European Rates Weekly

The bears have killed Goldilocks

Overview (p2): there is a difference between forecasting something and it actually crystallising. We think investors should be afraid that the ominous outlook for the world in our Year Ahead has been borne out (ex-ECB cuts) over the past six weeks. This hardens our 'anti-goldilocks' and deflationist views. Rather than fade, we say follow - and be cautious in 2016. We have been warning in past weeklies that this all looks similar to 2008. We dust off our old mantra: this is about 'return of capital, not return on capital'. We suspect 2016 will be characterised by more focus on how the exiting occurs of positions in the 3 main asset classes that benefitted from QE (other than high quality govt FI, which is cheap): 1) EM, 2) credit, 3) equities. We stick to our -10 - 20% equity downside call. In a crowded hall, exit doors are small. Risks are high.

Euro Area: Next rate hike from the ECB? Not this cycle. Bunds are cheap (p12): No rate hikes this cycle in Europe. Bunds are cheap. Inflation has fallen back after accelerating through the middle of 2015. Inflation shows no sign of sustained upturn, in our view, and market divergence from the ECB's projections are at new extremes. Over the longer term, China's slowdown may turn into an L-shaped recovery if recent BIS research is right, and in the meantime, history tells us that a US downturn may be nearer than you think. The ECB's rate hike window may not open for years.

2016 EMU Supply picture (p16): EMU supply is down €65bn year/year (€845bn vs €910bn); the lowest since 2011, with net supply down €75bn. The fall is steepest in Spain, Netherlands and Italy, meaning the weight of German and French supply in indices will rise. Most of the fall will be in the 2-5y sector but there will also be less 10y and 30y. There are no new 30y benchmarks from Germany, France or the Netherlands but instead there will be more 50y is a near doubling of 20y supply in 2016.

Spain (p26): Three Kings Bring Two Elections to Spain: The market is too complacent about Spanish politics. We think the parliamentary deadlock in both Madrid and Barcelona will result in Catalan elections in March and national elections in Q2 2016. Political risk led to SPGB underperforming BTPs in 2015 and has now intensified, so we prefer to hold our peripheral longs in 10y BTP and 4y PGB.

UK (p31): Price action in early 2016 is reminiscent of that in early 2015. Supply dynamics are back in focus. We run through the details of the coming Gilt cash flow events (redemption, coupons and BoE QE re-investment buybacks). Buy UKT 2% 2025 on the UKT 3.75% 2020/ 2% 2025/ 3.5% 2045 1:2:1 fly, positioning for 5bp of 10y outperformance.

Volatility (p41): We look at the main European political events which could increase market volatility in the Beginning of 2016.

Technical Outlook (p48): Bunds: the view remains constructive with near-term correction possible. **Treasuries**: 2.11% - 2.30% range to remain in place. **Gilts**: 1.75% / 1.80% target area reached, the bias remains bullish. **Gilts-Bunds**: change of view, we favour being neutral for now. **BTPs**: correction may be limited by 1.60%, as the market remains bullish. **Brent**: $26/bbl targeted, as $34.40/bbl support broken.

Trade Recommendation Performance (p52)

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Andrew Roberts

Overview: all playing out to plan so far. As we warned, this looks very much like 2008

Question of the week: Composite PMI compiled by Markit is probably your best broad indicator of economic performance which is comparable globally.

EMU composite PMI is now > US composite PMI.

Yet EMU is easing policy, with a lot more to come in 2016; and the US has severely tightened policy up to now, with allegedly more to come.

A status quo that surely cannot exist for much longer?

My old credit crunch mantra makes a comeback:

Return *of* capital, not return *on* capital

Overview: there is a difference between forecasting something and it actually crystallising. We think investors should be afraid that the ominous outlook for the world in our Year Ahead has been borne out (ex-ECB cuts) over the past six weeks. This hardens our 'anti-goldilocks' and deflationist views. Rather than fade, we say follow - and be cautious in 2016. We have been warning in past weeklies that this all looks similar to 2008. We dust off our old mantra: this is about 'return *of* capital, not return *on* capital'. We suspect 2016 will be characterised by more focus on how the exiting occurs of positions in the 3 main asset classes that benefitted from QE (other than high quality govt FI, which is cheap): 1) EM, 2) credit, 3) equities. We stick to our -10 -20% equity downside call. In a crowded hall, exit doors are small. Risks are high.

A recap of our '16 in 16' global macro year ahead – bullet point conclusions

Our year ahead is still our main marketing tool as we enter early January, and most of it is still relevant (though we were too bullish short-term on the ECB, which has turned into a more slow burn story – but with CPI averaging at best -0.1% in 2016 according to our new forecast from chief euro economist Andy Cates, the ECB is in deep trouble and will soon know it when the consensus 1% CPI for 2016 is shown to be very optimistic). Hopefully the Year Ahead still adds value to exactly what is now transpiring on China, oil, global equities, food and metal commodity prices, global credit spreads, global growth, and global inflation. Please do have a read here.

