



EUR rates: Tactical long Bund

TRADE: Enter long Bund now at 2.32% Stop: 2.50% Target 2.00% Carry & roll: -0.6bp/m. Size: 15k/01.

The US-led rates sell-off has pushed Bund yields well above fair value. With the start of the new maintenance period, the fair value is dropping to 2%, while the mid-point between the FV and the upper bound (usually a level followed by a correction to the downside) is dropping to 2.30%, roughly where Bund yields are (2.57% being the upper bound). Our 3m-z-score is also in excess of 2, suggesting now maybe a good time to buy.

The main risk to longs is the march to the US election and US price action. Already the US rates sell-off has spilled over to DM rates. But US rates were still trading rich early in October, so a US rates sell-off was justified considering not only the market's U-turn on the economy but also the rising odds of a Trump presidency.

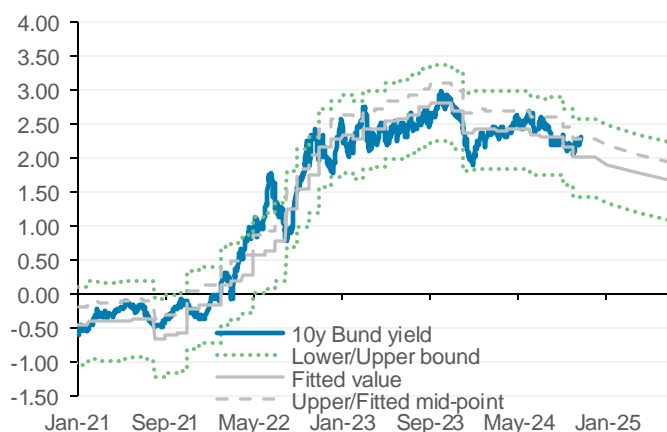
Both have triggered a reassessment of where neutral might be, but it's also been a term premium move. The question is how much further can that go. The reassuring part is that US rates have finally caught up with their fair value (perhaps with a small premium for the election) after the recent sell-off to 4.20% on the 10y. We also note that US 5y5y is now back to July levels, just 25bp away from the H1 highs. So from here, the momentum might start slowing down. We do feel, however, that on balance, risks on US rates are still probably skewed to the upside: another 40bp sell-off is not impossible in a market pricing more fiscal, large tariffs, while ignoring the potential ramifications for growth.

But we think EUR rates' beta to the US will have a hard time keeping in check. The domestic fundamental picture is weak. Risk to growth is skewed to the downside; the ECB is getting increasingly concerned about the risk of undershooting its inflation target, and we had some dovish comments from ECB speakers yesterday, even from the hawks.

As such, adding longs in EUR rates now, after the setback in yields, looks appealing to us.

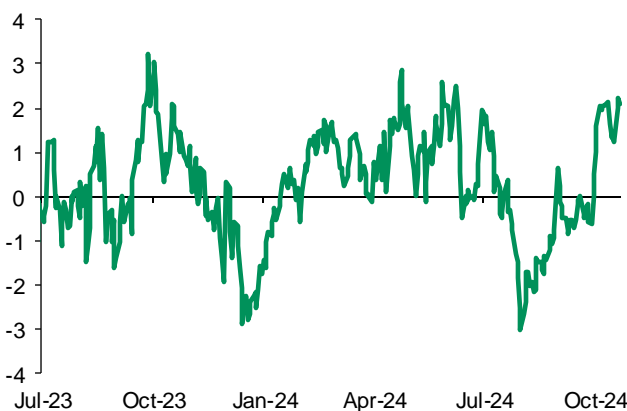
We expect tomorrow's Eurozone PMIs to show a rebound. At the end of last week, we argued there was a risk to the upside at the front end of the curve. However, given the repricing, we'd argue risks now seem to us to be more to the downside across the curve.

Fig.1: Bund 'Expectations' channel model



Sources: BNP Paribas, Bloomberg

Fig.2: 3m z-score



Sources: BNP Paribas, Bloomberg



Camille de Courcel, Head of DM Rates Strategy, Europe | BNP Paribas London Branch – MAR

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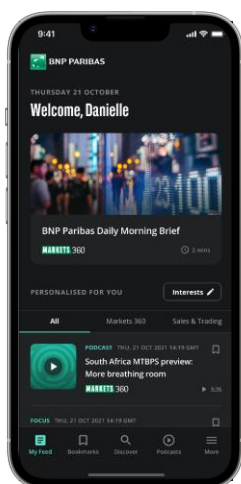
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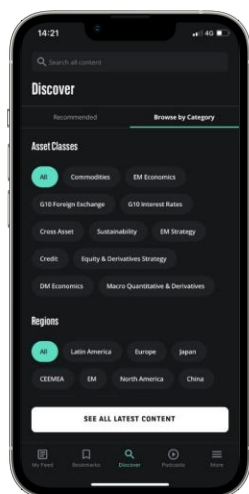
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