Citi Research
| VIEWPOINT

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European Rates Weekly

Why demand might not keep up with supply

Flagship

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CITI'S TAKE

In a special topic, we explore who has been buying EGBs and whether it is sustainable. The majority of demand has come from banks and retail, but both risk waning ahead. Foreign portfolio selling might also resume if market-priced Fed cuts are realized. Net, this increases our conviction in wider EGB spreads, tighter swap spreads and a steeper Bund curve. Elsewhere, in € swaps, we argue that the cost of carrying steepeners may just not be worth it if the swaption market is right about near-term volatility. In Euro inflation, we continue to see 2.6% very much within reach for 5y5y HICP swaps and, in contrast, consider RPI shorts. Finally, in the UK, we stick with longs in 1y1y SONIA vs Fed Funds despite negative price action. We also suggest asymmetric bullish risk to gilts from any change to the remit on 25 April.

Special topic: who is buying EGBs and could this continue? — The record EGB net supply in Q1 found an offset from strong demand from EA banks across the board, retail investors in the periphery, and Dutch pension funds in the core, but these might have peaked now. Further, net foreign portfolio demand for EA paper might turn into net selling if the market-priced Fed cuts are realized. Overall, it might become increasingly difficult to absorb the relentless EGB supply in coming months, especially with the ECB likely to pursue full passive APP QT from July and potentially then shift attention to PEPP reinvestments. This increases our conviction in wider EGB spreads, tighter swap spreads, and a steeper Bund curve for Q2 and beyond.

€ swaps — The € 2s10s curve is back to -50bp inversion, with forwards pricing 35bp steepening over the next year – which make paying the curve expensive to carry. With short-expiry volatilities below their early March troughs, starting a trade with negative roll-down may not be desirable despite the historically attractive entry levels. A volatile rally is what steepener trades arguably need to prove successful in the near term. Until then, fading the flattening requires a great deal of conviction.

Euro/UK inflation — We see little potential for a large breakevens fall in Europe, which should remain supported by the lack of DV01 supply, perhaps pushing 5y5y back towards 2.6%. The situation feels more fragile in the UK, with data at risk of pushing the BoE into overtightening. That said, as tempting as it is, we refrain from entering RPI shorts, with core UK CPI still due to peak.

UK — This week: (1) The GBP front-end was hit by a one-two punch by wages/CPI, but the medium-term outlook still supports long 1y1y SONIA vs Fed Funds, in our view. (2) The gilt remit is due for revision on 25 April. Base case is that any change will be minimal. If not, there is asymmetric bullish risk for gilts as any cut in funding is likely to be met fully by gilts, whereas any larger increase is likely split with Treasury bills.

Closed trades this week —Buy 3m conditional bear flattener on EUR 10s30s (trade expired) and PGB Apr34-Apr27 steepener vs Bono Jul33-Jan27 (hit target).

Please join us for a 15-minute *call* on Monday, 24 April at 3pm London, when we will summarize key global rates views.

Note: Futures trading involves substantial risk of loss.

Aman Bansal, CFA

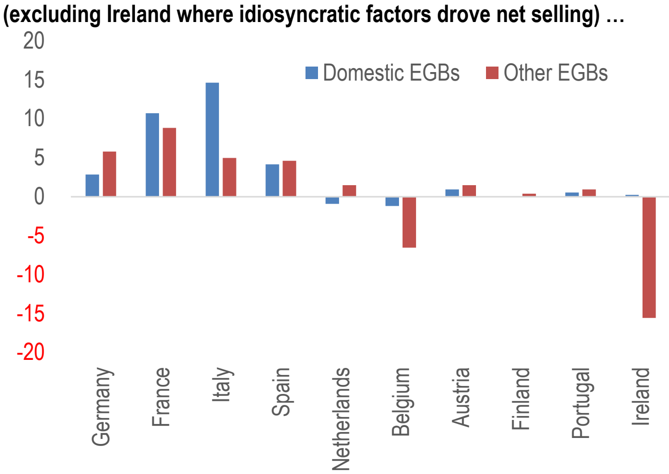
Special topic: Who is buying EGBs and could this continue?

EGBs have seen record net supply in Q1. We recently highlighted how issuer flexibility (see here) has helped supply absorption so far. Here we discuss how different investor groups have changed their behaviour and whether this could persist as net supply DV01 remains heavy past Q1, unlike past years. The analysis leads us to believe that the market might need a higher demand-supply equilibrium as various sources of current demand risk drying up, supporting our medium-term views of wider EGB spreads, tighter swap spreads and a steeper Bund curve.

(1) YTD bank demand for EGBs at multi-year high

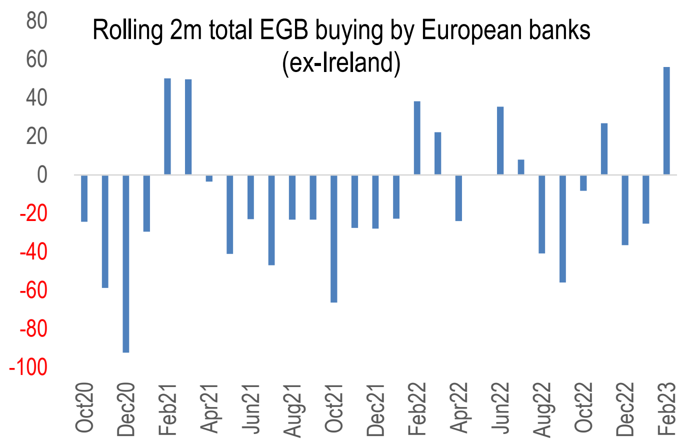
European banks have been a major buyer of EGBs in 2023 (**Figure 1**). Excluding Ireland, where idiosyncratic factors related to two major banks unwinding some businesses might be at play according to our bank analysts, European banks have bought net €56bn of EGBs (nominal value) across domestic and non-domestic issuers over January-February. This is more than a third of EMU-11 net cash requirement (gross supply less free float coupons, redemptions, net QE/QT) at €157bn over January-February and partly reverses the €250bn of bank selling of sovereign debt over 4Q20-4Q22 (**Figure 2**).

Figure 1. EA banks have bought €56bn of EGBs over January-February (excluding Ireland where idiosyncratic factors drove net selling) ...



Source: Citi Research, ECB

Figure 2. ...with 2m buying highest since Q4-20 and partly reverses €250bn of selling over the preceding 9 quarters



Source: Citi Research, ECB

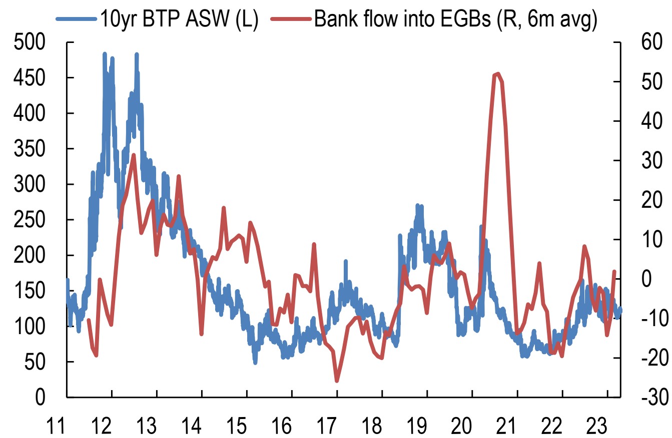
This flow has been most concentrated in France and Italy. Bank earnings reports for Q1 starting in two weeks might shed light on the drivers behind this and whether the direction has changed following the banking sector turmoil in March. For now, we think that the shift to longer-duration assets might have been partly driven by the deposit shift from sight deposits to term deposits at banks since mid-2022, though many banks prefer to use derivatives for this. The EGB demand might also be a result of banks locking in higher yields on offer, which would explain why Italian banks favoured domestic sovereign debt more than other European banks, as evident from **Figure 1**.

For now, our bank colleagues believe that Italian banks have some space to buy BTPs but not much due to regulatory pressures and diversification requirements. The large upcoming TLTRO repayment in June worth €475bn also remains a risk given periphery banks' balances in ECB deposit facility are less than repayments due. However, it is not clear where the assets could be reduced, and our base case is that the impact on EGB holdings will be limited.

These could also temper any inflows into EGBs if EGB ASW cheapens in line with our expectations, with bonds then looking more attractive for banks to hold compared to swaps (**Figure 3**, the flows show better association with BTP ASW than GDP-weighted EMU ASW).

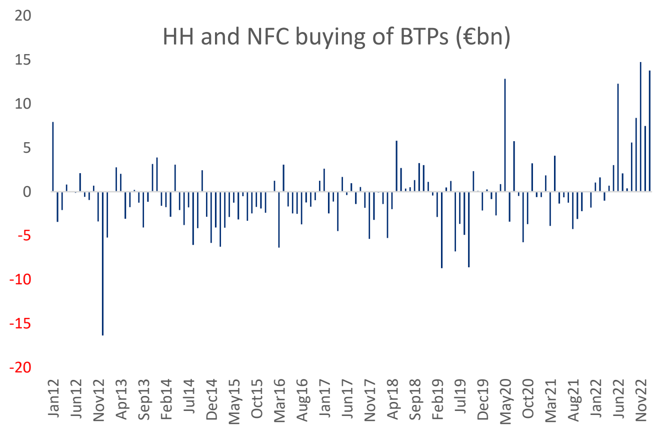
On balance, the risk seems that the bank buying of EGBs decelerates in coming months.

Figure 3. Bank flows into EGBs tend be related to the attractiveness of bonds vs swaps. The exception was the start of QE in 2015 with banks buying bonds on anticipated ECB support despite richer BTP ASW.



Source: Citi Research, ECB, Bloomberg. As at 15:00 BST, 20 April

Figure 4. There has been strong retail demand for BTPs since September.

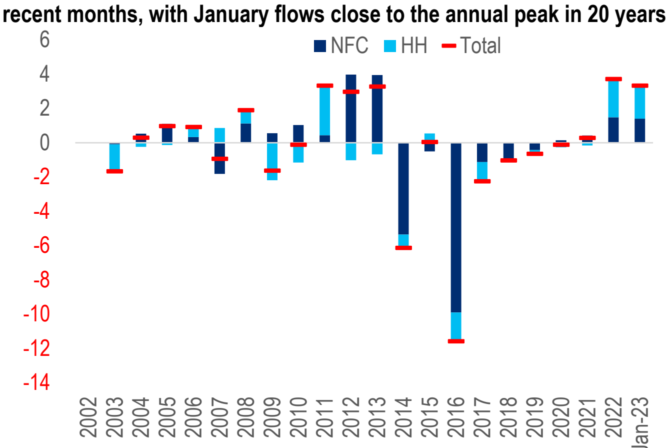


Source: Citi Research, BdI

(2) Retail demand for periphery also at multi-year high

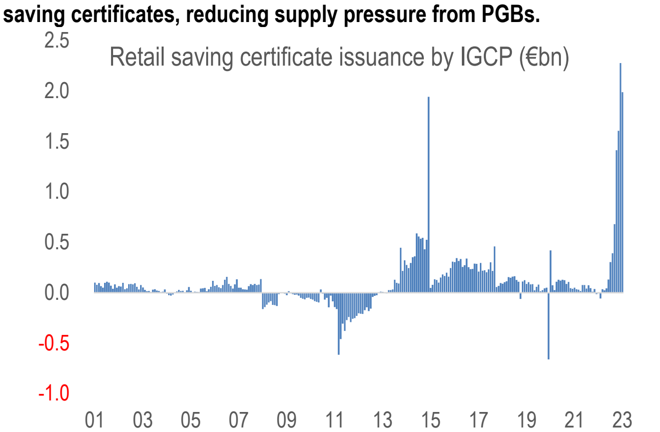
EMU periphery has seen strong demand from retail investors over recent months. BdI data shows that households and NFC bought €50bn of BTPs over Sep22-Jan23 (the last data point available) – **Figure 4**. This demand might have continued in February, judging by the increase in assets under custody (AUC) with large Italian banks, according to our bank analysts. Similarly, BdS data shows HHs and NFCs buying €8bn of Bonos over this period including Letras in non-competitive tranche of auctions (**Figure 5**). In Portugal, retail investors have bought €11bn of saving certificates, taking pressure off PGB supply (with €5bn over January-February vs the full year target of €3.6bn) – **Figure 6**. For context, this is 60% of annual PGB gross supply in 2023 based on our estimates.

