	08-Oct-18				(2.5)		(2.5)	5.4M							(2.5)								(2.5)
	Total		(2.5)		(2.5)		(5.0)	6.8M							(5.0)								(5.0)
Spain	17-Sep-18		(2.0)	(2.0)			(4.0)	3.9M							(4.0)								(4.0)
	24-Sep-18																						
	01-Oct-18		(1.0)	(2.0)		(1.5)	(4.5)	3.6M							(4.5)								(4.5)
	08-Oct-18																						
	Total		(3.0)	(4.0)		(1.5)	(8.5)	7.5M							(8.5)								(8.5)
Others	17-Sep-18		(0.1)	(0.1)	(1.0)		(1.2)	1.6M		5.0				5.0	3.8		0.1	0.1			0.2	5.2	4.0
	24-Sep-18																						
	01-Oct-18																						
	08-Oct-18			(1.3)			(1.3)	1.2M							(1.3)								(1.3)
	Total		(0.1)	(1.4)	(1.0)		(2.5)	2.8M		5.0				5.0	2.5		0.1	0.1			0.2	5.2	2.8
Total	17-Sep-18	(4.0)	(7.1)	(10.1)	(2.0)	(1.5)	(24.7)	18.7M		5.0			10.8	15.8	(8.9)		0.3	0.1	0.6	1.4	2.4	18.2	(6.5)
	24-Sep-18		(11.5)	(2.0)		(1.5)	(15.0)	6.9M							(15.0)		0.4	1.5			1.9	1.9	(13.1)
	01-Oct-18		(1.6)	(9.2)	(2.0)	(1.5)	(14.3)	16.9M							(14.3)		0.1				0.1	0.1	(14.1)
	08-Oct-18	(3.0)	(3.0)	(7.3)	(2.5)	(1.0)	(16.8)	16.5M		17.0				17.0	0.3		0.2			0.0	0.2	17.2	0.5
	Total	(7.0)	(23.2)	(28.5)	(6.5)	(5.5)	(70.7)	59.1M		22.0			10.8	32.8	(37.9)		1.0	1.6	0.6	1.4	4.6	37.4	(33.3)

Note: Supply numbers are shown as negative and include both official country estimates and HSBC projections. *Basis Point Value estimates by HSBC FI Research in EUR million. The numbers in Italics represent possible syndications. Others constitute Portugal, Finland, Slovakia and Ireland. Following Eurozone countries excluded from the totals: Cyprus, Greece, Malta, Luxembourg, Estonia, and Latvia. Source: HSBC, Official debt agency and central bank websites

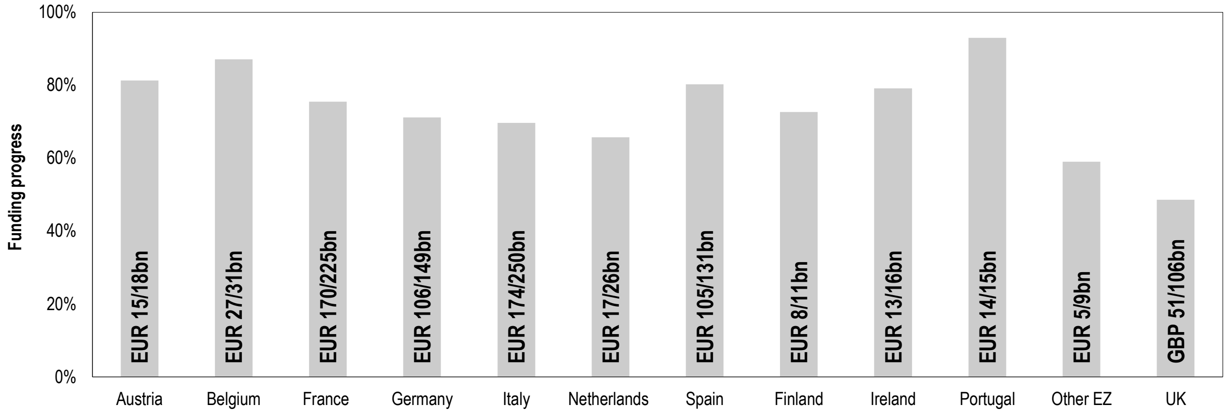
Source: HSBC, Official debt agency and central bank websites

Table 9: Weekly supply, coupon and redemption flows per segment for the upcoming four weeks (UK) in GBPbn

		SUPPLY (A)							REDEMPTIONS (B)						Net Supply (A+B)	COUPONS (C)						Total Cash (B+C)	Net Flows (A+B+C)
Week comm.	Maturity (yr)	1-3	3-7	7-15	15+	IL	Total Cash	BPV*	1-3	3-7	7-15	15+	IL	Total		1-3	3-7	7-15	15+	IL	Total		
UK	17-Sep-18			(2.8)			(2.8)	2.6M							(2.8)								(2.8)
	24-Sep-18					(1.3)	(1.3)	7.4M							(1.3)					0.3	0.3	0.3	(1.0)
	01-Oct-18		(2.8)				(2.8)	1.5M							(2.8)								(2.8)
	08-Oct-18																						
	Total		(2.8)	(2.8)		(1.3)	(6.8)	11.5M							(6.8)					0.3	0.3	0.3	(6.5)

Note: Supply numbers are shown as negative and include both official country estimates and HSBC projections, *Basis Point Value estimates by HSBC FI Research in GBP million The numbers in Italics represent possible syndications
Source: HSBC, Official debt agency and central bank websites

Figure 17: Fiscal funding progress (as a percentage of the 2018 gross bond issuance targets)



