European Rates Alpha

Close received Dec ECB €str position

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We (tactically) close our long-standing EUR front-end long

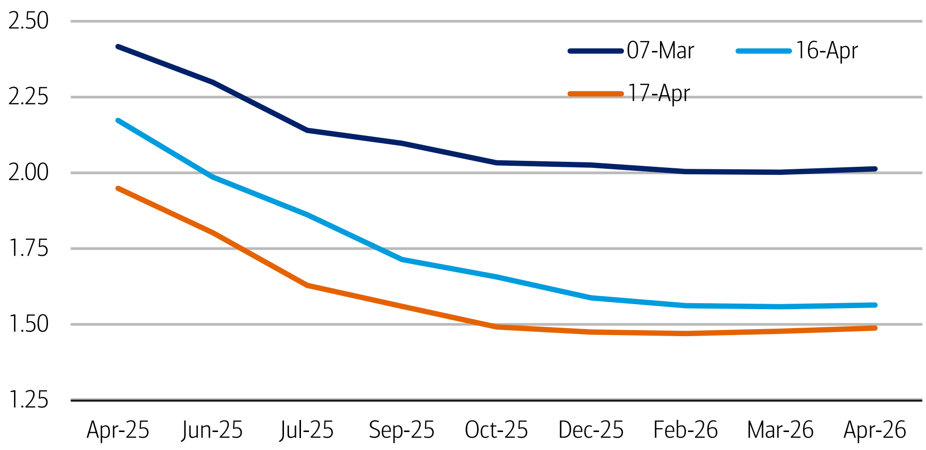
We have held a long front-end view for several quarters, currently expressed with a received Dec ECB €str position entered in December, at 1.77%. We now close this position at 1.47%, as today's dovish ECB meeting supported a meaningful extension of the front-end rally (over 10bp on the day) – see Euro area watch. Dec is when the market prices in the trough in the cutting cycle, therefore implied at the equivalent of c.1.55% ECB Depo. This is just 5bp above our economists' baseline for the terminal rate. We close the position before target as the move has been significant, and there is now risk that a recovery in sentiment leads to a short-term reversal higher in front-end pricing.

We remain long via 6m5y receiver spread & 15y France

Structurally, there is room for the market to reprice rates lower still given the trade war has not been resolved and downside risks to the Euro area's outlook from potential US tariffs (post 90-day reprieve) remain. Given the extent of the front-end repricing, we favour expressing these downside risks further out the curve in the near term.

We hold a 6m5y 1x1.5 receiver spread (1.92/1.78% strikes, expiring in Aug), currently valued at 1bp. We target 14bp, with stop at -10bp (see European rates watch, 5-Feb). In addition, we are long 15y OATs, with the argument that technicals are favourable for French bonds up until end of May (see Global Rates Weekly, 21-Mar). We target 3.5%, with stop at 4.05% (current: 3.67%). The risk to both trades is a significant reduction in trade war concerns.

Exhibit 1: Market implied path of ECB €str, on the day post March ECB meeting, yesterday & today.
Front-end EUR rates have repriced meaningfully lower, with a terminal €str rate now implied at c.1.47%



Source: Bloomberg

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