Figure 5. Bonos have also seen sharp inflows from retail investors over recent months, with January flows close to the annual peak in 20 years



Source: Citi Research, BoS

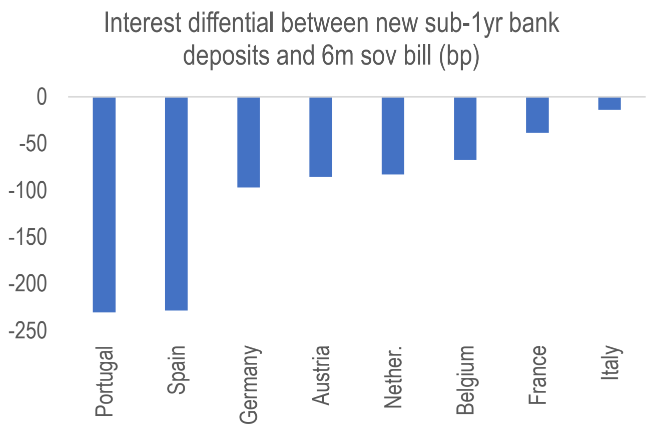
Figure 6. Portuguese Treasury has been issuing record amount of retail saving certificates, reducing supply pressure from PGBs.



Source: Citi Research, IGCP

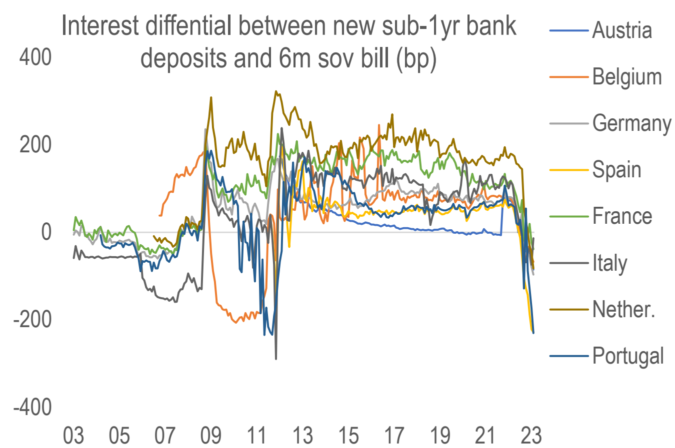
We believe this demand might have been driven by the limited passthrough of ECB rate hikes into bank deposit rates, especially in Portugal and Spain, aided by record high spreads between bill yield and bank term deposits (**Figure 7-Figure 8**).

Figure 7. In Portugal and Spain, demand for sovereign paper might have been helped by the lowest passthrough of ECB hikes to bank deposit interest rates…



Source: Citi Research, ECB, Bloomberg. As of 15:00 BST, 20Apr23

Figure 8. …with the spread now record negative.



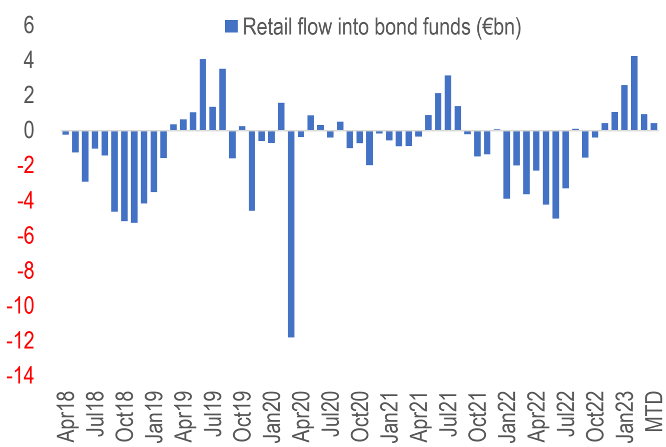
Source: Citi Research, ECB, Bloomberg. As of 15:00 BST, 20Apr23

David Groman

However, the official data on retail flows is only available till January/February. The timelier EPFR data on retail flow into bond funds suggests that this flow might have slowed from March. This might have been impacted by the banking sector turmoil, though it hasn't recovered in April as those concerns eased, presumably as most of the flexible disposable savings were already shifted and the increased cost of living weighed on further accumulation of household savings (**Figure 9**).

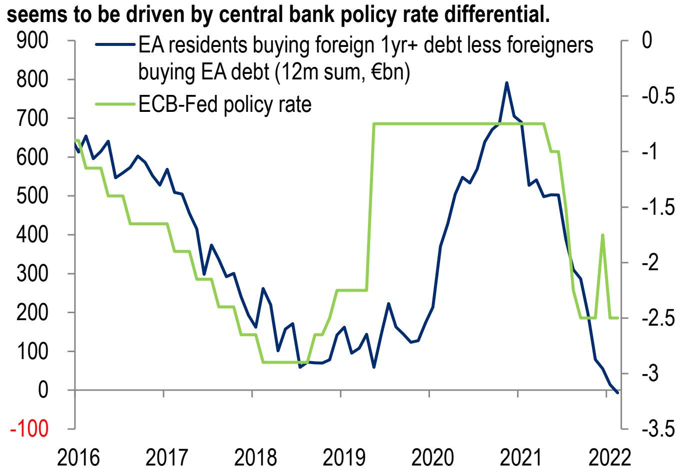
Net, retail demand has been a strong support for the periphery over recent months, but it might be past its peak.

Figure 9. However, retail flows into bond funds have been declining since March and have not recovered even when banking concerns have somewhat eased.



Source: Citi Research, EPFR

Figure 10. The pace of net outward portfolio investments from EA turned negative for the first time since 2016. Over the long-term, this seems to be driven by central bank policy rate differential.



Source: Citi Research, ECB

(3) Net foreign demand a function of policy rate differentials

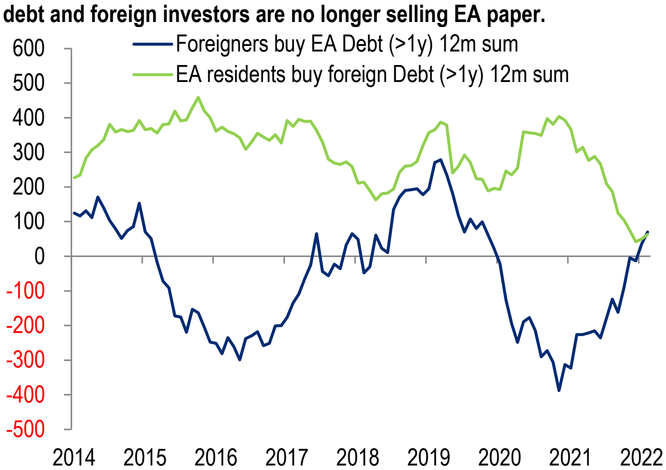
ECB data on portfolio investments shows that global inflows into 1yr+ EA debt matched EA flows into overseas bonds in December (last data available) for the first time since 2014 on a 12m rolling sum basis (**Figure 10**). This was driven by both non-EA investors reducing the pace of their selling of EA debt and EA investors also reducing foreign debt purchases, with both flows now close to flat (**Figure 11**). For most of the last six years, the net flow seems to be driven by central bank policy – EA investors buy foreign bonds when the ECB tightens policy more than the Fed and vice versa.

For 2023, country-level data suggests foreign investors were net sellers of both BTPs and Bonos in January (-€7bn each) but bought €5bn of BTPs in February. However, this reversal might be short-lived if the correlation to ECB-Fed policy rate differential reasserts itself and the market-priced policy rate paths are realized. Further, the duration impact is not the only one affecting the portfolio diversification stance of €-based investor. Indeed, an investor willing to increase their exposure to $-denominated paper would find it cheaper to hedge their FX exposure if the Fed realized the cuts priced by the market.

In particular, Japanese accounts bought large amounts of US Treasuries in February, but their EGB buying was flat/slightly negative (**Figure 12**). With EGBs looking relatively unattractive vs JGBs on an FX-hedged basis, we don't expect this to change in the fiscal new year. For this source of demand, the key wildcard remains BoJ stance on YCC. Citi's house view remains for a reduction in target duration from 10yr to 5/3yr to be announced in June, which is when the position buildup might also accelerate. As we discussed earlier this year, Japanese banks and lifers might shift demand to JGBs if yields increase. Pension fund demand might be less sensitive to FX-hedged yields. Overall, this could weigh on semi-core demand from Japanese accounts.

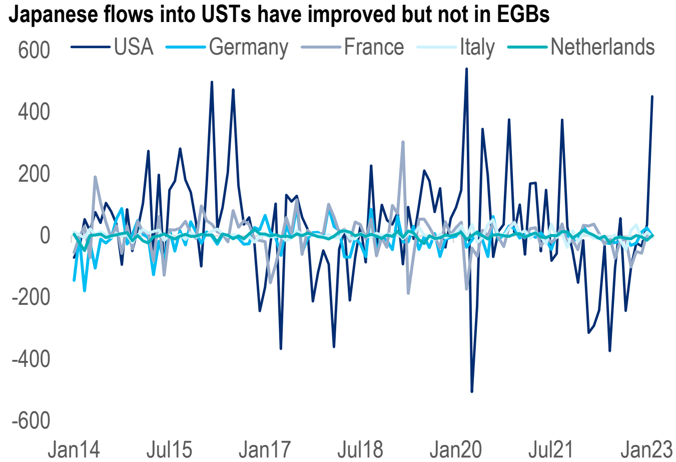
Net, outward portfolio investments from EA trickled to a stop over 2022 but might start again in 2023 if market-priced Fed cuts are realized.

Figure 11. Euro area residents have almost stopped buying foreign debt and foreign investors are no longer selling EA paper.



Source: Citi Research, ECB

Figure 12. Monthly JPY flows into sovereign bonds (¥bn) show that Japanese flows into USTs have improved but not in EGBs



Source: Citi Research, MoF

(4) Dutch pension fund demand has helped core, but will it sustain into the pension reform deadline?

While retail demand has supported mainly the periphery, Dutch pension fund buying in the primary markets might have supported the core paper (mainly Bunds and DSLs).

Ahead, the high funding ratios (around 117% in January according to some estimates) might enable hedging flows into core paper in coming months, but Dutch pension fund demand from H2 might be impacted by the upcoming pension reform due by June. There is a lot of uncertainty on this currently, but the risk remains that the reform triggers a long-term decline in PF bond holdings from currently around 50% as the new schemes resemble defined-contribution more than defined-benefit schemes.

Net, Dutch PF flows might continue to support the core in coming months but risk turning into persistent outflows from H2.

Conclusion – demand backdrop looks tenuous

The heavy EGB net supply in Q1 found an offset from strong demand from banks across the board, retail investors in the periphery, and Dutch pension funds in the core. However, risks now seem tilted towards weakening of demand from all these channels in coming months. Further, net foreign demand might again turn into net selling if the market-priced Fed cuts are realized. Overall, it might become increasingly difficult to absorb the relentless EGB supply in coming months, especially with the ECB likely to pursue full passive APP QT from July and potentially then shift attention to PEPP reinvestments.

For Q2 and beyond, this might mean:

- **wider EGB spreads** – we target 220bp by year-end (current 187bp);
- **tighter Bund swap spreads** – we target 40bp by year-end (current 64bp);
- **steeper EGB curves** – we target 2s10s Bund at -25bp (current -45bp) and 10s30s Bund at 25bp (current 6bp) by year-end.

Pricing as of close, 20 April 2023, unless otherwise specified.