Note: Mixture of official country estimates and HSBC projections; Funding progress of the UK is based on FY18/19 (Apr-Mar). Austria: we estimate EUR18bn. Official target by Austrian Treasury is EUR17-20bn, The Netherlands: we take mid-range of EUR23-29bn (official target)
Source: Official debt agency website(s), HSBC and central bank websites

Upcoming T.Bill auctions

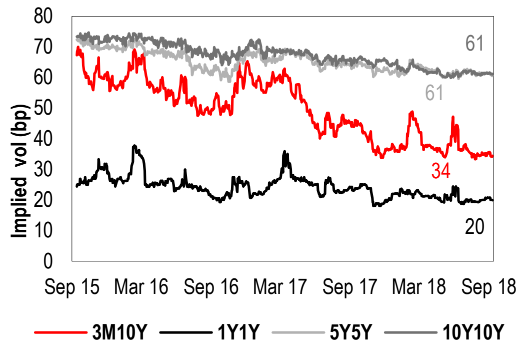
Table 10: Bills supply in the upcoming week

17 Sep	France	3m, 6m & 12m
	Netherlands	3m,6m
18 Sep	Spain	3m,9m
19 Sep	Portugal	6m,12m
21 Sep	UK	1m, 3m & 6m

Source: HSBC, official debt agency and central bank websites

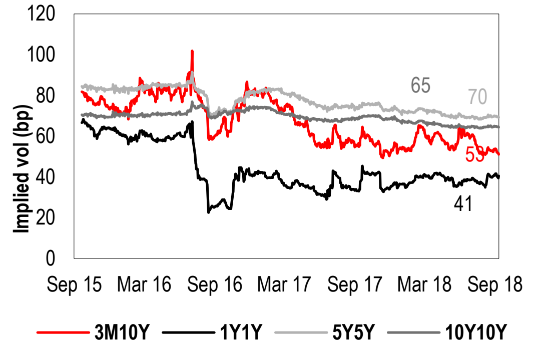
Volatility corner

Figure V1: Swaption implied volatility (EUR)



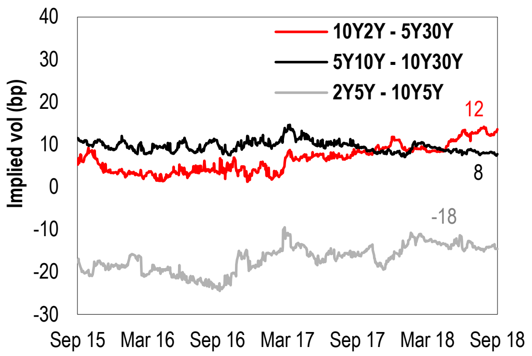
Source: HSBC

Figure V2: Swaption implied volatility (GBP)



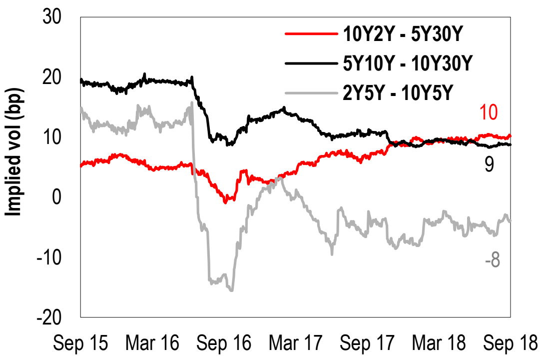
Source: HSBC

Figure V3: Vega spreads (EUR)



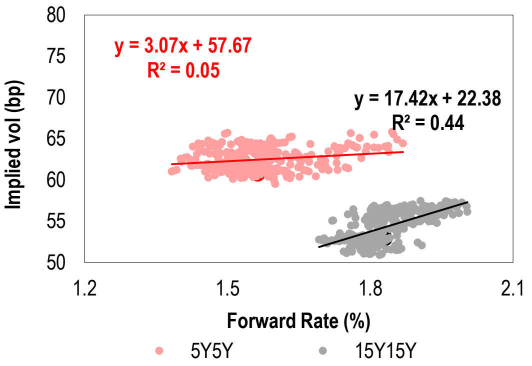
Source: HSBC

Figure V4: Vega spreads (GBP)



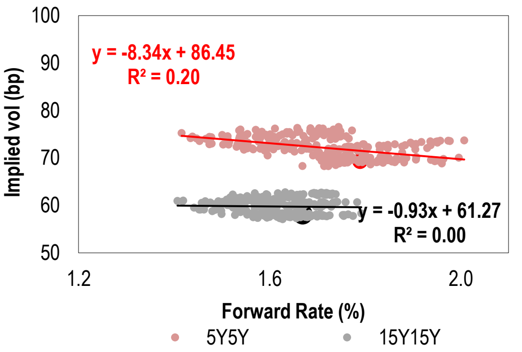
Source: HSBC

Figure V5: Regressed implied volatility versus forward rate (EUR)



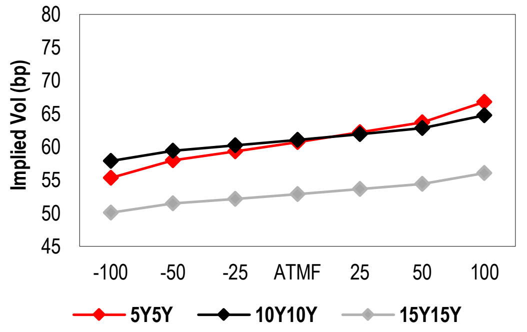
Source: HSBC

Figure V6: Regressed implied volatility versus forward rate (GBP)



