

European Rates Strategy

European Rates Perspectives: What lies beyond

Interest Rates

Europe including UK

What if Greece stays?

There has been a sharp increase in the probability of Greece remaining in the euro area since the start of the week. Should Greece remain in the Eurozone, we look for: 10yr Bund yields rising to 2% at end-2016, tighter peripheral & core spreads to Germany over the next 24months, steeper core curves (long-end steepeners remain attractive), and flatter 5yr/30yr peripheral curves. We think the current level of the 10yr UST-Bund spread is in line with fair value.

UK: Watch 2s10s for early signs a hike is nearing

While market pricing of the first BoE rate hike has moved a bit closer following upbeat labour data and a pick-up in hawkish rhetoric from MPC members, 2s10s for now remains strongly directional with yield changes. Historically, this directional relationship tends to break down around four months prior to the first hike – around the time the market becomes increasingly confident monetary tightening is imminent. Forward rates price in a slow, modest bear flattening. We think it will be faster, and come sooner. We recommend entering a 2s10s flattener with a forward start date of the November MPC meeting (5th) at 95bp, with a target of 67bp and a stop at 111bp. The rolldown is -7bp per three months.

Enter Italy 5yr/30yr flatteners

Should Greek and Eurozone creditors be able to reach a deal in the next week we think there is a reasonable chance that 5yr/30yr Italy will bull-flatten over the next few months (due to the reach for yield and supportive net issuance in the long-end of Italy over the summer).

Another month of small Eurozone index extensions

After a small extension in May (0.025y), we forecast that the duration of the iBoxx Eurozone Sovereign Index will extend by a similarly meagre 0.027 years in June. Austria is likely to contribute significantly to the extension relative to its index weight. For all other countries, extensions are likely to fall short of historical averages.

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Euro area

- What if Greece stays?
- Two supports for Italy 5yr/30yr flatteners
- Another month of small Eurozone index extensions
- The fortnight ahead in the euro area

What if Greece stays?

Nishay Patel

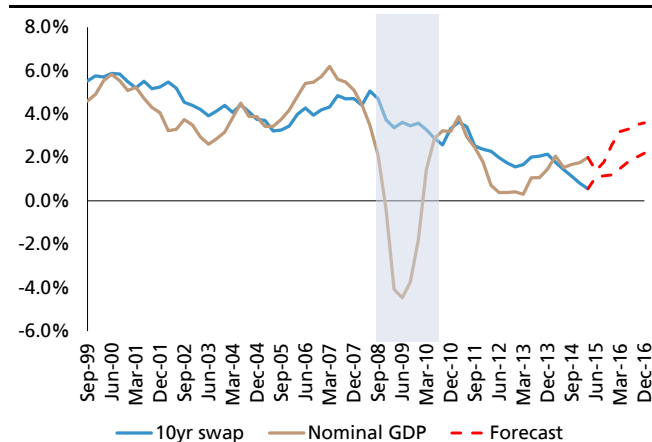
Justin Knight

- There has been a sharp increase in the probability of Greece remaining in the euro area since the start of the week. Should Greece remain in the Eurozone, we look for: 10yr Bund yields rising to 2% at end-2016, tighter peripheral & core spreads to Germany over the next 24 months, steeper core curves (long-end steepeners remain attractive), and flatter 5yr/30yr peripheral curves. We think the current level of the 10yr UST-Bund spread is in line with fair value
- Investors who do not share our base case view that Greece will remain in the euro area may wish to consider the trading strategies that we highlighted earlier this year (["Trading strategies: If Greece exits the Euro Area"](#)).

Duration: 10yr Bund to rise to 2% at end-2016 (0.90% at end-2015)

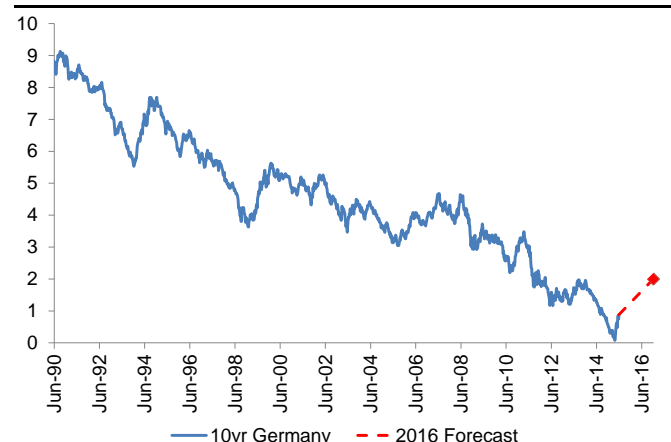
- 10yr Germany:** We are still not tempted to chase Bund yields higher from here: metrics which pointed to Bund richness two months ago now flag significantly more value. We think a pullback (to 0.60-0.70%) in what is now a bear trend in price is likely before the 10yr yield can rise to 1.20%-1.30%.
- We recommend using yield pullbacks to reduce duration. We still see 10y Bunds yielding 2% by end-2016 (and 0.90% at end-2015). See last week's [European Rates Perspectives: Where next for Bunds?](#) for a full write up.

Figure 1: Euro Area nominal GDP (quarterly, YoY) vs 10yr euro interest rate swap yield: an increase in nominal GDP should result in higher 10yr yields



Source: Bloomberg, UBS

Figure 2: 10yr Germany yields, weekly, since June 1990 (we forecast 2% at end-2016)



Source: Bloomberg, UBS

UST spreads to Bunds: limited value

- UST-Bund:** A regression between 10yr US Treasuries-Bunds vs the level of short-end yields, shows that the current spread level of ~155bp is close to fair-value (Global Rates Strategy, 11 June 2015).
- We expect UST-Bund spread to end 2015 at 160bp.

EMU spreads to Germany: tighter spreads

- **Fundamentals matter:** Our forecasts for nominal GDP in the euro area imply a continuation of the economic recovery over the coming quarters. This is likely to ease some of the most pressing concerns about European growth (and move the euro area further away from any concerns over deflation).

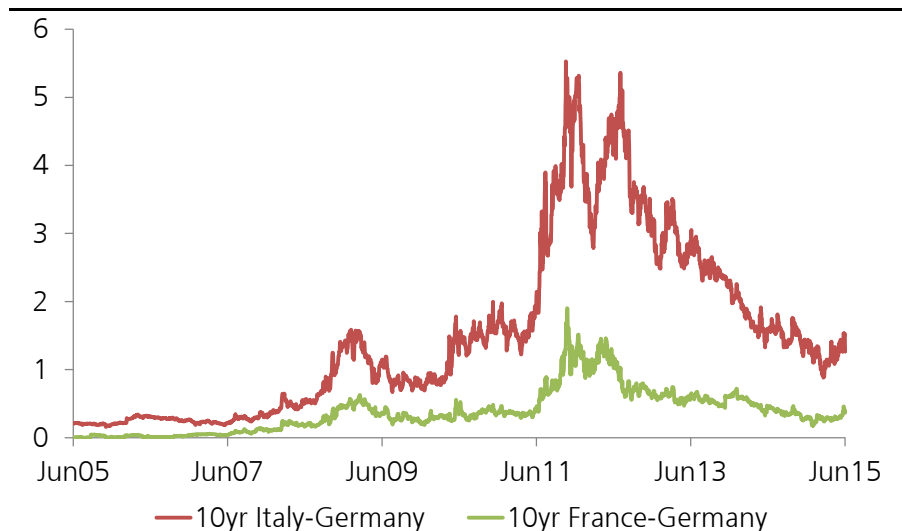
Figure 3: Euro area economic and interest rate forecasts

					2014				2015				2016			
% yoy	2013	2014	2015F	2016F	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	-0.4	0.9	1.6	2	1.1	0.8	0.8	0.9	1.0	1.5	1.8	1.9	1.9	1.9	2	1.9
HICP	1.4	0.4	0.1	1.5	0.7	0.6	0.4	0.2	-0.3	0.2	0.5	0.7	1.4	1.3	1.5	1.6
ECB refi rate (yr-end)	0.25	0.05	0.05	0.05	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
German 10yr yield (yr-end)	1.9	0.6	0.9	2	1.5	1.3	1	0.6	0.2	0.6	0.7	0.9	1.1	1.4	1.7	2

Source: Haver, UBS estimates

- **Outlook:** In the absence of a Greek exit from the euro area, we do not expect spreads to deviate substantially from current levels until the end of the year.
- Looking beyond this year, we expect both core and peripheral spreads to Germany to compress during the course of 2016. We envisage 10yr Italy-Germany spreads returning to pre-crisis lows of 50bp by early-2017 and 10yr France-Germany spreads tightening to 20bp.

Figure 4: 10yr spreads between Italy and France to Germany



Source: Bloomberg, UBS

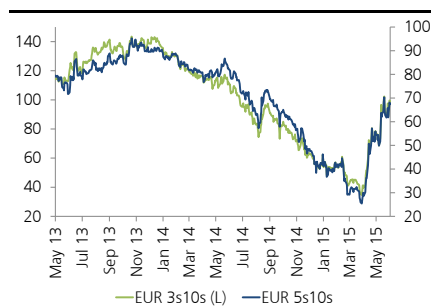
Yield curve: steeper core relative to peripherals

- **Core markets:** The very front-end of the euro curve is expected to remain supported by accommodative ECB policy (negative deposit rates in the context of a further rise in excess liquidity). Meanwhile, we expect yields in the 10yrs+ sector to rise over the next 24 months. This should result in further steepening of core yield curves over the medium-term.
- With euro area nominal GDP set to improve over the coming quarters we continue to favour a steepening bias in the long-end of the euro curve (e.g.

EUR 10s30s) over the medium-term. We look for EUR 10s30s to move above 80bp by end-2016 (based on our 2% German yield forecast for end-2016).

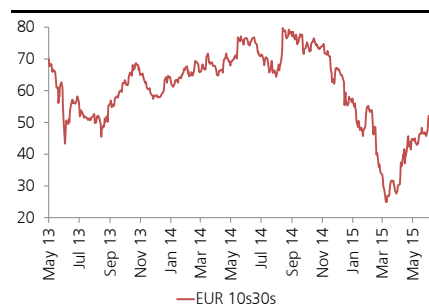
- **Peripherals:** We continue to hold our recommendation of Italy 5yr/10yr flatteners vs France ([initiated on 2 June](#)) and see good value in Italy 5yr/30yr flatteners. A full write up can be found in the next section of this report.

Figure 5: EUR 3s10s and 5s10s to remain steep and steepen further over the medium-term



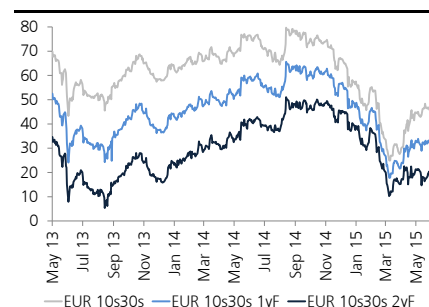
Source: Bloomberg, UBS

Figure 6: EUR 10s30s to steepen much further over the next 24months



Source: Bloomberg, UBS

Figure 7: Steepeners in EUR 10s30s forwards offer positive carry and have lagged the recent steepening in spot



Source: Bloomberg, UBS

Two supports for Italy 5yr/30yr flatteners

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- Enter BTP Mar19-Sep40 curve flattener (BTP 4yr/25yr is our preferred pick) - (Figure 8)
- Current = 250bp. Target = 175bp. Stop = 280bp. Carry = -12bp/6months. This trade was opened at 246bp on 16 June.