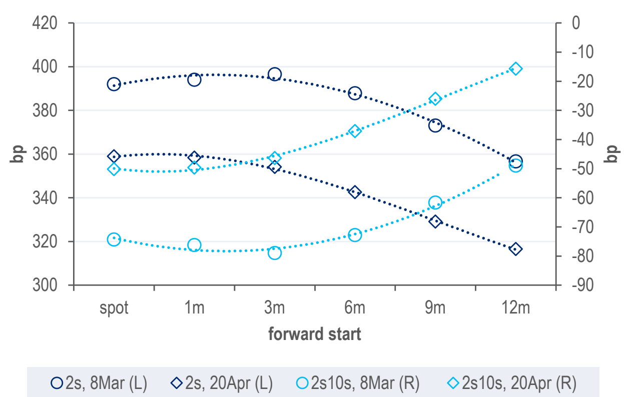
Andrea Appeddu

€ curve: curb your steepening enthusiasm

The € 2s10s curve is back to -50bp inversion, with forwards pricing 35bp steepening over the next year – which make paying the curve expensive to carry. With short-expiry volatilities below their early March troughs, starting a trade with negative roll-down may not be desirable despite the historically attractive entry levels. Our historical analysis indeed shows that carry at inception has a high discriminatory power relative to the future profitability of curve trades, for both € and $. A volatile rally is what steepener trades arguably need to prove successful in the near term. Until then, fading the flattening requires a great deal of conviction.

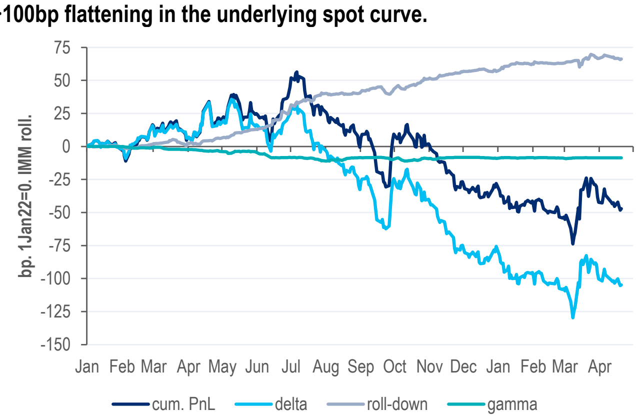
While the Governing Council may have "*a little way to go on the path*" on its policy tightening path – as Lagarde said in Paris on 20 April, the market seems impatient to shift into a regime of lower rates and steeper curves. Relative to the early March peak (before US banking stability turmoil hit the markets), the priced path for € swaps is indeed still significantly lower and steeper, despite the recent bear flattening normalization (**Figure 13**). In roll-down terms, 2s10s steepeners are not exactly portable trades, more so at longer horizons – with the curve priced for 4bp (35bp) steepening over the next three (twelve) months. With short-expiry vols now marking below their early March troughs (3m10y vol now some 7bpv cheaper), historically flat levels of the 2s10s spot curve may not be appealing enough given the negative carry profile.

Figure 13. Relative to pre banking turmoil, the market has revised the path for 2s lower – resulting into expectation for more steepening in 2s10s.



Source: Citi Research

Figure 14. An investor systematically paying € 2s10s (3mF implementation, rolled and delta hedged on IMM dates) would have incurred a close to 50bp loss as of 20 April, considerably less than the >100bp flattening in the underlying spot curve.



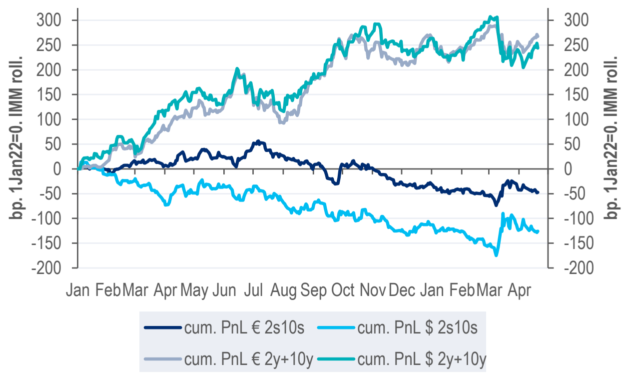
Source: Citi Research

Even in the most recent sample featuring heightened rates volatility, carry has been a key driver of the PnL accrued to an investor systematically steepening € 2s10s: the ~65bp cumulative roll-down since January 2022 partly offset the >100bp flattening move in the underlying spot curve (for a 3mF implementation of the strategy, see **Figure 14**).

The negative carry is not a unique feature of the € swap market, with the 2s10s SOFR curve priced for a ~20bp (~80bp) steepening over the next three (twelve) months. The two curves have indeed co-moved quite tightly, with an estimated daily PnL correlation of 0.68 since January 2022 (still lower than the 0.95% correlation on paying the level of the two curves – **Figure 15**).

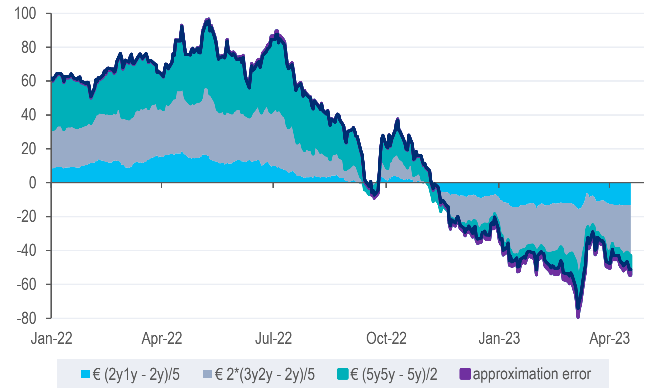
A (roughly) equivalent way of looking at the 2s10s curve is to break it down into three underlying forward curves. In a portfolio of continuously compounded zero rates, we can indeed re-write the 2s10s curve as a sum of three underlying curves. With par rates and discrete compounding, we need to add an approximation error, which in our sample has been less than 1bp on average, with a 1.5bp standard deviation (**Figure 16**).

Figure 15. The PnL co-movement of steepeners in € and $ has been remarkable – but still a third lower than the correlation between outright bearish strategies (that we proxy with a DV01-weighted portfolio of 2s and 10s).



Source: Citi Research

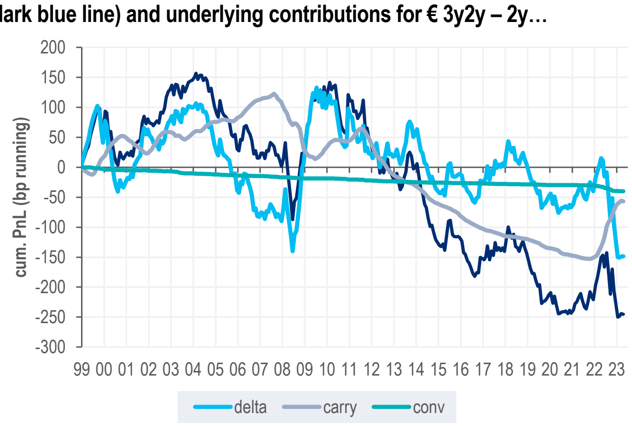
Figure 16. We can approximately re-write any 2s10s curve as a sum of tenor-weighted forward curves. Since January 2022, the two largest contributors to the curve variability have been the (5y5y-5y) curve and – particularly over the last six months – the (3y2y-2y) curve.



Source: Citi Research

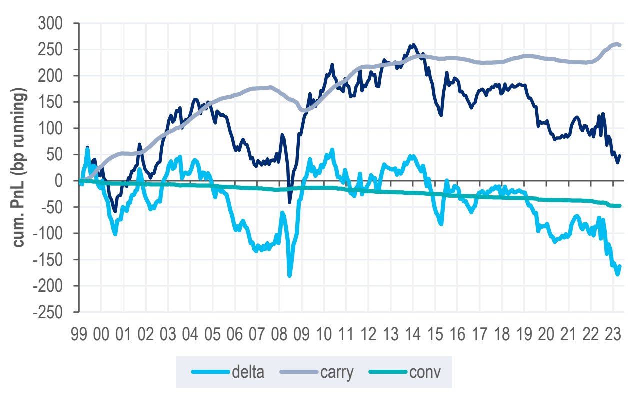
In what follows, we focus on two of the three underlying curves: (i) the 3y market expectation of the 2y rate relative to 2y spot; and (ii) the 5y market expectation of the 5y rate relative to 5y spot. What we like about framing our analysis in terms of these two curves is that they arguably incorporate information about the medium-term (3y2y – 2y) and the longer-term (5y5y – 5y) equilibrium rates expected by the market.

Figure 17. Cumulative PnL of curve steepener with monthly rebalancing (dark blue line) and underlying contributions for € 3y2y – 2y…



Source: Citi Research

Figure 18. … and € 5y5y – 5y.

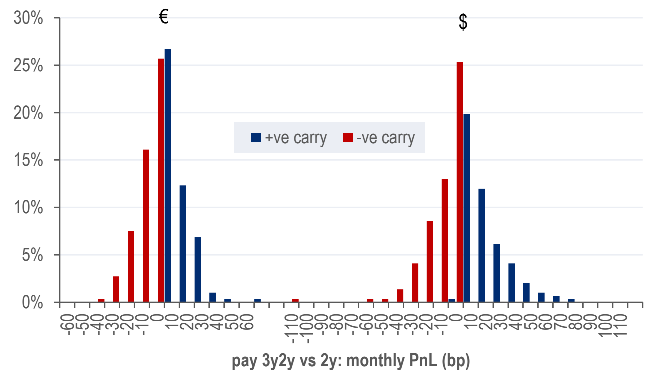


Source: Citi Research

In particular, we look at the historical PnL on a systematic curve paying strategy with monthly (third Wednesday of the month) roll and delta rebalancing of the position since 1999, which allows us to incorporate four hiking cycles for the ECB as well as for the Fed. We highlight three main aspects:

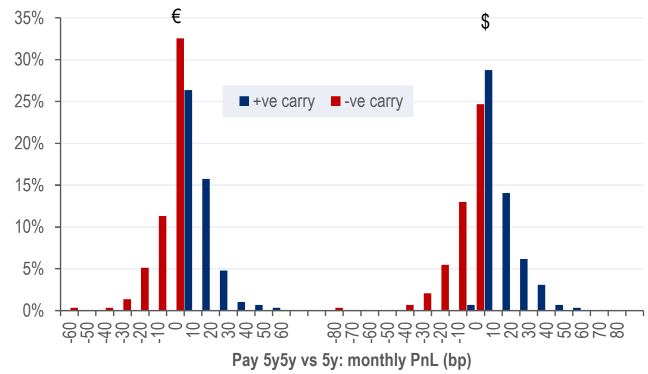
1. Carry has been a key driver for both curves, broadly informing the drift of the cumulative PnLs (**Figure 17** and **Figure 18**). However, harvesting carry in the 5y5y-5y curve has proved considerably more profitable than in 3y2y-2y (15bp annualized vs -2bp), even when normalizing by the PnL realized volatility (which has been roughly the same, around 50bpv). Making money conditional on a negative 1m carry at inception has historically been challenging, as inferred by the distribution of monthly PnLs for both € and $ curves (**Figure 19** and **Figure 20**).

Figure 19. Consistently with the evidence from the historical PnL attribution, we find that the sign of the carry at trade inception has been an accurate predictor of the PnL realized one month later for both € and $ steepeners – when paying 3y2y vs 2y…



Source: Citi Research

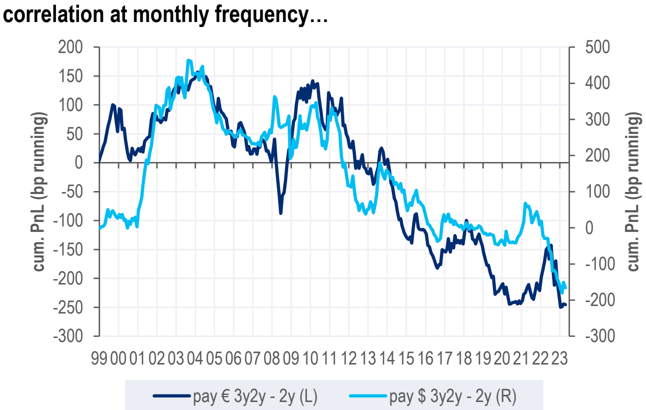
Figure 20. …as well as when paying 5y5y vs 5y.