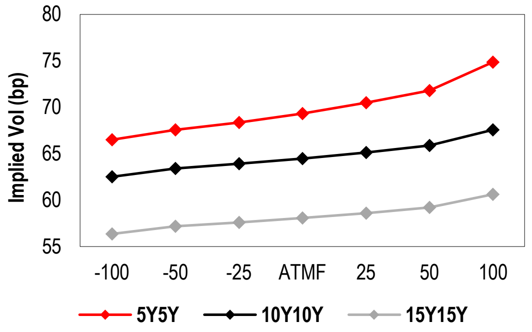
Source: HSBC

Figure V7: Vega skew snapshot (EUR)



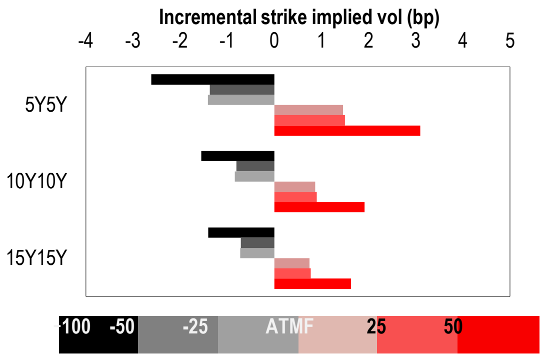
Source: HSBC

Figure V8: Vega skew snapshot (GBP)



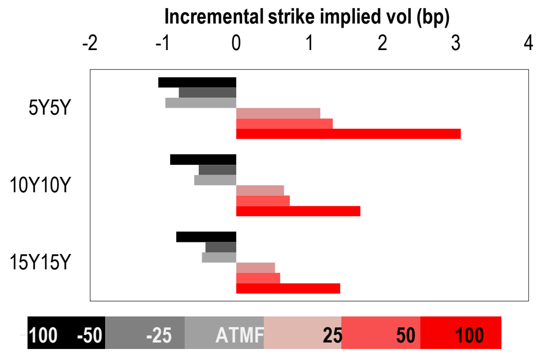
Source: HSBC

Figure V9: Vega skew ladder (EUR)



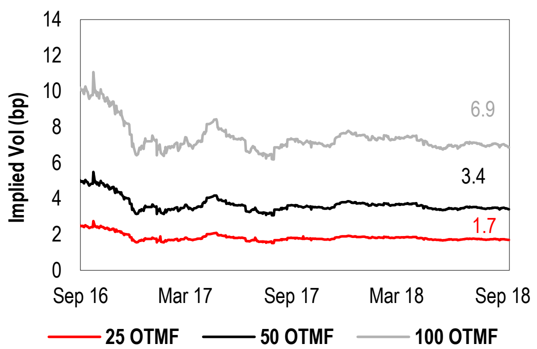
Source: HSBC

Figure V10: Vega skew ladder (GBP)



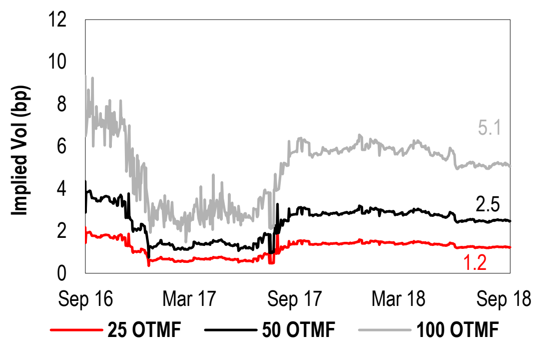
Source: HSBC

Figure V11: 5Y5Y Risk reversal (EUR)



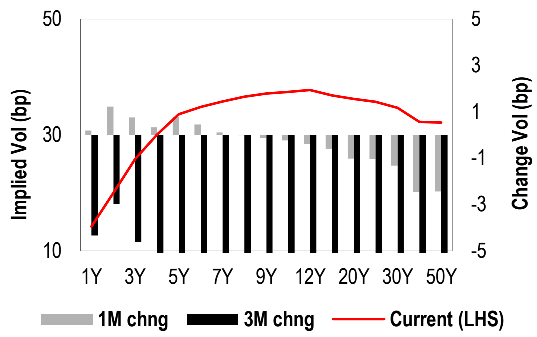
Source: Note: Payer- Receiver. Source: HSBC

Figure V12: 5Y5Y Risk reversal GBP)



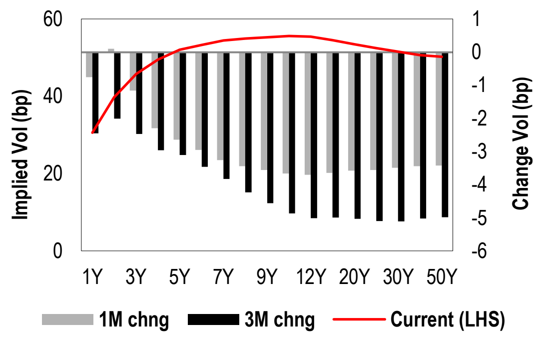
Source: Note: Payer- Receiver. Source: HSBC

Figure V13: 6M gamma term structure (EUR)



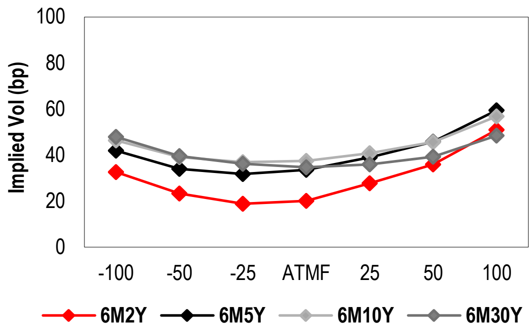
Source: HSBC

Figure V14: 6M gamma term structure (GBP)