Support 1: limited 15-30yr supply, cash flows and regular issuance in 3-7yrs.

We expect net supply (gross supply - coupons) in the BTP 15-30yr sector to be - €2.3bn until 11 September (15-30yr sector: €1.5bn of supply on 13 July vs €2bn of coupons on 3 August and €1.8bn of coupons on 1 September). This is due to our expectation of there being no mid-month BTP auction on 13 August (Italy has not held a mid-month BTP auction in August since 2010. Mid-month BTP auctions are in [3/7/15/30yr](#) tenors).

If the Italian Treasury decides to hold an auction on 13 August this could be due to a significant improvement in long-end funding rates around the auction date. Thus, is likely to be supportive for the long-end. We forecast a regular amount of issuance in the 3-7yr sector (i.e. no cancelled auctions - Figure 10).

Support 2: ongoing discussions between Greece and creditors

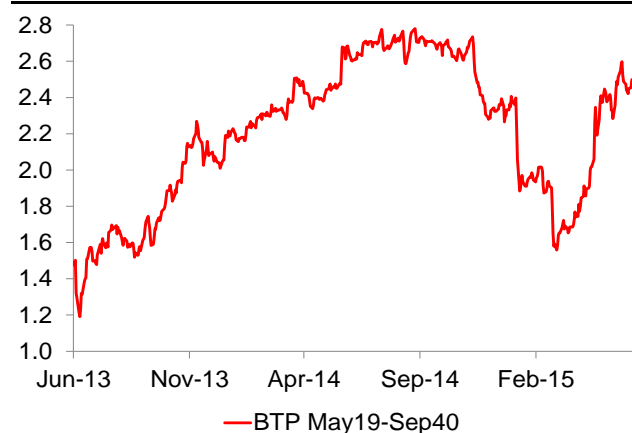
Should Greek and Eurozone creditors be able to reach a deal in the next week we think there is a reasonable chance that 5yr/30yr Italy will bull-flatten in the next few months (due to the reach for yield and the limited amount of supply in long-end Italy over the summer). If Greece exits the Euro Area (not our base case) we would expect peripheral curves to bear-flatten sharply.

We still view peripheral curves as [too steep](#). Italy 5yr/30yr curve flatteners offer an attractive way to position for a reversal of the recent steepening.

Update on France 5yr/10yr steepener vs Italy 5yr/10yr flattener trade

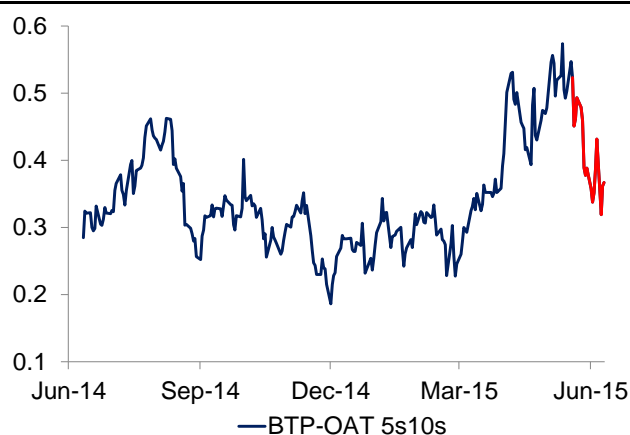
We continue to see value in this [trade recommendation](#) and recently tightened our [stop](#) to +50bp to lock in gains. We expect further normalisation of the relative curve slope between core and peripheral markets to continue. We still target +20bp (current +37bp, entered at +55bp on [2 June](#)) - Figure 9.

Figure 8: We expect Italy May19-Sep40 to flatten further (yield)



Source: UBS Research, Bloomberg

Figure 9: OAT 5yr/10yr steepener vs BTP flattener has room to normalise



Source: UBS Research, Bloomberg

Figure 10: Major Euro Area issuers: issuance (positive numbers) and coupon payments (negative numbers) by tenor and redemptions.

2015	2yr/3yr	5yr/7yr	10yr	15yr/30yr	Redemption
Thu 25-Jun					
Fri 26-Jun	Italy (CTZ) +€1.75bn				
Mon 29-Jun					
Tue 30-Jun		Italy (BTP) +€2.5bn, Italy	Italy (BTP) +€2.5bn		Italy CTZ -€15.9bn
Wed 01-Jul		Germany +€5bn			
Thu 02-Jul	Spain +€2bn		France +€4.5bn	Spain +€2bn France +€3.5bn	
Fri 03-Jul					
Mon 06-Jul	Germany -€3.3bn	Germany -€2.5bn	Germany -€0.7bn	Germany -€3.7bn	Germany -€21bn
Tue 07-Jul					
Wed 08-Jul	Germany +€3bn				
Thu 09-Jul					
Fri 10-Jul					
Mon 13-Jul	France -€0.4bn Italy (BTP) +€3bn	Italy (BTP) +€2.5bn		Italy (BTP) +€1.5bn	France -€22.2bn
Tue 14-Jul			Netherlands +€2.5bn		
Wed 15-Jul	Netherlands -€2.2bn Italy (BTP) -€0.4bn	Netherlands -€2.2bn	Netherlands -€0.3bn Germany +€5bn		Netherlands -€12.4bn Italy BTP -€16.1
Thu 16-Jul	France +€3.5bn	Spain +€1.3bn France +€4.5bn	Spain +€2.5bn		
Fri 17-Jul					
Mon 20-Jul					
Tue 21-Jul					
Wed 22-Jul					
Thu 23-Jul					
Fri 24-Jul					
Mon 27-Jul	France -€1bn				
Tue 28-Jul	Italy (CTZ) +€2bn	Netherlands +€2bn			
Wed 29-Jul					
Thu 30-Jul	Spain -€3.2bn	Spain -€1bn Italy (BTP) +€2.5bn, Italy	Spain -€1.6bn Italy (BTP) +€3.5bn	Spain -€2.3bn	Spain -€19.6bn
Fri 31-Jul					
Mon 03-Aug	Italy (BTP) -€3.2bn	Italy (BTP) -€2.3bn		Italy (BTP) -€2bn	Italy (BTP) -€24bn
Tue 04-Aug					
Wed 05-Aug		Germany +€4bn			
Thu 06-Aug	Spain +€1.5bn		Spain +€2bn		
Fri 07-Aug					
Mon 10-Aug					
Tue 11-Aug					
Wed 12-Aug			Germany +€4bn		
Thu 13-Aug					
Fri 14-Aug					
Mon 17-Aug		Germany -€0.4bn		Germany -€0.3bn	
Tue 18-Aug					
Wed 19-Aug	Germany +€5bn				
Thu 20-Aug					
Fri 21-Aug					
Mon 24-Aug					
Tue 25-Aug					
Wed 26-Aug	Italy (CTZ) +€3.5bn				
Thu 27-Aug					
Fri 28-Aug		Italy (BTP) +€2.5bn, Italy	Italy (BTP) +€5bn		
Mon 31-Aug					
Tue 01-Sep	Italy (CCT) -€0.03bn	Italy (BTP) -€4.2bn	Italy (BTP) -€1.9bn	Italy (BTP) -€1.8bn	Italy (CCT) -€10bn
Wed 02-Sep		Germany +€4bn Spain +€1.5bn	France +€7bn Spain +€2bn	France +€3bn Spain +€1.5bn	
Thu 03-Sep					
Fri 04-Sep		Germany -€1bn			
Mon 07-Sep					
Tue 08-Sep				Netherlands +€1bn	
Wed 09-Sep			Germany +€4bn		
Thu 10-Sep	Italy (BTP) +€3bn Germany -€0.04bn	Italy (BTP) +€2.5bn		Italy (BTP) +€1.5bn	Germany -€15.0bn
Fri 11-Sep					
Mon 14-Sep	Italy (BTP) -€0.4bn			Italy (BTP) -€0.1bn	
Tue 15-Sep					
Wed 16-Sep				Germany +€2bn	
Thu 17-Sep	France +€3bn Spain +€1.5bn	France +€5bn Spain +€1.5bn	Spain +€2bn		
Fri 18-Sep					
Mon 21-Sep					
Tue 22-Sep	Netherlands +€3bn				
Wed 23-Sep	Germany +€5bn				
Thu 24-Sep					
Fri 25-Sep	Italy (CTZ) +€2.5bn				
Mon 28-Sep					
Tue 29-Sep		Italy (BTP) +€2.5bn, Italy	Italy (BTP) +€3.0bn		
Wed 30-Sep	Spain -€0.2bn				
Thu 01-Oct			France +€6bn Spain +€2bn	France +€2bn Spain +€1bn	

Source: UBS Research, DMOs, Bloomberg

Another month of small Eurozone index extensions

Joakim Tiberg

- After a small extension in May (0.025y), we forecast that the duration of the iBoxx Eurozone Sovereign Index will extend by a similarly meagre 0.027 years in June. Austria is likely to contribute significantly to the extension relative to its index weight. For all other countries, extensions are likely to fall short of historical averages.

Fewer bonds dropping out leads to small extension

An estimated €73bn (notional) of bonds will join the index at the June month-end rebalancing while only €17bn drops out. Austria's contribution (0.005y, largest since Sep-13) is likely to stand out relative to its index weight. For other countries, extensions are likely to fall short of historical averages.

Figure 11: Markit iBoxx Eurozone Sovereign Index, duration* and extension, history and UBS forecast

Constituents	Old duration	New duration	Forecast Jun-15 extension	5y avg. Jun extension	3m avg. extension	6m avg extension	12m avg extension	May-15 extension	Apr-15 extension	Mar-15 extension
Luxembourg	0.006	0.006	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Belgium	0.499	0.500	0.002	0.007	0.006	0.005	0.004	0.008	0.005	0.004
Netherlands	0.451	0.454	0.003	0.007	0.005	0.004	0.004	0.011	-0.002	0.006
Spain	0.737	0.746	0.009	0.014	0.012	0.013	0.012	-0.008	0.026	0.019
Austria	0.284	0.290	0.005	0.004	-0.001	0.000	0.001	-0.001	0.001	-0.003
Finland	0.098	0.097	-0.001	0.002	0.002	0.001	0.001	-0.001	-0.001	0.007
France	1.717	1.725	0.008	0.026	0.012	0.014	0.015	0.012	0.019	0.006
Germany	1.329	1.332	0.002	0.011	0.002	0.003	0.007	0.012	0.004	-0.011
Ireland	0.119	0.119	0.000	0.001	0.001	0.004	0.003	0.000	-0.001	0.003
Italy	1.556	1.555	-0.001	0.018	0.014	0.019	0.017	-0.008	0.026	0.024
Latvia	0.003	0.003	0.000							
Lithuania	0.003	0.003	0.000							
Slovenia	0.015	0.015	0.000							
Slovakia	0.038	0.038	0.000	0.000	0.000	0.000	0.002	0.000	0.001	0.000
Overall	6.854	6.882	0.027	0.056	0.053	0.064	0.066	0.025	0.077	0.058

Source: Markit, Bloomberg, UBS *Defined as Modified duration. We use the Markit iBoxx Eurozone Sovereign Index as a proxy for other euro area sovereign bond indices.

We forecast that the **1-3y sub-index** will extend by 0.048 years, in line with its 5y avg. for June (0.045y). Italy looks set to extend by a hefty 0.044y (largest since Feb-15), followed by Belgium (0.027y). Germany, which has historically contracted the sub-index in June (in 3 out of the last 5 years), is likely to post its smallest extension (-0.017y) since Feb-09.