To condense my 24 pages, here is a short repeat of my conclusionary points:

"*My bullet point themes into 2016 are (remain):*

- *bearish China*
- *bearish global commodities (hards, softs, fluids). And more specifically . . .*
- *bearish oil (target $26, then clear risk of $16)*
- *CBs (mostly everywhere) will ease more*
- *The world has far too much debt to be able to grow well – global output gap widens*
- *Emerging market majors (outside India & Eastern Europe) all remain sells*
- *Automation on its way to destroy 30-50% of all jobs in developed world*
- *Currency war / mercantilism*

And my new bullet point themes:

- *Global disinflation risks turning into global deflation in 2016*

"Not a rout, but worst global equity performance since 2008."

- *Everyone thinks 'goldilocks'. We thought this strongly for >2 years (on our liquidity theme) but now worry about equities/credit, both huge, multi-year, well held positions. Negative returns in 2016 are probable, though without a recession they should be manageable, think -10-20%, rather than a rout*
- *If we see weaker 'risk on' products, the last safe 'high yielder' is the EMU periphery. Our new 0.75% 10y BTP target could prove too high a yield*
- *Risks to 0.16% new 10y bund target are on the downside, not upside*
- *Main risk comes from oil. A plunge sub $20 would aid consumption"*

That was then. What now?

A round-up of how those views look in the past six weeks

I think my 'severe downside for the world' call is looking ok so far.

Danger is lurking out there for every investor . . .

The fact that we are going well is **very dangerous for every investor in the world**.

Why?

We posited a negative outcome in the Year Ahead, risks for which were very high, and massively underpriced, with consensus on its usual 'goldilocks'' platform. What we are now seeing is **those risks now playing out**. That is the problem. It is not lost on me when something goes from a forecast, to an actual outcome.

The downside is crystallising.

Watch out.

Sell (mostly) everything.

Since we published this Year Ahead on 24 November 2015:

- **China stocks** are down a healthy -10%, a good start to the year, more to come.
- **Brent** is -$12, halfway to our $26 (then $16) target already.
- **Baltic Dry** is -16%, **copper** -1.5%, **coal** -6.3%, **soybeans** +0.3%, **wheat** -3.5%, **corn** -4.1%, also partly showing up what a super calm El Nino does to food prices, a much forgotten component of inflation indices. Stay limit short.
- **Emerging market I-share** total return down another -13%. Do NOT try to catch this falling knife.
- **5yr EMU iTraxx crossover** spreads +47bp; **10y EMU iTraxx crossover** index spreads +44bp. Both still have immense widening potential, why are spreads still >100bp BELOW the 2013 averages? There are far too many consensus longs (ask yourself how many bullish EMU credit notes you have read already this year), a rapidly shrinking exit door as banks continue to cut risk-weighted assets and this is a balance sheet intensive industry, and earnings have now turned negative in some sectors ex-commodities (e.g., in the US, but this is a global theme) – the next accident awaits.
- **Currency war** is ongoing, see our FX monthly for more (they have recently re-joined our research team and we will be doing more cross marketing with them in future – if you need to get on their new mail lists, please contact David Simmonds or Paul Robson). However, USD trade-weighted is -1% since the

Year Ahead so this has not been broad brushed, we do need to pick our 'sale' FX currency a tad more carefully. This will be especially so as perceptions build that the US cannot withstand tighter policy from here. Open question: are we nearing the end of the 'straightforward' USD upside trade? USD TWI flat since start Nov, after +25% since mid 2014.

- **10y bunds**: flat, and **10y BTPs** +2bp outright, with carry they end up as flat trades more or less (marginally up, but it is marginal).

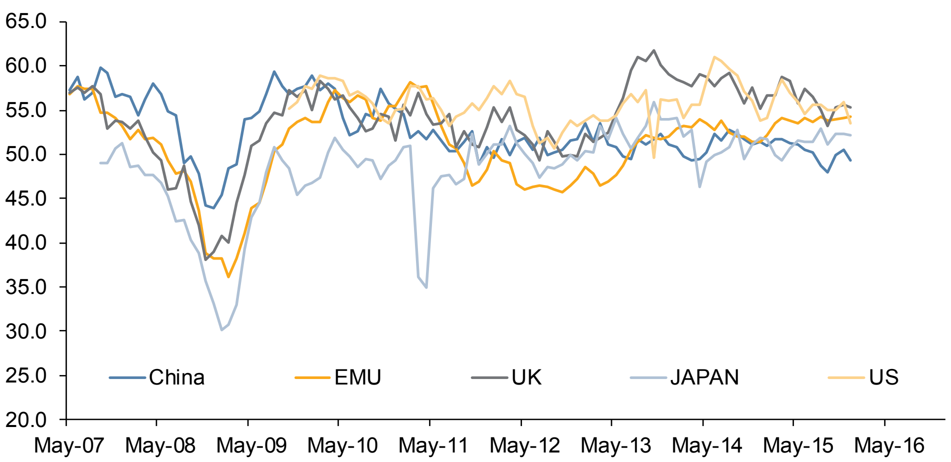
PMIs: Europe up, US down. Watch out for those ubiquitous 200bp 10y bund/UST calls (we like both longer dated USTs and bunds)

Here is the latest composite PMI. One of the world's most consensus positions is 'long European bonds, short US bonds', and we do worry about this. It is one reason bunds have had trouble rallying in the past few weeks, whereas 10y USTs – which we also like – are net small up (-5bp) since the Year Ahead.

