European Rates Perspectives

A game of two halves

Interest Rates

Europe including UK

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Scale into long Bund ASW positions in 20-25yrs

We recommend scaling into long Bund ASW positions in the 20-25yr point given (1) the attractive entry levels on offer (Bunds historically cheap to swaps and the relative cheapness of this sector compared to other tenors) and (2) in anticipation of the large long-end coupons in Germany (~€9million/bp) on 4 July. Using Buxl futures (CTD = Jul39) or longer maturity bonds (e.g. Jul42 or Jul44) to express long ASW positions is also attractive, in our view.

Spain leading the June index extension

We estimate that the duration of the iBoxx Eurozone Sovereign Index will be extended by 0.04 years in June. This corresponds to the second smallest monthly extension in 2014 so far. However, Spain's expected extension of 0.015 years will be the largest since January this year.

Month-end Index Changes: RV opportunities

We expect month end index changes, upcoming cash flows and accommodative ECB policy to be supportive for short-end Spanish bonds. We highlight a number of reasons why we do not expect index changes to provide a headwind for Italian bonds in the near-term. We maintain our view that 5yr France will move down to 0.46% and 5yr Germany-France spreads will tighten (further) to 13bp.

Will the Bank of England sell gilts?

Recent comments from Governor Carney suggest the BoE might soon start considering selling gilts as a policy option. We think that this would only be one of several options and others, such as liquidity-absorbing operations, seem more likely than outright gilt sales in the near term. The distribution of the BoE's gilt holdings shows that a large proportion matures between 2015 and 2022. However, when examining the distribution in DV01 terms, the market seems vulnerable to sales of gilts beyond 2024. The eventual impact from any such sales by the BoE will in our view depend on how it decides to structure its activity.

Good value in long-end gilts

After several years of falling yield levels and rising equity markets, anecdotal evidence suggests there is still significant pent-up demand for long-end gilts. We see a solid case for 'de-risking' flows from UK pension schemes intensifying as we approach the monetary policy tightening cycle. This, we think, will help 30-year gilts stay well supported. We suggest adding to positions on dips.

ECB Watch: Most likely done now

Our base-case assumption is that rates will stay on hold for the foreseeable future. We also do not expect that a broad-based QE programme will be deployed. As we have argued repeatedly, we believe QE will only be triggered in the event of more disconcerting signs that the Eurozone is about to slide into deflation.

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A game of two halves

In this edition of European Rates Perspectives, we focus more on carry aspects of rates markets, at least of those of the euro area, as unlike in the first half of the year, we are expecting little market movement in the coming month or so. We do not expect significant upward moves in yields (or at least not until later in the second half) and while there is still room for yields to fall, it is becoming increasingly limited. The impact of negative deposit rates which we discussed so extensively for several months prior to the event has now largely played out, with German 5-year yields close to our target of 0.33% (from 0.55% when we set in early May) and French 5-year spreads to Germany half-way to our 13bp target. Markets can overshoot our targets from here, but we do not expect by much.

We can say the same of the peripheral spread targets of 150bp for Spain and Italy versus Germany in the 10-year sector which we set in January. As we have written in this document since, we can expect further tightening from current levels (of 138bp in Spain and 158bp in Italy) but we think that in the longer term – over the next 9 months or so – that 150 remains the more stable level. The reason for this is simple – yields in other markets are beginning to look attractive versus those of the periphery. Supporting peripheral markets in the near term will be large redemptions in both Spain and Italy over the next month or so and a strong index extension for Spain.

One curve now yielding more than that of Spain out to the 10-year point is that of the UK. Bank of England governor Mark Carney this week stated that the BoE would not start to sell its gilt holdings acquired in the QE programme until its bank rate was above 1%. As we point out later on, we doubt that he meant that this would happen *once* the rate hit 1%, but rather not to expect it until some point after that – if it ever happens at all (as there would be several alternatives). Nonetheless, we look at the composition of the BoE's portfolio and the dv01 distribution within it.

More immediately in the gilt market we think that there could be strong demand for 30-year bonds versus other points in the curve as the UK goes into a monetary policy tightening cycle. As we argue, the chance of an interruption to the equities bull trend as a result of higher rates we think could trigger hedging by pensions funds and insurance companies in the long end of the gilt curve, this could come in an environment of rising 10-year yields which would tend towards flattening of the long end anyway.

We also take a look at the long end of the German curve where we think that 20 to 25-year bonds currently look cheap to swaps. We do not expect any German 30-year issuance until October of this year, and in the meantime a large proportion of coupon payments are to be made on bonds in that sector of the curve.

So, unlike in the opening phase of the World Cup, we expect little in the way of upsets for Spain, Italy, UK or indeed any other European market in the near term. Take the carry for now.

Euro Area

- **Scale into long-end Bund ASW positions ahead of July cash flows**
- **Month-end Index Changes: RV Opportunities**
- **Spain leading the June index extension**
- **European Economic Outlook Q2 2014**
- **ECB Watch**
- **Euro Technical Analysis**
- **The fortnight ahead in Euro area**

Scale into long-end Bund ASW positions ahead of July cash flows

Nishay Patel

- We recommend scaling into long Bund ASW positions in the 20-25yr point at current levels. We think Jul34 and Jul39 ASW levels can richen by around 10bps from current levels over the coming months (bonds outperforming swaps).
- There will be a sizeable amount of German coupon payments (€11.4bn) and a redemption (€25bn) on 4 July. The PV01 of coupon payments on 4 July 2014 will be approximately €11.5million/bp. Around 78% of these payments will fall in the long-end of the German curve (Figure 4).
- Using Buxl futures or longer maturity bonds (e.g. Jul42 or Jul44) to express long ASW positions in the 20-25yr sector is also attractive, in our view.

We expect Bund Jul34 and Jul39 to outperform euro swaps over the coming months

Trading strategies & implications for the curve

Long Bund ASW in 20-25yr: We recommend scaling into long Bund ASW positions in the 20-25yr point at current levels given (1) the attractive entry levels on offer (historically cheap and the relative cheapness of this sector compared to other tenors) and (2) in anticipation of a large amount of cash flows that will be paid in Germany on 4 July (€11.4bn of coupons where 78% of the total DV01 falls in 10yrs+ and a €25bn redemption). We think Jul34 and Jul39 Bund ASW levels can richen by around 10bps from current levels over the coming months.

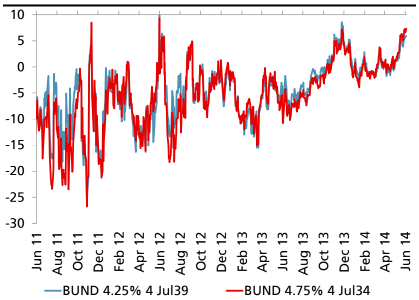
Buxl futures or 30yr ASW: As mentioned previously, we accept that some investors may have concerns over the liquidity of Bunds in the 20-25yr point of the curve. Using Buxl futures (CTD = Jul39) or buying longer maturity bonds such as Jul42s and Jul44s vs swaps as an alternative is also attractive, in our view.

Avoid long 30yr Germany vs the Netherlands for now: Whilst it could be tempting to take advantage of historically rich core spreads to 30yr Germany at current levels it is worth noting that there will also be €17.6bn of cash flows on 15 July for the Netherlands (€12.5bn of redemptions and €5.1bn of coupons). Although these coupon payments do not fall in 15yrs+ we feel the risk reward is better suited to long Bund ASW positions than long 30yr Germany vs the Netherlands at this stage.

Bund 10s30s: All things being equal, upcoming coupon payments (largely distributed in the long-end of the Bund curve) could be supportive for flattening positions in Bund 10s30s (and EUR 10s30s) – particularly for Bunds due to the absence of supply in this segment until October 2014 (€2bn of 30yr Bund).

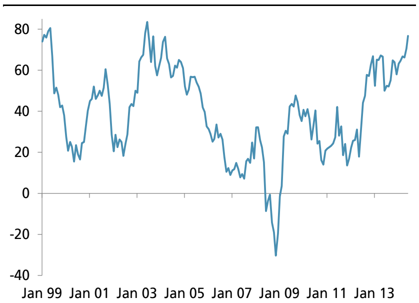
With EUR 10s30s trading at 77bp (five year high) holders of steepening positions may wish to consider taking profits at current levels. Overall, we continue to expect 10s30s to remain largely directional and would consider entering steepeners if we move below 70bp in euro swaps. See *Fixed Income Strategy Comment: EUR 10s30s too steep?* for further details.

Figure 1: Bund 20-25yr ASW levels



Source: UBS, Reuters

Figure 2: EUR 10s30s



Source: UBS, Bloomberg

Below, we highlight two main reasons why we see value in long Bund ASW positions in 15yrs+ over the coming weeks

[1] Large coupons & redemptions on 4 July (€36bn)

As can be seen in Figure 3 below, there will be a sizeable amount of German coupon payments (€11.4bn) and redemptions (€25bn) on 4 July. The size of coupon payments in July is equivalent to ~41% of total coupon payments for Germany in 2014.

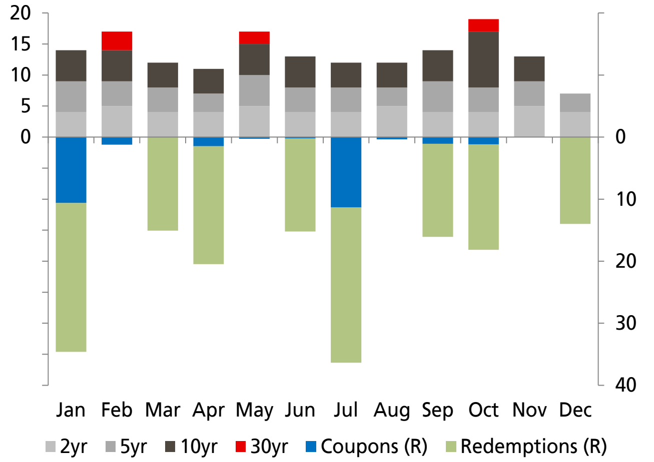
Sizeable amount of German coupon payments (€11.4bn) and redemptions (€25bn) on 4 July

Cash flows in Germany (coupons + redemptions) easily outweighs €12bn of gross issuance during the course of July. All things being equal, this is likely to be supportive for Bunds around 4 July 2014 when €36bn of cash flows will be paid.

In PV01 terms ~78% of coupon payments fall in 10yrs+

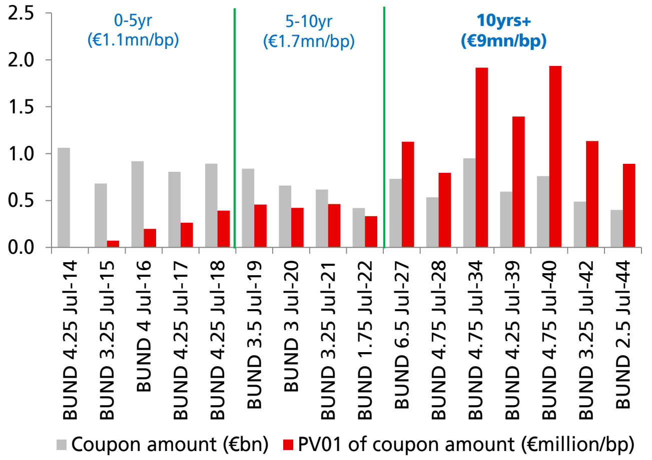
On a micro level, the PV01 of coupon payments on 4 July 2014 will be approximately €11.5million/bp. Around 78% of these payments (~€9million/bp) will fall in the long-end of the German curve (Figure 4).

Figure 3: July: Coupons and redemptions outweighs gross supply by ~€24bn in Germany



Source: UBS, German finance agency, Bloomberg

Figure 4: In PV01 terms, 78% of German coupons on 4 July 2014 are 10yrs+



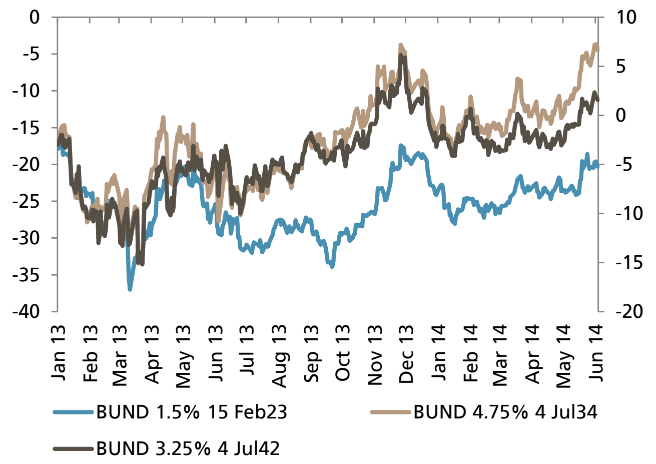
Source: UBS, Bloomberg

[2] Optically attractive entry levels: sector & outright level

Sector comparison: Comparing the evolution of Bund ASWs since the start of 2013 shows that the 20yr sector has cheapened markedly when compared to other tenors such as 10yrs and 30yrs (Figure 5). This has taken the Bund 10yr-20yr-30yr ASW barbell to its highest level since the start of the period (indicating 20yr Bunds are historically cheap to swaps relative to other tenors) – Figure 6.