Source: Citi Research

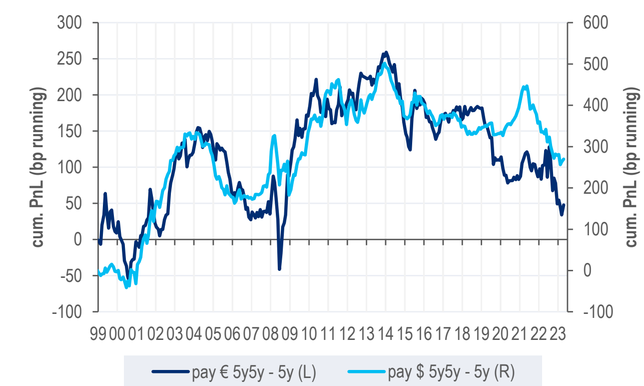
2. The international diversification content of the two strategies has been pretty low, as gauged by the co-movement between € and $ cumulative PnLs (**Figure 21** and **Figure 22**).

Figure 21. The international diversification content of curve trades has historically been low, with € and $ steepeners showing a 0.45 correlation at monthly frequency…



Source: Citi Research

Figure 22. … rising slightly (to 0.49) for 5y5y-5y.

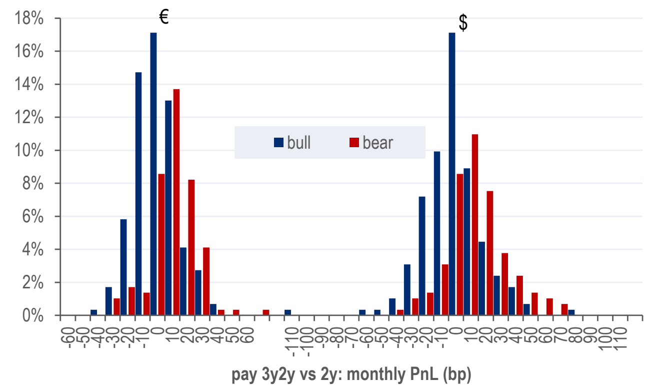


Source: Citi Research

3. The outright direction of € rates has had no clear discriminatory power for the profitability of steepeners (for either curve, for either € or $). In other words, even if we were able to forecast accurately the level of the curve (that we proxy with the average between 2s and 10s rates) in one month time, we wouldn't gain a great deal of predictability about the profitability of curve trades over the same month

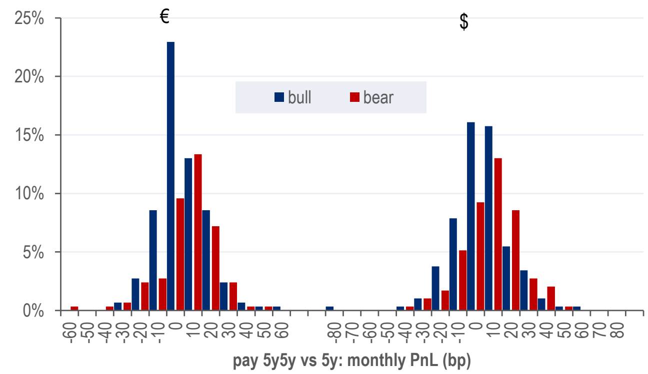
(**Figure 23** and **Figure 24**).

Figure 23. It's not as easy as bull steepeners vs bear flatteners: conditioning on the direction of rates hasn't shown a great deal of discriminatory power relative to profitability of curve trades – if we pay 3y2y vs 2y…



Source: Citi Research

Figure 24. … or 5y5y vs 5y.



Source: Citi Research

Summing up, our analysis has shown that carry at inception has historically been a key driver of the future performance of steepeners, across curves and currencies. A volatile rally is what a steepening proposition in the belly of the € curve would arguably need to overcome the negative carry associated to the trade. Until such catalyst materializes, we'd rather avoid steepeners despite the historically attractive entry levels.

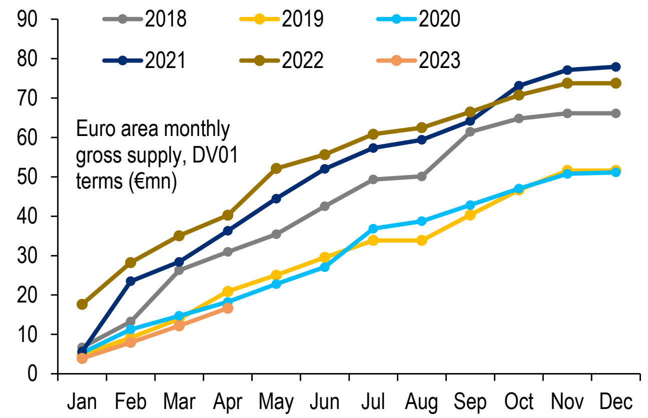
Euro inflation: breakevens at a sweet spot in Europe, and a more fragile one in the UK

Antoine Gaveau

We see little potential for a large fall in breakevens in Europe, which should remain supported by the lack of DV01 supply, perhaps pushing 5y5y back towards 2.6%. The situation feels more fragile in the UK, with data at risk of pushing the BoE into overtightening. That said, as tempting as it is, we refrain from entering RPI shorts, with core UK CPI still due to peak.

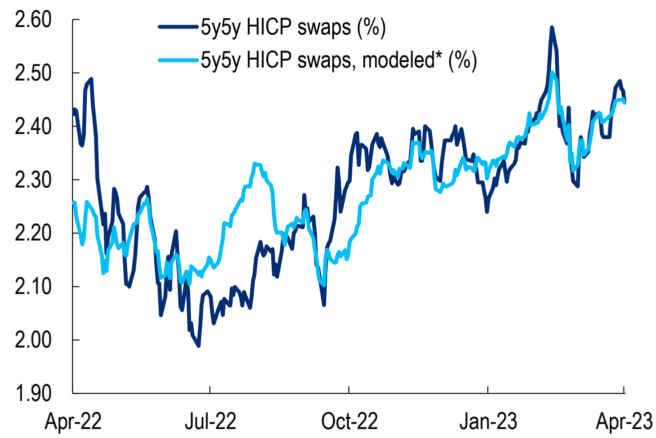
The Euro inflation market is somewhat stabilizing, with 5y5y settling at 2.45% (as of Thursday's close). **We find it more likely than not that those forwards revisit 2.6%, driven by a lack of DV01 supply** – see **Figure 25** updated after Thursday's French auction.

Figure 25. We continue to believe the lack of DV01 supply could drive 5y5y HICP swaps higher…



Note: We assume the Italy Tesoro issues €2.5bn of the new BTPei29 on Friday
Source: Citi Research, National Issuers

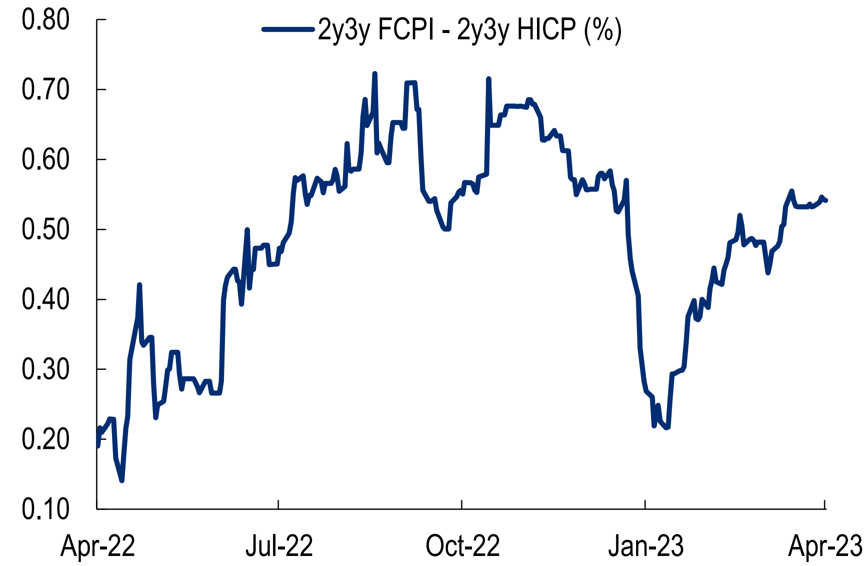
Figure 26. …starting from fair levels on the curve



* 5y5y HICP = 0.61 + 0.00 * SX5E + 0.22 * 5y HICP (roll-adjusted); R-sqr: 57%
Source: Citi Research, Bloomberg, as of 5:30pm CET

As a side note, we highlight that the 2y3y FCPI – HICP spread (a gauge of Livret A premium) is broadly unchanged on the day, despite €802mn of OATi28 supply at Thursday's auction – a sign of DV01 thirst *across* European inflation markets.

Figure 27. OATi28 supply on Thursday was not enough to satiate the demand for FCPI instruments



Source: Citi Research, as of 5:30pm CET

Elsewhere, however, we find it difficult to argue much against current valuations: 1y HICP swaps look only 9bp rich against Citi Economics' baseline forecast, and all short-dated forwards are consistent with the 2% ECB target + some positive premium. Even 5y5y HICP looks fair on our high frequency RV model vs. 5y HICP and SX5E equity prices (a 0.1bp residual – see **Figure 26** above), with Thursday's 2bp selloff most likely driven by the modest macro risk off than the French linker supply, anecdotally well absorbed.

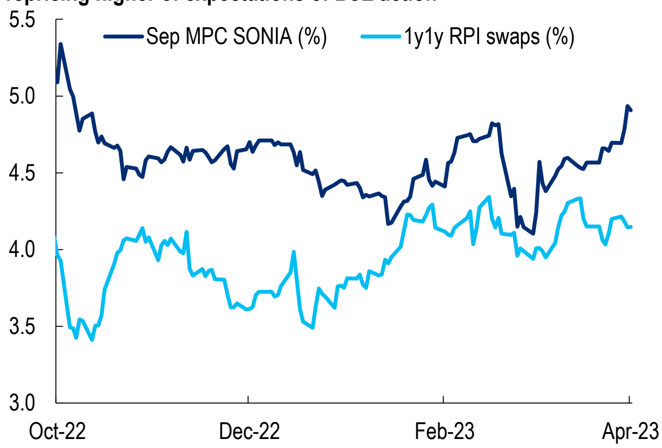
Aside from supply (aforementioned) and oil (whether as an input to the HICP basket, or as a proxy for broad risk-on/risk-off dynamics), we identify two other drivers that could have adversely impacted the inflation market valuations – but we don't think they will.

The first one is the inflation outlook itself. It is *not* near-term bearish, in our view, with Citi Economics seeing upside risks to the April release (HICPxT forecast at 7.15% YY vs. current market valuations of 6.94% YY, as of Thursday's close), and overall modestly cheap valuations until the end of this year. More generally speaking, **the inflation outlook remains confusing**, with the final March HICP print showing worrisome strength in food prices, slowing core goods inflation, and unclear services price inflation trajectory. In our view, such an uncertainty warrants the inflation premium currently priced in, with stickiness on the way down. In particular, **we do not think the market is ready to price in our scenario of a sharp deceleration of inflation below target in 2025**.

The second driver is ECB action. As discussed at length in recent publications, the risk is for breakevens to become negatively *directional* to monetary policy shocks (shifting from away the typical positive *correlation*), with hawkish rhetoric and the associated rise in nominal yields pressuring breakeven lower, and with the combination of higher nominal yields and lower breakevens turbo pushing real yields cheaper. As discussed in yesterday's [Euro inflation monitor](), this is not what we are observing now, with a relative stability of 1y1y HICP swaps in an environment where expectations of ECB action have repriced significantly higher.

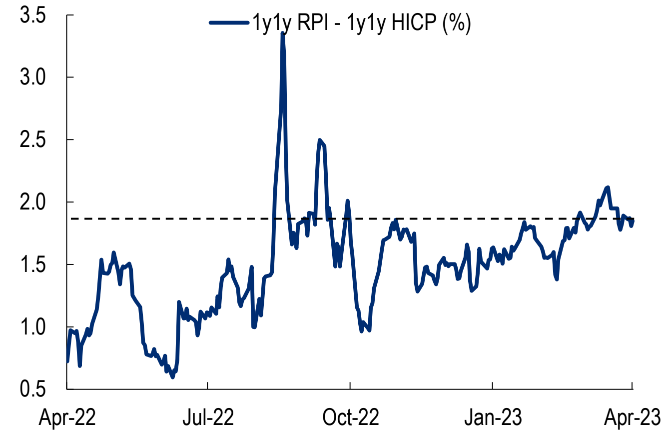
Looking ahead, **we see little likelihood that a ramp up in hawkish rhetoric (June ECB ESTR cheaper) precipitates 1y1y HICP lower** (leaving real yields cheaper). In fact, we are *already* observing the central bank response (June ESTR OIS higher) without significant pressure (1y1y at 2.29% or 2.38% using the previous month's base). **In other words, we see protection against cheaper real yields from the low levels of 1y1y HICP to start with.** We are also at a stage where the ECB GC is looking to fine-tune their response to the macro outlook – see the signposts identified by our economics team into the May meeting, with the base case a *cautious* 25bp.