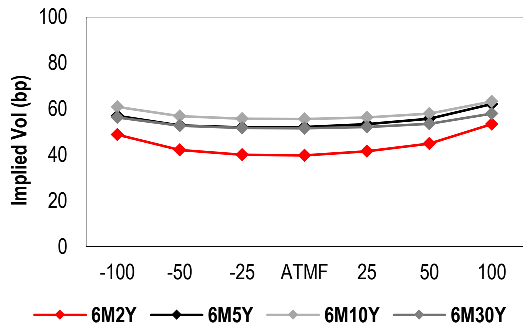
Source: HSBC

Figure V15: Gamma skew snapshot (EUR)



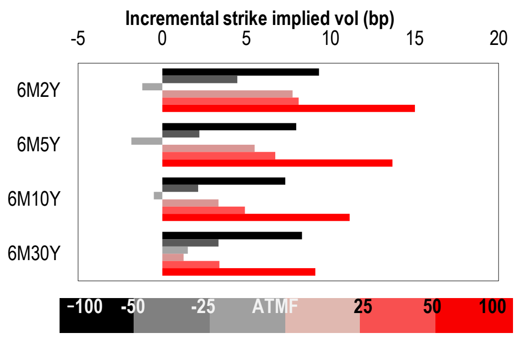
Source: HSBC

Figure V16: Gamma skew snapshot (GBP)



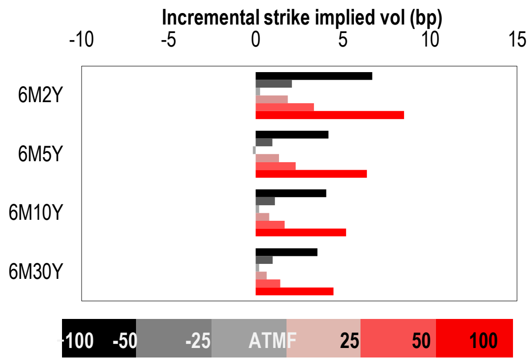
Source: HSBC

Figure V17: Gamma skew ladder (EUR)



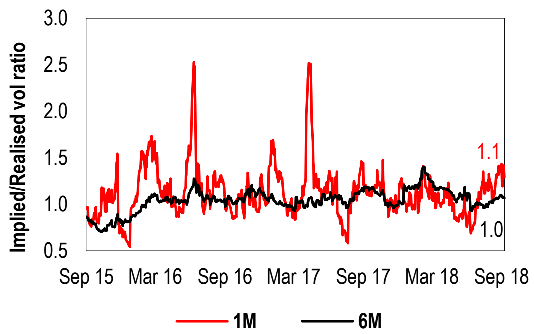
Source: HSBC:

Figure V18: Gamma skew ladder (GBP)



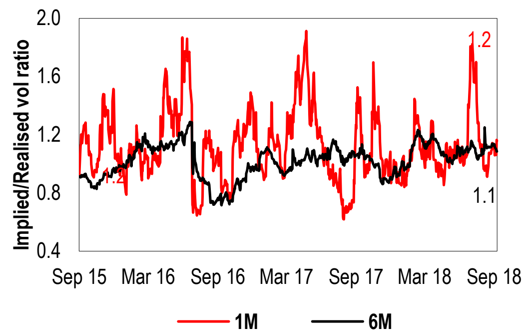
Source: HSBC:

Figure V19: Vol ratio on 10Yswaption (EUR)



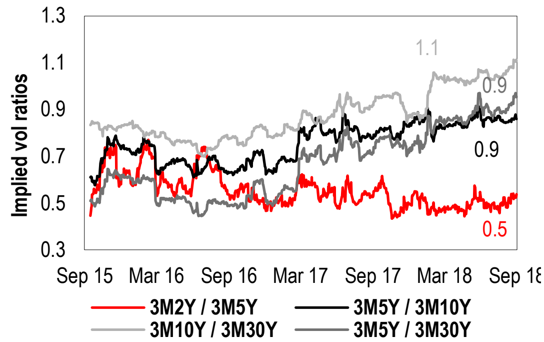
Source: HSBC

Figure V20: Vol ratio on 10Y swaption (GBP)



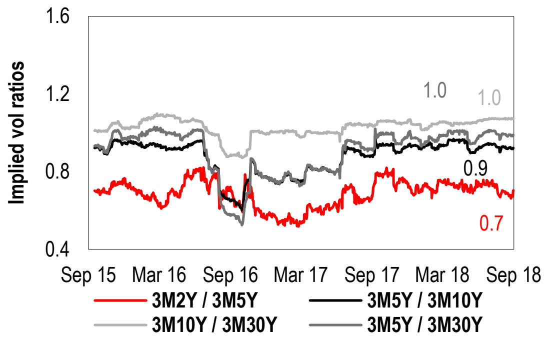
Source: HSBC

Figure V21: Implied volatility ratios (EUR)



Source: HSBC

Figure V22: Implied volatility ratios (GBP)