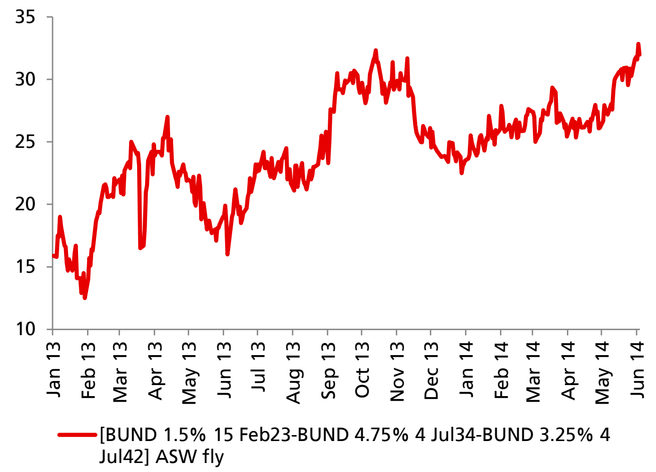
Bund 20-25yr ASWs are historically cheap on the curve…

Figure 5: Bund ASW: spreads have cheapened across the curve in recent months (bonds underperforming swaps)



Source: UBS, Reuters

Figure 6: 20yr ASW have cheapened markedly when compared to other tenors such as 10yrs & 30yrs

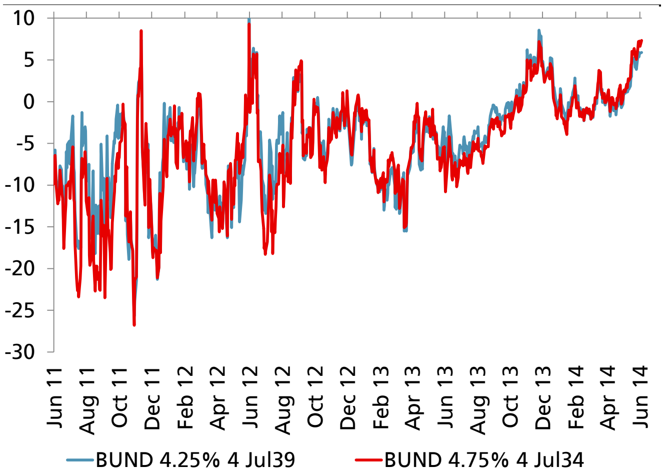


Source: UBS, Reuters

...outright levels for long-end ASWs are historically cheap too

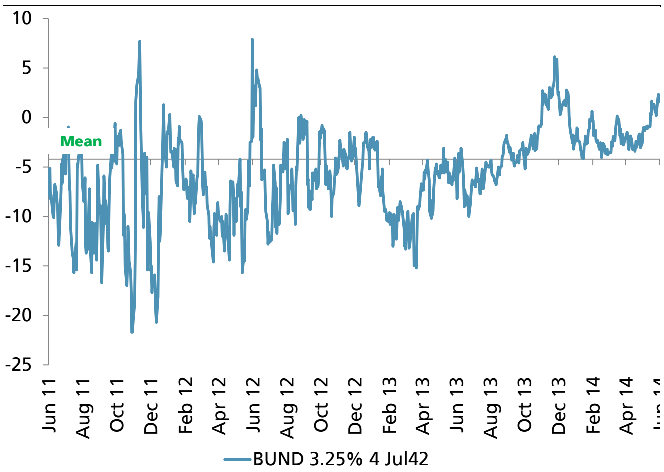
Outright levels: As shown in Figure 7 below, the 20-25yr point of the ASW curve is trading close to the top end of the three year range (bonds cheap to swaps). Purely from a technical perspective current levels offer an attractive entry point for long Bund ASW positions, in our view.

Figure 7: ASW levels: Bunds in the 20-25yr sector are close to their cheapest levels to swaps in the last three years



Source: UBS, Reuters

Figure 8: 30yr ASW: Bunds in the 30yr sector are also close to their cheapest levels to swaps



Source: UBS, Reuters

Buxl futures or 30yr Bund ASW offers an attractive alternative if concerned about liquidity in the 20-25yr point

We accept that some investors may have concerns over the liquidity in Bunds for the 20-25yr point of the curve. We recommend considering long ASW positions using Buxl futures (the CTD in the Buxl contract is the Jul39 bond and the likelihood of a CTD switch is very low, in our view) or using longer maturity Bunds (Jul42s or Jul44s) which are also trading close to their cheapest levels vs swaps (Figure 8).

Month-end Index Changes: RV Opportunities

For an overview of our forecasts for month-end changes for the Market iBoxx Eurozone Sovereign index see the next page of this report.

Nishay Patel

- **Spain:** We expect month end index changes, upcoming cash flows and accommodative ECB policy to be supportive for short-end Spanish bonds.

- **Italy:** This month's index extension for Italy is much lower than the 3month, 12month and 5year average level. However, we do not expect this to be a headwind for BTPs in the near-term due to large redemptions payments and the price level for this week's new 5yr BTP auction being supportive for this sector, as well as the implications of ECB policy and the likelihood of there being further interest in extension trades out of 2yr BTPs into the 5-7yr point.

- **France**: We maintain our view that 5yr France will move down to 0.46% and 5yr Germany-France spreads will tighten (further) to 13bp. On a sub-index level, 5-7yr France will extend by 0.05yrs which is higher than the aggregate 5-7yr index change of only 0.012years

Spain: supportive index changes, cash flows and ECB policy

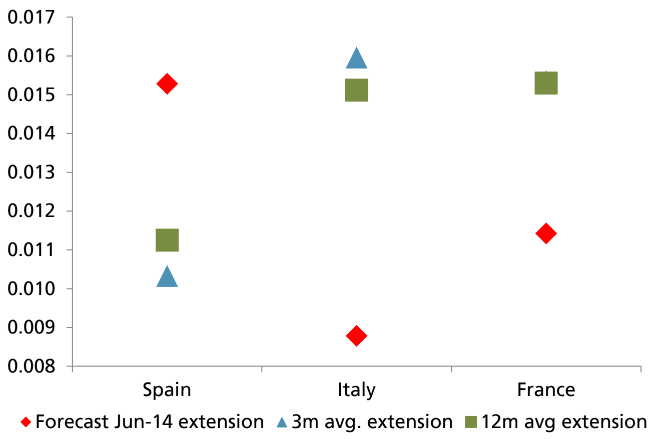
We see three factors over the short-term that are supportive for long Spain positions.

- First, Spain will have the largest index extension amongst all constituents at the end of this month. On a relative basis end-June index changes for Spain will be considerably larger than the 3month, 12month and 5yr average (Figure 9).

- Second, during the course of July, there will be sizeable coupon payments (€8.4bn) and redemptions (€16.4bn) on 30 July which is considerably larger than an estimated €7bn of gross supply (Figure 10).

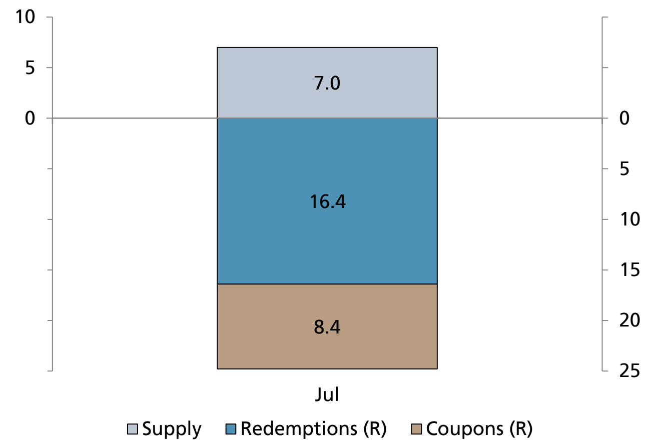
- Third, as mentioned on previous occasions we expect the introduction of a negative deposit rate by the ECB (which is applicable to excess reserves in the current account as well as the deposit facility) to be supportive for short-end Spanish and Italian bonds (*Fixed Income Strategy Comment: How to play the June ECB meeting*, 2 June 2014).

Figure 9: Markit iBoxx Eurozone Sovereign extension forecasts for end-June



Source: UBS, Markit

Figure 10: Spain: Supply, Redemptions and Coupons in July (€bn)



Source: UBS, Bloomberg

Italy: index extension is below average but unlikely to be a headwind

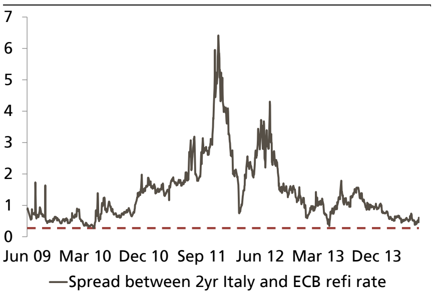
This month's index extension for Italy is much lower than the 3month, 12month and 5year average level. However, we do not expect this to be a headwind for BTPs in the near-term.

One main reason for this is: that there will be a large BTP redemption on 1 July for €14bn which could also be supportive for Friday's BTP auction. Furthermore the new 5yr BTP that will be launched on Friday is likely to have the lowest price in the sector as well as having a price close to par which has traditionally encouraged demand for domestic institutions such as bank treasury accounts and insurers.

As noted on previous occasions we recommend switching long 2yr BTP positions into the 5-7yr point of the curve (ideally 7yrs)[1] due to two main reasons:

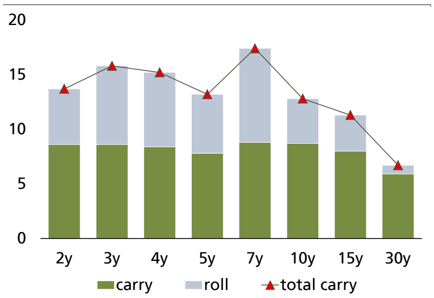
- First, 2yr BTPs have previously faced a support level of 27bps over the ECB refi-rate and with the current spread at 45bp the room for a sizeable rally could be limited (Figure 11).
- Second, the 7yr sector has one of the highest total carry points on the curve (Figure 12). Despite the flattening seen in recent weeks the 7yr point still offers an attractive yield pick-up when compared to shorter maturities such as the 5yr point (Figure 13).

Figure 11: Italy 2yr yield less ECB refi-rate



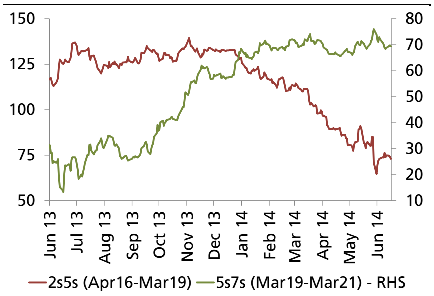
Source: UBS, Bloomberg

Figure 12: Italy: carry, roll and total carry 3m horizon (bp)



Source: UBS, Reuters

Figure 13: Italy 2yr-5yr spread & 5yr-7yr spread



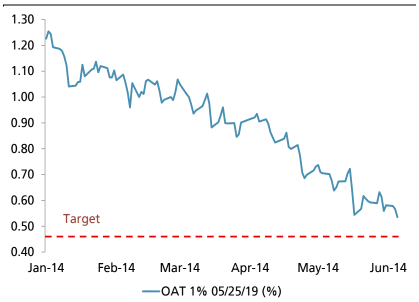
Source: UBS, Reuters

France: 5yr point has further to rally

We maintain our view that 5yr France will move down to 0.46% and 5yr Germany-France spreads will tighten (further) to 13bp (Fixed Income Strategy Comment: How to play the June ECB meeting).

On a sub-index level, 5-7yr France will extend by 0.05yrs which is higher than the aggregate 5-7yr index change of only 0.012years. Meanwhile, within the 7-10yr sub index France will contract by 0.034yrs. Overall, this is likely to be supportive for 5yr France to the extent that investors track the 5-7yr sub index.

Figure 14: 5yr France yield (%)



Source: UBS, Bloomberg

[1] *European Rates Perspectives: Reaching for the floor,* 11 June 2014

Spain leading the June index extension

Joakim Tiberg

- We estimate that the duration of the iBoxx Eurozone Sovereign Index will be extended by 0.04 years in June. This corresponds to the second smallest monthly extension in 2014 so far. However, Spain's expected extension of 0.015 years will be the largest since January this year.

Spain main contributor to an on aggregate relatively small extension

Spain's extension is mainly driven by the €9bn syndication of a new Oct-24 bond in combination with the switch auction out of three 2015 bonds (two of which with a remaining life over a year and therefore included in the index) in mid-June. As a result, Spain's share of the index will increase to 10.7% from 10.5%.

Elsewhere, Austria's 0.005 year extension is together with its April extension the country's largest since September last year. Germany, France and Italy will all extend by less than their 3-12-month and 5-year average June extensions.

Figure 15: Markit iBoxx Eurozone Sovereign Index, duration* and extension, history and UBS forecast

Constituents	Old duration	New duration	Forecast Jun-14 extension	5y avg. Jun extension	3m avg extension	6m avg extension	12m avg extension	May-14 extension	Apr-14 extension	Mar-14 extension
Luxembourg	0.006	0.006	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Belgium	0.467	0.469	0.002	0.006	0.004	0.006	0.005	-0.001	0.008	0.008
Netherlands	0.416	0.418	0.002	0.007	0.005	0.004	0.005	0.001	0.004	0.011
Spain	0.696	0.711	0.015	0.010	0.010	0.012	0.011	0.001	0.012	0.007
Austria	0.288	0.292	0.005	0.005	0.002	0.002	0.002	-0.001	0.005	-0.002
Finland	0.104	0.103	-0.001	0.002	0.002	0.001	0.001	0.003	0.001	-0.001
France	1.609	1.621	0.011	0.030	0.015	0.013	0.015	0.005	0.030	0.010
Germany	1.342	1.341	-0.001	0.010	0.006	0.008	0.008	-0.002	0.016	-0.001
Ireland	0.100	0.099	-0.001	0.003	0.001	0.001	0.001	0.000	0.002	0.001
Italy	1.544	1.553	0.009	0.019	0.016	0.016	0.015	0.020	0.027	0.013
Slovakia	0.036	0.036	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total	**6.608**	**6.649**	**0.040**	**0.059**	**0.062**	**0.062**	**0.064**	**0.026**	**0.105**	**0.047**

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

Sub-indices

The **1-3-year index** will likely extend by 0.063 years, slightly below the 3-12-month average of around 0.075 years. Belgium will with its 0.034-year extension make up for more than half of the sub-index's extension.

We forecast a 0.057 year extension in the **3-5-year index** – this too is slightly below its 3-12-month average. While Ireland will extend by 0.044 years, Italy and Belgium will likely contract by 0.031 and 0.044 years respectively.

The **5-7-year index** will extend by a relatively small 0.012 years. In this sub-index France will extend by 0.05 years while Austria and Ireland will contract by 0.045 and 0.053 years respectively.

The **7-10-year index** will likely extend by 0.022 years. This corresponds to the smallest extension since December last year. While Belgium likely will extend by 0.084 years, France will contract by 0.034 years.

European Economic Outlook Q2 2014

Reinhard Cluse

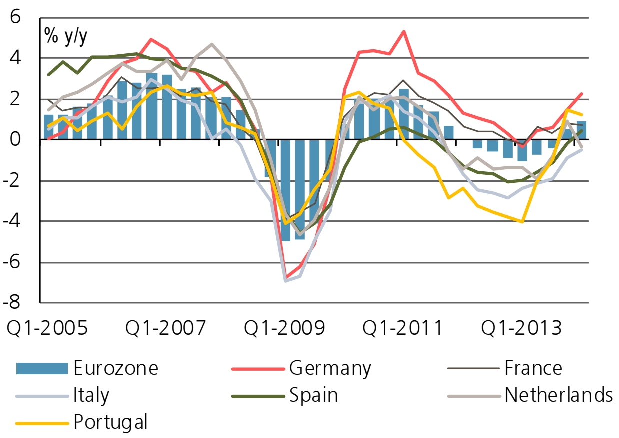
- We expect Eurozone GDP growth of 1.0% for 2014 (previously 1.1%) and 1.5% for 2015.
- Domestic demand to accelerate, net exports to soften, and current account adjustments to lose momentum.
- Prolonged period of low inflation, but not deflation. ECB to refrain from further significant stimulus.