The **3-5y sub-index** is likely to extend by 0.036 years, also in line with its 5y avg. for June (0.034y). France (0.040y) is likely to surpass its historical avg. followed by Germany (0.027y, largest since Jan-15). Belgium (-0.032y) along with Italy (-0.027y, smallest since Nov-14), which has historically posted negative contributions to this sub-index (in 3 out of the last 5 years), are likely to contract the sub-index.

We estimate that the **5-7y sub-index** will contract by 0.003 years (smallest extension since Dec-10). Only Spain (0.016y), Italy (0.006y, larger than historical avg.) and Belgium (0.003y) are likely to extend among all constituents.

The **7-10y sub-index** is expected to extend by 0.059 years, greater than its 5y avg. for June (0.034y). Belgium (0.099y) and Italy (0.053y, surpassing its historical avg.) stand out while Spain (-0.029y) followed by Germany (-0.027y, smaller than historical avg.), the Netherlands (-0.018y) and Ireland (-0.009y) contract the sub-index.

The fortnight ahead in the euro area

Figure 12: Selected events in the euro area until Q3 2015

Date	Event
25-Jun-15 (Thu)	European council meeting
30-Jun-15 (Tue)	Greece bundled IMF repayment €1.7bn
30-Jun-15 (Tue)	Eurozone CPI advance estimate (June)
02-Jul-15 (Thu)	ECB to publish minutes
10-Jul-15 (Fri)	Greece T-bill redemption, €2bn
14-Jul-15 (Tue)	Greece International government bond (JPY denominated) redemption €88mn
16-Jul-15 (Thu)	ECB Governing Council meeting and press conference
17-Jul-15 (Fri)	ECB survey of professional forecasters
17-Jul-15 (Fri)	Greece interest payment on government bond €16.4mn
19-Jul-15 (Sun)	Greece interest payment on government bond €225.1mn
20-Jul-15 (Mon)	Greece government bond redemption €3.491bn
20-Jul-15 (Mon)	Greece interest payment on government bond €381.3mn
25-Jul-15 (Sat)	Greece interest payment on government bond €27mn
30-Jul-15 (Thu)	ECB publishes economic bulletin
31-Jul-15 (Fri)	Eurozone CPI advance estimate (July)
01-Aug-15 (Sat)	Greece interest payment to IMF €178.4mn
07-Aug-15 (Fri)	Greece T-bill redemption, €1bn
13-Aug-15 (Thu)	ECB to publish minutes
14-Aug-15 (Fri)	Eurozone advance GDP estimates Q2 2015
20-Aug-15 (Thu)	Greece government bond redemption €3.188bn
20-Aug-15 (Thu)	Greece interest payment on government bond €194.5mn
31-Aug-15 (Mon)	Eurozone CPI advance estimate (August)
03-Sep-15 (Thu)	ECB Governing Council meeting and press conference
4-5 Sep-15	G-20 Finance ministers, central bankers meet in Ankara
17-Sep-15 (Thu)	ECB publishes economic bulletin
17-Sep-15 (Thu)	SNB monetary policy assessment
24-Sep-15 (Thu)	ECB TLTRO-5 allotment announcement (11:15 CET)
27-Sep-15 (Sun)	Spain's Catalonia region will hold an election for its regional parliament
30-Sep-15 (Wed)	Eurozone CPI advance estimate (September)

Source: European governments, European Commission, ECB, Bloomberg, UBS

Figure 13: Forthcoming bond auction calendar

Date	Country	Bond auction details	Details announcement
26-Jun-15 (Fri)	Italy	CTZ Feb-17, €1.25-1.75bn	
30-Jun-15 (Tue)	Italy	BTP Auction	25-Jun-15 (Thu)
01-Jul-15 (Wed)	Germany	New Bobl Oct-20, €5bn	
02-Jul-15 (Thu)	France	Long term auction	26-Jun-15 (Fri)
02-Jul-15 (Thu)	Spain	BONO/SPGB Auction (Could include linker)	26-Jun-15 (Fri)
07-Jul-15 (Tue)	Austria	RAGB auction	30-Jun-15 (Tue)
07-Jul-15 (Tue)	Germany	Inflation-linked auction	03-Jul-15 (Fri)
08-Jul-15 (Wed)	Germany	Schatz Jun-17, €3bn	

Source: National Debt Agencies and Treasuries, UBS

Figure 14: Euro area sovereign bond issuance monitor* (€bn) (as of 24th June 2015)

Country	Supply				Redemptions		Net Issuance**				Coupons	
	2015E	YTD	%	Remaining	2015E	YTD	2015E	YTD	Remaining	%	2015E	YTD
Germany	159.0	84.5	53%	74.5	155.0	89.0	4.0	-4.5	8.5	213%	26.8	13.8
France	215.0	125.4	58%	89.6	115.5	37.3	71.5	77.1	-5.6	-8%	42.3	20.8
Italy***	240.0	136.4	57%	103.6	195.9	67.5	43.7	68.5	-24.8	-57%	56.3	28.4
Spain	140.0	83.5	60%	56.5	84.5	50.3	55.5	33.2	22.3	40%	29.5	14.2
Netherlands	48.0	31.0	65%	17.0	35.5	23.5	8.5	5.0	3.5	41%	8.9	4.1
Belgium	33.0	21.5	65%	11.5	20.8	12.0	6.2	7.1	-0.9	-14%	11.6	6.2
Austria	19.0	10.8	57%	8.2	13.1	0.0	5.9	10.8	-4.9	-84%	6.7	3.0
Finland	11.0	4.0	36%	7.0	5.0	0.0	6.0	4.0	2.0	33%	2.1	0.8
Ireland	13.5	11.0	81%	2.5	2.2	2.2	11.3	8.8	2.5	22%	4.1	2.5
Portugal	17.0	12.1	71%	4.9	5.5	0.0	11.5	12.1	-0.6	-5%	4.3	2.9
Greece	0.0	0.0	0%	0.0	0.0	0.0	0.0	0.0	0.0	0%	0.9	0.8
Total	895.5	520.3	58.1%	375.2	633.1	281.8	224.0	222.1	1.9	1%	193.4	97.6

Source: National Debt Agencies and Treasuries, Bloomberg, UBS *including inflation-linked issuance, excluding foreign currency debt **Defined as gross issuance – redemptions (- buybacks for France, Netherlands, Belgium and Portugal) ***Including CTZs and CCTs.

- **Change in Ireland's annual gross issuance forecast:** We have increased Ireland's annual issuance forecast from €12bn to €13.5bn, expecting three more re-openings this year.

Figure 15: CRA sovereign rating calendar until Q3 2015

	UK	Germany	France	Italy	Spain	NL	Belgium	Austria	Finland	Greece	Ireland	Portugal	US
Calendar													
26-Jun-15		Moody's	S&P				Moody's	Moody's					
3-Jul-15													
10-Jul-15	DBRS	Fitch				Moody's							
		S&P											
17-Jul-15							S&P						
24-Jul-15							Fitch						
31-Jul-15										Moody's			
7-Aug-15		DBRS						Fitch			Fitch		
14-Aug-15													
21-Aug-15													
28-Aug-15													
4-Sep-15						DBRS						Moody's	
11-Sep-15							DBRS		DBRS	S&P	Moody's		
											DBRS		
18-Sep-15	Moody's		Moody's						Fitch			S&P	
25-Sep-15				DBRS				S&P	S&P			Fitch	
Current ratings													
S&P	AAA (Neg)	AAA (Stable)	AA (Neg)	BBB- (Stable)	BBB (Stable)	AA+ (Pos)	AA (Stable)	AA+ (Stable)	AA+ (Stable)	CCC (Neg)	A+ (Stable)	BB (Pos)	AA+ (Stable)
Moody's	Aa1 (Stable)	Aaa (Stable)	Aa1 (Neg)	Baa2 (Stable)	Baa2 (Pos)	Aaa (Stable)	Aa3 (Stable)	Aaa (Stable)	Aaa (Neg)	Caa2 (Neg)	Baa1 (Stable)	Ba1 (Stable)	Aaa (Stable)
Fitch	AA+ (Stable)	AAA (Stable)	AA (Stable)	BBB+ (Stable)	BBB+ (Stable)	AAA (Stable)	AA (Neg)	AA+ (Stable)	AAA (Neg)	CCC	A- (Stable)	BB+ (Pos)	AAA (Stable)
DBRS	AAA (Stable)	AAA (Stable)	AAA (Neg)	A low (Stable)	A low (Stable)	AAA (Stable)	AA high (Stable)	AAA (Stable)	AAA (Stable)	CCC high (Neg)	A (Stable)	BBB low (Stable)	AAA (Stable)

Source: S&P, Moody's, Fitch, DBRS, Reuters, UBS *RWN implies rating under negative watch or rating under review for downgrade

UK

- Watch 2s10s for early signs a hike is nearing
- The fortnight ahead in the UK

Watch 2s10s for early signs a hike is nearing

John Wraith

Joakim Tiberg

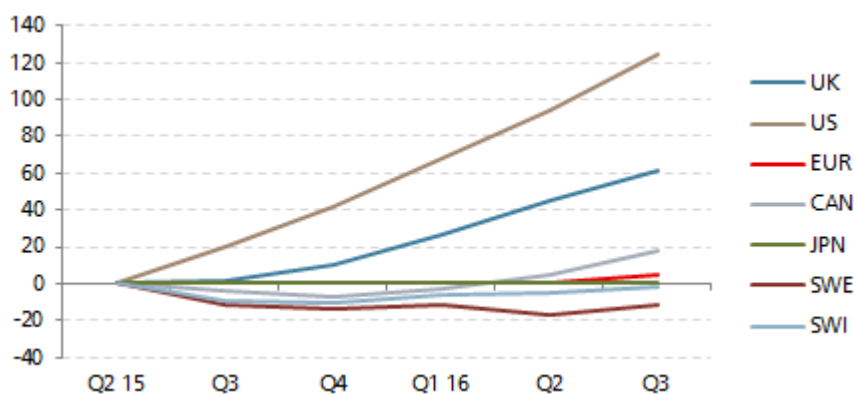
- While market pricing of the first BoE rate hike has moved a bit closer following upbeat labour data and a pick-up in hawkish rhetoric from MPC members, 2s10s for now remains strongly directional with yield changes. Historically, this directional relationship tends to break down around four months prior to the first hike – around the time the market becomes increasingly confident monetary tightening is imminent. Forward rates price in a slow, modest bear flattening. We think it will be faster, and come sooner.
- We recommend entering a 2s10s flattener with a forward start date of the November MPC meeting (5th) at 95bp, with a target of 67bp and a stop at 111bp. The rolldown is –7bp per three months.

Forward rates seem to price in too little flattening

The recent acceleration in the pace of UK wage inflation has led to a noticeable shift in the tone of several members of the Monetary Policy Committee (MPC), for whom the previous lack of earnings strength was a key concern in their assessment of the ability of the economy to withstand any tightening of policy. There remain several reasons for sticking to an extremely cautious path, in particular the tighter fiscal stance due to be confirmed when the Chancellor delivers the extra Budget on the 8th July, and the still uncertain evolution of the ongoing Greek saga, but it seems clear that the debate has swung back in the hawks' direction recently.