Source: HSBC

Credit ratings

Table 11. Credit tracker: Eurozone countries

	Rating[1]					next rating review			5Y Credit Spreads (bp)		
Country	Moodys	S&P	Fitch	CDS implied[3]	momentum[5]	Moody's	S&P	Fitch	ASW[4] (bp)	CDS[2]	CDS chart
Austria	Aa1	AA+	AA+	AA+ (-0.5)	flat	16 Nov	14 Sep		-35	13	
Belgium	Aa3	AA	AA-	AA (-0.3)	down	19 Oct	21 Sep	30 Nov	-31	22	
Cyprus	Ba2	BB+	BB+	BBB- (-1.3)	up		14 Sep	19 Oct	99	145	
Estonia	A1	AA-	A+	A- (+2.4)	n/a		7 Dec	5 Oct		62	
Finland	Aa1	AA+	AA+	AAA (-0.6)	flat	19 Oct	14 Sep		-37	13	
France	Aa2	AA	AA	AA- (+0.7)	down	26 Oct	5 Oct		-31	24	
Germany	Aaa	AAA	AAA	AAA+ (-0.5)	flat		26 Oct		-49	10	
Greece	B3	B+	BB-	B+ (-0.8)	up	21 Sep			282	386	
Ireland	A2	A+	A+	A+ (-0.6)	flat	5 Oct	30 Nov	14 Dec	-24	32	
Italy	Baa2 *-	BBB	BBB	BB (+2.6)	down		26 Oct		169	228	
Latvia	A3	A-	A-	A- (+0.2)	flat		21 Sep	26 Oct	-17	65	
Lithuania	A3	A	A-	A- (+0.4)	flat				10	62	
Luxembourg	Aaa	AAA	AAA		n/a	26 Oct	14 Sep	28 Sep			
Malta	A3	A-	A+		n/a		21 Sep				
Netherlands	Aaa	AAA	AAA	AAA (+0.2)	up		16 Nov	26 Oct	-46	12	
Portugal	Ba1	BBB-	BBB	BBB+ (-1.6)	up	12 Oct	14 Sep	30 Nov	38	91	
Slovakia	A2	A+	A+	A (+0.6)	flat				-28	45	
Slovenia	Baa1	A+	A-	BBB+ (+1.0)	flat	2 Nov	14 Dec		-25	74	
Spain	Baa1	A-	A-	A- (-0.4)	flat	5 Oct	21 Sep		14	61	

Source: Markit, Bloomberg, HSBC calculations

Notes

1. Local currency, long-term rating. Shaded for Positive or Negative outlook.
2. Bloomberg D14 CDS spreads
3. Implied rating versus Eurozone peer group in log CDS fit (cheap/rich in notches). "AAA+" denotes an implied rating less than 1 notch
4. Latvia ASW is for 6Y point
5. For calculation methodology, see *Buried treasure: Using information hidden in CDS prices*, 22 September 2014
6. Any reviews for the publication date are highlighted in red

Trade tracker

Table 12. New trades

	Instrument	Entry (date)	Target	Stop	Current	Rationale and risk
US						
Buy	T2.875 8/28	2.96% (13 Sep 18)	2.85%	3.1%	2.96%	Rationale: 10-year is at upper end of recent range Risk: Fed outlook turns more hawkish
Euro						
ASW	FRTR0 3/23	-33bp (13 Sep 18)	-43bp	-28bp	-34bp	Rationale: France cheapened in ASW terms Risk: safe haven flows reversing massively
Buy	BTPS 0.05% 4/21	1.25% (13 Sep 18)	0.60%	1.60%	1.25%	Rationale: market-friendly budget expected; uncertainty still priced in. Risk: budget upset; Tria forced out
Buy Sell	6Minto2Y and 6Minto30Y ATMF Receiver swaptions 6Minto5Y ATMF - 7bp receiver swaption	0 cents (13 Sep 18)	30 cents	-15 cents	0 cents	Rationale: five-year to underperform amid long-end flattening Risk: if ECB turns dovish with rate cut expectations
UK						
Buy Sell Buy	UKT 2T 24 (1.25) UKT 4Q 27 (1.92) UKT 4T 30 (0.83)	-15bp (13 Sep 18)	0bp	-23bp	-15bp	Rationale: Rich UKT 4Q 27 relative to peers Risk: the 10-year bond continues to richen due to CTD demand

Source: HSBC

Table 13. Closed trades

	Instrument	Entry (date)	Target	Stop	Exit (date)	PnL	Rationale
Euro							
Sell RASW	CDS protection on Spain rY (D14) SPGB0.35 7/23	63bp (21 Jun 18)	45bp	72bp	47bp (13 Sep 18)	+16bp (+13bp carry)	Take profit
Buy	GGB3.5 1/23	3.25% (27 Jun 18)	2.25%	3.80%	3.10% (13 Sep 18)	+15bp (+24bp carry)	More bearish on EM, which is taking GGB yields higher
Buy Sell	BTPS 3.45% 03/48 BTPS 0.35% 15/6/20	238bp (16 Aug 18)	130bp	275bp	275bp (10 Sep 18)	-37bp (-8bp carry)	Stop hit
RASW	FRTR4 4/55	20bp (13 Jul 18)	32bp	13bp	29bp (13 Sep 18)	+9bp	Take profit