Recovery on track, albeit slow and uneven

The Eurozone recovery remains on track, but it is slow and uneven. Real GDP in Q1 disappointed. First, the headline numbers of +0.2% q/q and 0.9% y/y were below consensus. Second, the divergence within the Eurozone increased again, with Germany and Spain growing at decent rates of 0.8% q/q and 0.4% q/q, respectively, while France and Italy saw rather weak growth of zero and -0.1% q/q, respectively. The Netherlands also disappointed (-1.4% q/q), although this was largely due to weaker natural gas production during the mild winter. In light of the soft Q1, we have tweaked our 2014 Eurozone GDP forecast marginally lower, to 1.0% from 1.1% (consensus 1.1%). However, we maintain our 2015 forecast of 1.5%, in line with consensus.

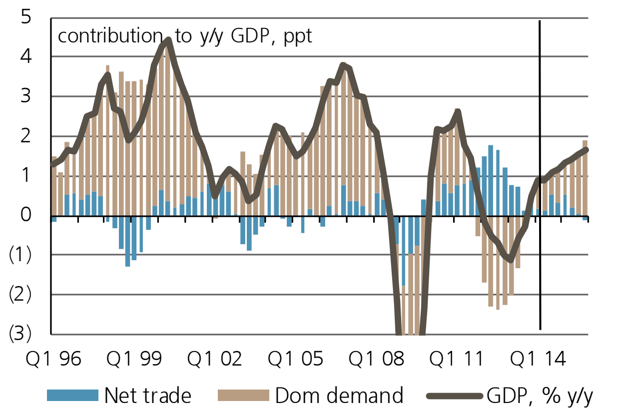
Given very low inflation, nominal GDP in the Eurozone will grow only 1.7% this year and 2.7% in 2015 – better than in 2013 (1.1%), but still much slower than would be desirable to support debt deleveraging.

Figure 16: Real GDP growth, % y/y



Source: Haver, UBS

Figure 17: Eurozone real GDP and contributions in ppt



Source: Haver, UBS

Figure 18: Euro area economic forecasts

					2013		2014F				2015F			
% y/y	2012	2013	2014F	2015F	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP (% qoq)	-	-	-	-	0.1	0.3	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.5
Real GDP	-0.6	-0.4	1.0	1.5	-0.3	0.5	0.9	0.9	1.1	1.2	1.3	1.4	1.5	1.7
Consumers' expenditure	-1.4	-0.6	0.8	1.3	-0.4	0.1	0.4	0.7	0.9	1.2	1.4	1.3	1.3	1.3
Govt consumption	-0.6	0.1	0.0	0.3	0.5	0.1	0.2	0.2	-0.4	-0.1	-0.2	0.0	0.5	0.8
Fixed investment	-3.8	-2.8	2.3	3.1	-2.4	-0.1	1.9	2.3	2.5	2.4	2.8	3.0	3.2	3.4
Exports of gds and serv.	2.7	1.5	3.5	4.3	0.9	2.9	4.1	2.8	3.7	3.4	4.1	4.2	4.4	4.4
Imports of gds and serv.	-0.8	0.4	3.2	4.4	0.7	2.5	4.1	2.9	2.9	3.0	3.3	4.2	4.7	5.3
Stocks*	-0.5	0.0	-0.1	0.0	0.2	0.1	0.1	-0.1	-0.3	-0.3	-0.5	-0.1	0.1	0.3
Domestic demand*	-2.1	-0.8	0.7	1.3	-0.4	0.2	0.8	0.8	0.5	0.8	0.8	1.2	1.5	1.8
Net exports*	1.5	0.5	0.3	0.2	0.1	0.3	0.2	0.1	0.5	0.3	0.5	0.2	0.1	-0.1
Money GDP	0.7	1.1	1.7	2.7	1.2	1.6	1.8	1.5	1.7	1.9	2.5	2.8	2.8	2.9
Industrial production	-3.0	-1.0	2.2	2.7	-1.1	1.2	2.2	1.9	2.2	2.4	2.6	2.6	2.8	3.0
Employment	-0.7	-0.9	0.0	0.3	-0.8	-0.5	-0.1	0.0	0.0	0.1	0.2	0.2	0.3	0.5
Unemployment rate (%)	11.4	12.0	11.7	11.5	12.0	11.8	11.8	11.7	11.7	11.7	11.5	11.5	11.5	11.5
HICP	2.5	1.4	0.7	1.1	1.3	0.8	0.7	0.6	0.6	0.9	1.1	1.1	1.1	1.2
Wages	1.9	1.7	1.5	1.7	1.8	1.5	1.5	1.3	1.5	1.6	1.6	1.7	1.7	1.7
ULC	1.9	1.2	0.5	0.5	1.2	0.5	0.6	0.4	0.4	0.5	0.5	0.5	0.4	0.5
Govt budget bal (% GDP)	-3.7	-3.0	-2.6	-2.0	-	-	-	-	-	-	-	-	-	-
Primary balance (% GDP)	0.0	0.0	0.0	0.9	-	-	-	-	-	-	-	-	-	-
Govt debt (% GDP)	92.6	95.5	96.0	95.5	-	-	-	-	-	-	-	-	-	-
Current account (% GDP)	1.4	2.4	2.4	2.3	-	-	-	-	-	-	-	-	-	-
ECB refi rate (yr-end)	0.75	0.25	0.15	0.15	0.50	0.25	0.25	0.15	0.15	0.15	0.15	0.15	0.15	0.15
German 10yr yield (yr-end)	1.30	1.90	1.60	2.00	1.90	1.90	1.50	1.40	1.50	1.60	1.70	1.80	1.90	2.00
EUR/USD (end period)	1.32	1.35	1.25	1.20	1.32	1.38	1.38	1.35	1.31	1.25	1.24	1.23	1.21	1.20

Source: Haver, UBS forecasts. Note: * Percentage point contribution to GDP growth

Figure 19: New, old and consensus GDP growth forecasts, % y/y

	New forecasts			Old forecasts			Consensus			New vs old - change		New vs consensus	
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2014F	2015F	2014F	2015F
Eurozone (A)	-0.4	1.0	1.5	-0.4	1.1	1.5	-0.4	1.1	1.5	-0.1	0.0	-0.1	0.0
Germany	0.5	1.9	2.0	0.5	1.8	1.9	0.4	2.0	2.0	0.1	0.1	-0.1	0.0
France	0.4	0.7	1.2	0.3	0.9	1.5	0.4	0.8	1.3	-0.2	-0.3	-0.1	-0.1
Italy	-1.8	0.2	0.8	-1.8	0.3	0.7	-1.8	0.4	1.2	-0.1	0.1	-0.2	-0.4
Spain	-1.2	1.1	1.6	-1.2	0.8	1.3	-1.2	1.1	1.6	0.3	0.3	0.0	0.0
Netherlands	-0.8	0.5	1.8	-0.8	1.0	1.8	-0.8	0.6	1.4	-0.5	0.0	-0.1	0.4
Ireland	-0.3	1.8	2.3	0.2	1.8	2.5	-0.3	1.7	2.3	0.0	-0.2	0.1	0.0
Portugal	-1.4	1.0	1.8	-1.4	1.0	1.8	-1.4	1.0	1.3	0.0	0.0	0.0	0.5
Greece	-3.9	0.5	2.5	-3.9	0.2	2.2	-3.9	0.1	1.7	0.3	0.3	0.4	0.8
Non-Eurozone Europe (B)	1.7	2.8	2.7	1.7	2.7	2.7	1.7	2.7	2.4	0.2	0.0	0.2	0.3
UK	1.7	3.1	2.8	1.7	2.8	2.7	1.7	2.8	2.4	0.3	0.1	0.3	0.4
Switzerland	2.0	2.1	2.2	2.0	2.1	2.4	2.0	2.1	2.2	0.0	-0.2	0.0	0.0
Sweden	1.6	2.5	2.7	1.5	2.6	2.9	1.5	2.8	2.8	-0.1	-0.2	-0.3	-0.1
Norway (mainland)	2.0	2.0	2.6	2.1	2.2	2.7	2.1	2.1	2.2	-0.2	-0.1	-0.1	0.4
Europe (A+B)	0.1	1.5	1.8	0.2	1.5	1.8	0.1	1.5	1.7	0.0	0.0	0.0	0.0

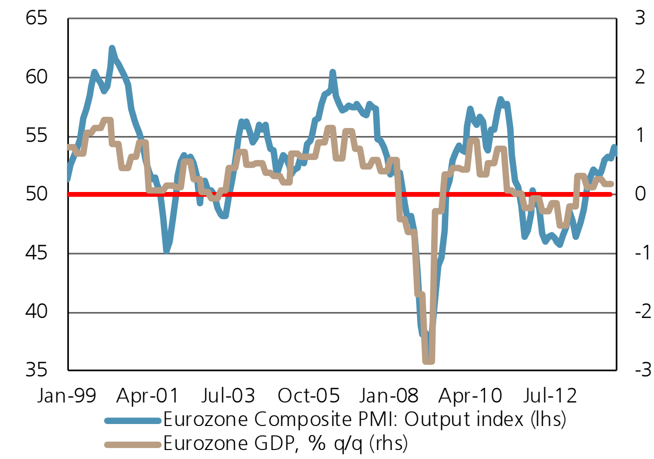
Source: UBS estimates; 'Consensus Forecasts', Consensus Economics 9 June, 2014.

The key drivers of the recovery remain: (1) the gradually improving external environment; (2) very easy monetary policy; (3) low inflation supporting household consumption; and (4) a moderation in fiscal austerity. And, as the recovery proceeds, we also expect some pent-up demand to become effective, at least in the core of Europe.

It is true that headline PMIs have softened somewhat in recent months, while remaining above the neutral level of 50 in the Eurozone overall and most individual countries (exception: France). The pullback seems to have been caused mainly by external factors (e.g. Ukraine), whereas the domestic prospects seem to have improved further. For example, manufacturing PMIs, which are more export related, softened a bit, while services PMIs have strengthened further or held up better, respectively. Other domestic indicators, such as consumer confidence and retail sales, have also improved. Labour markets across the Eurozone are stabilising, with some improvement visible, and wage dynamics are improving gradually, in nominal terms, but also in real terms, supported by very low inflation. This helps.

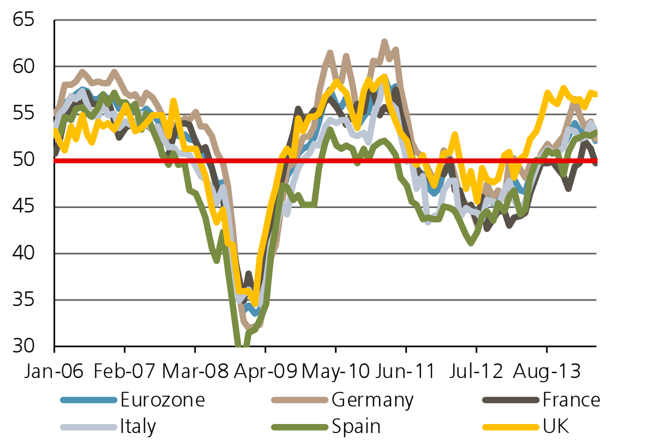
Overall, the Eurozone expansion will continue to be driven mainly by domestic demand whereas net exports should moderate, as imports recover. As a result, we think the Eurozone current account surplus might be about to peak.

Figure 20: Eurozone PMI and real GDP



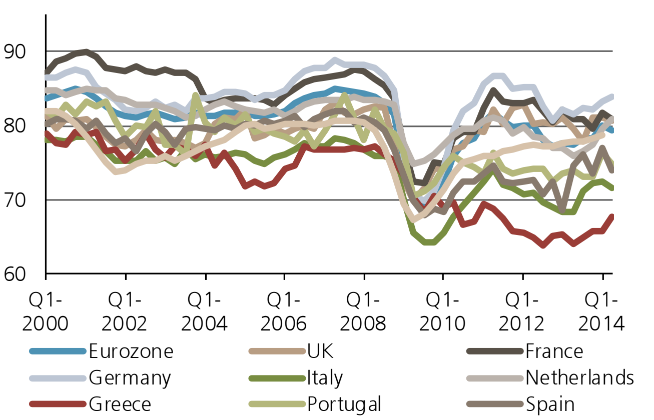
Source: Haver, Markit, UBS

Figure 21: Eurozone manufacturing PMIs



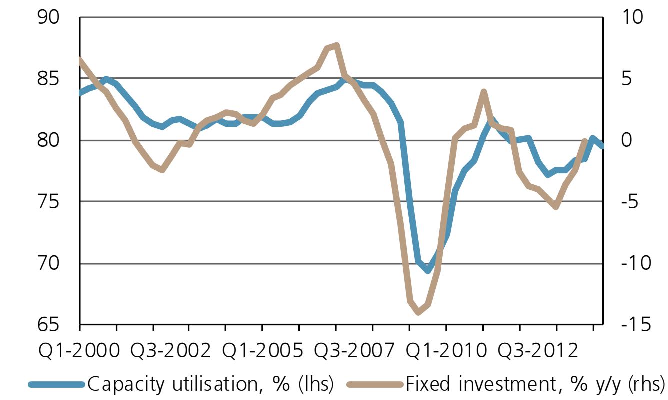
Source: Haver, Markit, UBS

Figure 22: European capacity utilisation, %



Source: Haver, UBS

Figure 23: Eurozone capacity utilisation & fixed investment



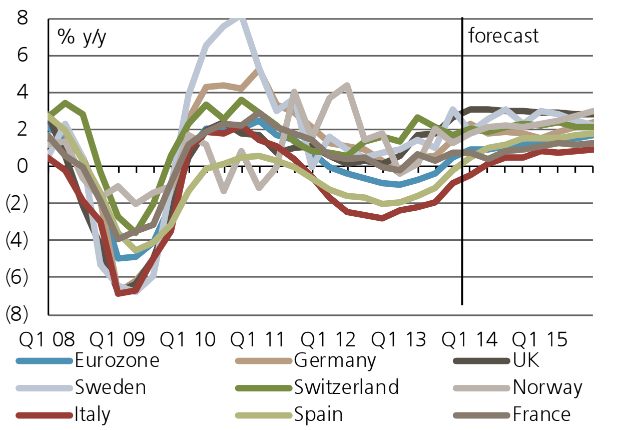
Source: Haver, UBS

Within the large Eurozone economies, we expect **Germany** to remain the strongest performer, and we have tweaked our forecast up by 0.1% for both 2014 and 2015. We now project 1.9% in 2014 and 2.0% in 2015 (consensus 2.0% for both years). In contrast, we cut our growth forecast for **France** by 0.2pp to 0.7% for 2014 and by 0.3pp to 1.2% for 2015, slightly below consensus. Given the weak Q1 (-0.1% q/q), we also cut our 2014 GDP forecast for **Italy** from 0.3% to 0.2% (consensus: 0.4%). However, given slightly better expectations regarding business and household sentiment, lending conditions as well as the reform agenda, we revise our 2015 GDP forecast up by 0.1pp, to 0.8% – but this still leaves us well below 2015 consensus (1.2%). In our view, the below-average growth outlook for France and Italy underlines the case for further structural reform. The economic performance in **Spain** continues to surprise to the upside, prompting us to lift our growth projections by 0.3pp for both 2014 and 2015, to 1.1% and 1.6%, respectively, in line with the consensus.