The recent PMIs highlight what indeed should happen when currencies make major moves.

EMU is doing fine, thanks to lower oil and a weaker currency, and the fact it comes from a weak level, and is rebuilding. We could be harsh and use our usual descriptor of 'plateauing', though this would be a bit tough in a month when the PMI data in EMU has been generally fine.

Composite PMIs: US now below EMU and UK



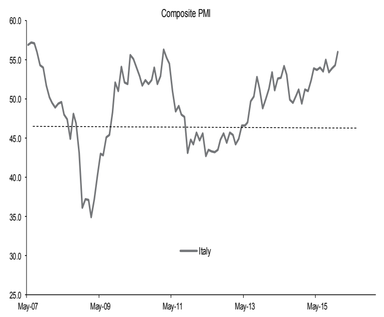
Source: Markit; RBS

It is perhaps logical that two of the pockets of strength are Germany and Italy (France remains very weak relative to other EMU countries, and Spain remains ok but has come markedly off its high, which is very likely EM related). Germany and Italy are the two countries most exposed to exports, and should be the biggest beneficiaries of euro FX weakness.

Mercantilism works.

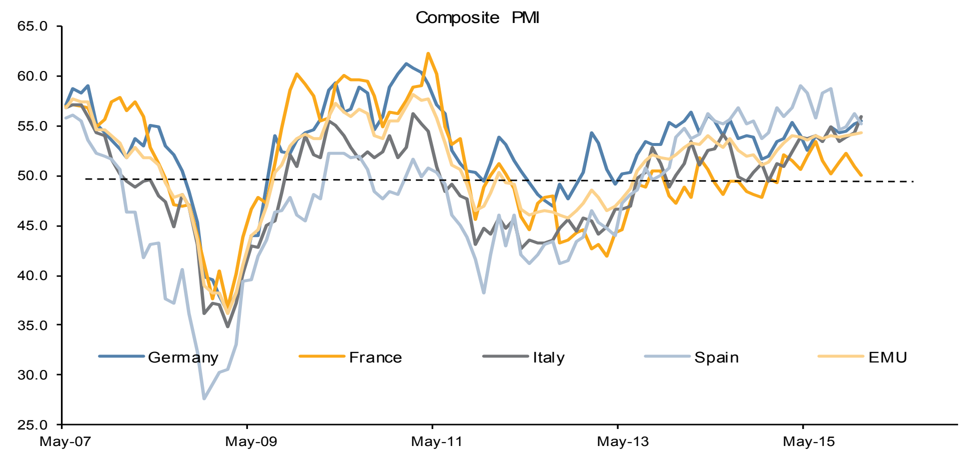
And because it is seen to work, it can only act as a spur for all countries involved in the mercantilist war (everywhere ex US and UK, and, bizarrely so it seems for now, Japan) to carry on / accelerate their part in the currency war.

Italy LOVES a weaker €. This also answers the worry about BTPs in a lower nominal GDP world – not a theme for now in my view.



Source: Markit; RBS

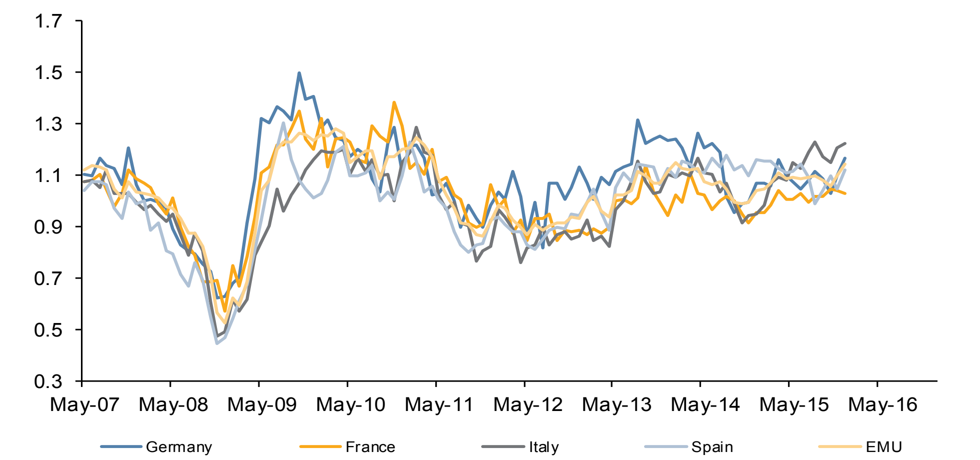
EMU composite PMI



Source: Markit; RBS

If anything, you could be even more sanguine about EMU, given manufacturing orders/inventory ratios have also perked up:

EMU manufacturing orders/inventories: picked up (ex France)



