Global | Rates, Credit

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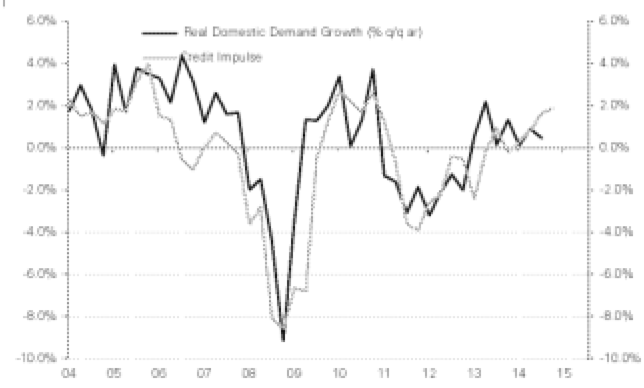
Bond Market Strategy

- The improved growth momentum in Europe remains favourable for reflation trades and peripheral assets. However, the increase in the duration supply in the periphery could be material and is likely to increase market volatility
- We maintain long EUR5Y breakevens, the Bund ASW widener as a hedge, and shorts in the front-end of the eonia curve. We exit the long 30Y BTP and move instead to an optimised 7Y BTP – 30Y OAT cross market steepener. .
- The risk premium priced in the US rates market remains low, especially given the latest increase in oil prices and relative weakness of the USD. We maintain USD2s5s steepeners

Supply Response

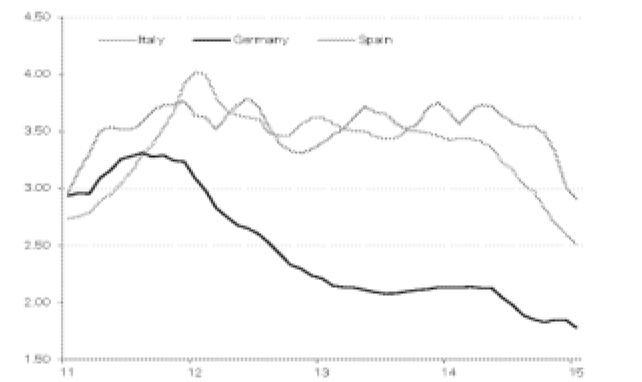
The growth momentum in the euro-area continues to improve. The Eurozone Flash PMIs were above expectations and reached the highest level since May 2011. The details of the composite PMIs were also encouraging, with new orders, employment, input and output prices all up. The credit data is also improving, as the 3-month MFI loans to the private sector is at the highest since August 2011. If these levels of credit growth are maintained next month, the credit impulse should continue to improve. Moreover, as highlighted by Draghi in his recent speeches, the easy monetary policy is increasingly being transmitted to the real economy as the interest rate charged on loans to the private sector in Italy and Spain are converging towards the interest rate charged in core countries. In short, the hard data, business surveys and credit dynamics are all consistent with better growth momentum in the Eurozone in Q1.

Credit dynamics suggest improving growth momentum



Source: Deutsche Bank, ECB , Haver Analytics

Convergence of corporate lending interest rates (3M moving average)



Source: Deutsche Bank, ECB, Haver Analytics

The improved economic outlook should be positive for reflation trades and peripheral bond markets, especially in the context of QE. However, the cash inflation linked and peripheral bond markets have underperformed on a relative basis. This underperformance is to some extent related to quarter-end