In the periphery, we have raised our **Greek** GDP forecasts to 0.5% (from 0.2%) for 2014 and to 2.5% (from 2.2%) for 2015. We kept unchanged our growth forecast for **Portugal**, at 1.0% for 2014 and 1.8% for 2015.

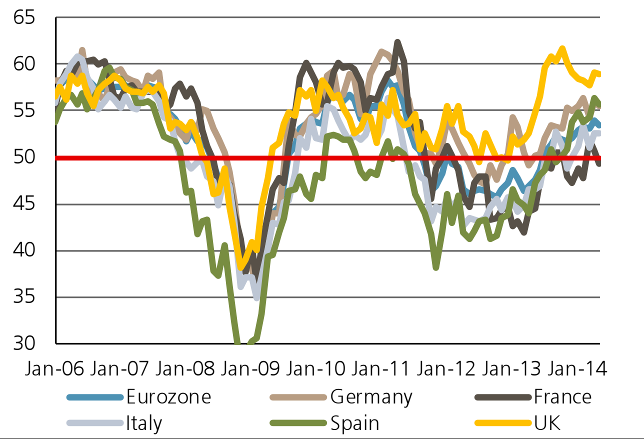
We expect the countries *outside* of the Eurozone to continue to outperform. The outlook for the **UK** remains strong, and we upgrade our 2014 GDP forecast to 3.1% (previously 2.8%) and our 2015 forecast to 2.8% from 2.7% (consensus 2.8%; 2.4%). **Switzerland** is expected to deliver a growth rate of 2.1% in 2014 and 2.2% in 2015 (revised from 2.4%) with the Scandinavian economies expected to post even higher prints for 2014 and 2015: **Sweden** 2.5% and 2.7%, and mainland **Norway** 2.0% followed by 2.6%.

Figure 24: Real GDP growth in Eurozone and wider EU



Source: Haver, UBS estimates

Figure 25: Composite PMIs



Source: Markit, Haver, UBS

ECB Watch

Reinhard Cluse

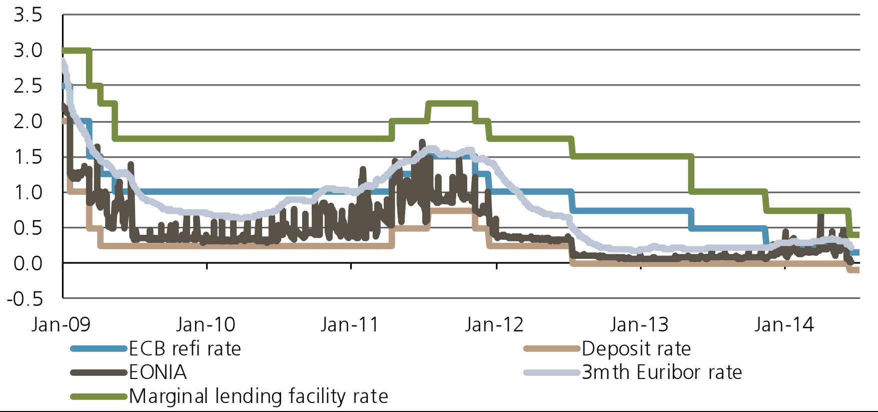
- Our base-case assumption is that rates will stay on hold for the foreseeable future. We also do not expect that a broad-based QE programme will be deployed. As we have argued repeatedly, we believe QE will only be triggered in the event of more disconcerting signs that the Eurozone is about to slide into deflation, which is not our base-case scenario.

Most likely done now

On 5 June, the ECB delivered a comprehensive monetary policy package, comprising cuts in the refi rate (from 0.25% to 0.15%), the deposit rate (from zero to -0.1%) and the marginal lending facility (from 0.75% to 0.4%). The ECB also rolled out the 'full allotment mode' – the commitment to supply unlimited liquidity (against adequate collateral) at the refi rate – from July 2015 to December 2016, and it will inject liquidity by ending the sterilisation of the Securities Markets Programme (SMP) portfolio. In addition, the ECB will intensify its efforts to boost the Asset Backed Security (ABS) market, which could play an important role in the bank's future monetary policy. And last, but not least, it announced the launch of a new targeted LTRO (TLTRO), which will set incentives for banks to lend to the real economy.

The ECB's announcement of an "intensification of preparatory work related to outright purchases of ABS" did not come entirely unexpected.[2] As the ECB has mentioned many times, a revival of the ABS market in the Eurozone is urgently needed – not only because ABS (based on bank loans to corporates and households) would be the ECB's preferred vehicle for Quantitative Easing (QE), but also because ABS could play an important role in the supply of liquidity to the corporate sector (including SMEs) and the de-risking of banks' balance sheets. However, irrespective of the ECB's newly-declared ambition to accelerate the process, resurrecting the ABS market will take time and – importantly – require the support of international regulators.[3]

Figure 26: ECB interest rates, EONIA, and Euribor



Source: Haver, UBS

We believe that the new TLTRO is likely to be an attractively priced source of funding for banks, irrespective of whether or not they lend the funds to the private

[2] See our report, *Lifting the lid on the ECB's toolbox* – UBS Macro Keys, 23 May 2014

[3] See ECB, Bank of England: *The impaired EU securitisation market: Causes, roadblocks and how to deal with them*, 11 April 2014

sector. Access to TLTRO funding is likely to be particularly attractive for periphery banks, for which the costs of TLTRO could be as much as 109-114bp below equivalent wholesale funding for four years, or 68-73bp for two years if they do not increase net lending to the private sector. While this impact is important, we are not sure the TLTRO will lead to a substantial increase in net lending in the Eurozone. After all, weak credit growth (particularly in the periphery and to SMEs) remains due to a combination of protracted supply and demand problems that will be overcome only gradually – irrespective of lower funding costs.[4]

The ECB also published its new staff macroeconomic forecasts, which paint a picture of an ongoing, albeit moderate, economic recovery (with the risks still skewed to the downside) and a prolonged period of low inflation, but not deflation. Following the disappointing Q1 GDP numbers, the ECB lowered its 2014 growth forecast to 1.0% from 1.2% in the March projections. However, the 2015 growth forecast was increased to 1.7% (from 1.5%), while the 2016 forecast was left unchanged, at 1.8%. The inflation forecast (HICP) was cut visibly to 0.7% (from 1.0%) for 2014, to 1.1% from 1.3% for 2015, and to 1.4% from 1.5% for 2016. For Q4 2016, the ECB sees HICP at 1.5% (previously 1.7%).

As regards the forward guidance, the ECB said that "interest rates will remain at present levels for an extended period of time." This was a distinct change from previous statements, where the bank referred to rates at "current or *lower* levels". Also ECB president Mario Draghi commented that the ECB had practically reached "the lower bound" for interest rates. This suggests the ECB wants to signal that it hopes to have done enough in terms of monetary accommodation.

Nevertheless, the ECB kept a clear easing bias in place by stating: "[I]f required, we will act swiftly with further monetary policy easing. The Governing Council is unanimous in its commitment to using also unconventional instruments within its mandate should it become necessary to further address risks of too prolonged a period of low inflation." This obviously leaves the door open for more easing, including QE, as President Draghi confirmed explicitly.

Outlook: Rates on hold, no QE, but...

Our base-case assumption is now that rates will stay on hold for the foreseeable future. We also do not expect that a broad-based QE programme will be deployed. As we have argued repeatedly, we believe QE will only be triggered in the event of more disconcerting signs that the Eurozone is about to slide into deflation, which is not our base-case scenario. We expect inflation to be rather low over the coming months, but to move back to around 1% in Q4 2014, not least helped by base effects and a softening EUR/USD exchange rate.

However, the risks to our call remain obvious and the ECB's ongoing easing bias implies that the ECB remains prepared to do more, if needed. One key risk – although apparently less relevant right now, given the price action in recent weeks – would be ongoing strength of the EUR. In our view, this could prompt the ECB to cut the deposit rate further. The much bigger risk, however, would be that inflation would continue to stay very low (even in/after Q4) or fall even further. In this case – we expect greater clarity towards year-end 2014 – the ECB would still have to deploy QE, in our view.

[4] See our report, *What to make of the ECB's TLTRO*, 13 June 2014

Euro Technical Analysis

Richard Adcock

- While open for a correction in BTP futures to unwind upside extremes, we viewed support at 124.69 as strong enough to hold and reverse weakness. This has so far proved to be the case and a further buy signal has just developed.
- Bunds have successfully closed above resistance at 146.00, which looks set to trigger further upside. The immediate risk is to the 147.36 extension level.

BTP Futures: Further Buy Signal Seen

Our concern following the sharp advance into the June 9th all-time high was for BTP's to unwind upside extremes, with support offered by the 124.69 mid-point. The setback duly materialised and the market has so far held at 124.66, from which a recovery developed. Evidence of a more prolonged advance has also just been seen now momentum has crossed higher on a closing basis with the MACD above its zero line, confirming the resumption of the longer term bullish trend.

Having suggested using the setback as a buying opportunity at 124.85, the latest momentum signal has triggered a further buy recommendation, as its clear long term bullish trending conditions remain in force. Further strength is on the cards to at least 126.95, the 162% Fibonacci extension of the May sell-off, potentially even the higher 200% point at 128.56. We maintain the bullish outlook with support at 124.66, then 124.04, the 38% retracement of the May/June bull trend, targeting 128.50, with stops now pulled higher to 124.60.

Figure 27: BTP Futures Daily Chart

Source: CQG, Inc. © 2014 All rights reserved worldwide.www.cqg.com

Figure 28: Bund Futures Daily Chart

Source: CQG, Inc. © 2014 All rights reserved worldwide.www.cqg.com

While a consolidation developed in Bunds over the last few weeks, the latest activity has now seen a closing break above the upper limits of the recent sideways range at 146.00. This is a further bullish signal and likely trigger for acceleration of the long term bullish trend. The next main resistance is marked by the 162% extension of the April to September 2013 sell-off at 147.36, which we set as our objective. Only closes below last week's 144.91 recovery point will trigger a deeper sell-off towards 143.95, the 38% retracement of the YTD range.

The fortnight ahead in the euro area

Figure 29: Selected events in the euro area until Q3 2014

Date	Event
26--27-Jun-14	European Council meeting
27-Jun-14	Moody's credit rating publication date for Germany and Austria
4-Jul-14	Moody's credit rating publication date for Netherlands and Belgium
11-Jul-14	S&P credit rating publication date for Germany; Fitch for Netherlands; DBRS for Greece
18-Jul-14	Fitch credit rating publication date for Germany; DBRS for UK
25-Jul-14	S&P credit rating publication date for Belgium
1-Aug-14	Moody's credit rating publication date for Greece
15-Aug-14	Fitch credit rating publication date for Austria and Ireland
31-Aug-14	Germany - Saxony state election
Summer	Germany - Thuringia state election
5-Sep-14	Moody's credit rating publication date for Portugal
12-Sep-14	S&P credit rating publication date for Greece; Moody's for Ireland
14-Sep-14	Germany - Brandenburg state election
19-Sep-14	Moody's credit rating publication date for UK and France; Fitch for US; DBRS for Belgium
26-Sep-14	DBRS credit rating publication date for Germany and Ireland; S&P for Austria; Fitch for Finland

Source: European governments, European Commission, ECB, S&P, Moody's, Fitch, DBRS, UBS

Figure 30: 2014 Euro area issuance monitor* (€bn) (as of 25th June 2014)

	Supply				Redemptions		Net Issuance**				Coupons	
Country	2014E	YTD	%	Remaining	2014E	YTD	2014E	YTD	Remaining	%	2014E	YTD
Germany	173.0	91.0	53%	82.0	144.0	73.0	29.0	18.0	11.0	38%	28.5	14.6
France	199.0	120.2	60%	78.8	103.8	42.1	69.2	69.4	-0.3	0%	42.8	21.1
Italy***	229.0	148.0	65%	81.0	190.6	75.0	38.4	73.0	-34.7	-90%	58.4	28.8
Spain	125.0	85.6	68%	39.4	67.9	29.7	57.1	55.9	1.2	2%	28.2	13.2
Netherlands	50.0	35.6	71%	14.4	28.2	15.7	13.0	11.1	1.9	15%	9.1	4.0
Belgium	30.0	21.4	71%	8.6	17.6	8.2	7.9	13.1	-5.2	-66%	11.6	7.2
Austria	26.0	10.0	39%	16.0	22.0	1.3	4.0	8.7	-4.7	-118%	7.2	3.1
Finland	13.0	5.5	42%	7.5	6.5	0.0	6.5	5.5	1.0	15%	2.2	0.7
Greece	6.0	3.0	50%	3.0	0.0	0.0	6.0	3.0	3.0	50%	0.6	0.6
Ireland	8.0	6.5	81%	1.5	2.7	2.7	5.3	3.8	1.5	28%	4.1	2.5
Portugal	13.0	8.0	61%	5.0	9.7	4.4	3.3	3.6	-0.3	-	4.3	2.7
Total	872.0	534.8	61.3%	337.2	593.1	252.1	239.7	265.3	-25.5	-11%	197.0	98.6

Source: Bloomberg, National Debt Agencies and Treasuries, UBS *including inflation-linked issuance, excluding foreign currency debt **Defined as gross issuance-redemptions-buybacks (when applicable) ***includes CTZs and CCTs

Figure 31: Forthcoming bond supply calendar

Date	Country	Bond	Details announcement
27-Jun-14	Italy	New BTP 1.5% Aug-19, €3.0-€4.0bn, BTP 3.75% €2.0bn-€2.5bn, CCTeu Nov-19, €1.0bn-€1.5bn	
02-Jul-14	Germany	Bobl 0.5% Apr-19, €4bn	
03-Jul-14	France	Long term Auction	27-Jun-14
03-Jul-14	Spain	BONO and/or SPGB auction	27-Jun-14
08-Jul-14	Austria	RAGB Auction	01-Jul-14
08-Jul-14	Netherlands	DSL 2% Jul-24, €1.5-€2.5bn	
08-Jul-14	Germany	Inflation Linked Auction	04-Jul-14
09-Jul-14	Germany	Schatz 0.25% Jun-16, €4bn	
11-Jul-14	Italy	BTP Auction	08-Jul-14
16-Jul-14	Germany	Bund 1.5% May-24, €4bn	
17-Jul-14	France	Medium Term and Inflation Linked Auction	11-Jul-14
17-Jul-14	Spain	BONO and/or SPGB auction	11-Jul-14
22-Jul-14	Belgium	OLO auction	15-Jul-14
28-Jul-14	Italy	CTZ and/or BTPei Auction	23-Jul-14
30-Jul-14	Italy	BTP Auction	25-Jul-14