The timing of the first rise in Bank Rate is still highly dependent on the actions of the Federal Reserve in our opinion, as although the June MPC meeting minutes included the observation that *"the path for UK monetary policy would depend on the prospects for inflation in the United Kingdom and would not be determined by the actions of other central banks"*, the clear correlation between the difference in the expected timing of the first hike in the UK and the US and the level of the GBP / USD exchange rate, together with the repeatedly expressed sensitivity of the MPC to an excessively strong pound which risks prolonging the period for which CPI remains below target and increasing downside risks to inflation expectations, illustrate the interdependence of major central banks in their policy decisions.

Figure 16: Economists' average forecasts for G10 Central Bank rate changes to Q3 2016



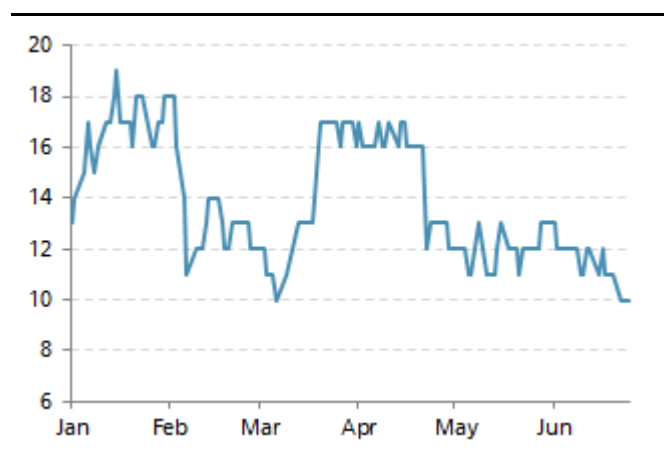
Source: Bloomberg, UBS (Rates used: UK – BoE Bank Rate, US – average of lower and upper Fed Funds Target Rate bands, EUR – ECB Main Refinancing Rate, Canada – Overnight Rate, Japan – BoJ Target Rate, Sweden – Repo Rate, Switzerland – SNB Libor Target)

As the US is the only other G10 economy expected to tighten monetary policy to any meaningful extent in the foreseeable future (Figure 16), the MPC's actions will surely be influenced heavily by the Fed. We still expect the latter to raise rates in September, which would free the hand of the MPC to act soon after (we forecast a November rise in Bank Rate). If, on the other hand, the Fed remains on hold, we would anticipate a more circumspect tone being adopted in the MPC's formal communications.

The market is slowly moving expectations of the first hike earlier

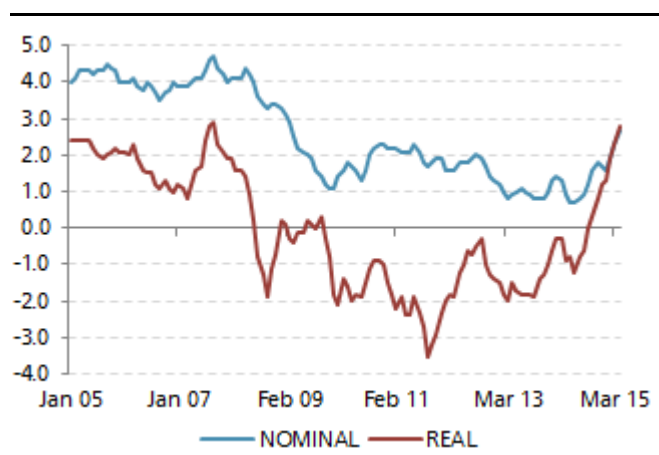
As recently as the middle of April, policy rate expectations implied by OIS forwards did not fully price in the first 25bp rise in Bank Rate until August 2016. As data published thereafter increasingly suggested a reacceleration of GDP after the soft first quarter, this timing started to inch closer, and the pace at which the market has reeled in the expected first hike has recently accelerated following the confirmation that core average earnings rose in April at the fastest pace (+2.7% 3m y/y) since the crisis (Figure 17). Subdued wage inflation has long been one of the strongest factors influencing the arguments of the more dovish MPC members, and if the recent trend persists and takes nominal earnings back towards levels that would leave real wages in healthily positive territory as and when CPI returns towards target, their reticence may rapidly diminish (Figure 18).

Figure 17: Number of months until first 25bp rise in Bank Rate implied by OIS forwards (2015 ytd)



Source: Bloomberg, UBS

Figure 18: Nominal and real (CPI adjusted) average earnings ex-bonus (% 3m y/y), 2005-2015



Source: ONS, Bloomberg, UBS

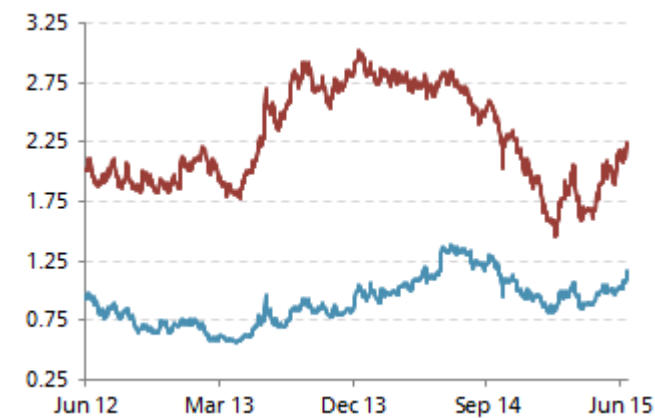
Recent signs of a change in tone from MPC members

There have been some recent indications that several MPC members are starting to strike a different balance in their assessments of the outlook for monetary policy. The erstwhile voters for a hike (Weale and McCafferty) have both dropped strong hints that they may return to an activist stance over the next few months, with the former saying that the labour market is now more inflationary than it was when he was voting for higher rates last year, and the latter that there is a (data dependent) possibility of a rise before the end of 2015. Other members who have previously been more neutral in their views have also seemingly edged in a hawkish direction, with Cunliffe noting that the UK is "*getting close to the end*" of the reservoir of spare labour supply and Forbes saying that inflation should bounce back fairly quickly toward target by early 2016 (barring exchange rate or commodity price shocks).

Curve shape and outright yield moves well correlated...for now

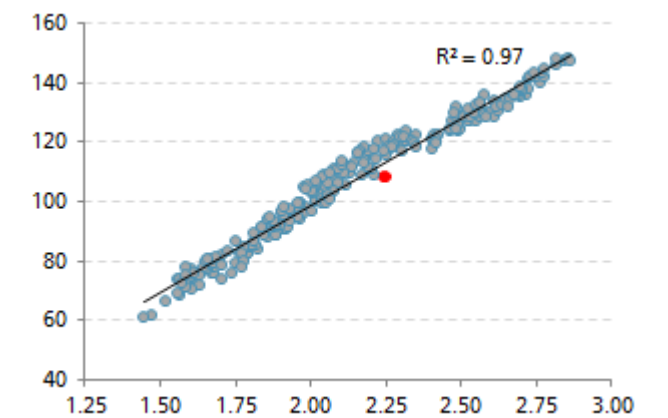
Although there have been some modest shifts in the expected timing of the first hike over the past couple of months, the changes have not been emphatic and have tended to "borrow" a little of the subsequent implied tightening rather than add incremental rate hike expectations. To illustrate this, we can consider the relatively muted moves in the 2y swap rate, which has been in a range between 0.60% and 1.40% for the past three years, contrasting with the markedly more volatile 10y swap rate (Figure 19). The MPC's mantra of slow, gradual hikes towards a lower peak is thus still having the desired impact, leaving the curve in a very close directional correlation with outright 10y yields (Figure 20).

Figure 19: 2y swap rate has been in a relatively narrow range for the past two years (%)



Source: Bloomberg, UBS

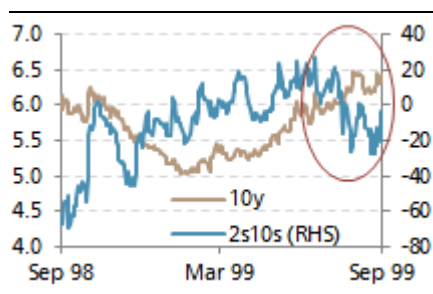
Figure 20: 10y swap rate (%) and the spread between 2y and 10y swaps (2s10s, bp), June 2014-June 2015



Source: Bloomberg, UBS

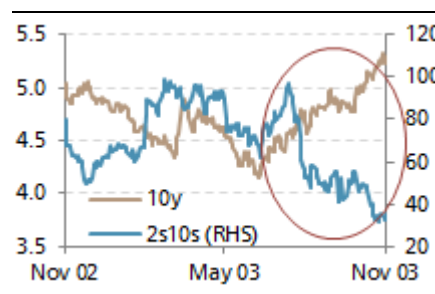
While the strength of this correlation is not yet showing signs of breaking down, we strongly believe it will do so in the last few months before the first rise in Bank Rate. This has been the clear pattern in the approach to earlier rate hiking cycles in the UK, as although 10y yields have tended to keep rising into that first hike, shorter dated rates start to climb at an accelerating speed and outpace the rise in longer yields, flattening the curve. The next charts show how 10y yields and 2s10s have decoupled sharply in the run-up to the hiking cycles that began in September 1999, November 2003, and August 2006. If this pattern starts to emerge again in the approach to the next hiking cycle, higher 10y yields will no longer coincide with a steepening of 2s10s (as in Figure 20), but with a bear flattening of the curve.

Figure 21: 10y swap rate and 2s10s in the year to the first hike on 8/9/99



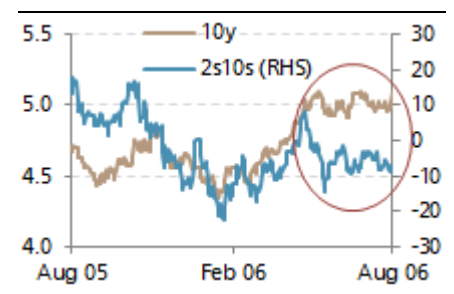
Source: Bloomberg, UBS

Figure 22: 10y swap rate and 2s10s in the year to the first hike on 6/11/03



Source: Bloomberg, UBS

Figure 23: 10y swap rate and 2s10s in the year to the first hike on 3/8/06



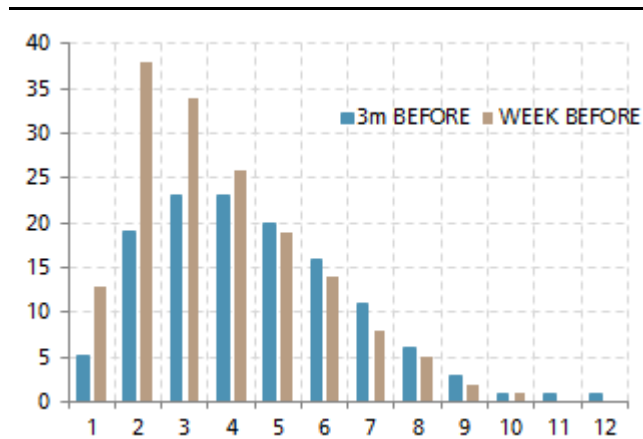
Source: Bloomberg, UBS

Mounting conviction of imminent hikes will be the driver

As the most striking example of how the shape of the curve can suddenly decouple sharply from a directional relationship with outright 10y yields, we can look in more detail into the behaviour of the front end in the run up to the November 2003 cycle (Figure 22) to identify what one of the main drivers of this decoupling might be. On each prior occasion, the flattening of the curve began to unfold around four months before the first hike was sanctioned, which is the approximate point at which market expectations of a hike at some point in the future start to harden into increasingly intense speculation centred on a specific MPC meeting in the near future.