Figure 28. For now, 1y1y RPI swaps have been resilient to the repricing higher of expectations of BoE action



Source: Citi Research, as of 5:30pm CET

Figure 29. Short positions in 1y1y RPI swaps vs. longs in 1y1y HICP swaps are tempting

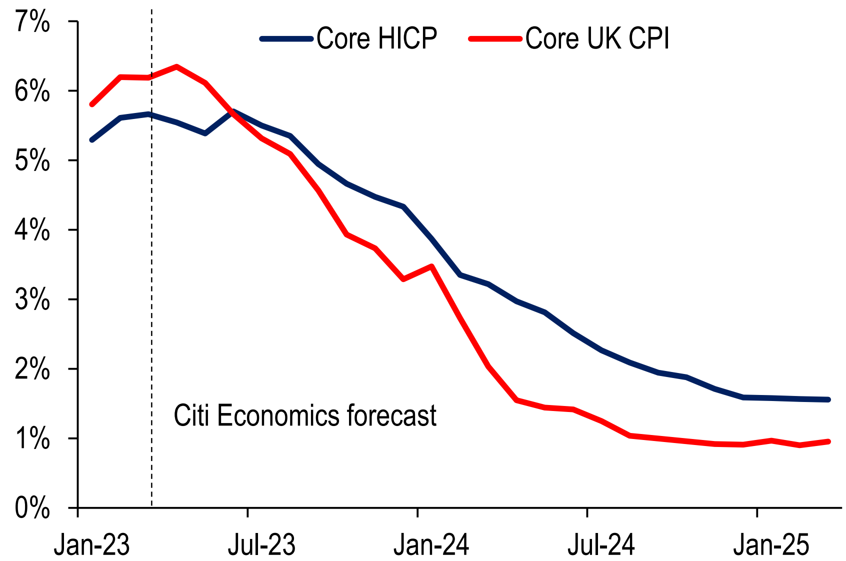


Source: Citi Research, as of 5:30pm CET

The situation feels different on the other side of the Channel. True, there has been a relative stability in 1y1y RPI swaps despite the sharp repricing of expectations of BoE action (**Figure 28**), but **overtightening feels much less distant, amidst an impatient BoE**.

The risk is for BoE action to push 1y1y RPI swaps lower, starting from arguably expensive levels (4.15% as of 5:30pm CET). The trick to play such a scenario, however, is to find the right timing, with short positions in 1y1y RPI swaps very exposed to short covering in a positive macro surprise (frequent, of late). Considering we do not expect a sharp deceleration in core inflation until after the summer, it may be too early to enter shorts, as tempting as it is, especially vs. Euro inflation (**Figure 29**). We also note that our economists expect core UK CPI to rise again in April (**Figure 30**).

Figure 30. Anatomy of a core deceleration



Source: Citi Research

UK – Hold your nerve

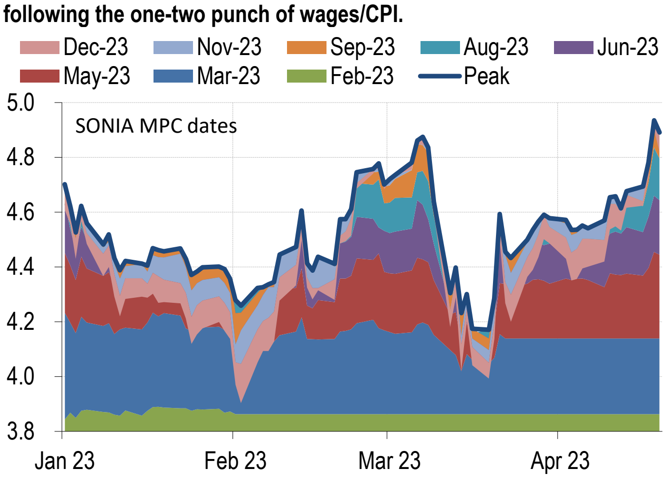
Jamie Searle

This week: (1) The GBP front-end was hit by a one-two punch by wages/CPI, but the medium-term outlook still supports long 1y1y SONIA vs Fed Funds, in our view. (2) The gilt remit is subject to revision on 25 April. Base case is that any change will be minimal. If not, there is asymmetric bullish risk for gilts as any cut in funding, however large, is likely to be met fully by gilts, whereas any larger increase is likely split with Treasury bills.

(1) Holding our nerve after a one-two punch

The one-two punch of upside in wages and CPI this week has hit the front-end and forced a rethink of the house view. Citi Economics now expect two further 25bp rate hikes in May/June (with reacceleration to 50bp unlikely at this stage of the cycle) to a peak of 4.75% (vs old view of 4.25%). The market has already pushed on to a 5% peak, however – **Figure 31** (add around 7bp for Bank Rate inference). We doubt the MPC will offer anything on 11 May capable of out-hawking current terminal rate pricing (especially with this week's sell-off impacting the projections). Moreover, pricing for the May meeting exceeds 25bp (27bp as of 16:45 BST 20Apr23).

Figure 31. Peak pricing for Bank Rate is near 5% (add 7bp to SONIA) following the one-two punch of wages/CPI.



Source: Citi Research. As of 16:00 BST 20Apr23.

Figure 32. The relative pricing for the BoE vs the Fed is too wide in our view. We are encouraged the widening wasn't even greater this week.

Source: Citi Research, Bloomberg. As of 16:00 BST 20Apr23.

The additional premium is understandable given the familiar tale of a peak that is never quite in reach and given near-term upside risk to service price inflation and wages. It is worth noting, however, that 1y1y RPI has not moved that much (see the Inflation section above). **There has to be a point soon where the MPC's reaction function of hindsight** (relying on data reflecting what has just happened) **turns to foresight** (as confidence in the dovish projections returns).

The longer policy is backward-looking, the greater the likelihood of overtightening and the earlier the corrective cuts. To quote the BoE directly on how monetary policy decisions should be taken, *"It can take around two years for monetary policy to have its full effect on the economy. So MPC members need to consider what inflation and growth in the economy are likely to be in the next few years."*

The updated Citi Economics view sticks with rate cuts from this November (six months is a long time in central banking) and negative premium kicks in in MPC dates from December (vs August for the Fed). **The optics will all feel very different when energy base effects kick in** and inflation is falling quickly in H2.

TRADE UPDATE: Stay long 1y1y SONIA vs Fed Funds

Growing overtightening risk may be why the sell-off this week hasn't been even greater. For sure, it has been brutal week for our long in 1y1y SONIA vs Fed Funds (current 75bp as of 16:30 BST 20Apr23), which flipped from a PNL up around 10bp to down over 10bp over two days. The trade has been volatile around entry levels since inception and is yet to sustain a decisive move – **Figure 32**. **We are not inclined to throw in the towel** with SONIA pricing looking peaky and Fed Funds still light (vs the house view of 3x 25bp).

If anything, we take slight encouragement given it hasn't widened significantly more in response to downside in US CPI last week vs upside in UK CPI this week. We opt to hold our nerve and stick with a target of flat for the medium-term.

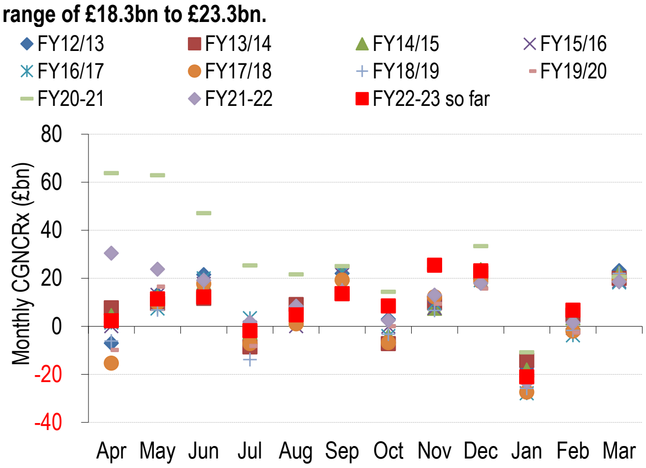
(2) Asymmetric to gilts from the remit revision on 25 April

The new gilt remit of £241.1bn for FY23/24 is due for revision on Tuesday 25 April after the publication of the full-year outturn for CGNCRx in FY22/23. The current financing arithmetic assumes a CGNCRx outturn of £115.4bn for last year creating a carry forward of £21.3bn (reducing this year's funding need).

The cumulative CGNCRx to February totals £86.2bn, meaning the cash need for March needs to be **£29bn to hit the forecast** (which would be the second-highest monthly cash need outside of the pandemic borrowing of FY20-21). The historical average for March is lower at £20.5bn, and the range is tight (£18.3bn to £23.3bn for the 10 years 2013-22) – **Figure 33**. The energy bailouts do make this year different, however. As **Figure 34** shows, since October, the monthly cash need has flipped from below-average to above-average for four months out of five.

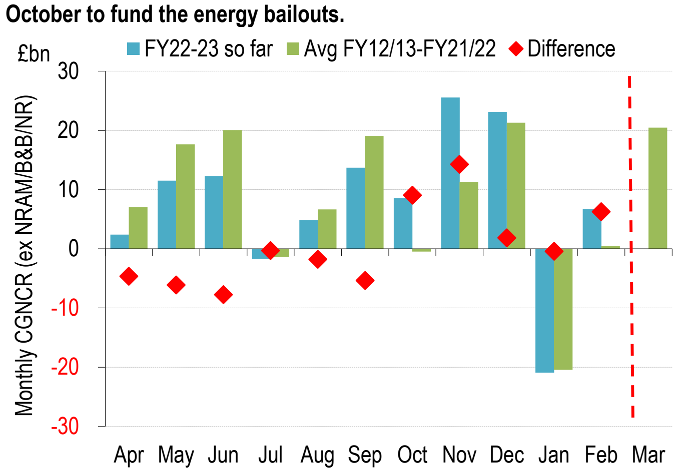
With this in mind, we think **CGNCRx looks on track to meet the OBR's forecasts and prevent much revision**. A downward revision of up to £10bn cannot be ruled out, however, if the usual seasonal transpires. An upward revision is also possible depending on when the energy cash need falls. For example, the OBR's CGNCRx forecast for March was £43.4bn back in November, although gas prices have fallen considerably since (unfortunately a month-by-month forecast update is not available post the Budget in March).

Figure 33. The CGCNRx in March averages £20.5bn 2013-22 with a tight range of £18.3bn to £23.3bn.



Source: Citi Research, ONS.

Figure 34. The CGCNR has flipped from below- to above-average since October to fund the energy bailouts.



Source: Citi Research, ONS.

What about NS&I?

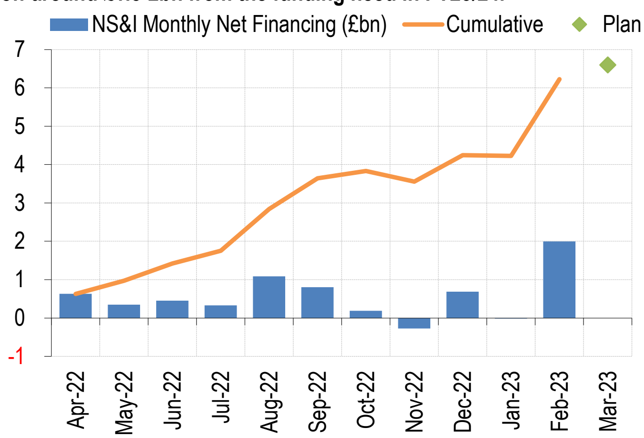
Other tweaks to the carry forward are possible on 25 April from 'other items' and from the **provisional outturn from NS&I** net financing for FY22-23. Inflows into NS&I are picking up following the introduction of new products with higher rates. The +£2bn in February took the cumulative total to £6.2bn in FY22/23 with one month left vs the assumption of £6.6bn (£6.1bn + £0.5bn Green Savings Bonds) in the financing arithmetic – **Figure 35**. The assumption of a similar inflow in March (not due for release until 4 May) would increase the carry forward by £1.6bn. This would therefore likely add to any downward revision to the funding need on 25 April but cushion any increase.