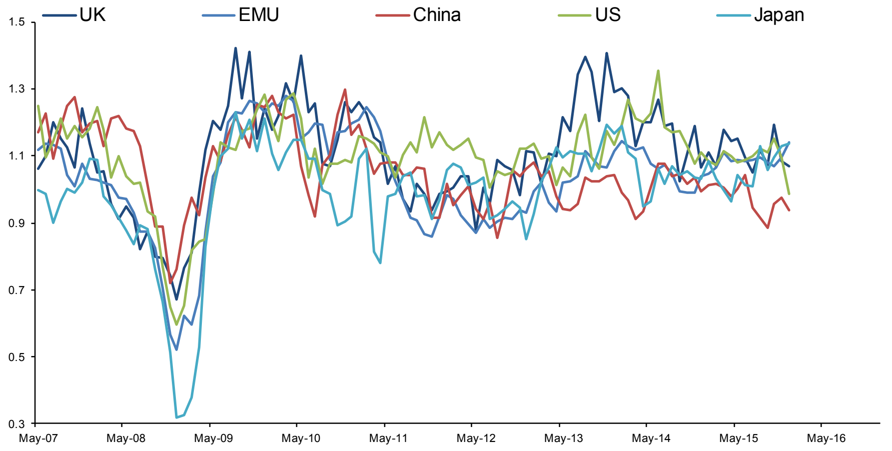
Source: Markit; RBS

Again, we put this down to the fact that mercantilism works. Perhaps this is also a function of the near-term move down in the euro from the $1.15 area that prevailed in Sep/Oct 2015 having a very quick effect (I buy this story, given it is not repeated globally in all PMIs, so there is clearly something specifically EMU occurring, and the FX move is a valid explanatory factor).

So, the big picture theme of mercantilism, is still at play. Sell FX where the CB is most active or will need to be most active (e.g., our FX colleagues still like shorting Malaysian, Korea, Euro, etc).

We say above not all areas are witnessing the good news. This is how the global orders/inventories ratio now looks after the past week of data:

Global manufacturing orders/inventories: US plunge



Source: Markit; RBS

US weakness, forecasts cut

This is what we warned about in the Year Ahead. This is what happens when global credit growth is running negative and you tighten your domestic financial conditions (the USA).

Please see our US desk strategy chief economist Michelle Girard's latest GDP update, where she has cut Q4 2015 GDP to 0.5% from 1.3% (all annualised data).

Also, the Atlanta Fed's GDPnow is showing 1% for Q4 GDP, down from indicating Q4 at 2% just a month ago.

Payrolls was fine, but to print >140k (including revisions) above consensus and yet have wages running sub consensus, at a time when CPI globally has come in sub consensus (e.g., EMU CPI this week 0.2%yoy versus 0.3%yoy expected), leaves one sanguine about the future path of US inflation pressures.

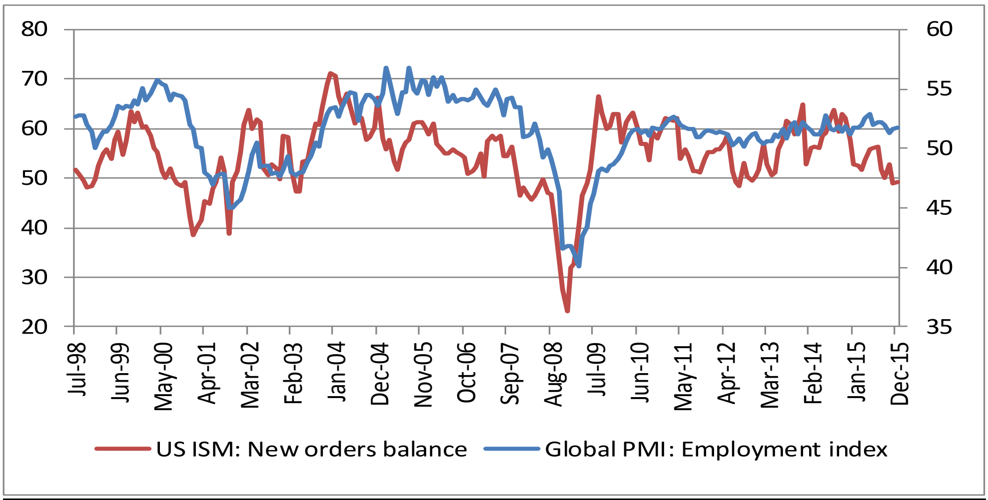
New punchy European economics research

New, short and punchy, regular Euro economics publication . . .

I will repeat a chart by our new global economist/chief euro economist **Andy Cates**, which he has just created and appears in his new 'Economics Perspectives' document I linked at the start of this piece.

Please read/subscribe, it is a new short document aimed at providing a two page text of Europe as a standalone and within a global economics context, and accompanied by his 10-15 most valid charts that back up such views.

As we continually argue, PMIs do tell us something. They now signal (in US and China) deep downside, corroborating the global credit and global trade data (both negative).



Source: Macrobond; RBS

The eye of the storm - an update on China

Anyway, this is all very vanilla, we suspect many readers this week will want an update on our negative China views.