Source: National Debt Agencies and Treasuries, UBS

Figure 32: CRA sovereign rating calendar until Q3 2014

	UK	Germany	France	Italy	Spain	NL	Belgium	Austria	Finland	Greece	Ireland	Portugal	US
Calendar													
27-Jun-14		Moody's						Moody's					
4-Jul-14						Moody's	Moody's						
11-Jul-14		S&P				Fitch				DBRS			
18-Jul-14	DBRS	Fitch											
25-Jul-14							S&P						
1-Aug-14										Moody's			
8-Aug-14													
15-Aug-14								Fitch			Fitch		
22-Aug-14													
29-Aug-14													
5-Sep-14												Moody's	
12-Sep-14										S&P	Moody's		
19-Sep-14	Moody's		Moody's				DBRS						Fitch
26-Sep-14		DBRS						S&P	Fitch		DBRS		
Current ratings													
S&P	AAA (Stable)	AAA (Stable)	AA (Stable)	BBB (Neg)	BBB (Stable)	AA+ (Stable)	AA (Stable)	AA+ (Stable)	AAA (Neg)	B- (Stable)	A- (Pos)	BB (Stable)	AA+ (Stable)
Moody's	Aaa (Stable)	Aaa (Stable)	Aaa (Neg)	Baa2 (Stable)	Baa2 (Pos)	Aaa (Stable)	Aa3 (Stable)	Aaa (Stable)	Aaa (Stable)	Caa3 (Stable)	Baa1 (Stable)	Ba2 (Pos)	Aaa (Stable)
Fitch	AA+ (Stable)	AAA (Stable)	AA+ (Stable)	BBB+ (Stable)	BBB+ (Stable)	AAA (Neg)	AA (Stable)	AAA (Stable)	AAA (Stable)	B (Stable)	BBB+ (Stable)	BB+ (Pos)	AAA (Stable)
DBRS	AAA (Stable)	AAA (Stable)	AAA (Stable)	A (Neg)	A (Neg)	AAA (Stable)	AA (Stable)	AAA (Stable)	AAA (Stable)	CCC (Neg)	A (Stable)	BBB (Stable)	AAA (Stable)

Source: S&P, Moody's, Fitch, DBRS, Bloomberg, UBS

UK

- **Will the Bank of England sell gilts?**
- **Good value in long-end gilts**
- **Gilt Technical Analysis**
- **The fortnight ahead in the UK**

Will the Bank of England sell gilts?

Joakim Tiberg

- Recent comments from Governor Carney suggest the BoE might soon start considering selling gilts as a policy option. We think that this would only be one of several options and others, such as liquidity-absorbing operations, seem more likely than outright gilt sales in the near term.
- The distribution of the BoE's gilt holdings shows that a large proportion (in cash terms) matures between 2015 and 2022. However, when examining the distribution in DV01 terms, the market seems vulnerable to sales of gilts beyond 2024. The eventual impact from any such sales by the BoE will in our view depend on how it decides to structure its activity.

Liquidity-absorbing operations more likely in the near term

In a Treasury Select Committee hearing on 24 July, Governor Carney was asked when the BoE might start considering off-loading the gilts it for QE purposes has acquired via its Asset Purchase Facility (APF). Mr Carney suggested the Bank will keep reinvesting the (cash amount paid for) proceeds from maturing gilts until the first rate hike, and said he expects the bank rate "*to be higher than 1 percent*" before undertaking any sales, as reported by Bloomberg.

We think Mr Carney's statement should not be read as when the BoE *will* start selling gilts, but rather the nearest point at which some type of liquidity absorbing measure *might be considered*. In our view, the BoE essentially has three options were it to want to shrink its balance sheet to a level more typical in past economic cycles:

1) *Liquidity-absorbing operations via short-term instruments*. We find it likely that rather than selling its gilt holdings, the BoE will carry out some type of sterilising operation to offset the liquidity injected into the system from its asset purchases. This could for example be done via reverse repo arrangements under which the BoE could offer collateral (e.g., T-bills or the APF gilts) in exchange of cash. This is how the ECB until recently sterilised the liquidity effect of its Securities Market Programme.

2) *Let QE roll off naturally*. Although it currently seems unlikely that the BoE would sit on all of its gilt holdings until it matures, this option would likely be used in combination with liquidity-absorbing operations (and possibly gilt sales). As highlighted below, the BoE has in cash terms paid more than half of its total QE spending on gilts maturing prior to 2022.

3) *Outright gilt sales*. We think it in the near term is unlikely that the BoE will start selling gilts, not least since gilt issuance likely will remain elevated for some years to come. Although the public finances are improving, the DMO's most recent illustrative gross financing projections outline that gilt sales could total £77bn in 2018-19. That compares to £127bn in the current fiscal year.

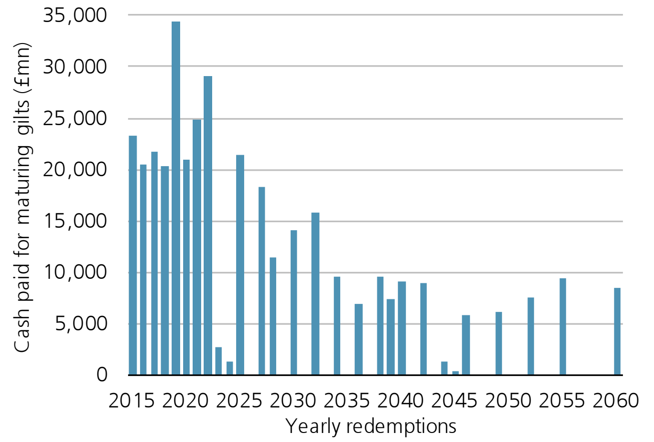
Figure 33: Current and estimated March 2015 profile of the BoE's gilt holdings

	Cash paid (£mn)	Nominal holdings (£mn)	Market value of holdings (£mn)	Average remaining life (years)	Modified duration	DV01 (£mn)
Current	374.9	325.9	372.4	12.74	8.58	319.7
Estimate 31 March 2015	370.7	322.4	360.9	12.69	8.50	306.8

Source: BoE, UBS calculations

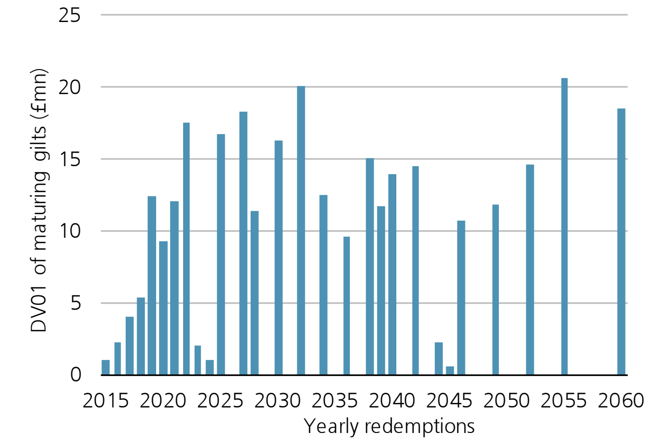
Should the BoE nevertheless start selling gilts when the bank rate hits 1% – something UBS Economics expects to happen in the first quarter of next year – a few statistics are worth taking into consideration. In Figure 33 we estimate that the profile of the BoE's gilt holdings in March next year will be largely unchanged from now.

Figure 34: The estimated cash amount paid across the curve for the BoE's gilt holdings as of March 2015



Source: UBS calculations

Figure 35: The estimated DV01 profile of the BoE's gilt holdings as of March 2015



Source: UBS calculations

The distribution of the APF gilts shows that a large proportion of the QE programme (in cash terms) has been allocated to gilts maturing prior to 2022 – we estimate that as of the end of March next year, £195bn of the total £370bn of BoE holdings fall into this group (Figure 34). While it could be argued that the 4-7-year sector of the curve as a result could come under pressure from the prospect of BoE selling, we would not be so sure. Figure 35 shows why the opposite could be argued as well. When looking at the distribution in DV01 terms, gilts beyond 2024 maturity seem vulnerable.

The eventual impact from any gilt sales by the BoE would in our view depend on how it decided to structure the sales.

In our estimates we have assumed the proceeds from the gilt maturing in September this year would be reinvested in equal proportions across the BoE's three typical maturity buckets (3-7y, 7-15y and 15y+). We have further assumed that the proceeds from the gilt maturing in January 2015 will not be reinvested, as Mr Carney's comments might suggest that reinvestments cannot be taken for granted following the first rate hike (UBS Economics expects the first rate hike in November 2014). We have calculated the forward value of the remaining APF holdings as of 31 March 2015.

A detailed snapshot of the current BoE gilt holdings is given at page 37.

Good value in long-end gilts

Joakim Tiberg

- After several years of falling yield levels and rising equity markets, anecdotal evidence suggests there is still significant pent-up demand for long-end gilts. We see a solid case for 'de-risking' flows from UK pension schemes intensifying as we approach the monetary policy tightening cycle. This, we think, will help 30-year gilts stay well supported. We suggest adding to positions on dips.

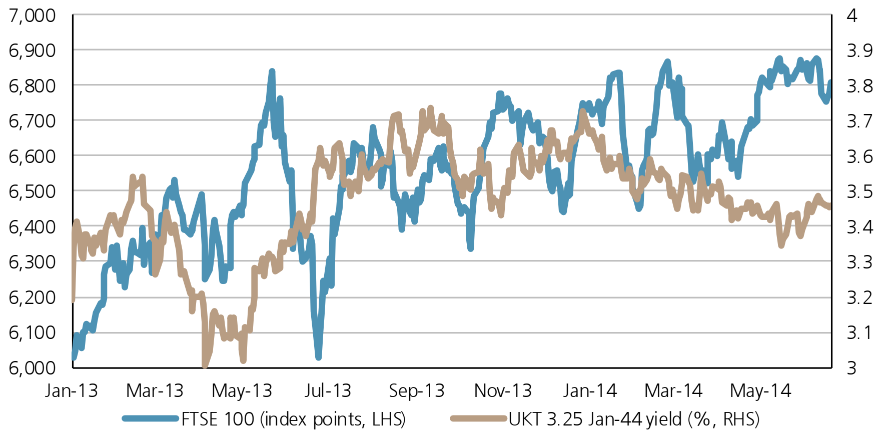
'De-risking' flows may accelerate as the tightening cycle approaches

We think an acceleration in de-risking flows from domestic pension schemes could be triggered by either one (or both in combination) of the following factors:

- *Equities wobble*. Our colleagues in Equity Strategy are cautious on the UK equity market relative to the rest of Europe, while noting that the FTSE historically has tended to trade sideways around the time of the first hike (see *European Equity Strategy – The Carney in the Coalmine*, 13 June). A stumble in the equity market would in our view incentivise defined benefit schemes to lock in gains, and do so promptly.

- *Bond yields rise*. UBS Economics forecasts 10-year gilt yields to reach 3.25% by the end of 2014. This would be favourable for funding ratios. However, we doubt that 30-year yields will rise much beyond the 3.60% level, and suggest adding to positions on spikes.

Figure 36: UK equities and 30-year gilt yield



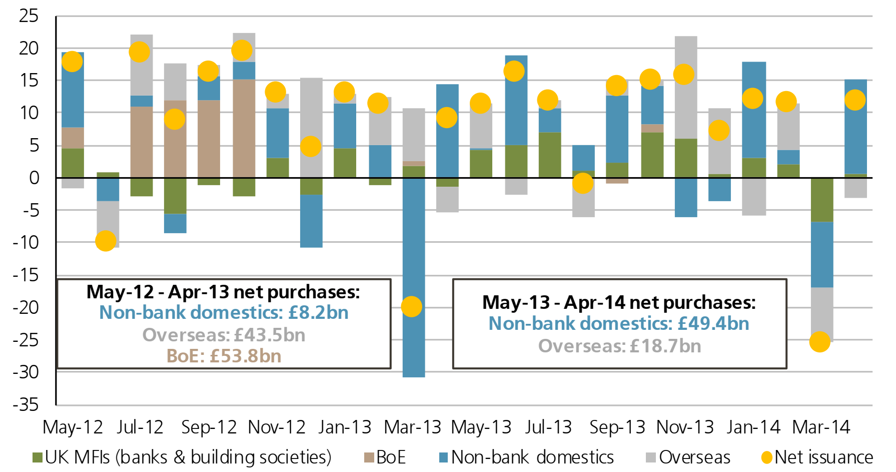
Source: Bloomberg, UBS

Why the standing of the domestic investor base matters

Pension funds and insurance companies have historically been the largest component of the demand structure for gilts. Their natural domain is the long end of the curve, consistent with their hedging needs. However, in the aftermath of the financial crisis, both overseas investors and the BoE (via its Asset Purchase Facility) became dominant in the market, triggering a shift in demand dynamics towards shorter segments of the curve.

As the crisis in Eurozone markets eased and the BoE stopped adding to its QE programme in late 2012, UK pension funds and insurance companies' influence on price action gradually increased. However, the real come back for these investors occurred as yields shot higher on tapering fears in mid-2013 (Figure 37).

Figure 37: Monthly net investment in gilts across investor categories (£bn)

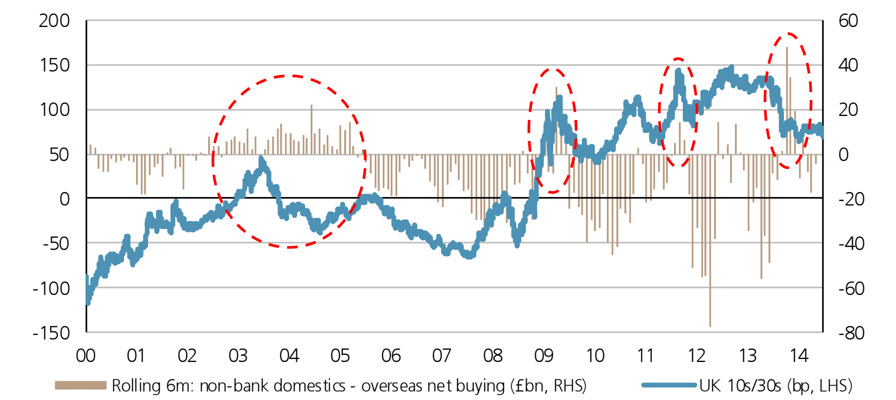


Source: BoE, UBS

As (real and nominal) yields drift higher, the present value of the liabilities of defined benefit pension schemes fall. The change in value of pension schemes' assets, on the other hand, is driven by market prices – mostly those of stocks. As the UK Pension Protection Fund (PPF) puts it: "*due to their weight in asset allocation and volatility, equities are usually the biggest driver behind changes in scheme assets.*"

The PPF 7800 index, an estimate of the funding position for 6,150 UK DB schemes, shows how the aggregate deficit in pension schemes has narrowed from approximately £230bn in the mid-months of 2013 to just short of £120bn today. The aggregate funding ratio – the present value of assets over the present value liabilities – has meanwhile improved from 84% to 91%. Rising funding ratios have enabled schemes to lock in (or de-risk) some of the gains made on other investments (most notably on equities) in the fixed income markets.