If there is a revision, how will it be met?

Figure 36 shows a history of remit adjustments at the time of the April outturn. There is a bias to meet the revision by adjusting just gilts, leaving Treasury bills unchanged. That was true for both the small tweaks of 2015-19 but also the larger changes of 2020-21. Last year, however, it was split 50:50.

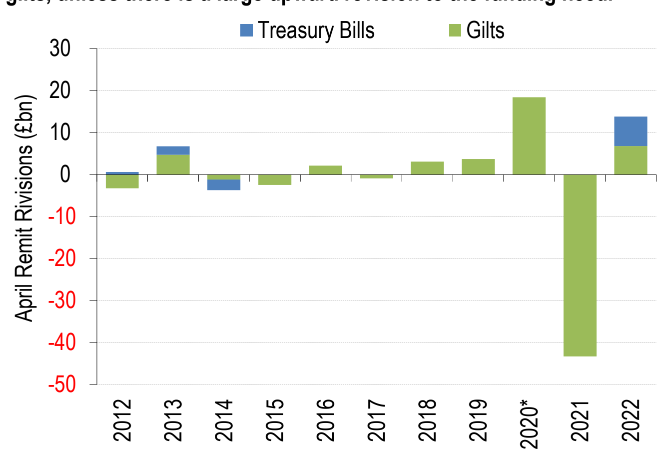
This year, we suspect it will depend on the direction. If there is a downward revision to the net financing need, then we suspect the adjustment will be all in gilts (given there were calls for a larger increase in the Treasury Bill stock in March). If there is a very small upward adjustment, again it may be met again by gilts only, but any larger upward revision (say £3bn+) will likely be split gilts/Treasury bills.

Figure 35. If the NS&I inflow in February is repeated in March, NS&I may exceed the assumption in the financing arithmetic, potentially shaving off around £1.5-2bn from the funding need in FY23/24.



Source: Citi Research, Bankstats, HM Treasury.

Figure 36. There is a historical basis to meet April revisions entirely with gilts, but last year was 50:50. We suspect this year it will be all gilts, unless there is a large upward revision to the funding need.



Source: Citi Research, DMO. *Only reflects revision due to outturn factors (excludes Covid-19 financing)

(Limited) potential market impact

- Base case is that any revision will be small, limiting the market impact. If we are wrong, there is asymmetric bullish risk for gilts as any downward adjustment, however large, is likely to be met entirely by gilts, while if there is a need for materially higher issuance, the burden is likely to be split with bills.
- Any relief for gilts is likely to be short-lived, however, given the bigger picture of relentless issuance pressure likely requiring concession at supply events and weighing on valuations (most notably cheapening gilts vs swaps, in our view).

Tradesheet

Recommended trades

Figure 37. Open Trades

Trade	Entry Date	Entry level	Live[1]	MTM Level[2]	Target	Stop	Carry 3m (bp)	PnL (bp)	Reasonable basis and risks
Sell RX for June delivery in invoice spread against €STR OIS	12-Apr-23	47.0	47.9	47.9	35.0	52		-1	Spreads too rich given collateral/liquidity outlook. Risk: resurgence of financial stability concerns
Pay € 15m1y (vs 3s) in a fly against 3m1y and 27m1y	12-Apr-23	-39.0	-33.7	-31.2	10.0	-55		8	Too much accommodation priced in reds vs greens. Risk: sudden deterioration in risk sentiment.
Receive 1y1y SONIA vs Fed Funds	23-Mar-23	58.0	75.3	72.4	0.0	87		-14	The Fed/BoE path may be more aligned than current pricing. Risk: a credit crunch in the US supercharges Fed cuts.
Buy OAT Nov32 vs PGB Jul32	23-Mar-23	-34.0	-32.8	-32.8	-50.0	-26		-1	Pension reforms OAT-positive, PGB reform dividend waning. Risk: An increase in risk appetite on lower terminal rate pricing.
Sell RAGB Feb32 vs RFGB Sep31	9-Feb-23	6.5	6.5	6.5	16.5	2		0	Fade the richness of 9yr RAGB into supply pressure. Risk: Supply pressure shifting longer.
DSL Jan40-Jul32 steepener vs Bund Jul42-Feb32	9-Feb-23	-10.0	-7.4	-7.4	0.0	-15	0.5	3	20yr core/semi-core rich. DSL supply profile best to fade this Risk: Frequent re-openings of new 10yr DSL.
Pay EUR 10s30s 1yF	3-Feb-23	-46.0	-45.0	-45.0	5.0	-65		1	Position for cross-market convergence. Risk: inflationary shock ahead of March meeting.
Sell gilt Jul27 ASW****	1-Dec-22	-62.5	-40.3	-40.3	-20.0	-60		22	Unprecedented supply, QT, and possible peak for policy rates. Risk: the hiking cycle extends or the pick-up in supply is too
Sell BTP Sep52 vs Bono Oct52	1-Dec-22	50.0	53.0	53.0	75.0	38	-1	2	Correlated to 10yr BTP-Bund with a smaller negative carry. Risk: A benign ECB.
Sell gilt Jul51 vs Jun32***	20-Oct-22	5	41	41	85	25	3	42	10s30s flattening looks overdone vs prospective QT flow Risk: PF demand returns for long-dated gilts amid volatile

Source: Citi Research, Bloomberg. [1] As at 16:30 London 20 April 2023. 1 Trade level if initiated today. 2 The level of our trade marked to market today. Note: Futures trading involves substantial risk of loss. This table does not include trades subject to a restriction. * Stop changed on 19 January. Kept on 3 Feb to effectively become receive Mar MPC SONIA and target/stop changed on 9 February. *** Target/stop revised on 3 February. **** Stop changed on 9 February. *Note: Futures trading involves substantial risk of loss.*

Figure 38. Open Trades

Trade	Entry Date	Entry level	Live[1]	MTM Level[2]	Target	Stop	Carry 3m (bp)	PnL (bp)	Reasonable basis and risks
Sell PGB Oct31 vs Bono Oct31	30-Jun-22	-6.5	-15	-15	8.5	-14.0	0.2	-8	Fundamentals should drive PGBs above Bonos. Risk: heavy Bono supply in H2.

[1]Trade level if initiated today. [2]The level of our trade marked to market today. This table does not include trade ideas subject to a restriction.

Book PnL		57
Closed Trades PnL		464
Total PnL		521
Book 3m carry	3	

Source: Citi Research, Bloomberg. As at 16:30 London 20 April 2023. 1 Trade level if initiated today. 2 The level of our trade marked to market today. Note: Futures trading involves substantial risk of loss. This table does not include trades subject to a restriction.

Recommended and closed trades over the past 12 months

Figure 39. Closed trades

Trade	Close Date	Entry level	Live	Closing MTM Level	Target	Stop	Carry 3m (bp)	PnL (bp)	Reasonable basis and risks
PGB Apr34-Apr27 steepener vs Bono Jul33-Jan27	Hit target 14-Apr-23	7.00	21	21	21	0		14	Attractive entry level to fade PGB outperformance vs Bonos. Risk: Longer Spanish supply.
Buy 3m conditional bear flattener on EUR 10s30s	Trade expired 19-Apr-23	9.75c			20c	4c		-6	Fade bull steepening. Risk: another bout of duration strength.
Buy OE in the snake against DU and RX for M3 delivery	Change of view 13-Apr-23	0.00	-1	-1	9	-4		-1	Tightening swap spread bias. Risk: another bout of risk-off sentiment fueling demand for high-quality paper.
Buy IRISH May33 vs OLO Apr33	Take profit 13-Apr-23	10.00	-14.5	-14.5	-20	4		24	Further outperformance likely on improving fundamentals relative to other EGBs. Risk: Slow supply progress.
Short 50% risk in 1y HICP swaps (Dec fixings) vs. 100% risk in paid pos	Take profit 13-Apr-23	130.30	149.3	149.3	170	110		19	Position for a repricing lower in 1y HICP swaps. Risks include commodity price moves and financial stability.
Sell Bono Oct24 vs OAT Nov24	Hit target 17-Mar-23	3.00	20.0	20.0	20	-5	-0.9	16	Overdone EGB tightening, especially in the front-end, led by Bonos and PGBs. Risk: Domestic MFIs continue to buy Bonos.
OLO Mar41-Apr33 steepener vs RAGB Oct40-Feb32	Take profit 30-Mar-23	10.50	21	21	25	4		11	Decoupling looks unsustainable. Risk: Large 30yr RAGB supply.
Sell BTP Sep52 YYS	Take profit 30-Mar-23	171.50	187	187	210	152		15	Supply trade and could underperform BTP-Bund on beta. Risk: A less hawkish ECB.
ERM3-ERH4 flatteners	Hit revised stop 30-Mar-23	24.00	-10	-10	-35	-10		34	Position for further inversion of the curve. Risks include premium build-up, Fed pricing.
Short 2y3y HICP swaps	Take profit 14-Mar-23	2.67	2.30	2.30	2.27	2.47		37	Tactically position for retracement. Risks include dovish ECB, and market positioning.
Receive May23 MPC SONIA vs ECB €STR	Hit stop 14-Mar-23	107	121	121	78	121		-14	BoE far more likely to disappoint market pricing. Risk - ECB signals a downshift to 25bp in May.
Feb/Mar MPC SONIA flattener	Take profit 14-Mar-23	35	17	17	0	30		18	MPC is likely to reach terminal rate by slowing to increments of 25bp in 2022. Risk: new inflation risk that maintains larger increments as MPC front-loads.
Sell RX invoice spread for June delivery	Hit revised stop 14-Mar-23	72	67	67	45	67		5	More collateral and less liquidity. Risk: risk-off increasing demand for German paper.
Pay 2s5s10s 3mF	Change of view 9-Mar-23	-32	-34	-34	0	-40		-2	Monetize a tighter-for-longer scenario. Risk: Sudden deterioration in macro backdrop
Pay June23 ECB ESTR and go short 1y1y HICP swaps	Take profit 8-Mar-23	87	111	111	120	70		24	Position for higher ECB tightening expectations or lower 1y1y HICP swaps. Risks include inflation market positioning.
1y/1y1y HICP curve flatteners	Hit target 24-Feb-23	-4	-34	-34	-34			30	Position for a more pronounced inversion of the HICP curve. Risks include a large fall in commodity (oil) prices.
Sell Bund Jul42-OAT Jun44-Bono Jul42 PCA fly (0.33:1:0.66)	Take profit 23-Feb-23	-17	-15	-15	0	-27		2	Rich semi-core, with green supply pressure on 15/20yr sector Risk: France's less reliance on imported gas reduces fiscal measures needed
Buy IKH3 115 put and sell 120 call	Hit target 16-Feb-23	0	118	118	118	121		14	Exaggerated EGB reaction to February ECB Risk: Further rally on German inflation downside surprise.
3m 2s10s conditional bear steepener	Take profit 16-Feb-2023	-27	-50	-50	10	-40		11	Fading recent bull flattening. Risk: year-end duration rally.
5y5y/10y10y HICP curve flatteners	Take profit 9-Feb-2023	30	24	24	20	35		6	RV and way to express low-beta bullish view. Risks: change in directionality and large breakeven selloff.
Sell EU Jun28 versus swaps	Hit target 16-Jan-23	-28	-10	-10	-10	-35		18	Rich valuation of 5-7yr EU with supply risk ahead. Risk: Further widening in EGB swap spreads
Short 5y5y FCPI swaps vs. HICP swaps	Take profit 5-Jan-23	54	45	45	34	64		10	Position for a normalization in the 5y5y cross-market spread. Main risks include strong Livret A hedging flows, limited OATi supply.
Long 10y10y RPI swaps	Take profit 5-Jan-23	300	321	321	340	280		21	Position for a retracement higher in 10y10y RPI swaps, with limited supply ahead and a fast unwinding of BoE purchases. Risks include LDI positioning.
Receive 3m FRA/EST for March 2023	Take profit 5-Jan-23	13	7	7	5	17		6	Too wide relative to the expected level of excess liquidity. Risk: large TLTRO repayment in December.
RX/UB invoice spread steepener	Hit stop 5-Jan-23	-27	-40	-40	0	-40		-13	Monetizes expected decrease in realized and implied volatility. Risk: risk-off fueling demand for convexity.
Buy FINNVE Apr26 vs OSEOFI May26 (on ASW)	Hit target 6-Jan-23	24	0	0	0	50	1.8	29	French agencies are currently fundamentally rich on a cross-market basis Risk: Widening of EGB swap spreads.
Buy NRWBK Nov25 vs AGFRNC Mar25s (on ASW)	Hit target 6-Jan-23	22	0	0	0	50	0.5	24	French agencies are currently fundamentally rich on a cross-market basis Risk: Widening of EGB swap spreads, increased supply by NRWBK.
Sell OAT Nov30 vs OLO Jun30	Hit stop 15-Dec-22	2	-3	-3	12	-3		-5	10yr OATs rich, OLOs cheap on PCA. Risk: liquidity premium supports OATs.
Long OATei31 breakevens vs. short 9y HICP swaps*	Hit revised stop 15-Dec-22	39	34	34	29	34		5	Position for a retracement in IOTAs going into year-end. Risk: further cheapening into supply.
Z2 FRA/€STR tightener	Take profit 8-Dec-22	6	2	2	-1	12		5	Historically Dec contract has generally over-estimated future spot realization. Risk: larger-than-expected TLTRO repayments.
Sell DU for December delivery against €STR	Change of view 8-Dec-22	59	62	62	45	70		-3	Collateral scarcity backdrop has already started turning. Risk: front-end led selloff in core € rates increasing demand to borrow Schatz.
Buy 3m2y ATMF payer vs 3m10y ATMF payer	Take profit 1-Dec-22	-2	-26	-26	-40	20		5	ECB takes depo into restrictive territory. Risk: ECB stops hiking on sovereign fragmentation concerns.
Sell Bono Oct50 vs OLO Jun50	Take profit 1-Dec-22	46	48	48	66	36	-0.2	2	Fading the recent EGB spread tightening with an RV overlay & small negative carry. Risk: Downward revision in Bono funding target for 2022.
OAT May52-May36 steepener vs DSL Jan52-Jan38 flattener	Take profit 1-Dec-22	20	23	23	35	13	2.5	6	30yr OATs look rich into September supply while DSLs look well priced. Risk: Liquidity risk premium supports OATs.
BTP Sep52-Dec32 flattener vs swaps	Change of view 1-Dec-22	-50	-56	-56	-20	-65	-3.0	-9	We expect decoupling with 10yr BTP-Bund to be short-lived. Risk: Further flattening in the swap curve extends this decoupling.
Bono Jan27-Bobl Oct27 widener vs 2x OLO Oct27-Bobl Oct27 tightener	Take profit 1-Dec-22	-12	5	5	10	-23	0.5	17	Bonos look rich & might not find relief from a loans-only joint issuance program. Risk: Thin liquidity delays the correction.
BTP Aug27-Bund Aug27 widener vs OAT May27-Bund Aug27 tightener	Take profit 1-Dec-22	-97	-89	-89	0	-146	0.9	9	Italian political risk resurfacing while BTPs look rich vs OATs. Risk: ECB anti-fragmentation tool surprises on the upside.