As it stands, we have been **very wary of China** indeed, **and deeply sceptical of the suspiciously large consensus that has thought the authorities can 'buy time'** by their heavy intervention in cutting reserve ratio requirements (RRR), rate cuts, and easing in fiscal policy.

As I wrote in the year ahead when pushing our negative views on China (and therefore global credit**, global equities, which we saw as a -10% to 20%** play):

For the world:

"the game is up."

The game is up

The world is in trouble.

Our net rationale in 6 bullets:

1. The baton of growth pre credit crunch was in the western world, and passed to Asia post credit crunch.
2. But this has been a debt fuelled build up.
3. We have come to the end of the willingness to build up such debt, especially as demand factors start to act against this build-up (e.g. especially demographics).
4. I showed in the Year Ahead two facts, either of which would lead a visitor from Mars to conclude, knowing nothing else, that we are in global recession:

- Negative world trade growth
- Negative world credit growth

5. This is a terrible cocktail. How consensus suggested a month ago that 2016 would be better than 2015 is a total mystery to me.
6. And there is no-one left to take up the baton of growth.

Hence the ex-Fed official Mr Richard Fisher's pertinent comments this past week:

'The Federal Reserve is a giant weapon that has no ammunition left' (source: Bloomberg)

Of course, he is not strictly correct because the Fed has limitless ammunition, it has just chosen to take its bullets home rather than deploy them.

Global "risk off" occurs within weeks of the first Fed hike. Coincidence?

There is surely no coincidence that this **'risk off'** bout has occurred within weeks of the Fed hike, I am firmly in the camp of those who thought 'be careful what you wish for', and was actually quite surprised at the calm way the hike was taken in the first week afterward.

The key though, is the actual backdrop. What counts is that the **world is slowing, trade is slowing, credit is slowing, we are in a currency war, global disinflation is turning to global deflation as China finally realises what it needs to do (devalue soon, and sharp)** and **the US then, against ALL THIS countervailing pressure, then stokes the fire by hiking rates.**

This is why I cannot see much in terms of global hikes in 2015, other than countries trying to keep their currencies up (e.g., EM, Denmark).

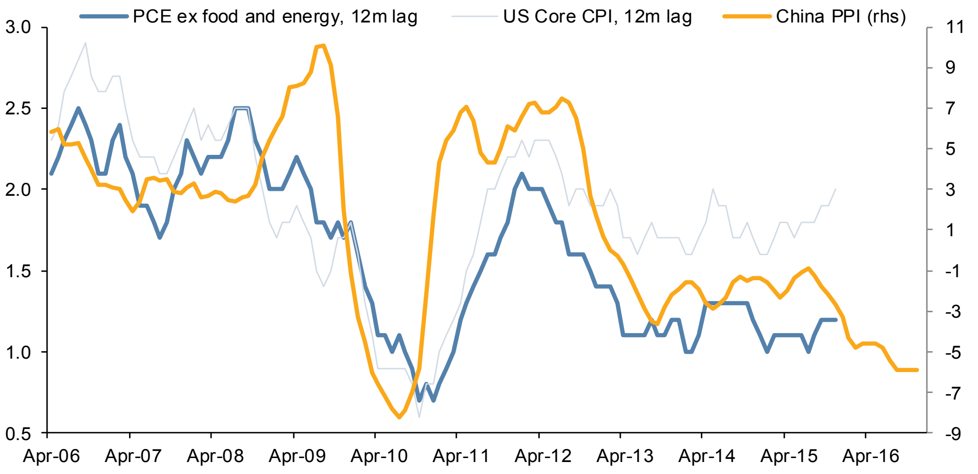
Back to China.

In my last trip round the USA in autumn 2015, I remember China took up most of the air-time, and my argument was that in a world of slowing trade, China, more than any other , needed to do something. They were pegged to the only currency rising in the world, so suffering a traumatic tightening in financial conditions.

More to the point, it would lose market share without cutting prices.

We have seen – as we show every month – the effect of its cutting prices directly, which is also a lovely flipside of the lower commodity price story (I have been limit short all commodities, softs, hards, and fluids, throughout 2015 and still am).

Where China PPI leads, global inflation follows . . .



Source: Bloomberg; RBS

The chart above shows that China is already a deflationary force for 2016, even before we discuss the currency.

But the much more urgent question was (is) around its currency. It needs to be dramatically lower.

China has showed its willingness to be ultra-aggressive to suit domestic policy before (e.g. running up a $4trn reserve portfolio to keep the yuan over-competitive is surely the best example).

With a severely over-valued currency, the problem they face in our view is continual enormous capital outflow, which has to be stemmed by reserves shrinkage.

I will never regard high reserves as a sign of strength, the world seems somewhat perverse in thinking this, but it is certainly the case that the worst case for China was always going to be 'do nothing, let capital outflow (bad for the domestic economy), offset by reserve selling, and when reserves run out, then devalue, but from a position of weakness'.

This seems inconceivable. It is possible, of course, but as we have been arguing for months, it is just totally illogical. Which makes the status quo on FX very unlikely to prevail in my opinion.