Source: HSBC

Table 14. Open trades

	Instrument	Entry (date)	Target	Stop	Current	Rationale and risk
US & Canada						
Widener	5th IMM USD FRA-OIS spread widener	33bp (15 Feb 18)	50bp	24bp	27bp	Non-US banks to face dollar liquidity squeeze in the medium term. Risk: Lacklustre Tbill issuance, limited liquidity squeeze
Buy Sell	TII0.625 4/23 0.5 Beta T2.5 3/23	75bp (19 Apr 18)	100bp	50bp	58bp	Rationale: High carry and attractive carry point. Risk: softer commodity prices and flows out of TIPS.
Buy	T2.375 4/20 vs OIS	12bp (2 May 18)	2bp	17bp	10bp	Rationale: Near-term drivers may push cash yields lower than OIS swaps. Risk: two-year yields remain sticky amidst structural factors
Buy	4/22/2019 JGB bill swapped to CAD	2.09% (15 May 18)	1.30%	3.00%	2.20%	Rationale: significant yield pick-up. Risk: mark to market volatility
Sell Buy Buy	1.00 units T4.5 2/36 0.815 units T2.25 11/27 0.483 units T2.75 11/47	2.93% 2.91% 3.05% (21 Jun 18)	+150bp return	-50bp	6bp	Rationale: attractive projected return profile. Risk: Fed outlook shifts to easing.
Pay Rec	CAD 1Yfwd5Y CAD 1Yfwd2Y	4bp (3 Jul 18)	19bp	-5bp	3bp	Rationale: attractive carry and roll opportunity Risk: limited flattening potential given trading range history
Pay Rec	EURUSD 5Y5Y EURUSD 1Y1Y (1:1.185)	-5bp (12 Jul 18)	+10bp	-12bp	0bp	Rationale: xccy curve is too flat Risk: sustained paying at the front end
Sell Buy Sell	TII0.375 7/23 TII0.5 1/28 TII3.375 4/32	10bp (19 Jul 18)	-10bp	20bp	10bp	Rationale: Cheap 10Y TIPS sector. Risk: A sudden increase in energy prices
Pay	USD 1Y1Y 1s3s basis swap	11bp (26 Jul 18)	17bp	8bp	10bp	Rationale: T.Bill supply and MMF changes are under-priced Risk: Dollar liquidity compresses spreads
Buy	Italy 6mo 31 Dec 2018 Bill xccy (USD)	2.79% (26 Jul 18)	Maturity	3.50%	2.77%	Rationale: cross-currency basis offers significant yield pick-up Risk: short-term market volatility
Buy Sell	TII1.875 7/19 TII1.625 7/19	184bp (31 Jul 18)	230bp	160bp	220bp	Rationale: cheap 1Y Bes vs forecasts Risk: a sharp drop in oil prices
Buy Sell Sell	100 par T 2.5 5/20 59.1 par 6M T-bill 42.9 par T 1.875 04/22	2.67% 2.21% 2.83% (03 Aug 18)	+20bp (Total Return)	-10bp	-4bp	Value on curve and carry Risk: Fed outlook shifts to easing
Sell Buy Buy	100 par T 2.25% 12/31/24 53.9 par T 1.625% 08/31/22 47.1 par T 2.25% 11/30/27	2.80% 2.72% 2.87% (16 Aug 18)	+20bp (Total Return*)	-10bp	-3bp	Rationale: Expect spread to mean revert with limited risk of loss Risk: Fed eases aggressively & curve steepens significantly
Sell Buy	TII0.75 7/28 T2.875 8/28	212bp (30 Aug 18)	195bp	225bp	212bp	Rationale: fall in yields to take BEs much lower Risk: a strong increase in energy prices
Buy	USD BNG2.5 1/23 vs OIS	36bp (30 Aug 18)	22bp	43bp	34bp	Rationale: structural demand for OIS ASW positions Risk: European SSAs underperform
Euro						
Pay Rec Rec	EUR 2Yf5Y IRS EUR 2Yf2Y IRS EUR 10Yf10Y IRS (1:1:0.2 DV01)	-4bp (18 Jan 18)	16bp	-14bp	2bp	Euro curve should bow-out after the un-anchoring of forward guidance. Risk is if curve begins to bow in.
Buy Sell	NETHER0.75 7/28 DBR0.5 2/28	19bp (31 May 18)	10bp	25bp	16bp	Rationale: spread widened on elevated Italian political risks Risk: if liquidity in the Eurozone bond market worsens
Buy Sell	CFF0.25 3/22 PBBGR0.2 3/22	7bp* (30 May 18)	0bp*	20bp*	7bp*	Rationale: Recent underperformance of French covered bonds seems overdone. Risk: German names could benefit more from political uncertainty than other covered bonds *(ASW swap)

Source: HSBC; Options may result in greater losses than equivalent trades should the market move against one's expected direction *Total return measures price appreciation, accrual and coupon payment