Figure 38: UK 10s/30s vs. the difference between non-bank domestics' and overseas investors' net purchases of gilts (2000 – current)



Source: BoE, Bloomberg, UBS

In Figure 38 we plot 10s/30s against the 6-months rolling difference between net buying of gilts by non-bank domestics (predominantly pensions and insurers) and overseas investors. Although the relationship is far from perfect, it appears as if the curve has flattened in periods when non-bank domestics have been the relatively dominant force. The significant de-risking flows seen over the last year have been no exception – the curve has flattened from 140bp to levels around 70bp today.

Still, from a historical perspective the curve looks far from flat. Prior to the financial crisis, the shape of the long end of the curve was inverted. We attribute this to the dominance of domestic pension funds and insurance companies at a time of a relatively small stock of outstanding gilts.

A historical perspective: 30-year yields not particularly sensitive to hikes

UBS Economics expect the first rate hike from the BoE on 6 November this year, with subsequent quarterly hikes taking the bank rate to 1.75% by the end of 2015 (see *European Economic Comment – BoE to hike already in November*, 13 June). Below we consider how 30-year gilts have held up during the last three tightening cycles (outlined in Figure 39), assuming the first rate hike takes place in November this year.

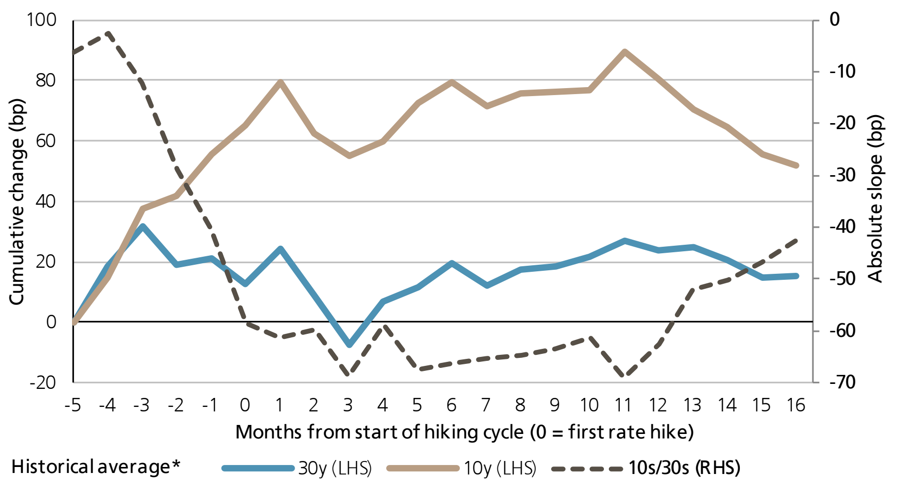
Figure 39: The last three BoE rate hiking cycles

Tightening cycle	Length (months)	Bank Rate (start %)	Bank Rate (end %)	Tightening (bp)
Aug-06 - Jul-07	11	4.50	5.75	125
Nov-03 - Aug-04	10	3.50	4.75	125
Sep-99 - Feb-00	6	5.00	6.00	100

Source: BoE, UBS

Historically, both 30- and 10-year yields sell off some 30bp between five and three months prior to the first hike. From that point on, 30-year yields tend to trade sideways or even fall, but the long end of the curve appears to exhibit relatively little sensitivity to monetary tightening. 10-year yields, on the other hand, tend to shoot higher up to one month or so after the first hike, driving an aggressive flattening of the curve.

Figure 40: 10- and 30-year gilts going into the tightening cycle (assuming first rate hike in November, five months from now)



Source: UBS Delta * Average change and steepness during last three hiking cycles

Gilt Technical Analysis

Richard Adcock

- With the recent decline in Gilts, there has been a lack of follow through after the break above the important 111.00 area. However, good support is evident at 108.47/83, which we expect to continue to limit downside.
- Our long standing EURGBP objective at 0.7960, the November 2012 low was hit last week. While the risk is for a recovery from this point, all evidence points to upside as limited in time and extent before downside is resumed again.

Gilts Consolidate Within Uptrend

Early June saw Gilts sell-off sharply, which following the break above 111.00, highlighted a lack of bullish follow through. However, there is no evidence of a bearish shift in sentiment in the shape of reversal patterns and the market continues to display longer term bullish trending conditions. The weekly MACD remains above its zero line and the price pattern of higher highs/higher lows is in force; this will stay the case while closes are seen above 108.47/83 support.

Equal to the April 2013 low and 38% retracement of the YTD range, 108.47/83 represents an important focus and the more bullish call is maintained while closes are seen above it. The risk is for a break above the 62% retracement of the April 2013 to December 2013 sell-off at 111.51 to be the next bullish trigger, opening the door to the mid-May 2013 bounce high at 113.84. To the downside, only closes under 108.47 will see a more serious and prolonged sell-off materialise, exposing the market to the deeper 62% level at 106.82.

Figure 41: Gilt Futures Weekly Chart

Source: CQG, Inc. © 2014 All rights reserved worldwide.www.cqg.com

Figure 42: EURGBP Weekly Chart

Source: CQG, Inc. © 2014 All rights reserved worldwide.www.cqg.com

Early April saw downside acceleration in EURGBP to see tests of 0.7960, our long standing objective, the November 2012 low. Not too surprisingly, considering the speed and extent of the decline, a consolidation has materialised from this area to unwind downside extremes. While this can continue over the short term, with weekly MACD and Stochastic indicators bearish, resistance up to 0.8033, the 38% retracement of the June sell-off, is set to hold and resume downside. Against this backdrop, we suggest re-establishing EURGBP shorts at 0.8028 and/or on a close below 0.7960, targeting the 0.7754 July 2012 low, with stops at 0.8135, just above the 38% retracement of the March/June sell-off.

The fortnight ahead in the UK

Figure 43: Auctions, syndications and mini-tender schedule

Date	Type	Bond	Details announcement
1-Jul-14	Auction	UKT 1.75 Jul-19, £4bn	
8-Jul-14	Auction	UKT 4 Jan-60	1-Jul-14
Second half of July*	Syndication	UKTI with a maturity of 25 years or longer	Around two weeks in advance
17-Jul-14	Auction	UKTI 0.125 Mar-24	8-Jul-14
22-Jul-14	Auction	UKT 2.75 Sep-24	15-Jul-14
6-Aug-14	Auction	UKTI 0.125 Nov-19	29-Jul-14
12-Aug-14	Auction	UKT 4.75 Dec-30	5-Aug-14
21-Aug-14	Auction	UKT 2.75 Sep-24	12-Aug-14
27-Aug-14	Auction	UKTI 0.625 Mar-40	19-Aug-14
2-Sep-14	Auction	New UKT Jul-20	26-Aug-14
9-Sep-14	Auction	UKTI 0.25 Mar-52	2-Sep-14
11-Sep-14	Auction	Re-opening of new UKT Jan-45	2-Sep-14

Source: UK DMO, UBS *Subject to market conditions

Figure 44: UK issuance monitor for 2014-15 (£bn) (as of 25th Jun 2014)

£ bn	Planned Issuance 2014-15	Issued until 06/25/2014	% Issued	% Remaining
Short	32.0	8.0	24.9%	75.2%
Medium	26.7	6.7	25.1%	74.9%
Long	33.4	10.2	30.5%	69.5%
Index-Linked	30.6	6.0	19.7%	80.3%
Mini Tenders	4.5	0.0	0.0%	100.0%
Total	**127.2**	**30.9**	**24.3%**	**75.7%**

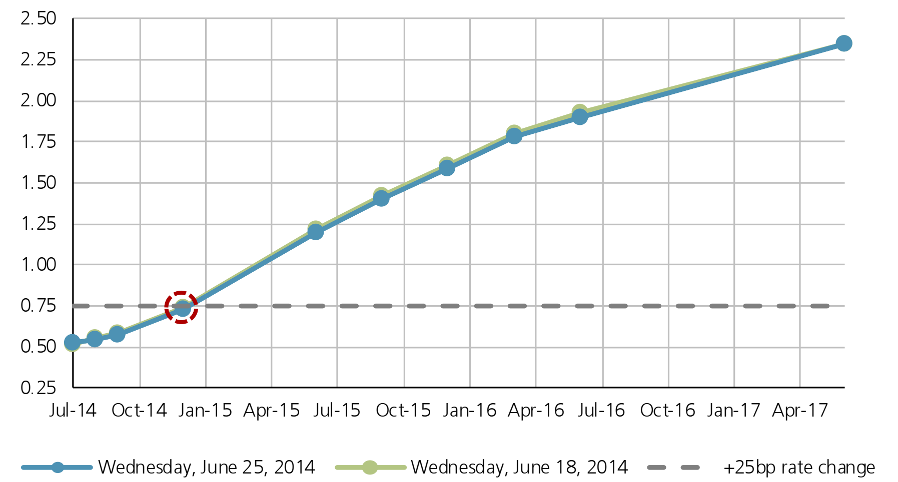
Source: UK DMO, UBS

Figure 45: Maturity bucket breakdown of demand and supply and roadmap for BoE purchases (in £mm) (including UBS estimates for DMO supply), as of 25th June 2014

		3- to 7-year	7- to 15-year	over 15-year	Index-linked
26th June – 30th June	BoE purchases (A)				
	Supply (B)				
	Coupons (C)				
	Net (A+C-B)				
July	BoE purchases (A)				
	Supply (B)	4,000	3,250	2,500	5,650
	Coupons (C)	430		918	843
	Net (A+C-B)	-3,570	-3,250	-1,582	-4,807
August	BoE purchases (A)				
	Supply (B)		3,250	2,500	2,800
	Coupons (C)	122			
	Net (A+C-B)	122	-3,250	-2,500	-2,800
September	BoE purchases (A)*	4,809	4,809	4,809	
	Supply (B)	4,000		2,500	1,400
	Coupons (C)	1,827	1,552	990	205
	Net (A+C-B)	2,636	6,361	3,299	-1,195
Cumulative		-812	-139	-783	-8,801

Source: Bank of England, UK DMO, Dealogic, Bloomberg, UBS. Note that coupons are ex-BoE and UK central government holdings. * Assuming BoE reinvests proceeds from its holdings of UKT 5 Sep-14.

Figure 46: BoE policy rate expectations as implied by OIS forwards (%)



Source: Bloomberg, UBS

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
26-Jun-14	11:00	Euro Zone	EU Conservative Leaders Hold Pre-Summit Meeting in Kortrijk					
26-Jun-14	12:30	Euro Zone	EU Socialist Leaders Hold Pre-Summit Meeting in Elverdinge					
26-Jun-14	13:00	Euro Zone	Moldova's Prime Minister Speaks at Brussels Think Tank					
26-Jun-14	15:00	Euro Zone	EU Leaders Start Summit in Ypres With Great War Ceremony					
26-Jun-14		Euro Zone	EU Hosts E3+3 Meeting on Iran Nuclear Talks in Brussels					
27-Jun-14	07:00	Euro Zone	EU Leaders Hold Summit in Brussels					
27-Jun-14	09:00	Euro Zone	Economic Confidence	Jun		102.7	103	
27-Jun-14	09:00	Euro Zone	Industrial Confidence	Jun		-3	-3	
27-Jun-14	09:00	Euro Zone	Consumer Confidence (Final)	Jun		-7.4		**
27-Jun-14	09:00	Euro Zone	Services Confidence	Jun		3.8	4	
27-Jun-14	09:00	Euro Zone	Business Climate Indicator	Jun		0.37	0.4	
27-Jun-14	11:00	Euro Zone	EMA Releases Drug Approvals & safety Decisions					
27-Jun-14		Euro Zone	EU's Almunia Speaks at IBEI in Barcelona					
30-Jun-14	08:00	Euro Zone	M3 Money Supply (YoY)	May		0.80%		**
30-Jun-14	08:00	Euro Zone	M3 3-month average	May		1.00%		
30-Jun-14	09:00	Euro Zone	CPI Estimate (YoY)	Jun				*
30-Jun-14	09:00	Euro Zone	CPI Core (YoY) (Advance)	Jun		0.70%		
30-Jun-14	15:45	Euro Zone	Soros Participates in Debate on Europe in Brussels					
1-Jul-14	07:00	Euro Zone	EU's Van Rompuy Speaks on Europe Strategic Options in Brussels					
1-Jul-14	08:00	Euro Zone	Markit Eurozone Manufacturing PMI (Final)	Jun		51.9		**
1-Jul-14	09:00	Euro Zone	Unemployment Rate	May		11.70%		*
2-Jul-14	09:00	Euro Zone	PPI (MoM)	May		-0.10%		
2-Jul-14	09:00	Euro Zone	PPI (YoY)	May		-1.20%		
3-Jul-14	08:00	Euro Zone	Markit Eurozone Services PMI (Final)	Jun		52.8		
3-Jul-14	08:00	Euro Zone	Markit Eurozone Composite PMI (Final)	Jun		52.8		*
3-Jul-14	09:00	Euro Zone	Retail sales (MoM)	May		0.40%		*
3-Jul-14	09:00	Euro Zone	Retail sales (YoY)	May		2.40%		
3-Jul-14	11:45	Euro Zone	ECB Main Refinancing Rate			0.15%		***
3-Jul-14	11:45	Euro Zone	ECB Marginal Lending Facility			0.40%		
3-Jul-14	11:45	Euro Zone	ECB Deposit Facility Rate			-0.10%		
3-Jul-14	12:00	Euro Zone	EU's Oettinger in Panel Discussion on Energy in Berlin					
3-Jul-14	12:30	Euro Zone	ECB'S Draghi Holds Press Conference After Rate Decision					
3-Jul-14	15:00	Euro Zone	EU's De Gucht Speaks at Conference in Berlin					
4-Jul-14	08:10	Euro Zone	Markit Eurozone Retail PMI	Jun		49.9		
4-Jul-14		Euro Zone	EFSF Sovereign Debt Rating Published by Fitch					
7-Jul-14	08:30	Euro Zone	Sentix Investor Confidence	Jul		8.5		
8-Jul-14		Euro Zone	EU Hosts Donor Meeting for Ukraine in Brussels					
27-Jun-14	06:00	Germany	Import Price Index (MoM)	May		-0.30%	0.00%	
27-Jun-14	06:00	Germany	Import Price Index (YoY)	May		-2.40%	-2.20%	
27-Jun-14	07:00	Germany	CPI saxony (MoM)	Jun		-0.10%		
27-Jun-14	07:00	Germany	CPI saxony (YoY)	Jun		0.80%		
27-Jun-14	08:00	Germany	CPI Brandenburg (MoM)	Jun		-0.20%		
27-Jun-14	08:00	Germany	CPI Brandenburg (YoY)	Jun		0.80%		
27-Jun-14	08:00	Germany	CPI Hesse (MoM)	Jun		-0.20%		
27-Jun-14	08:00	Germany	CPI Hesse (YoY)	Jun		0.70%		
27-Jun-14	08:00	Germany	CPI Bavaria (MoM)	Jun		-0.10%		