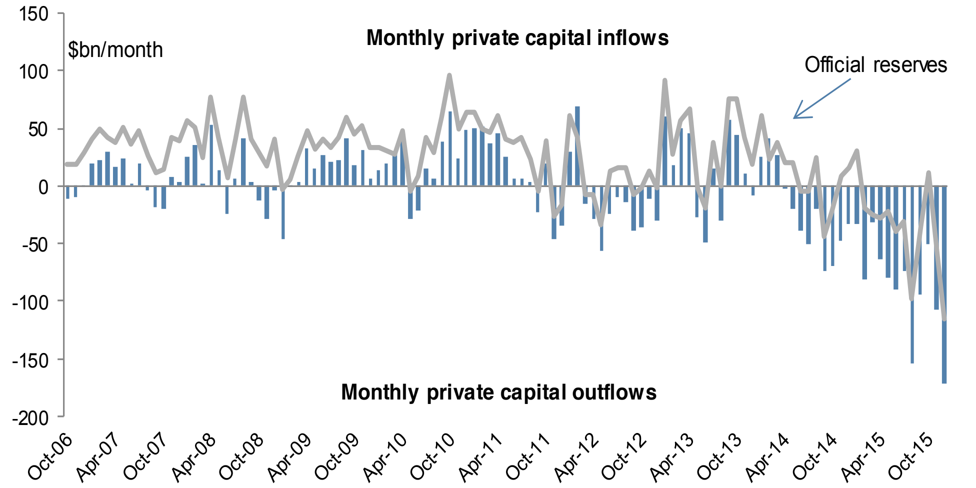
And in the face of this chart below by my colleague Giles, it was surely always nonsense that this was a 'later rather than sooner' theme, as so many have thought.

Surely the most important chart in the world now?

It shows the level of urgency for Chinese authorities to act on the currency

'Watch out below' on the yuan

RBS European rates strategy - China private capital outflow estimator



Source: Bloomberg; RBS

$170bn left China in December 2015, a record outflow

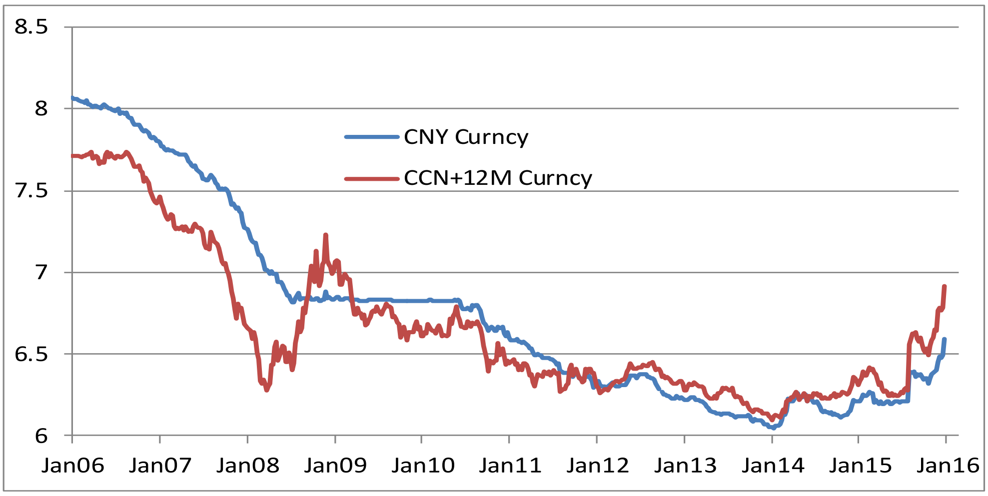
Giles estimates that around $170bn of private capital left China in December (subject to confirmation from the c/a balance and FDI data).

Small wonder then that the USD is rising, since this is money going straight back into USD, whereas the offsetting flow – selling of reserves – is spread across many countries (though our FX colleagues do estimate that the biggest holding is in USD, it is certainly not 100% of the reserve holding).

For our purposes, what counts is that this **outflow is accelerating.**

Giles' chart is surely now the most important chart in the world – it shows the extreme level of urgency for China to get its FX rate where it should be, toward a -20% depreciation. It has fallen -6.2% versus the USD since the summer when it started to move (and we started to discuss it every week in this weekly). I should repeat that everyone in RBS, from **Sanjay Mathur** our head of Asia economics who writes on China (here is his short note about the latest reserves fall, arguing action needs to come quickly), to **David Simmonds** our head of global FX research, and we in rates strategy/global macro, feel very high conviction in remaining on the 'more devaluation and quicker' side of the debate.

Chinese yuan, spot and 12m fwd. Expectations now starting (rightly) to motor. Follow



Source: Bloomberg; RBS

The chart above shows this is now starting to happen in sharp fashion.

And the key for the rest of the world is simple – and always has been.

China trying to grab market share of (shrinking) world trade leaves every corporate facing tougher conditions, a cheapening competitor selling their wares at a lower prices.

Beware of credit

I suspect the world of non-credit investors will all get more (negatively) credit focused in 2016

So, to recap, this is:

- bad for global earnings
- bad for global equities
- bad for corporate balance sheets
- bad for global credit spreads
- bad for commodities

One thing I do not like to do is think because something has moved 20bp I may have missed it. So, ask yourself if we have moved too far already on this theme, or if it has just started?