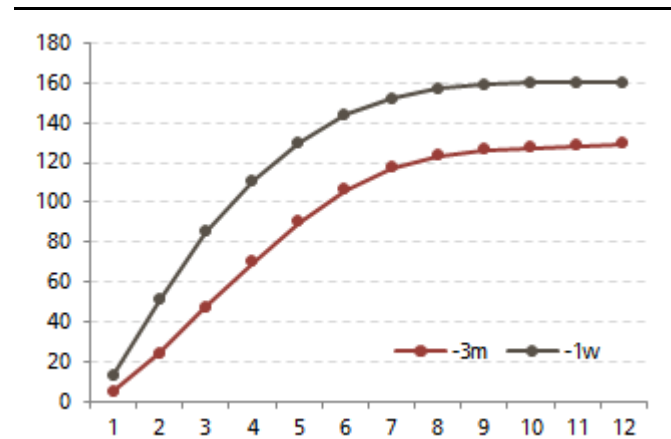
When a shift from general to specific anticipation happens, the shape of the interest rate futures strip starts to change, as the implied tightening path evolves from a slow, undefined projection into a more quantifiable forecast of imminent rises. To illustrate this, we consider the interest rate futures strip three months and one week before the first hike in 2003 (Figure 24). At the earlier date, the front 7 contracts (after the first) each implied 11-19bp of tightening, while by the week before the hike (by then a near certainty), this vague path had been telescoped into more defined and emphatic near term tightening, with each of the front 5 contracts implying 19-38bp of increases. As a result, the pace of expected tightening had accelerated significantly, and the overall amount expected over the next three years had risen from 129bp to 160bp (Figure 25).

Figure 24: Implied change in 3m LIBOR in each interest rate futures contract in the run up to 6/11/03 (bp)



Source: Bloomberg, UBS

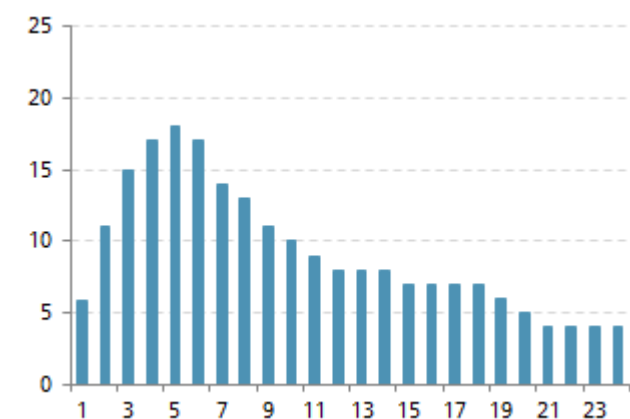
Figure 25: Cumulative amount of tightening priced into first 12 futures contracts in the run up to 6/11/03 (bp)



Source: Bloomberg, UBS

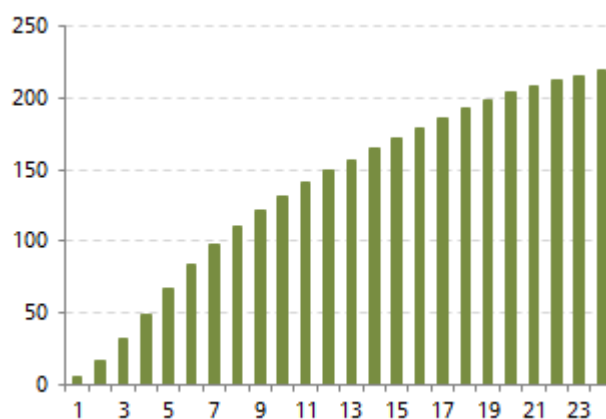
While the cycle we expect to begin in November is likely to be more gradual than in the past, we anticipate a similar shift on the futures strip and in short dated swap rates. With the market unfocused and vague as to precisely when hikes may begin, with what frequency they will be enacted, and how far they may go, the strip is reflecting a general averaging out of future hikes, with each contract all the way out for the next six years showing a rise in implied 3m LIBOR of between 4-18bp (Figure 26) amounting to cumulative tightening of 220bp (Figure 27).

Figure 26: Current implied change in 3mL, first 24 short sterling futures contracts (bp)



Source: Bloomberg, UBS

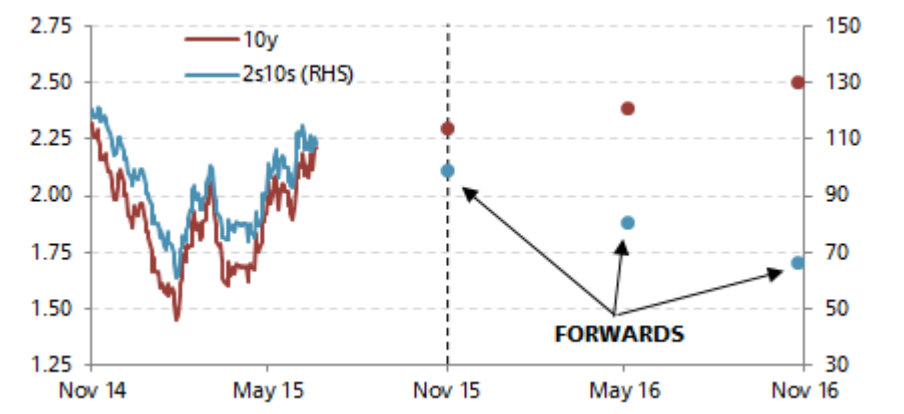
Figure 27: Cumulative amount of tightening priced into first 24 futures contracts (bp)



Source: Bloomberg, UBS

We anticipate that by the time a hike is a near-certainty and imminent, this picture will have changed to show a more rapid path over the first year or two of the cycle, perhaps nearer 25bp a quarter, and a moderately greater overall amount of tightening. This would still represent a slower pace than in the past (the three MPC hiking cycles since 1997 have seen average increases of 42bp a quarter), and a much lower peak (the average level of Bank Rate from the introduction of the MPC until the end of 2008 was 5.10%).

Figure 28: 10y swap rate (%) and 2s10s (bp) since Nov 2014, and current forward levels for Nov 2015, May 2016, Nov 2016



Source: Bloomberg, UBS

Time to enter forward starting 2s10s flattener

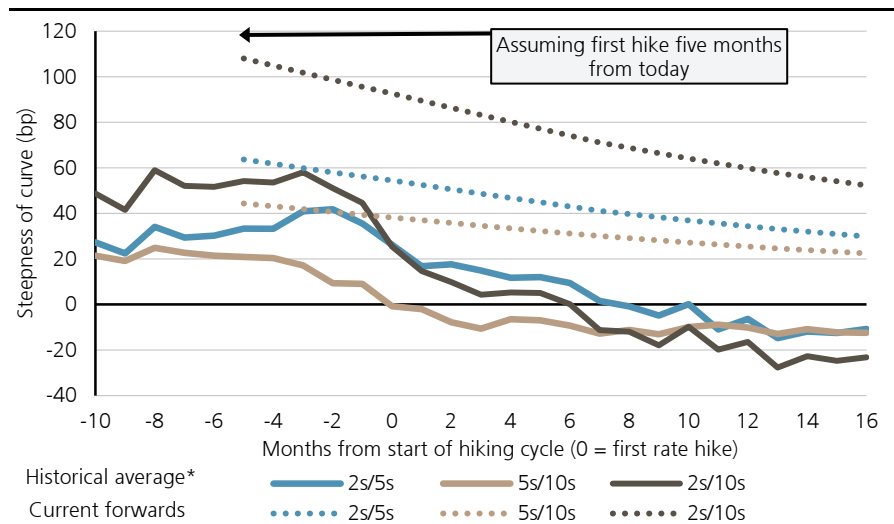
Given our house view that the MPC will vote to raise Bank Rate in November – just over four months from now – and in anticipation of a more hawkish tone therefore gradually being adopted by the MPC from here, we believe the time is right to set forward starting flatteners in anticipation of near term, pre-hiking cycle bear flattening of the yield curve. Forward rates do anticipate a modest flattening of the curve and higher 10y yields (Figure 28), so the roll down on this trade is negative. However, we believe the earlier hike we expect will see the curve flatten sooner and faster than is priced in, and that this will more than offset the negative rolldown. Figure 28 plots the recent history of the 10y swap rate and 2s10s, and shows the forward levels for the time we anticipate the first hike (November 2015), and out of May and November 2016. **We recommend entering a 2s10s**

flattener with a forward start date of the November MPC meeting (5th) at 95bp, with a target of 67bp and a stop at 111bp. The rolldown is –7bp per three months.

Figure 29 shows how our target level of 67bp sits well above the average slope of 2s10s at the time of the start of historic tightening cycles. Again, we doubt that the curve reaction this time will be an exact replica of history, but the difference between the 5m forward shape of the curve and the historic average looks extreme.

The main risk to this trade is in our view if the sell-off that started in early May this year continues alongside relatively dovish signals from the BoE and/or the Fed. Under such a scenario, the directional relationship between 2s10s and outright yields would likely persist, driving the curve steeper.

Figure 29: Average steepness of GBP swap curve in last four hiking cycles* vs. current forward rates



Source: Bloomberg, UBS * Average slope Oct-96-Jun-98, Sep-99-Feb-00, Nov-03-Aug-04, Aug-06-Jul-07

The fortnight ahead in the UK

Figure 30: Auctions, syndications and mini-tender schedule until September 2015

Date	Type	Bond	Details announcement
02-Jul-15	Auction	UKT 2% Jul-20, £3.75bn	
07-Jul-15	Auction	UKT 3.5% Jan-45	30 June
15-Jul-15	Auction	A new index-linked gilt maturing on 22 March 2026	07 July
Second half of July*	Syndication	A conventional gilt with a maturity in the 40-year area or longer	Around two weeks in advance
04-Aug-15	Auction	UKT 2% Sep-25	28 July
11-Aug-15	Auction	UKTI 0.125% Mar-58	04 August
20-Aug-15	Auction	UKT 4.25% Mar-36	11 August
02-Sep-15	Auction	A new conventional gilt maturing on 22 January 2021	25 August
08-Sep-14	Auction	UKT 3.5% Jan-45	01 September
16-Sep-14	Auction	UKT 2% Sep-25	08 September
Second half of September*	Syndication	An index-linked gilt	Around two weeks in advance

Source: UK DMO, UBS *subject to market conditions

Figure 31: UK issuance monitor for 2015-16 (£bn)

£ bn	Planned Issuance 2015-16	Issued until 24 th June 2015	% Issued	% Remaining
Short (A)	33.2	8.4	25.2%	74.8%
Medium (B)	26.2	6.3	24.0%	76.0%
Long (C)	37.7	8.2	21.7%	78.3%
Index-Linked (D)	31.1	8.4	26.9%	73.1%
Unallocated* (E)	2.7			
Total (A+B+C+D+E)	130.9	(A+B+C+D) 31.2	23.8%	76.2%

Source: UK DMO, UBS *the unallocated portion will be adjusted into syndicated offerings or directed to gilt mini-tenders

Figure 32: Maturity bucket breakdown of demand and supply and roadmap for BoE purchases (in £mm) (including UBS estimates for DMO supply), as of 24th June 2015

		3- to 7-year	7- to 15-year	over 15-year	Index-linked
25 th June – 30 th June	BoE purchases (A)				
	Supply (B)				
	Coupons (C)				
	Net (A+C-B)				
July	BoE purchases (A)				
	Supply (B)	4,000		7,000	1,400
	Coupons (C)	708		1,491	766
	Net (A+C-B)	-3,292		-5,509	-634
August	BoE purchases (A)				
	Supply (B)		3,250	2,250	1,400
	Coupons (C)				
	Net (A+C-B)		-3,250	-2,250	-1,400
September	BoE purchases (A)*	5,000	5,000	5,000	
	Supply (B)	4,000	3,250	2,250	4,000
	Coupons (C)	1,951	1,161	1,012	233
	Net (A+C-B)	2,951	2,911	3,762	-3,767
Cumulative		-341	-339	-3,998	-5,801