	Instrument	Entry (date)	Target	Stop	Current	Rationale and risk
Buy Buy Sell	1yinto2y receiver swaption 3yinto2y receiver swaption 1yinto4y receiver swaption (all strikes at 0.3%, all notionals of 10MM)	34k (27 Apr 18)	105k	0k	n/a	Rationale: implied vol may pick-up in the near future. Risk: ECB back-pedals on tightening
Buy	1Yinto2Y ATMF payer swaption and 1Yinto2Y ATMF -25bp receiver swaption	27cents (22 Mar 18)	75cents	0cents	n/a	Rationale is that front-end rates could move aggressively either way. Risk: rates remain in a narrow trading range
ASW RASW	T2.75 2/28 DBR0.5 2/28	-45bp (22 Mar 18)	-30bp	-53bp	-45bp	Rationale: UST swap spread is too tight vs Bund equivalent Risk: UST swap spread is too tight vs Bund equivalent
Buy Sell	TD0.375 1/21 AIB2.25 3/21	10bp* (28 Mar 18)	0bp*	20bp*	2bp*	Rationale: Pick-up looks attractive as TD is a much better credit than AIB. Risk: changes to ECB purchase behaviour. *(ASW swaps)
Flattener Steepener	6mf 2-5Y EUR IRS 6mf 2-5Y SEK IRS	-9bp (5 Apr 18)	-30bp	2bp	-13bp	Rationale: too much tightening priced for the euro swap curve. Risk: a decidedly hawkish ECB vs Riksbank
Buy Sell	NDB0.375 6/23 NDB0.375 10/24	22bp* (19 Apr 18)	18bp*	30bp*	21bp*	Rationale: pick-up looks attractive as both bonds are exposed to largely the same issuer risk. Risk: Pfandbriefe could in the short term widen more in light of the higher liquidity. *(ASW spread)
Buy Sell	IL22 OATei22	-32bp (14 May 18)	-100bp	0bp	-49bp	Rationale: cheap UK real rates vs OATeis. Risk: a hawkish BoE along with an overly dovish ECB
Buy Sell	SPGB10Y10Yfwd FRTR10Y10Yfwd	103bp (10 May 18)	0bp	150bp	115bp	Rationale: long-term rating convergence. Risks: Spanish slowdown, political upset
Buy Sell	OATi21 OATei21	18bp (24 May 18)	-15bp	30bp	11bp	Rationale: cheap OATis vs OATeis. Risk: French inflation fails to pick-up
Pay Rec	EUR 5Y5Y EUR 2Y2Y	108bp (13 Jun 18)	138bp	93bp	110bp	Rationale: 5s10s steepener looks attractive given ECB's policy stance and political backdrop. Risk: A big mark-down in euro-area macroeconomic picture
Buy Sell	EUR 1Yinto10Y ATMF straddle EUR 1Yinto2Y ATMF straddle	16bpvol (21 Jun 18)	26bpvol	11bpvol	17bpvol	Rationale: EUR vol curve too flat for policy direction. Risk: If low for longer rates get entrenched
Buy Sell	CMCICB0.75 9/27 HESLAN0.625 1/27	16bp* (29 Jun 18)	11bp*	30bp*	16bp*	Rationale: recent underperformance of long French covered from bonds seems overdone. Risk: German names could *benefit more political uncertainty than other covered bonds *(ASW spread)*
Buy *Sell*	*EUR1Yinto20Y ATMF-5bp receiver swaption* *ATMF-25bp receiver (1:2)*	*0 cents* *(19 July 18)*	*50cents*	*-25cents*	*n/a*	*Rationale: mildly bullish bias on long-end rates Risk: if rates move meaningfully lower*
Buy *Sell*	*BGB1.9 6/38* *FRTR4 10/38*	*16bp* *(26 Jul 18)*	*5bp*	*23bp*	*17bp*	*Rationale: wide spread, favourable supply outlook Risk: long-end OLO syndicated transactions*
Buy *Sell*	*BTPei24* *BTPei 22*	*51bp* *(31 Jul 18)*	*20bp*	*65bp*	*50bp*	*Rationale: Slope at similar levels as in early May 2018 Risk: Pickup in risk appetite steepening nominal/real curves*

Source: HSBC; Options may result in greater losses than equivalent trades should the market move against one's expected direction

	Instrument	Entry (date)	Target	Stop	Current	Rationale and risk
Buy	RAGB3.15 6/44	1.30% (03 Aug 18)	1.10%	1.42%	1.28%	Rationale: Recent rise in yields and cut in bond supply Risk: Marked pick-up in EZ macro-economic data
Buy Sell	PKO0.625 1/23 HVB1.875 9/22	49bp (16 Aug 18)	43bp	70bp	44bp	Rationale: Recent underperformance of Polish covered bonds offers attractive entry point. Risk: German names would benefit from their safe haven status in a 'risk off' market.
RASW ASW	BKO0 6/20 OBL0 4/23 (vs OIS)	-3bp (16 Aug 18)	-11bp	+1bp	-9bp	Rationale: German repo rates are too high for being long Schatz. Risk: if Bund curve steepens more than Eonia swaps.
Buy	RFGB0.875 9/25	0.24% (30 Aug 18)	0.10%	0.33%	0.24%	Rationale: risk-off sentiment Risk: hawkish ECB / more supply
UK						
Buy	IL22	-195bp (30 Jan 18)	-270bp	-165bp	-206bp	RPI can exceed market expectations in the near term. The trade had +14/-20bp of carry in Feb/March and offers +12bp in April. Risk: an overly hawkish BoE
Buy Sell	5Y30Y RPI swap 5Y15Y RPI swap	-18bp (30 Jan 18)	-10bp	-22bp	-14bp	The 20-year sector in RPI swaps is rich and we favour 5Y30Y RPI forwards. A cushion of 19bp carry over the next five years makes it even more appealing. Risk: a further appreciation of the 20-year sector.
Buy Sell	UKTi 2046 UKT 2045 (70%)	282.5bp (13 Feb 18)	295bp	273bp	277bp	De-risking trend will remain strong; positive supply backdrop and seasonality. Risk: risk-off suppresses appetite for inflation
Buy	GBP 8th IMM FRA OIS spread Vs 2nd contract	4bp (1 Mar 18)	14bp	1bp	6bp	Rationale is FRA-OIS term structure is too flat given limited near-term funding issues. Risk: short-dated spreads continue to widen from here
Sell	5y5y RPI	3.49% (12 Mar 18)	3.25%	3.60%	3.45%	Rationale is that market is pricing an excessively optimistic macro outlook. Risk: a fall in sterling.
Buy Sell	UKT1.25 07/27 DBR0.5 02/28	97bp (24 May 18)	60bp	120bp	104bp	Rationale: gilts to outperform as UK data remains weak Risk: UK economy accelerates, causing gilts to sell off
Rec	4y1y Sonia	1.32% (14 Jun 18)	1.10%	1.50%	1.34%	Rationale: Front-end mispricing growth risks. Risk: Global factors cause yields to rise.
Buy	UKT 3H 45 vs MMS	24bp (1 Mar 18)	5bp	20bp	19bp	Rationale: evolution away from Libor, into gilts and Sonia. Risk: worse funding conditions, politics
Buy Sell Sell Buy	UKT 4Q 27 UKTi 27s UKT 4H 42 UKTi 42s	32bp (28 Jun 18)	45bp	27bp	31bp	Rationale: long-end BE cheap; bearish on fundamentals. Risk: oil price risk causing front-end BE to outperform
Buy Sell Buy	IL44 IL56 IL68	5bp (13 July 18)	11bp	2bp	8.2bp	Rationale: rich IL56 on curve Risk: even more supply of 25Y and 30Y linkers
Sell Buy	UKT 1Q 27 UKT 1H 47	39bp (12 July 18)	20bp	50bp	45bp	Rationale: hedge vs risk of hawkish Inflation Report Risk: dovish BoE supports front-end yields
Rec Pay	2Y Sonia swap 10Y Sonia swap	37bp (30 Aug 18)	60bp	24bp	41bp	Rationale: valuations, attractive roll-down, cautious BoE outlook Risk: BoE intent on hiking into a slowing economy