I think the world is nowhere close to where our fairly cataclysmic year ahead stands, and feedback from investors suggests such.

My biggest ‘bad news’ view for 2016?

We have been told for 7 years now since the credit crunch, under QE, to borrow money and invest it in one of 3 things: 1) EM 2) credit 3) global equities.

This is a big picture, **multi-year bet** that has been taken, which has worked fine, and **stopped working 10 months ago** (this is NOT NEW).

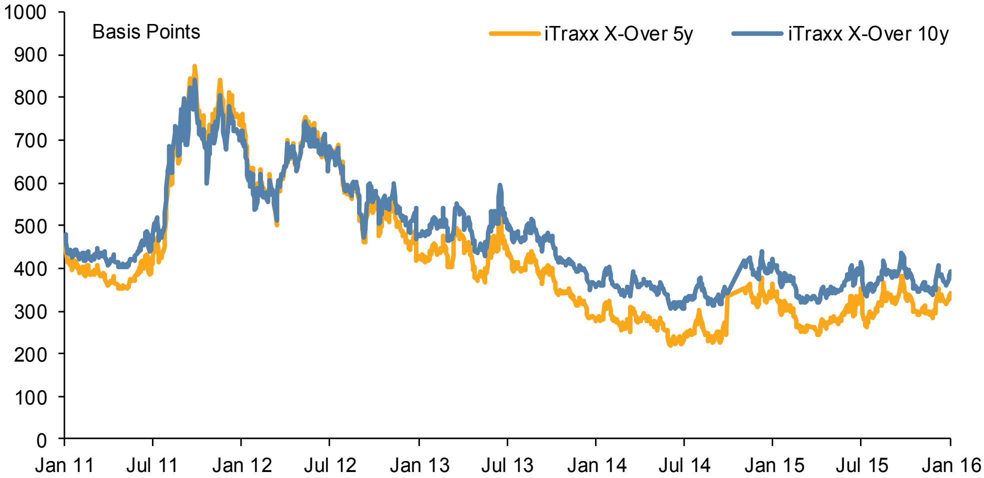
Meanwhile, **the exit door for both EM and credit has collapsed**, should such a door be needed (I think it will).

Against our weaker growth backdrop, I cannot see anything but problems for credit and EM and even equities in 2016, and the moves so far have been **very modest** (S&P -4%, France CAC -9%, 5y iTraxx +40bp) considering what discounts would need to be accepted if there were a more aggressive flight and everyone selling at the same time.

Sell mostly everything

Sell everything except high quality bonds.

There are many asset classes that have yet to move much at all . . . EMU crossover credit



Source: Bloomberg; RBS

Return of capital, not return on capital

Trades?

Long 10y Gilts, USTs, bunds, BTPs.

Long front ends as deposit rate cuts remain on the table, especially in EMU, but UK front end also looks cheap as hawks get bounced from the table and my mantra of 'no hikes this hike cycle' continues to flow.

And mostly, beware of the risk-on optimistics.

One lesson from Q2 2015 and the bund sell-off we got caught in, is that we need to always ask ourselves what the exit door is with any trade - as we said into the credit crunch in 2008, **this will be as much as limiting losses as making gains.**

Giles Gale

Euro Area: Next rate hike from the ECB? Not this cycle. Bunds are cheap

1. US hare to lap European tortoise

When do you think it becomes more likely than not that the ECB will have raised interest rates from today's -0.3%?

This kind of first-principles New Year's thinking is the kind you may already have indulged in with your colleagues. My answer when pressed this week was 7 years. Is that outlandish?

We wouldn't expect to find many who would argue for less than 3 years. The question then becomes, how confident are you that Europe will see rates rising before rates fall again in the Anglo-Saxon world? Larry Summers points out (see below) that this may well be less than three years away, if history is a guide.

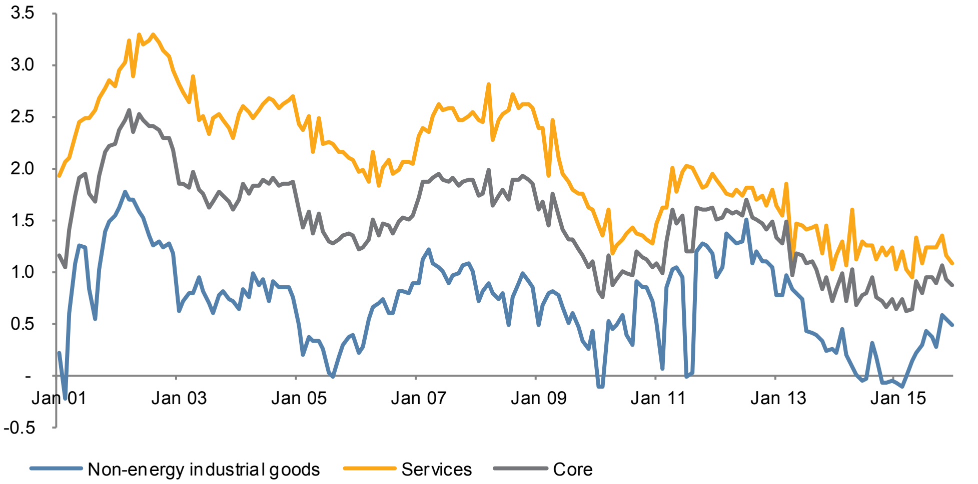
The FOMC may have been too quick to react to the inflation gun. We think it may be back at the start before the ECB gets its signal. In a world where rates may well return to zero in each downturn and the ECB may miss out on the next cycle bunds at 0.5% are cheap.