Source: Bank of England, UK DMO, Bloomberg, UBS. Note that coupons are ex-BoE and UK central government holdings *assuming BoE reinvests proceeds from its holdings of UKT 4.75% Sep-15

Data and Charts

- Euro area macroeconomic calendar
- Key market views: Euro area
- Key market views: UK
- UK macroeconomic calendar
- Gilt and GBP swap zero and forward curves
- Conventional Gilt yield barbells
- Conventional Gilts outstanding and BoE holdings

Euro area macroeconomic calendar:

Date	Time	Country	Indicator	Period	Forecast	Prior	Consensus	Importance
25-Jun-15	08:00	Euro Zone	ECB's Nouy Speaks at European Parliament in Brussels					
25-Jun-15	09:00	Euro Zone	ECB's Costa, Brazil's Tombini at Meeting of Central Banks					
26-Jun-15	09:00	Euro Zone	EU Leaders Conclude Summit in Brussels					
26-Jun-15	09:00	Euro Zone	M3 Money Supply (YoY)	May		5.30%	5.40%	**
26-Jun-15	09:00	Euro Zone	M3 3-month average	May		4.70%	5.10%	
29-Jun-15	10:00	Euro Zone	Economic Confidence	Jun		103.8		
29-Jun-15	10:00	Euro Zone	Business Climate Indicator	Jun		0.28		
29-Jun-15	10:00	Euro Zone	Industrial Confidence	Jun		-3		
29-Jun-15	10:00	Euro Zone	Services Confidence	Jun		7.8		
29-Jun-15	10:00	Euro Zone	Consumer Confidence (Final)	Jun		-5.6		**
30-Jun-15	10:00	Euro Zone	Unemployment Rate	May		11.10%		*
30-Jun-15	10:00	Euro Zone	CPI Estimate (YoY)	Jun				*
30-Jun-15	10:00	Euro Zone	CPI Core (YoY) (Advance)	Jun		0.90%		
30-Jun-15	17:00	Euro Zone	EU's Juncker Speaks at API-IPA in Brussels					
30-Jun-15	17:00	Euro Zone	EU's Juncker Speaks to Brussels Press Association					
1-Jul-15	09:00	Euro Zone	Markit Eurozone Manufacturing PMI (Final)	Jun		52.5		**
2-Jul-15	10:00	Euro Zone	PPI (MoM)	May		-0.10%		
2-Jul-15	10:00	Euro Zone	PPI (YoY)	May		-2.20%		
2-Jul-15	12:30	Euro Zone	ECB account of the monetary policy meeting					
2-Jul-15		Euro Zone	EU's Juncker, Moscovici at EU Parliament Panel in Brussels					
3-Jul-15	09:00	Euro Zone	Markit Eurozone Services PMI (Final)	Jun		54.4		
3-Jul-15	09:00	Euro Zone	Markit Eurozone Composite PMI (Final)	Jun		54.1		*
3-Jul-15	10:00	Euro Zone	Retail sales (MoM)	May		0.70%		
3-Jul-15	10:00	Euro Zone	Retail sales (YoY)	May		2.20%		
6-Jul-15	09:10	Euro Zone	Markit Eurozone Retail PMI	Jun		51.4		
6-Jul-15	09:30	Euro Zone	Sentix Investor Confidence	Jul		17.1		
23-Jun - 26-Jun-15		Germany	Queen Elizabeth II Visits Germany					
25-Jun-15	07:00	Germany	GfK Consumer Confidence	Jul		10.2	10.2	
26-Jun-15	07:00	Germany	Import Price Index (MoM)	May		0.60%	0.20%	
26-Jun-15	07:00	Germany	Import Price Index (YoY)	May		-0.60%	-0.40%	
29-Jun-15	08:00	Germany	CPI saxony (YoY)	Jun		0.80%		
29-Jun-15	08:00	Germany	CPI saxony (MoM)	Jun		0.20%		
29-Jun-15	09:00	Germany	CPI Brandenburg (MoM)	Jun		0.10%		
29-Jun-15	09:00	Germany	CPI Brandenburg (YoY)	Jun		0.60%		
29-Jun-15	09:00	Germany	CPI Hesse (MoM)	Jun		0.10%		
29-Jun-15	09:00	Germany	CPI Hesse (YoY)	Jun		0.80%		
29-Jun-15	09:00	Germany	CPI Bavaria (MoM)	Jun		0.10%		
29-Jun-15	09:00	Germany	CPI Bavaria (YoY)	Jun		0.80%		
29-Jun-15	09:30	Germany	CPI North Rhine Westphalia (MoM)	Jun		0.20%		
29-Jun-15	09:30	Germany	CPI North Rhine Westphalia (YoY)	Jun		0.70%		
29-Jun-15	13:00	Germany	CPI (MoM) (Provisional)	Jun		0.10%		*
29-Jun-15	13:00	Germany	CPI (YoY) (Provisional)	Jun		0.70%		*
29-Jun-15	13:00	Germany	CPI EU Harmonized (MoM) (Provisional)	Jun		0.10%		*
29-Jun-15	13:00	Germany	CPI EU Harmonized (YoY) (Provisional)	Jun		0.70%		*
29-Jun - 03-Jul-15		Germany	Retail sales (MoM)	May		1.70%		
29-Jun - 03-Jul-15		Germany	Retail sales (YoY)	May		1.00%		
29-Jun-15		Germany	CPI Baden Wuertemberg (MoM)	Jun		0.10%		
29-Jun-15		Germany	CPI Baden Wuertemberg (YoY)	Jun		0.70%		
30-Jun-15	08:55	Germany	Unemployment Change (000's)	Jun		-6K		**
30-Jun-15	08:55	Germany	Unemployment Rate	Jun		6.40%		*
1-Jul-15	08:55	Germany	Markit/BME Germany Manufacturing PMI (Final)	Jun		51.9		**

Date	Time	Country	Indicator	Period	Forecast	Prior	Consensus	Importance
3-Jul-15	08:55	Germany	Markit Germany Services PMI (Final)	Jun		54.2		
3-Jul-15	08:55	Germany	Markit/BME Germany Composite PMI (Final)	Jun		54		
6-Jul-15	07:00	Germany	Factory Orders (MoM)	May		1.40%		**
6-Jul-15	07:00	Germany	Factory Orders wda (YoY)	May		0.40%		
6-Jul-15	08:30	Germany	Markit Germany Construction PMI	Jun		50.8		
6-Jul-15	09:10	Germany	Markit Germany Retail PMI	Jun		55.8		
7-Jul-15	07:00	Germany	Industrial Production sa (MoM)	May		0.90%		***
7-Jul-15	07:00	Germany	Industrial Production wda (YoY)	May		1.40%		
26-Jun-15	07:45	France	Consumer Confidence	Jun		93	93	*
30-Jun-15	07:45	France	PPI (MoM)	May		-0.40%		
30-Jun-15	07:45	France	PPI (YoY)	May		-2.00%		
30-Jun-15	07:45	France	Consumer Spending (MoM)	May		0.10%		
30-Jun-15	07:45	France	Consumer Spending (YoY)	May		2.00%		
1-Jul-15	08:50	France	Markit France Manufacturing PMI (Final)	Jun		50.5		**
3-Jul-15	08:50	France	Markit France Services PMI (Final)	Jun		54.1		
3-Jul-15	08:50	France	Markit France Composite PMI (Final)	Jun		53.4		
6-Jul-15	09:10	France	Markit France Retail PMI	Jun		48.7		
7-Jul-15	07:45	France	Budget Balance YTD	May		€-59.8bn		
7-Jul-15	07:45	France	Trade Balance	May		€-3008mn		
8-Jul-15	07:30	France	Bank of France Business Sentiment	Jun		99		
26-Jun-15	09:00	Italy	Consumer Confidence Index	Jun		105.7	105.6	**
26-Jun-15	09:00	Italy	Business Confidence	Jun		103.5	103.8	***
26-Jun-15	09:00	Italy	Economic Sentiment	Jun		102		
30-Jun-15	09:00	Italy	Unemployment Rate (Provisional)	May		12.40%		
30-Jun-15	10:00	Italy	CPI NIC including tobacco (MoM) (Provisional)	Jun		0.20%		*
30-Jun-15	10:00	Italy	CPI NIC including tobacco (YoY) (Provisional)	Jun		0.20%		
30-Jun-15	10:00	Italy	CPI EU Harmonized (MoM) (Provisional)	Jun		0.20%		*
30-Jun-15	10:00	Italy	CPI EU Harmonized (YoY) (Provisional)	Jun		0.20%		***
30-Jun-15	11:00	Italy	PPI (MoM)	May		-0.30%		
30-Jun-15	11:00	Italy	PPI (YoY)	May		-3.10%		
1-Jul-15	08:45	Italy	Markit/ADACI Italy Manufacturing PMI	Jun		54.8		**
1-Jul-15	09:00	Italy	Deficit to GDP YTD	1Q		3.00%		
1-Jul-15	17:00	Italy	New Car Registrations (YoY)	Jun		10.78%		
1-Jul-15	17:00	Italy	Budget Balance	Jun		€-4.3bn		
3-Jul-15	08:45	Italy	Markit/ADACI Italy Services PMI	Jun		52.5		
3-Jul-15	08:45	Italy	Markit/ADACI Italy Composite PMI	Jun		53.7		
6-Jul-15	09:10	Italy	Markit Italy Retail PMI	Jun		48.3		
7-Jul-15	10:00	Italy	Bank of Italy Report on Balance-Sheet Aggregates					
25-Jun-15	08:00	Spain	PPI (MoM)	May		0.40%		
25-Jun-15	08:00	Spain	PPI (YoY)	May		-1.00%		
26-Jun-15	08:00	Spain	Total Mortgage Lending (YoY)	Apr		7.30%		
26-Jun-15	08:00	Spain	House Mortgage Approvals (YoY)	Apr		19.70%		
29-Jun-15	08:00	Spain	Retail sales (YoY)	May		2.90%		*
29-Jun-15	08:00	Spain	Retail sales sa (YoY)	May		4.00%		
29-Jun-15	08:00	Spain	CPI EU Harmonised (MoM) (Provisional)	Jun		0.40%		
29-Jun-15	08:00	Spain	CPI EU Harmonised (YoY) (Provisional)	Jun		-0.30%		***
29-Jun-15	08:00	Spain	CPI (MoM) (Provisional)	Jun		0.50%		*
29-Jun-15	08:00	Spain	CPI (YoY) (Provisional)	Jun		-0.20%		**
30-Jun-15	09:00	Spain	Current Account Balance	Apr		€0.9bn		
30-Jun-15		Spain	Spain Budget Balance Ytd	May		€-11.98bn		
1-Jul-15	08:15	Spain	Markit Spain Manufacturing PMI	Jun		55.8		**
2-Jul-15	08:00	Spain	Unemployment Net ('000s) (MoM)	Jun		-118		**
3-Jul-15	08:15	Spain	Markit Spain Services PMI	Jun		58.4		