Note: Futures trading involves substantial risk of loss.

Source: Citi Research

Figure 40. Closed trades (continued)

Trade	Close Date	Entry level	Live	Closing MTM Level	Target	Stop	Carry 3m (bp)	PnL (bp)	Reasonable basis and risks
OAT May53-May32 steepener vs Bund Aug52-Feb32	Take profit 1-Dec-22	31	38	38	45	24	1.2	11	10s30s OAT likely to steepen on EGB spread widening. Risk: 10yr remains the high beta point.
Buy OKB Oct26 vs OSEOFI May26 (on ASW)	Hit target 11-Nov-22	25	0	0	0	50	0.8	26	French agencies are currently fundamentally rich on a cross-market basis Risk: Widening of EGB swap spreads.
Short 5y5y HICP swaps	Change of view 9-Nov-22	2.323	2.359	2.359	2.050	2.460		-4	Play continuous breakeven volatility, starting from expensive levels on RV. Risk: real yield buying flows remain strong.
€ 3m2y receiver ladder	Trade expired 21-Oct-22	162	285	285	137	77		0	Take advantage of the rich vol and receiver skew. Risk: volatile rally where delta and vega perform in sync.
Pay SOFR 2s5s and receive €STR 2s5s	Change of view 13-Oct-22	-63	-64	-52	-30	-75		11	Position for curve convergence. Risk: bear flattening of the SOFR curve.
Buy NEDFIN Apr27 vs DSL Jul27	Hit stop 30-Sep-22	54	69	69	42	69	2.9	-8	2-5y € SSAs priced versus swaps look historically attractive versus EGBs. Risk: Significant further widening of Bund swap spreads
Sell gilt Oct50 ASW (vs SONIA)**	Hit revised stop 28-Sep-22	26	35	35	70	35		9	Year-end ASW richness is likely to fade over 2022 as QE ends. Risk: Market conditions richen ASW further.
Receive € 5s30s 3mF (vs 6s)	Hit target 26-Sep-22	-51	-90	-90	-90	-50		40	Real rate premium keeps increasing Risk: Deterioration in economic data leading to hike premium compression.
Buy RAGB Mar51 vs OLO Jun50 and Bund Aug52	Hit stop 6-Sep-22	37	48	48	15	48		-11	Best trailing risk-reward ratio in EGBs. Risk: Austria's exposure to Russian gas.
Pay 10s30s € swaps, 1yF	Hit stop 21-Sep-22	-41	-72	-60	0	-60		-20	Rationale: vol repricing lower. Risk: further cheapening in ER reds.
Pay Oct22 ECB €STR	Take profit 21-Sep-22	1.157	1.370	1.370	1.419	1.026		21	Position for the possibility of two 75bp hikes over the next 2 ECB meetings. Risks include a 50bp delivery and/or deteriorating macro backdrop.
IRISH May50-Oct31 flattener vs OAT May52-Nov31 steepener	Hit stop 15-Sep-22	-4	4	4	-20	4	0.3	-8	IRISH curve looks too steep based on its debt/GDP ratio. Risk: Liquidity premium in OATs.
Buy RX vs 6s and sell UB vs 6s (both for September delivery)	Take profit 8-Sep-22	-36	-41	-41	-42	-30		6	Partially hedge our strategic € long-end steepening bias. Risk: abrupt selloff in € gamma.
Buy 1x2 costless 6m2y receiver spread	Trade expired 5-Sep-22	23	245	245	-1	-34		0	Taking advantage of the elevated € vol levels. Risk: sustained rally in 2y rate coupled with higher vol.
Long October 2022 HICPxT	Hit stop 7-Sep-22	10	9	9	11	9		-42	We find the October fixing too low. Risk: large (and fast) government intervention.
Long 2y3y HICP swaps	Hit revised stop 31-Aug-22	1.91	2.02	2.00	2.20	2.00		9	Potential for an RV correction Risk: a deterioration of the growth outlook.
Receive Dec-22 3m FRA/€STR OIS vs pay Dec-23	Hit target 30-Aug-22	1.30	10.00	10.00	10.00	-3.00		9	Expected drop in excess liquidity in June 2023. Risk: New round of TLTROs aimed at avoiding a liquidity cliff edge in June 2023.
Receive 1y1y SONIA vs Fed Funds	Hit revised stop 19-Aug-22	8.70	31.86	0.00	-150.00	0.00		9	Market is pricing too fast a cycle for the BoE and not fast enough for the Fed. Risk: Much earlier BoE lift-off maintains hawkish SONIA pricing.
Pay € 2s5s, 12mF and receive € 2s5s, 6mF	Take profit 4-Aug-22	13.50	6.23	0.20	-10.00	20.00		13	Position for flatter 2s5s. Risk: Normalization pace slows down
Buy BPCECB Sep25 vs FRTR May25	Hit stop 4-Aug-22	48.00	65.00	65.00	35.00	65.00	5.7	-7	Short-dated covered bonds look historically attractive versus govvies. Risk: Significant further widening of Bund swap spreads
Receive Aug22 MPC SONIA	Change of view 4-Aug-22	1.66	1.69	1.69	1.44	1.75		-3	Heavily priced for 50bp despite it not being 'locked in'. Risk: 50bp delivered or a huge surprise like 75bp.
Buy NEDWBKJun24 vs DSL Jul24	Hit stop 28-Jul-22	50	70	70	35	70	11.2	0	2-5y € SSAs priced versus swaps look historically attractive versus EGBs. Risk: Significant further widening of Bund swap spreads
Buy TD Jun25 vs FRTR May25	Hit stop 21-Jul-22	52	68	68	40	68	7.3	-3	Short-dated covered bonds look historically attractive versus govvies. Risk: Significant further widening of Bund swap spreads
Buy ASFING Oct24 vs RAGB Oct24	Hit stop 14-Jul-22	52	68	68	40	68		-16	2-5y € SSAs priced versus swaps look historically attractive versus EGBs. Risk: Significant further widening of Bund swap spreads
Buy HVB May29 vs DBR Aug29	Hit stop 7-Jul-22	77	90	90	65	90		-13	5-7y covered bonds are historically attractive versus EGBs. Risk: Further widening of Bund swap spreads from historically elevated levels.
Long 10y10y US CPI swaps vs. 10y10y HICP swaps	Hit stop 7-Jul-22	0.14	-0.08	-0.10	0.32	-0.10		-24	Cross-market spread at stretched levels historically. Risk: US CPI swaps de-anchor from the 2% target, Euro area inflation optimism.
Sell BTP Sep51 vs OAT May52	Hit revised stop 17-Jun-22	108	121	121	160	121	-2.0	11	BTP-OAT decoupling vs BTP-Bund is unlikely to persist. Risk: The spread doesn't move and the small negative carry accumulates.
Sell OLO Jun25 vs DSL Jul25	Hit target 13/06/2022	0	10	10	10	-5	0.3	10	The spread looks fundamentally rich and might cheapen into French election Risk: Continued weakness in Bunds sustains EGB spread compression.
Long 5y5y HICP swaps	Change of view 9-June-22	2.11	2.27	2.27	2.35	1.99		16	Lagging short-end-driven rally in breakevens and equity prices. Risk: sharp deterioration of the growth outlook
Pay July ECB meeting	Change of view 9-June-22	-42	-28	-28	-20	-48		15	Position for further hawkishness on APP end. Risk: dovish turn at next week's meeting, with focus more to the risk to growth
Sell ER H3 vs H4	Hit stop 1-Jun-22	38	50	50	10	50		-12	US/UK data deterioration spreads to EA business sentiment. Risk: Continued resilience in EA business sentiment.
Pay Z2 FRA/€STR vs H3	Change of view 25-May-22	5	3	3	1	7		2	Pricing inconsistent with projected excess liquidity backdrop. Risk: dovish ECB turn.
Buy ER for September 2024 delivery against September 2023	Change of view 25-May-22	5.5	2.5	2.5	-7	18		3	Fade steepness of ER strip relative to ED. Risk: an improvement in the macro backdrop in the EA and / or US.
Short 5y FCPIxT swaps vs. long 5y HICPxT swaps	Hit revised stop 25-May-22	26	11	11	-20	11		15	We expect a fundamentals-driven correction. Risk: further Livret A flows, hedging demand moves shorter on the curve.
Receive Sep22 ECB €STR vs pay Oct22	Change of view 19-May-22	8	21	21	25	0		13	APP is more likely to end at quarter-end with lift-off shortly after. Risk: ECB only commits to APP for one more quarter in March.
Buy OLO Jun37 vs Bund May35 and Bono Jul35	Hit stop 12-May-2022	33	40	40	20	40		-7	Semi-core outperformance on less punitive net supply from May/ election risk gone. Risk: French legislative election upset causes semi-core contagion.
Sell RAGB Oct40 on a fly with Feb31 and Mar51	Hit target 26-Apr-2022	22	32	32	32	17	0.7	11	Heavy increase expected in 15-20yr supply in February and March Risk: Continued flattening in correlated 10s30s
Sell OAT May30 vs RAGB Feb30	Change of view 25-Apr-22	-5	-6	-6	6	-10		-2	OATs could underperform vs RAGBs if Macron's poll lead erodes further. Risk: Net supply support for OATs in April.
Sell OAT May36 YYS	Change of view 25-Apr-22	-15	-19	-19	0	-23		-4	OATs look rich given election risk, ECB QE withdrawal and heavy long-end supply. Risk: Duration sell-off on global cues.
Long 3y HICP swaps	Hit stop 26-Apr-2022	3.99	3.84	3.84	4.29	3.84		-15	Potential for short-end of € breakeven curve to stay well supported. Risk: downward moves in commodity prices.

