



From a trade recommendations perspective, we maintain our long 5Y breakevens as the macro backdrop is increasingly supportive for the trade. Moreover, we see upside risks to the consensus HICP print of next week.

We also shift our short 2Y1Y eonia into a simple short 3y eonia as the curve up to December 16 is now fully pricing the increase in liquidity (forward eonias around -15bp). If anything, there is a risk that because of market frictions, eonia does not trade as low in the corridor. For instance, eonia is proving relatively sticky given the current level of excess liquidity.

We exit the long 30Y BTP and move instead into an optimised cross-market steepener. We enter a long 7Y BTP to protect against the potential impact of the supply response on the long-end. Even if the most recent price action reverses, the volatility of the long-end of the curve makes this sector less compelling from a Sharpe ratio perspective. The 7 year point is the most attractive from a (volatility adjusted) carry and roll down perspective. At the same time, it is attractive to test a short in 30Y core rates given (a) the flatness of core curves, (b) the risk of unwind of Japanese portfolios and/or supply response from France and (c) the upside risks to the next inflation print. We therefore recommend a 7Y BTP – 30Y France cross-market steepener.

Finally, we maintain the Bund ASW widener as a hedge against renewed tensions in Greece.

Still looking for more risk premium in the US

In the US, the hard data continues to disappoint leading tracking GDPs below 1%. On the more positive side, the jobless claims have remained resilient and some of the business surveys have improved. In any case, the Fed and the market have already adjusted for a weak Q1 GDP, and the inflation outlook remains the key driver. From this perspective, the relative weakness of the USD and rise in oil prices should be supportive of a greater risk premium in US rates. For instance, USD 10Y Breakevens are low relative to oil prices, metal prices and DXY (see graph below). From a trade recommendation perspective, we continue to favour USD2s5s steepeners as an attractive way of positioning for steeper money market curves. The trade remains at risk from a renewed USD strength and/or oil price weakness. However, given the flatness of the money market curve (around 50bp priced between dec-16 and dec-17), the downside risks to the trade are limited.