Date	Time	Country	Indicator	Period	Forecast	Prior	Consensus	Importance
3-Jul-15	08:15	Spain	Markit Spain Composite PMI	Jun		58.3		
6-Jul-15	08:00	Spain	Industrial Output nsa (YoY)	May		2.70%		
6-Jul-15	08:00	Spain	Industrial Output sa (YoY)	May		1.80%		
8-Jul-15	08:00	Spain	House transactions (YoY)	May		9.40%		
1-Jul-15	08:00	Netherlands	NEVI Netherlands Manufacturing PMI	Jun		55.5		**
03-Jul - 12-Jul-15		Netherlands	CPI EU Harmonized (MoM)	Jun		0.20%		
03-Jul - 12-Jul-15		Netherlands	CPI EU Harmonized (YoY)	Jun		0.70%		
03-Jul - 12-Jul-15		Netherlands	CPI (MoM)	Jun		0.20%		**
03-Jul - 12-Jul-15		Netherlands	CPI (YoY)	Jun		1.10%		***
06-Jul - 11-Jul-15		Netherlands	Manufacturing Production (MoM)	May		2.00%		
06-Jul - 11-Jul-15		Netherlands	Manufacturing Production (YoY)	May		0.90%		
06-Jul - 11-Jul-15		Netherlands	Industrial sales (YoY)	May		-3.70%		

Source: Bloomberg, UBS (incl. UBS Economics estimates), all times are GMT+1

Key market views: Euro area

Figure 33: UBS Economics forecast and market views

Indicator	Current	2015E		2016E			
		Q3	Q4	Q1	Q2	Q3	Q4
ECB Bank rate (%)	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Euribor (3 months) (%)	-0.01	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05
Germany 10-year (%)	0.85	0.70	0.90	1.10	1.40	1.70	2.00
10y Bunds/Treasuries spread (bp)	-154	-150	-160	-150	-130	-115	-100
Nominal GDP (YoY %)	2.0 (Q1-15, Final)	2.1	2.8	3.3	3.2	3.5	3.6
Real GDP (QoQ %)	0.4 (Q1-15, Final)	0.5	0.5	0.5	0.4	0.5	0.5
Real GDP (YoY %)	1.0 (Q1-15, Final)	1.8	1.9	1.9	1.9	2.0	1.9
HICP (YoY %)	0.3 (May, Final)	0.5	1.0	1.4	1.3	1.5	1.6
EURUSD	1.12	1.17	1.05	1.14	1.13	1.11	1.10

Source: Bloomberg, UBS Economics estimates (end of period)

Key market views: UK

Figure 34: UBS Economics forecast and market view

Indicator	Current	2015E		2016E			
		Q3	Q4	Q1	Q2	Q3	Q4
Bank rate (%)	0.50	0.50	0.75	0.75	1.00	1.25	1.25
Libor (3 months) (%) (eop)	0.57	0.88	1.08	1.33	1.58	1.83	2.10
10-year (%) (eop)	2.13	2.30	2.35	2.40	2.45	2.50	2.50
10-year Gilts/Bund spread (bp)	129	160	145	130	105	80	50
10-year Gilts/Treasuries spread (bp)	-26	10	-15	-20	-25	-35	-50
Nominal GDP (YoY%)	4.3 (Q1-15,Preliminary)	4.1	4.4	4.8	4.6	4.2	3.9
Real GDP (QoQ %)	0.3 (Q1-15, Preliminary)	0.8	0.9	0.6	0.5	0.4	0.4
Real GDP (YoY %)	2.4 (Q1-15, Preliminary)	2.5	2.8	3.1	2.8	2.3	1.9
RPI (%) (YoY %)	1.0 (May)	1.0	1.5	2.2	2.6	2.7	2.7
CPI (%) (YoY %)	0.1 (May)	0.1	0.7	1.4	1.3	1.5	1.8
UK Unemployment Rate	5.5 (Apr, 3m)	5.3	5.1	5.0	4.9	4.8	4.7
GBPUSD	1.58		1.55				1.52
EURGBP	0.71		0.67				0.72

Source: Bloomberg, UBS Economics estimates (end of period)

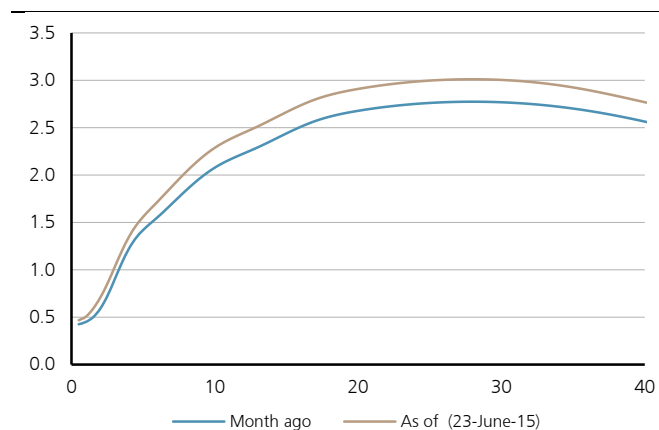
UK macroeconomic calendar

Date	Time	Indicator	Period	Forecast	Prior	Consensus	Importance
25-Jun-15	10:30	Bank of England's David Rule Speaks in Lisbon, Portugal					
25-Jun-15	11:00	CBI Reported sales	Jun		51	35	
26-Jun-15	15:15	BOE's Carney Speaks at Capitalism Conference on Fair Markets					
28-Jun - 03-Jul-15		Nationwide House PX (MoM)	Jun		0.30%		**
28-Jun - 03-Jul-15		Nationwide House Px nsa (YoY)	Jun		4.60%		**
29-Jun-15	09:30	Net Consumer Credit	May		£1.2bn		
29-Jun-15	09:30	Net Lending Sec. on Dwellings	May		£1.7bn		
29-Jun-15	09:30	Mortgage Approvals	May		68.1K		*
29-Jun-15	09:30	Money Supply M4 (MoM)	May		0.40%		
29-Jun-15	09:30	M4 Money Supply (YoY)	May		0.00%		
29-Jun-15	09:30	M4 Ex IOFCs 3M Annualised	May		4.00%		
30-Jun-15	00:05	GfK Consumer Confidence	Jun		1		
30-Jun-15	09:30	Current Account Balance	1Q		£-25.3bn		
30-Jun-15	09:30	GDP (QoQ) (Final)	1Q		0.30%		***
30-Jun-15	09:30	GDP (YoY) (Final)	1Q		2.40%		***
30-Jun-15	09:30	Total Business Investment (QoQ) (Final)	1Q		1.70%		
30-Jun-15	09:30	Total Business Investment (YoY) (Final)	1Q		3.70%		
30-Jun-15	09:30	Index of Services (MoM)	Apr		0.10%		
30-Jun-15	09:30	Index of Services 3M/3M	Apr		0.40%		
30-Jun-15	09:30	Lloyds Business Barometer	Jun		55		
1-Jul-15	09:30	Markit UK PMI Manufacturing sa	Jun		52		**
1-Jul-15	12:00	Prime Minister's Question Time in House of Commons					
2-Jul-15	09:30	Markit/CIPS UK Construction PMI	Jun		55.9		*
3-Jul-15	09:30	Official Reserves Changes	Jun		\$-324mn		
3-Jul-15	09:30	Markit/CIPS UK Services PMI	Jun		56.5		
3-Jul-15	09:30	Markit/CIPS UK Composite PMI	Jun		55.8		
05-Jul - 10-Jul-15		Halifax House Prices (MoM)	Jun		-0.10%		*
05-Jul - 10-Jul-15		Halifax House Price	Jun		8.60%		
6-Jul-15	09:00	New Car Registrations (YoY)	Jun		2.40%		
7-Jul-15	09:30	Industrial Production (MoM)	May		0.40%		**
7-Jul-15	09:30	Industrial Production (YoY)	May		1.20%		
7-Jul-15	09:30	Manufacturing Production (MoM)	May		-0.40%		**
7-Jul-15	09:30	Manufacturing Production (YoY)	May		0.20%		
7-Jul-15	15:00	NIESR GDP Estimate	Jun		0.60%		
8-Jul-15	00:01	BRC Shop Price Index (YoY)	Jun		-1.90%		
8-Jul-15	12:00	Prime Minister's Question Time in House of Commons					
8-Jul-15		Osborne Makes Budget Statement to UK House of Commons					

Source: Bloomberg, UBS (incl. UBS Economics estimates), all times are GMT+1

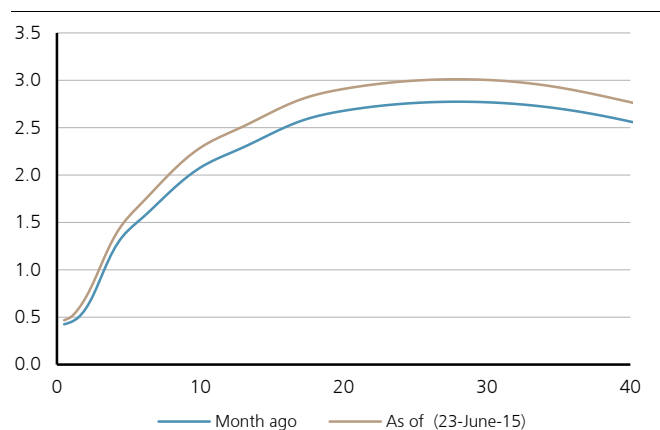
Gilt and GBP swap zero and forward curves

Figure 35: Gilt par curve (%)



Source: UBS

Figure 36: Gilt 5-year, 5-year forward par rate (%)



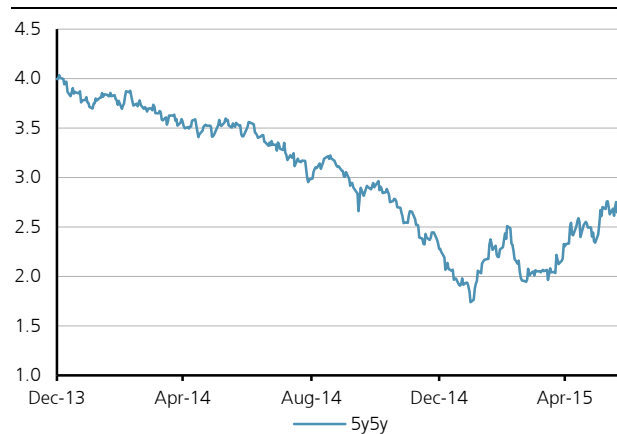
Source: UBS

Figure 37: Gilt 10-year, 20-year forward par rate (%)



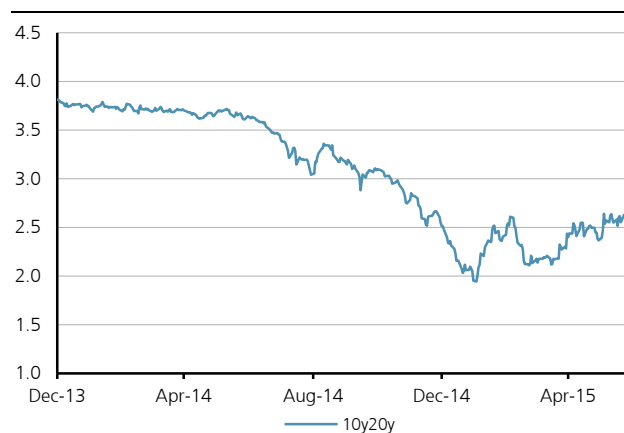
Source: UBS

Figure 38: GBP 5-year, 5-year forward swap rate (%)