Note: Futures trading involves substantial risk of loss.

Source: Citi Research

Auction calendar for next 4 weeks

Figure 41. Auction calendar for the next four weeks (provisional): gross issuance (local currency, billions) and DV01 (USD million/bp)

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYM3 (UST)	G M3 (Gilt)	RXM3 (Bund)
24 Apr (Mon)	Belgium	2.75	OLO 0.8% Jun28, 3% Jun33 and 3.3% Jun54 (issue confirmed, estimated size)				19k
25 Apr (Tue)	Germany	6.0	New Schatz Jun25 (issue and size confirmed)				10k
25 Apr (Tue)	UK	3.0	Syndicated new 15-25yr IL (w/c 24 April, estimated size)			87k	
25 Apr (Tue)	US	42.0	2-Year		137k		
26 Apr (Wed)	Germany	2.5	Bund 4% Jan37 and 1% May38 (issue and size confirmed)				24k
26 Apr (Wed)	US	43.0	5-Year		306k		
27 Apr (Thu)	Italy	8.5	5yr and 10yr BTPs (date confirmed, estimated size)				45k
27 Apr (Thu)	Italy	5.0	CCTeu (date confirmed, estimated size)				7k
27 Apr (Thu)	US	35.0	7-Year		341k		
			Weekly $DV01 of Issuance	**81.7**			
			Total Number of Futures Contracts		**862k**	**87k**	**105k**

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYM3 (UST)	G M3 (Gilt)	RXM3 (Bund)
02 May (Tue)	Germany	0.7	Bundei (date confirmed, estimated size)				6k
03 May (Wed)	Germany	3.0	Bund 2.1% Nov29 (issue and size confirmed)				16k
03 May (Wed)	UK	4.0	3.5% Treasury gilt 2025 (issue confirmed, estimated size)			9k	
04 May (Thu)	France	10.0	>8.5yr OATs (date confirmed, estimated size)				86k
04 May (Thu)	Spain	5.5	Bonos (date confirmed, estimated size)				24k
04 May (Thu)	Spain	0.7	SPGBei (date confirmed, estimated size)				6k
			Weekly $DV01 of Issuance	**18.1**			
			Total Number of Futures Contracts		**0k**	**9k**	**137k**

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYM3 (UST)	G M3 (Gilt)	RXM3 (Bund)
09 May (Tue)	Austria	1.5	RAGBs (date confirmed, estimated size)				10k
09 May (Tue)	Germany	5.0	Bobl 2.2% Apr28 (issue and size confirmed)				20k
09 May (Tue)	US	40.0	3-Year		131k		
10 May (Wed)	Germany	2.5	30yr Bunds (date and size confirmed)				42k
10 May (Wed)	UK	3.5	3.25% Treasury gilt 2033 (issue confirmed, estimated size)			33k	
10 May (Wed)	US	35.0	10-Year		473k		
11 May (Thu)	Italy	8.5	3/7/>15yr BTPs (estimated tenors and size)				42k
11 May (Thu)	US	21.0	30-Year		647k		
			Weekly $DV01 of Issuance	**102.3**			
			Total Number of Futures Contracts		**1251k**	**33k**	**115k**

Date	Country	Nominal Size (Local Ccy, bn)	Issue Details	DV01 $million/bp	Approx. Number 10yr Futures TYM3 (UST)	G M3 (Gilt)	RXM3 (Bund)
16 May (Tue)	Finland	1.0	RFGBs (date confirmed, estimated size)				5k
16 May (Tue)	UK	4.5	Syndicated long new 40yr (w/c 15 May, estimated size)			99k	
17 May (Wed)	France	12.0	2-8.5yr OATs (date confirmed, estimated size)				43k
17 May (Wed)	France	2.0	OATei/i (date confirmed, estimated size)				16k
17 May (Wed)	Germany	4.0	Bund 2.3% Feb33 (issue and size confirmed)				30k
17 May (Wed)	Greece	0.5	GGB (date confirmed, estimated size)				3k
17 May (Wed)	UK	4.0	4.125% Treasury gilt 2027 (issue confirmed, estimated size)			20k	
17 May (Wed)	US	15.0	20-Year		354k		
18 May (Thu)	Spain	6.5	Bonos (date confirmed, estimated size)				43k
18 May (Thu)	US	15.0	10-Year TIPS (re-opening)		203k		
			Weekly $DV01 of Issuance	**69.5**			
			Total Number of Futures Contracts		**558k**	**119k**	**140k**

Source: DMOs, Citi Research. *For EGBs, estimated auction sizes include non-competitive allocations and might exceed announced ranges. The table might be incomplete due to legal reasons.*

NB: Futures trading involves substantial risk of loss.

European rates forecasts

As published in *Global Economic Outlook & Strategy*, 19th April.

Figure 42. Interest Rate and Bond Market Forecasts (quarterly average unless specified)

Euro Area	As at 19 Apr	Current	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
Policy Rate End Quarter	3.50%	3.50%	3.50%	4.00%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%
Depo Rate End Quarter	3.00%	3.00%	3.00%	3.50%	4.00%	4.00%	4.00%	4.00%	3.75%	3.50%
Overnight Rate (€STR)	2.90%	2.90%	2.90%	3.41%	3.92%	3.93%	3.95%	3.96%	3.72%	3.47%
3-Month (Euribor)	3.22%	3.21%	3.10%	3.65%	4.15%	4.05%	4.00%	3.90%	3.66%	3.50%
2 Year Schatz Yield	2.88%	2.89%	2.74%	3.00%	2.85%	2.50%	2.25%	2.15%	2.15%	2.00%
5 Year Bobl Yield	2.50%	2.49%	2.39%	2.55%	2.45%	2.25%	1.95%	1.90%	1.90%	1.80%
10 Year Bund Yield	2.47%	2.45%	2.34%	2.50%	2.45%	2.25%	2.00%	2.00%	2.00%	2.00%
30 Year Bund Yield	2.55%	2.51%	2.32%	2.60%	2.60%	2.50%	2.35%	2.35%	2.35%	2.35%
2-10 Year Bund Curve	-41	-45	-40	-50	-40	-25	-25	-15	-15	0
10 Year BTP-Bund Spread	181	187	190	195	220	220	220	225	225	225
10 Year Bono-Bund Spread	102	103	103	105	108	108	108	110	110	110
10 Year OAT-Bund Spread	46	56	49	58	60	60	65	65	65	65
10 Year Swap Spread (Swap Less Govt.), bp	62	65	61	55	45	40	35	35	30	30
10 Year Breakeven Inflation	244	239	223	240	240	220	220	220	220	220
5y5y Implied vol	97	96	95	90	80	70	65	60	60	60
UK	**As at 19 Apr**	**Current**	**Q1 23**	**Q2 23**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**	**Q3 24**	**Q4 24**
Policy Rate	4.25%	4.25%	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.00
3-Month SONIA	4.38%	4.47%	4.06	4.20	4.15	3.95	3.70	3.45	3.20	2.95
2 Year Treasury Yield	3.61%	3.72%	3.54	3.35	3.10	2.85	2.60	2.60	2.50	2.30
5 Year Treasury Yield	3.51%	3.62%	3.37	3.35	3.15	2.90	2.75	2.75	2.75	2.65
10 Year Treasury Yield	3.69%	3.76%	3.47	3.45	3.25	3.05	2.90	2.90	2.90	2.80
30 Year Treasury Yield	4.05%	4.10%	3.85	3.95	3.85	3.65	3.55	3.55	3.55	3.45
2-10 Year Treasury Curve	8	4	-7	10	15	20	30	30	40	50
10 Year Swap Spread (Swap Less Govt.), bp	-10	-9	1	-5	-15	-30	-30	-30	-30	-30
10 Year Breakeven Inflation	364	359	342	345	325	325	325	300	280	280
Scandis	**As at 19 Apr**	**Current**	**Q1 23**	**Q2 23**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**	**Q3 24**	**Q4 24**
10 Year Switzerland Yield	1.11	1.06	1.30	1.50	1.75	1.50	1.25	1.00	0.75	0.75
10 Year Sweden Yield	2.50	2.46	2.30	2.35	2.20	2.00	2.00	2.00	2.00	2.00
10 Year Norway Yield	3.22	3.17	3.10	3.00	2.85	2.70	2.50	2.50	2.25	2.25

As at 16:30 20 April 2023. *NB: Futures trading involves substantial risk of loss*

Source: Citi Research

Figure 43. 10yr Year Yield Spread Forecasts (Period Average), (Basis Points)

	As at 19 Apr	Current	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24
France	55	56	49	58	60	60	65	65	65	65
Italy	184	187	190	195	220	220	220	225	225	225
Spain	103	104	103	105	108	108	108	110	110	110
Netherlands	36	36	32	35	35	35	35	35	35	35
Belgium	67	68	65	65	67	65	70	70	70	70
Austria	63	63	63	60	60	60	62	62	62	62
Finland	56	56	54	55	60	60	62	62	62	62
Ireland	39	41	46	45	45	50	50	50	50	50
Portugal	83	84	89	90	100	100	100	110	110	110
Greece	180	184	194	205	235	240	250	255	255	255

As at 16:30 20 April 2023.

Source: Citi Research

Summary of Recent Publications

Date	Publication	Topic	Region
19-Apr-23	NOTE	Euro inflation monitor: Revising higher again	EUR
18-Apr-23	NOTE	EMU Month-End Index Projections - Month-end supportive for OATs	EUR
13-Apr-23	Rates Weekly	Duration (€/£) – mildly bearish Bunds	Global
		€ curve: bearish bias	EUR
		€ swap spreads: Tighter, despite the reduction in govt. deposits remuneration	EUR
		EGBs – Bearish semi-core, range-bound periphery for the spring	EUR
		Euro inflation: Off balance?	EUR
13-Apr-23	NOTE	Weekly Supply Monitor - Euro, US and UK Supply Outlook	Global
6-Apr-23	NOTE	Weekly Supply Monitor - Euro, US and UK Supply Outlook	Global
6-Apr-23	NOTE	Euro inflation monitor: Core will slow, but just not yet	EUR
31-Mar-23	NOTE	Weekly Supply Monitor - Euro, US and UK Supply Outlook	Global
30-Mar-23	Rates Weekly	Will EGB resilience to supply persist in Q2?	EUR
		UK – caught in limbo into the new fiscal year	UK
		Euro inflation: back to centre stage	EUR
28-Mar-23	NOTE	EGB Supply Monthly - Net cash requirement neutral for EGBs	EUR
23-Mar-23	Rates Weekly	ECB's cycle: same length, lower end point?	EUR
		UK – are we nearly there yet?	UK
		EGBs – fading the OAT underperformance on pension reforms	EUR
		€ front-end: not time to sell DU/€STR yet	EUR
22-Mar-23	NOTE	French Pension Reform Passed, Political Divides Widened	EUR
17-Mar-23	NOTE	Rates Vol Lab - Historic repricing's lingering effects	Global
17-Mar-23	NOTE	Weekly Supply Monitor - Euro, US and UK Supply Outlook	Global
17-Mar-23	NOTE	Euro inflation monitor: short 1y HICP swaps hedged with June ECB ESTR	EUR
16-Mar-23	Rates Weekly	ECB – mindful of history	EUR
		ECB: lost in transmission?	EUR
		Inflation: attempt shorts in 1y HICP swaps (50% risk) hedged with paid June ECB ESTR positions	EUR
		EGBs – could banking turmoil be the catalyst for widening ahead?	EUR
		UK – Tipping the balance	UK
15-Mar-23	NOTE	Could banking turmoil be the catalyst for EGB widening?	EUR

All pricing in the publication as of close today unless otherwise specified.

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Appendix A-1

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