Date	Time	Country	Indicator	Period	Forecast	Prior	Consensus	Importance
27-Jun-14	08:00	Germany	CPI Bavaria (YoY)	Jun		0.60%		
27-Jun-14	08:30	Germany	CPI North Rhine Westphalia (MoM)	Jun		-0.20%		
27-Jun-14	08:30	Germany	CPI North Rhine Westphalia (YoY)	Jun		1.10%		
27-Jun-14	12:00	Germany	CPI (MoM) (Provisional)	Jun	0.10%	-0.10%	0.20%	*
27-Jun-14	12:00	Germany	CPI (YoY) (Provisional)	Jun	0.80%	0.90%	1.00%	*
27-Jun-14	12:00	Germany	CPI EU Harmonized (MoM) (Provisional)	Jun	0.0%	-0.30%	0.20%	
27-Jun-14	12:00	Germany	CPI EU Harmonized (YoY) (Provisional)	Jun	0.6%	0.60%	0.70%	
27-Jun-14		Germany	CPI Baden Wuerttemberg (MoM)	Jun		-0.20%		
27-Jun-14		Germany	CPI Baden Wuerttemberg (YoY)	Jun		0.80%		
30-Jun - 1-Jul-14		Germany	Retail sales (YoY)	May		3.40%	0.80%	
30-Jun - 1-Jul-14		Germany	Retail sales (MoM)	May	0.60%	-0.90%	0.80%	
1-Jul-14	07:55	Germany	Unemployment Change (000's)	Jun		24K		**
1-Jul-14	07:55	Germany	Unemployment Rate	Jun		6.70%		*
1-Jul-14	07:55	Germany	Markit/BME Germany Manufacturing PMI (Final)	Jun		52.4		**
3-Jul-14	07:55	Germany	Markit Germany Services PMI (Final)	Jun		54.8		
3-Jul-14	07:55	Germany	Markit/BME Germany Composite PMI (Final)	Jun		54.2		
4-Jul-14	06:00	Germany	Factory Orders (MoM)	May		3.10%		**
4-Jul-14	06:00	Germany	Factory Orders wda (YoY)	May		6.30%		*
4-Jul-14	07:30	Germany	Markit Germany Construction PMI	Jun		48.1		
4-Jul-14	08:10	Germany	Markit Germany Retail PMI	Jun		52.5		
7-Jul-14	06:00	Germany	Industrial Production sa (MoM)	May		0.20%		***
7-Jul-14	06:00	Germany	Industrial Production wda (YoY)	May		1.80%		*
8-Jul-14	06:00	Germany	Trade Balance	May		€17.4bn		
8-Jul-14	06:00	Germany	Current Account Balance	May		18.4bn		
8-Jul-14	06:00	Germany	Exports sa (MoM)	May		3.00%		
8-Jul-14	06:00	Germany	Imports sa (MoM)	May		0.10%		
26-Jun-14	06:45	France	Consumer Confidence	Jun	84	85	85	**
26-Jun-14	16:00	France	Total Jobseekers	May		3364.1k	3370.0k	
26-Jun-14	16:00	France	Jobseekers Net Change	May	15	14.8	6	
27-Jun-14	06:45	France	GDP (QoQ) (Final)	Q1	0.00%	0.00%	0.00%	**
27-Jun-14	06:45	France	GDP (YoY) (Final)	Q1	0.80%	0.80%	0.80%	*
27-Jun-14	06:45	France	Consumer Spending (MoM)	May		-0.30%	0.30%	
27-Jun-14	06:45	France	Consumer Spending (YoY)	May		-0.50%	-1.10%	
27-Jun-14	06:45	France	PPI (MoM)	May	0%	-0.10%		
27-Jun-14	06:45	France	PPI (YoY)	May		-0.90%		
1-Jul-14	07:50	France	Markit France Manufacturing PMI (Final)	Jun		47.8		**
3-Jul-14	07:50	France	Markit France Composite PMI (Final)	Jun		48		
3-Jul-14	07:50	France	Markit France Services PMI (Final)	Jun		48.2		
4-Jul-14	08:10	France	Markit France Retail PMI	Jun		50.5		
8-Jul-14	06:30	France	Bank of France Business Sentiment	Jun		97		
8-Jul-14	06:45	France	Budget Balance YTD	May		€-64.2bn		
8-Jul-14	06:45	France	Trade Balance	May		€-3933mn		
27-Jun-14	08:00	Italy	Business Confidence	Jun	100.2	99.7	100	***
27-Jun-14	08:00	Italy	Economic Sentiment	Jun	88	86.9		
30-Jun-14	08:00	Italy	PPI (MoM)	May		-0.30%		
30-Jun-14	08:00	Italy	PPI (YoY)	May		-1.80%		
30-Jun-14	09:00	Italy	CPI NIC including tobacco (MoM) (Provisional)	Jun		-0.10%		*
30-Jun-14	09:00	Italy	CPI NIC including tobacco (YoY) (Provisional)	Jun		0.50%		

Date	Time	Country	Indicator	Period	Forecast	Prior	Consensus	Importance
30-Jun-14	09:00	Italy	CPI EU Harmonized (MoM) (Provisional)	Jun		-0.10%		*
30-Jun-14	09:00	Italy	CPI EU Harmonized (YoY) (Provisional)	Jun		0.40%		**
1-Jul-14	07:45	Italy	Markit/ADACI Italy Manufacturing PMI	Jun		53.2		**
1-Jul-14	08:00	Italy	Unemployment Rate (Provisional)	May		12.60%		
1-Jul-14	16:00	Italy	New Car Registrations (YoY)	Jun		-3.83%		
1-Jul-14		Italy	Budget Balance	Jun		€-6.4bn		
3-Jul-14	07:45	Italy	Markit/ADACI Italy Composite PMI	Jun		52.7		
3-Jul-14	07:45	Italy	Markit/ADACI Italy Services PMI	Jun		51.6		
4-Jul-14	08:00	Italy	Deficit to GDP YTD	Q1		2.80%		
4-Jul-14	08:10	Italy	Markit Italy Retail PMI	Jun		45.2		
7-Jul-14	09:00	Italy	Bank of Italy Report on Balance-Sheet Aggregates					
26-Jun-14	07:00	Spain	Total Mortgage Lending (YoY)	Apr		16.00%		
26-Jun-14	07:00	Spain	House Mortgage Approvals (YoY)	Apr		2.00%		
27-Jun-14	07:00	Spain	Retail sales (YoY)	May		0.10%		**
27-Jun-14	07:00	Spain	Retail sales sa (YoY)	May		0.70%		
27-Jun-14	07:00	Spain	CPI EU Harmonised (YoY) (Provisional)	Jun	0.1%	0.20%	0.10%	***
27-Jun-14	07:00	Spain	CPI (YoY) (Provisional)	Jun	0.1%	0.20%	0.10%	**
30-Jun-14		Spain	Current Account Balance	Apr		€-1.8bn		
1-Jul-14	07:15	Spain	Markit Spain Manufacturing PMI	Jun		52.9		**
2-Jul-14	07:00	Spain	Unemployment Net ('000s) (MoM)	Jun		-111.9		**
3-Jul-14	07:15	Spain	Markit Spain Services PMI	Jun		55.7		
3-Jul-14	07:15	Spain	Markit Spain Composite PMI	Jun		55.6		
7-Jul-14	07:00	Spain	Industrial Output nsa (YoY)	May		-1.90%		
7-Jul-14	07:00	Spain	Industrial Output sa (YoY)	May		4.30%		
9-Jul-14	07:00	Spain	House transactions (YoY)	May		5.30%		
1-Jul-14	07:00	Netherlands	NEVI Netherlands Manufacturing PMI	Jun		53.6		**

Source: Bloomberg, UBS (incl. UBS Economics estimates)

Key market views: Euro area

Figure 47: UBS Economics forecast and market views

Indicator	Current	2014E		2015E			
		Q3	Q4	Q1	Q2	Q3	Q4
ECB Bank rate (%)	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Euribor (3 months) (%)	0.21	0.23	0.23	0.23	0.23	0.23	0.23
Germany 10-year (%)	1.30	1.50	1.60	1.70	1.80	1.90	2.00
10y Bunds/Treasuries spread (bp)	-128	-145	-165	-170	-180	-190	-200
Nominal GDP (YoY %)	1.8 (Q1-14, Final)	1.7	1.9	2.5	2.8	2.8	2.9
Real GDP (QoQ %)	0.2 (Q1-14, Final)	0.3	0.3	0.3	0.4	0.4	0.5
Real GDP (YoY %)	0.9 (Q1-14, Final)	1.1	1.2	1.3	1.4	1.5	1.7
HICP (YoY %)	0.5 (May,Final)	0.6	0.9	1.1	1.1	1.1	1.2
EURUSD	1.36	1.31	1.25	1.24	1.23	1.21	1.20

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

Key market views: UK

Figure 48: UBS Economics forecast and market view

Indicator	Current	2014E		2015E			
		Q3	Q4	Q1	Q2	Q3	Q4
Bank rate (%)	0.50	0.50	0.75	1.00	1.25	1.50	1.75
Libor (3 months) (%) (eop)	0.55	0.60	0.60	1.10	1.35	1.60	1.85
10-year (%) (eop)	2.70	2.95	3.25	3.40	3.60	3.80	4.00
30-year (%) (eop)	3.45	3.90	3.90	4.10	4.10	4.25	4.25
10s/30s (bp)	75	95	65	70	50	45	25
10-year Gilts/Bund spread (bp)	140	145	165	170	180	190	200
10-year Gilts/Treasuries spread (bp)	12	0	0	0	0	0	0
Nominal GDP (YoY%)	4.4 (Q1-14, Preliminary)	5.1	5.1	5.0	5.4	5.3	5.1
Real GDP (QoQ %)	0.8 (Q1-14,Preliminary)	0.8	0.7	0.7	0.7	0.7	0.7
Real GDP (YoY %)	3.1 (Q1-14,Preliminary)	3.0	3.0	2.9	2.9	2.8	2.8
RPI (%) (YoY %)	2.4 (May)	2.4	2.5	2.3	2.8	2.9	2.8
CPI (%) (YoY %)	1.5 (May)	1.8	2.0	1.9	2.2	2.0	2.0
UK Unemployment Rate	6.6 (Apr, 3m)	6.4	6.3	6.3	6.2	6.2	6.1
GBPUSD	1.70		1.60				1.60
EURGBP	0.80		0.78				0.75

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

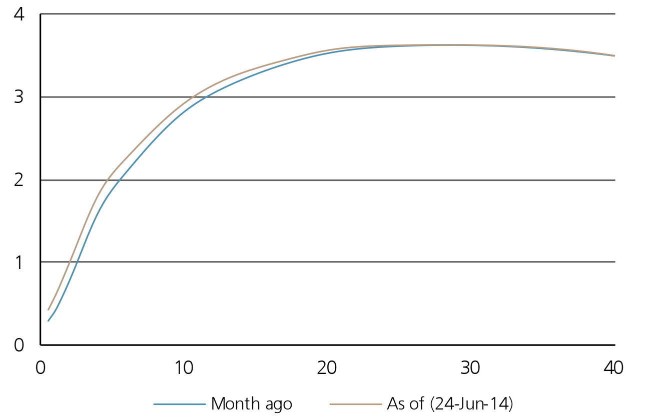
UK macroeconomic calendar

Date	Time	Indicator	Period	Forecast	Prior	Consensus	Importance
26-Jun-14	11:30	BOE's Carney Speaks in London on Financial Stability Report					
27-Jun-14	00:01	Hometrack Housing Survey (MoM)	Jun		0.50%		
27-Jun-14	00:01	Hometrack Housing Survey (YoY)	Jun		6.10%		
27-Jun-14	00:05	GfK Consumer Confidence	Jun		0	2	
26-Jun - 30-Jun-14		Nationwide House PX (MoM)	Jun		0.70%	0.50%	**
26-Jun - 30-Jun-14		Nationwide House Px nsa (YoY)	Jun		11.10%	11.20%	**
26-Jun - 30-Jun-14		BOE FPC Publishes Recommendations					
27-Jun-14	09:30	Lloyds Business Barometer	Jun		41		
27-Jun-14	09:30	GDP (QoQ) (Final)	Q1	0.8%	0.80%	0.80%	***
27-Jun-14	09:30	GDP (YoY) (Final)	Q1	3.1%	3.10%	3.10%	***
27-Jun-14	09:30	Current Account Balance	Q1		£-22.4bn	£-17.3bn	
27-Jun-14	09:30	Index of Services (MoM)	Apr		0.40%	0.30%	
27-Jun-14	09:30	Index of Services 3M/3M	Apr		0.90%	0.90%	
27-Jun-14	09:30	Total Business Investment (QoQ) (Final)	Q1		2.70%	2.70%	
27-Jun-14	09:30	Total Business Investment (YoY) (Final)	Q1		8.70%	8.70%	
30-Jun-14	09:30	Net Consumer Credit	May		£0.7bn		
30-Jun-14	09:30	Net Lending Sec. on Dwellings	May		£1.7bn		
30-Jun-14	09:30	Mortgage Approvals	May		62.9K		*
30-Jun-14	09:30	Money Supply M4 (MoM)	May		-0.20%		
30-Jun-14	09:30	M4 Money Supply (YoY)	May		-0.60%		
30-Jun-14	09:30	M4 Ex IOFCs 3M Annualised	May		4.50%		
1-Jul-14	09:30	Markit UK PMI Manufacturing sa	Jun		57		**
1-Jul-14	09:30	Bank of England Publishes FPC Record					
01-Jul - 08-Jul-14		Halifax House Prices (MoM)	Jun		3.90%		*
01-Jul - 08-Jul-14		Halifax House Price	Jun		8.70%		
2-Jul-14	09:30	Markit/CIPS UK Construction PMI	Jun		60		*
2-Jul-14	12:00	Prime Minister's Question Time in House of Commons					
3-Jul-14	09:30	Official Reserves Changes	Jun		$-613mn		
3-Jul-14	09:30	Markit/CIPS UK Composite PMI	Jun		59		
3-Jul-14	09:30	Markit/CIPS UK Services PMI	Jun		58.6		
4-Jul-14	09:00	New Car Registrations (YoY)	Jun		7.70%		
7-Jul-14	09:30	Lloyds Employment Confidence	Jun		4		
8-Jul-14	09:30	Industrial Production (MoM)	May		0.40%		**
8-Jul-14	09:30	Industrial Production (YoY)	May		3.00%		*
8-Jul-14	09:30	Manufacturing Production (MoM)	May		0.40%		*
8-Jul-14	09:30	Manufacturing Production (YoY)	May		4.40%		
8-Jul-14	15:00	NIESR GDP Estimate	Jun		0.90%		
9-Jul-14	00:01	BRC Shop Price Index (YoY)	Jun		-1.40%		
9-Jul-14	12:00	Prime Minister's Question Time in House of Commons					
9-Jul-14	00:01	RICS House Price Balance	Jun		57%		