Source: UBS, Bloomberg

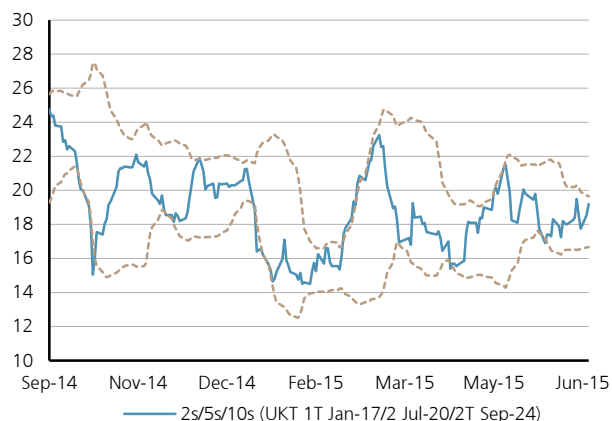
Figure 39: GBP 10-year, 20-year forward swap rate (%)



Source: UBS, Bloomberg

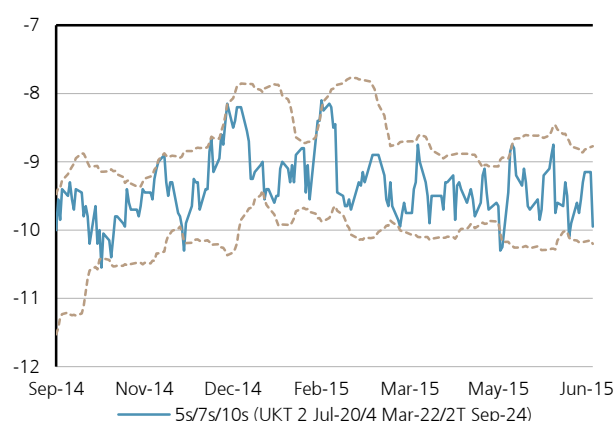
Conventional Gilt yield barbells

Figure 40: 2s/5s/10s (bp)



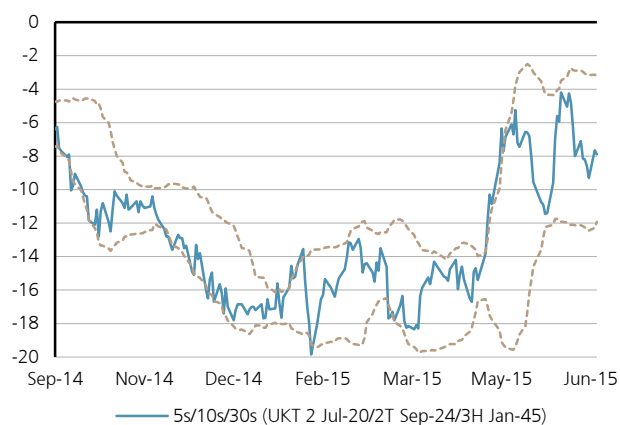
Source: UBS, Bloomberg

Figure 41: 5s/7s/10s (bp)



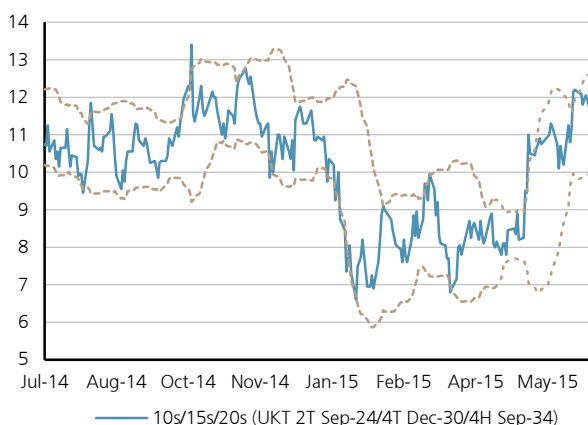
Source: UBS, Bloomberg

Figure 42: 5s/10s/30s (bp)



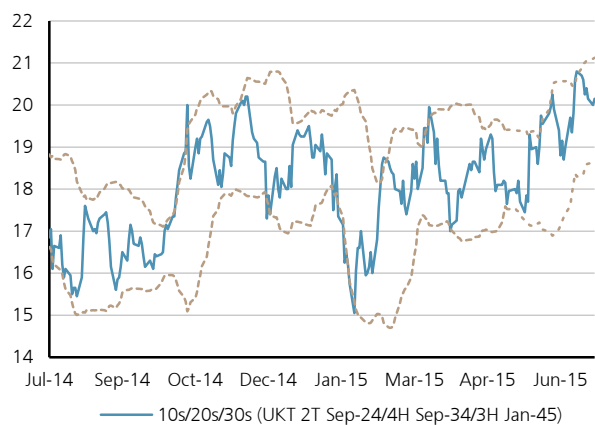
Source: UBS, Bloomberg

Figure 43: 10s/15s/20s (bp)



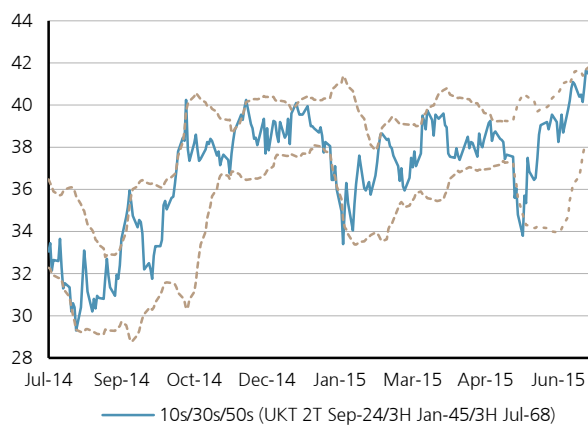
Source: UBS, Bloomberg

Figure 44: 10s/20s/30s (bp)



Source: UBS, Bloomberg

Figure 45: 10s/30s/50s (bp)



Source: UBS, Bloomberg

Conventional Gilts outstanding and BoE holdings

(£mm)	Free-float (amount outstanding less Government holdings)*	BoE purchases (in nominal terms)**	BoE holding as a percentage of free-float	Nominal outstanding in market hands	Eligible for Bank of England Asset Purchase Programme*** (0.7* Free float) - BoE holdings		
					3- to 7- year	7- to 15-year	15+ year
	[A]	[B]	[B] / [A]	[A] - [B]	0.7* [A] - [B]		
UKT 4.75 09/15	31,693	15,093	47.62%	16,600			
UKT 8.00 12/15	7,204	4,716	65.46%	2,489			
UKT 2.00 01/16	30,907	7,981	25.82%	22,926			
UKT 4.00 09/16	29,190	11,042	37.83%	18,148			
UKT 1.75 01/17	27,920	11,156	39.96%	16,764			
UKT 8.75 08/17	7,371	4,576	62.07%	2,796			
UKT 1.00 09/17	31,011	3,586	11.56%	27,425			
UKT 5.00 03/18	29,028	15,766	54.31%	13,262			
UKT 1.25 07/18	34,002	2,871	8.44%	31,131	20,930		
UKT 4.50 03/19	33,270	17,387	52.26%	15,883	5,902		
UKT 1.75 07/19	29,798	2,755	9.25%	27,043	18,104		
UKT 3.75 09/19	27,074	11,510	42.51%	15,564	7,442		
UKT 4.75 03/20	28,012	14,125	50.42%	13,887	5,484		
UKT 2.00 07/20	27,683	0	0.00%	27,683	19,378		
UKT 3.75 09/20	23,159	4,699	20.29%	18,460	11,512		
UKT 8.00 06/21	16,394	11,285	68.83%	5,110	-		
UKT 3.75 09/21	26,882	7,099	26.41%	19,783	11,719		
UKT 4.00 03/22	36,025	23,291	64.65%	12,734	1,927		
UKT 1.75 09/22	28,241	3,292	11.66%	24,949		16,477	
UKT 2.25 09/23	26,808	2,758	10.29%	24,050		16,008	
UKT 2.75 09/24	26,487	2,005	7.57%	24,482		16,536	
UKT 5.00 03/25	27,595	17,006	61.84%	10,530		2,251	
UKT 2.00 09/25	9,273	0	0.00%	9,273		6,491	
UKT 4.25 12/27	25,346	17,259	68.09%	8,087		483	
UKT 6.00 12/28	13,446	8,152	60.63%	5,294		1,260	
UKT 4.75 12/30	28,702	12,925	45.03%	15,777			7,166
UKT 4.25 06/32	27,580	14,487	52.53%	13,093			4,819
UKT 4.50 09/34	28,858	8,475	29.37%	20,383			11,726
UKT 4.25 03/36	19,906	5,942	29.85%	13,963			7,992
UKT 4.75 12/38	18,484	8,157	44.13%	10,327			4,782
UKT 4.25 09/39	18,612	6,547	35.18%	12,065			6,481
UKT 4.25 12/40	23,452	7,520	32.07%	15,932			8,896
UKT 4.50 12/42	21,129	7,302	34.56%	13,827			7,488
UKT 3.25 01/44	26,690	1,959	7.34%	24,731			16,724
UKT 3.50 01/45	17,470	180	1.03%	17,290			12,049
UKT 4.25 12/46	16,147	4,983	30.86%	11,164			6,320
UKT 4.25 12/49	17,311	5,208	30.09%	12,103			6,909
UKT 3.75 07/52	21,378	6,693	31.31%	14,685			8,271
UKT 4.25 12/55	19,203	8,150	42.44%	11,054			5,293
UKT 4.00 01/60	20,073	7,455	37.14%	12,618			6,596
UKT 3.50 07/68	15,150	381	2.51%	14,769			10,224
Total	973,967	325,831	33.45%	648,135	102,397	59,506	131,737

Source: Bank of England, DMO, Bloomberg, UBS.

* Government holdings include holdings by the Commissioners for the Reduction of the National Debt (CRND) and the DMO. Government holdings do not include holdings by local authorities, public corporations and the Bank of England. ** Included is also a small amount of gilts purchased before March 2009 as a result of its market operations. ** The BoE does currently not buy gilts in which they have acquired 70% of the market free-float. The calculation of 'Eligible for BoE Asset Purchase Programme' is an indication of how much more the Bank of England can buy of each gilt. Note: BoE made its first purchase of gilts within the Asset Purchase Facility on 11th March 2009. The first £122bn purchases were focused on the 5- to 25-year sector. From 10th August 2009, all conventional gilts with a maturity greater than 3-years were eligible for purchase. The last purchase in the first round of QE (total £200bn) took place on 26th January 2010. The first purchase in the second round of QE (£75bn) took place on 10th October 2011. On 9th February 2012 a £50bn extension of QE was announced (taking the total to £325bn) and at the same time the sectors were changed to 3-7yr, 7-15yr and over 15yr. The last purchases in QE2 took place on 2nd May 2012 and the total purchases amount to £324.7 bn. On 5th July 2012, another £50bn extension of QE was announced and the purchases resumed on 9th July 2012.

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Source: UBS

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Greece	-	-
Kingdom of Belgium ^{16, 22}	-	-
Kingdom of the Netherlands	-	-
Latvia	-	-
Lithuania	-	-
Portuguese Republic	-	-
Republic of Austria ¹⁶	-	-
Republic of Finland	-	-
Republic of Ireland ^{2, 4}	-	-
Republic of Italy ^{2, 4}	-	-
Slovak Republic	-	-
Slovenia	-	-
Spain	-	-
Switzerland ⁵	-	-
United Kingdom of Great Britain ^{2, 4, 5, 16, 22}	-	-
United States ²²	-	-

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