Source: HSBC Options may result in greater losses than equivalent trades should the market move against one's expected direction

	Instrument	Entry (date)	Target	Stop	Current	Rationale and risk
APAC						
ASW	ACGB 4.75 04/27	0bp (24 May 18)	-12bp	6bp	2bp	Rationale: a soft long that benefits from supply dynamics Risk: material rise in global yields
Sell Buy	JGB 0.1 06/28 JGB 0.7 06/48	71bp (03 Aug 18)	50bp	83bp	73bp	Rationale: Forward guidance and prospects of a pick-up in duration extension Risk: A significant reduction in purchase of super-long JGBs by the BoJ
Rec Pay	NZD 2Y IRS AUD 2Y IRS	1bp (15 Aug 18)	-18bp	11bp	-3bp	Rationale: Cyclical divergence in data and policy reaction functions. Risk: dovish shift by RBA
Buy Sell	ACGB 05/28 ACGB 05/21	56bp (30 Aug 18)	42bp	63bp	57bp	Rationale: Carry and offshore dynamics argue for move out the curve. Risk:higher global term premium

Source: HSBC Options may result in greater losses than equivalent trades should the market move against one's expected direction

For a full 12-month trade history, please see *DM Rates Trade Tracker* (14 September 2018).

Disclosure appendix

Analyst Certification

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Important disclosures

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Definitions for fundamental credit and covered bond recommendations from 22 April 2016

Overweight: For corporate credit, the issuer's fundamental credit profile is expected to improve over the next six months. For covered bonds, the bonds issued in this country are expected to outperform those of the other countries in our coverage over the next six months.

Neutral: For corporate credit, the issuer's fundamental credit profile is expected to remain stable over the next six months. For covered bonds, the bonds issued in this country are expected to perform in line with those of the other countries in our coverage over the next six months.

Underweight: For corporate credit, the issuer's fundamental credit profile is expected to deteriorate over the next six months. For covered bonds, the bonds issued in this country are expected to underperform those of other countries in our coverage over the next six months.

Prior to this date, fundamental recommendations for corporate credit were applied on the following basis:

Overweight: The credits of the issuer were expected to outperform those of other issuers in the sector over the next six months.

Neutral: The credits of the issuer were expected to perform in line with those of other issuers in the sector over the next six months.

Underweight: The credits of the issuer were expected to underperform those of other issuers in the sector over the next six months.

Distribution of fundamental credit and covered bond recommendations

As of 12 September 2018, the distribution of all independent fundamental credit recommendations published by HSBC is as follows:

	All Covered issuers		Issuers to whom HSBC has provided Investment Banking in the past 12 months	
	Count	Percentage	Count	Percentage
Overweight	97	24	37	38
Neutral	221	55	66	30
Underweight	84	21	15	18

Source: HSBC

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures.

Recommendation changes for long-term investment opportunities

To view a list of all the independent fundamental recommendations disseminated by HSBC during the preceding 12-month period, and the location where we publish our quarterly distribution of non-fundamental recommendations, please use the following links to access the disclosure page:

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
ALLIED IRISH BANK	AIBG.I	4.69	13 Sep 2018	1, 5, 6
BANK NEDERLANDSE GEMEENTEN	-	-	-	1, 5, 6
BANQUE FEDERATIVE CREDIT	-	-	-	1, 5, 6
COMPAGNIE DE FINANCEMENT FONCI	-	-	-	1, 5, 6
DEUTSCHE PFANDBRIEFBANK	PBBG.DE	12.59	13 Sep 2018	5, 6, 11
GOVERNMENT OF AUSTRALIA	-	-	-	6
GOVERNMENT OF AUSTRIA	-	-	-	6, 11
GOVERNMENT OF BELGIUM	-	-	-	1, 5, 6, 7, 11
GOVERNMENT OF FRANCE	-	-	-	1, 5, 6, 7, 11
GOVERNMENT OF GERMANY	-	-	-	1, 5, 6, 11
GOVERNMENT OF GREECE	-	-	-	11
GOVERNMENT OF ITALY	-	-	-	1, 5, 6, 11
GOVERNMENT OF JAPAN	-	-	-	6
GOVERNMENT OF NETHERLANDS	-	-	-	6, 11
GOVERNMENT OF SPAIN	-	-	-	1, 5, 6, 11
GOVERNMENT OF UK	-	-	-	2, 6, 7, 11
GOVERNMENT OF UNITED STATES	-	-	-	6, 11
LANDESBANK HESSEN-THUERIN	-	-	-	1, 5, 6
NORDDEUTSCHE LANDESBANK	-	-	-	5, 6
PKO BP	PKO.WA	39.58	13 Sep 2018	1, 5, 6
REPUBLIC OF FINLAND	-	-	-	1, 5, 6, 7, 11
TORONTO DOMINION BANK	TD.TO	78.57	13 Sep 2018	1, 2, 4, 5, 6
UNICREDIT	CRDI.MI	13.34	13 Sep 2018	1, 4, 5, 6, 7

Source: HSBC

1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.

2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.

3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.

4 As of 31 August 2018, HSBC beneficially owned 1% or more of a class of common equity securities of this company.

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