Source: Bloomberg, UBS (incl. UBS Economics estimates)

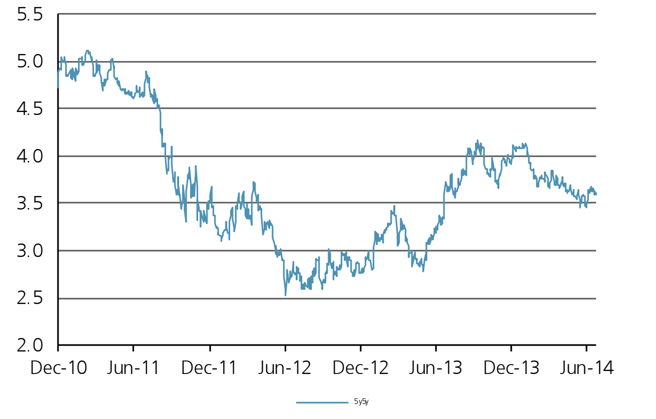
Gilt and GBP swap zero and forward curves

Figure 49: Gilt par curve (%)



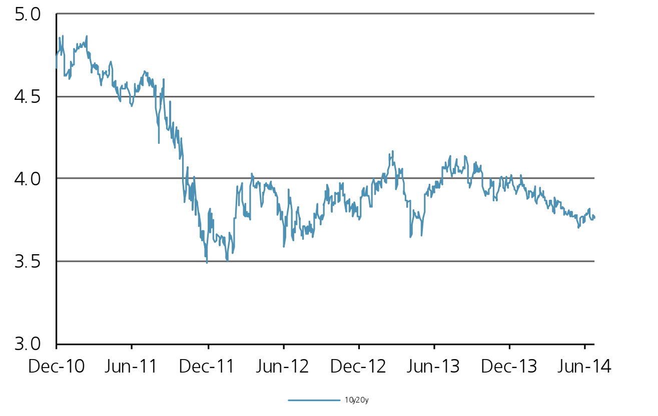
Source: UBS

Figure 50: Gilt 5-year, 5-year forward par rate (%)



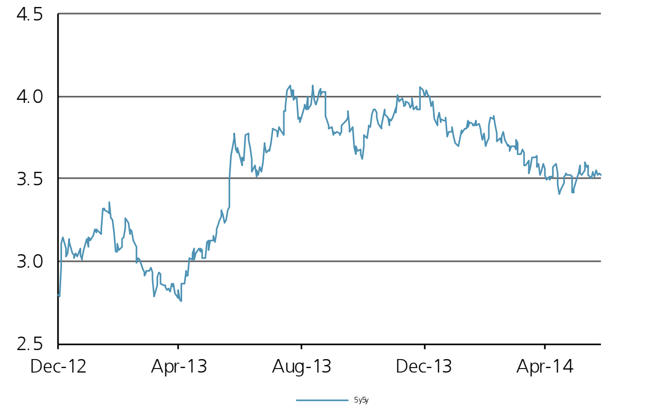
Source: UBS

Figure 51: Gilt 10-year, 20-year forward par rate (%)



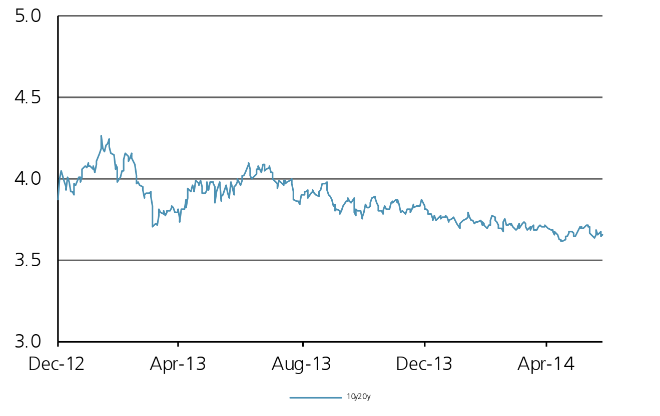
Source: UBS

Figure 52: GBP 5-year, 5-year forward swap rate (%)



Source: UBS, Bloomberg

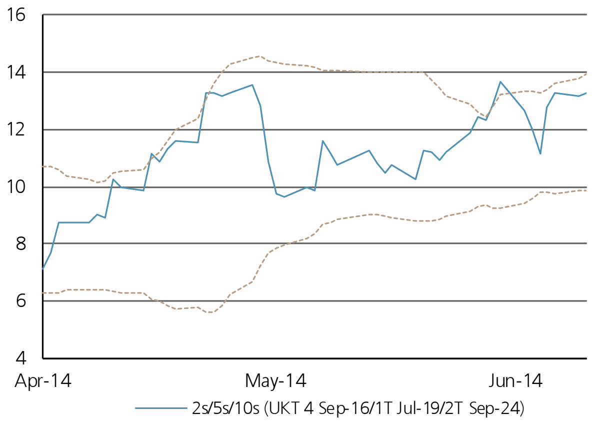
Figure 53: GBP 10-year, 20-year forward swap rate (%)



Source: UBS, Bloomberg

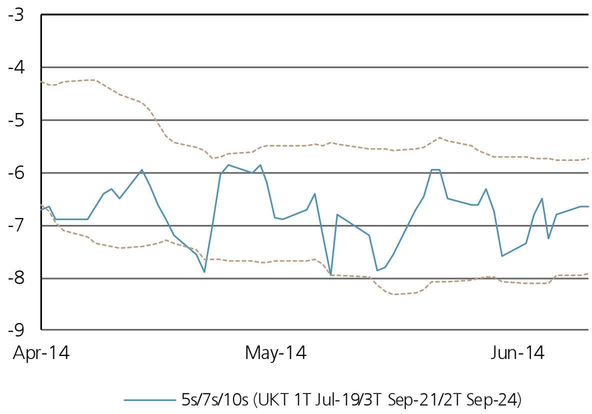
Conventional Gilt yield barbells

Figure 54: 2s/5s/10s (bp)



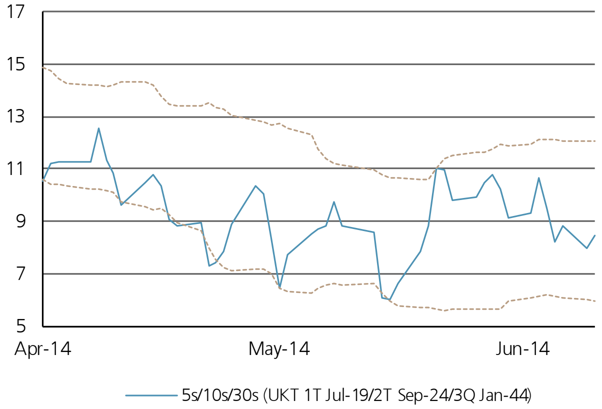
Source: UBS, Bloomberg

Figure 55: 5s/7s/10s (bp)



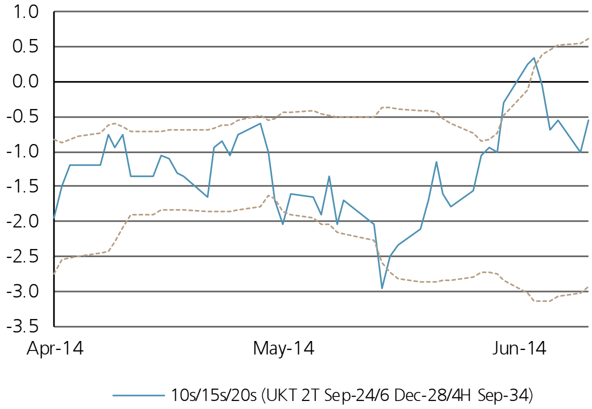
Source: UBS, Bloomberg

Figure 56: 5s/10s/30s (bp)



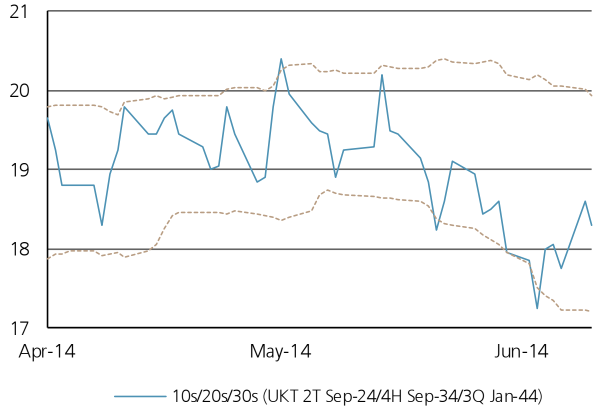
Source: UBS, Bloomberg

Figure 57: 10s/15s/20s (bp)



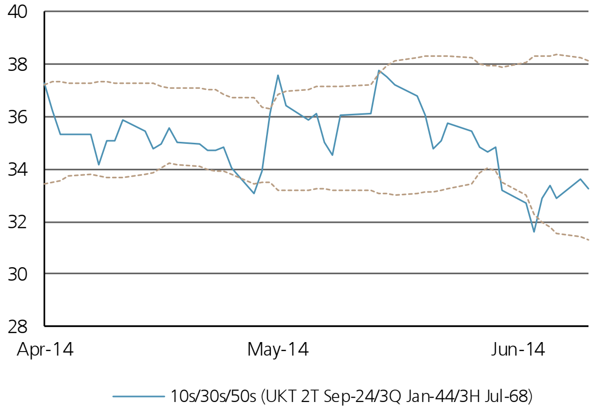
Source: UBS, Bloomberg

Figure 58: 10s/20s/30s (bp)



Source: UBS, Bloomberg

Figure 59: 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 5.00 09/14	34,540	12,716	36.82%	21,823			
UKT 2.75 01/15	27,785	4,084	14.70%	23,701			
UKT 4.75 09/15	31,693	15,093	47.62%	16,600			
UKT 8.00 12/15	7,204	4,716	65.46%	2,488			
UKT 2.00 01/16	30,907	7,981	25.82%	22,926			
UKT 4.00 09/16	29,191	11,042	37.83%	18,148			
UKT 1.75 01/17	27,921	11,156	39.96%	16,765			
UKT 8.75 08/17	7,371	4,576	62.07%	2,796	584		
UKT 1.00 09/17	31,011	3,586	11.56%	27,425	18,122		
UKT 5.00 03/18	29,028	15,656	53.93%	13,372	4,664		
UKT 1.25 07/18	34,002	1,248	3.67%	32,754	22,553		
UKT 4.50 03/19	33,270	17,263	51.89%	16,007	6,026		
UKT 1.75 07/19	25,799	95	0.37%	25,704	17,964		
UKT 3.75 09/19	27.074	11.405	42.13%	15.669	7.547		
UKT 4.75 03/20	28,012	13,385	47.78%	14,627	6,224		
UKT 3.75 09/20	23.159	4.256	18.38%	18.903	11.955		
UKT 8.00 06/21	16,394	11,285	68.83%	5,110	-		
UKT 3.75 09/21	26,882	6,921	25.75%	19,962		11,897	
UKT 4.00 03/22	36,025	23,186	64.36%	12,839		2,032	
UKT 1.75 09/22	28,241	2,442	8.65%	25,799		17,327	
UKT 2.25 09/23	26,808	1,480	5.52%	25,328		17,286	
UKT 2.75 09/24	10,030	0	0.00%	10,030		7,021	
UKT 5.00 03/25	27,595	16,703	60.53%	10,893		2,614	
UKT 4.25 12/27	24,346	16,554	68.00%	7,792		488	
UKT 6.00 12/28	13,446	7,766	57.75 %	5,680		1,647	
UKT 4.75 12/30	24,524	11,862	48.37%	12,661			5,304
UKT 4.25 06/32	27,580	14,213	51.53%	13,367			5,093
UKT 4.50 09/34	26,969	7,876	29.20%	19,093			11,002
UKT 4.25 03/36	19,906	5,795	29.11%	14,110			8,139
UKT 4.75 12/38	18,484	8,039	43.49%	10,445			4,900
UKT 4.25 09/39	18,612	6,356	34.15%	12,256			6,672
UKT 4.25 12/40	23,452	7,395	31.53%	16,057			9,021
UKT 4.50 12/42	21,143	7,091	33.54%	14,051			7,709
UKT 3.25 01/44	26,690	953	3.57%	25,737			17,730
UKT 3.50 01/45	5,000	0	0.00%	5,000			3,500
UKT 4.25 12/46	16,147	4,854	30.06%	11,293			6,449
UKT 4.25 12/49	17,311	5,070	29.29%	12,241			7,047
UKT 3.75 07/52	21,378	6,468	30.26%	14,910			8,496
UKT 4.25 12/55	18,453	8,105	43.92%	10,349			4,813
UKT 4.00 01/60	18,148	7,130	39.29%	11,018			5,574
UKT 3.50 07/68	9,500	94	0.99%	9,406			6,556
Total	**951,031**	**325,894**	**34.27%**	**625,137**	**95,639**	**60,311**	**118,006**

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. Excluded from the figures are holdings by local authorities, public corporations and the Bank of England (BoE). ** 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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	Time Horizon	**UBS Terminology**	**Expectation**	**Definition**
Sector recommendations	3 months	OVERWEIGHT	outperform	Sector is anticipated to <expectation> other sectors in the local currency investment universe* over a three-month horizon
		MARKET WEIGHT	perform in line	
		UNDERWEIGHT	underperform	
Company credit fundamentals	6 months	IMPROVING	improve	Credit fundamentals of the company are anticipated to <expectation> over the next six months
		STABLE	remain stable	
		DETERIORATING	deteriorate	
Company / bond	3 months	BUY	outperform	Company/Bond is anticipated to <expectation> other companies/bonds within a given peer group in the local currency investment universe* over a three-month horizon
		HOLD	perform in line	
		SELL	underperform	
Credit Default Swaps	3 months	BUY protection	widen by 5 bps or more	CDS level anticipated to <expectation>
		NEUTRAL protection	neither widen nor tighten by more than 5 bps	
		SELL protection	tighten by 5 bps or more	
All recommendation types	N/A	Under Review	N/A	The recommendation is under review and a new recommendation may be published within the next 18 days

Note: Recommendations for periods under 3 months are defined as 'Tactical', as in Tactical Buy or Tactical Sell.
* Europe - iBoxx NonSovereign € and NonGilt £ universe measured on a curve-adjusted, excess return basis
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Source: UBS

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Source: UBS; as of 01 Jul 2014.

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