2. European inflation falls back. This is just the beginning.

Core inflation increased from 0.63% in April 2015 to 1.06% in October. This may well have looked like a trend to many. Energy base effects will also pick up early this year. Some investors we speak to worried that their peers, who had come to think of this as a deflationary environment, might be shocked. Neither fear looks justified after the figures for November and December.

The chart below shows that core inflation in December fell back to 0.86%. Within that, services fell to near long-term lows.

Core inflation, and its main components. Services back to near lows. Non-Energy industrial goods slow.



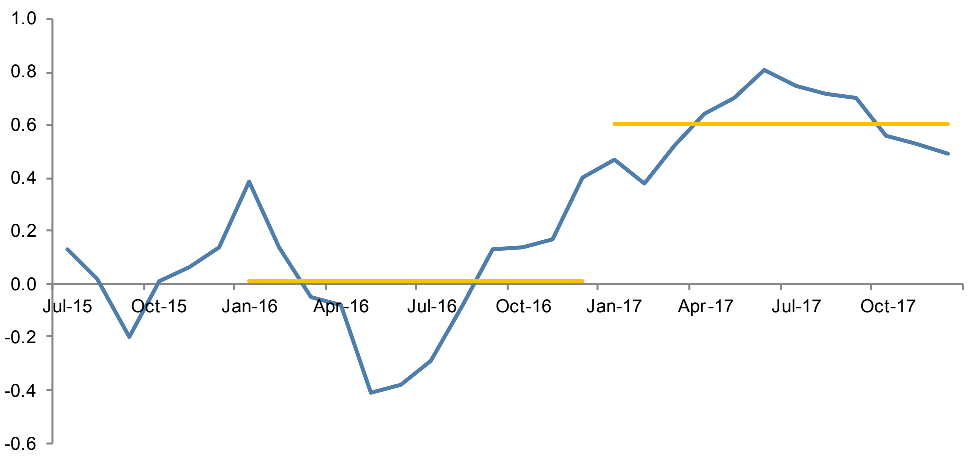
Source: RBS

The ECB's detailed analysis in August showed that the pick-up in core inflation was mostly driven by imported goods, which in turn were going up because the euro was going down. There was very little sign of inflation's rebound broadening out. Services, in particular, barely flinched.

If the ECB hoped that reflation might involve some kind of 'second-round' effects from non-energy industrial goods, we think they are badly mistaken. There is no reason to suppose these should matter more than energy prices, which look unlikely to bounce as soon as hoped.

In a separate note out this week, Andy Cates and Waylon Sittampalam highlight that headline inflation may average -0.1% over 2016 despite the early-year base effects.

RBS HICP y/y forecasts, monthly, and annual average rates.



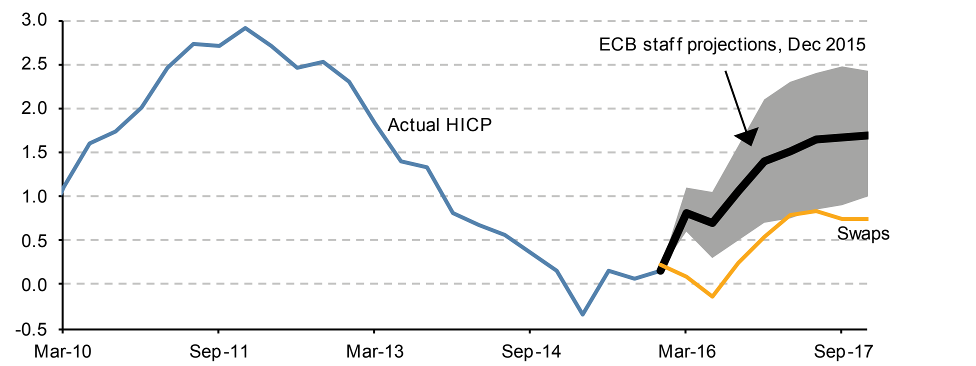
Source: RBS

To the ECB's credit, the rise in core inflation over the middle of 2015 wasn't trumpeted loudly. Draghi described it tentatively late in November as 'encouraging', and it certainly lent some credibility to the basic rhetoric that 'QE is working, just give us time'. There are lots of better data: PMIs and figures on bank lending in particular, and the euro has been much lower for a year.

But there has been no acceleration in inflation. Looking to the US as a lead indicator of the modern inflation process, we shouldn't find that surprising.

It is just a matter of time, therefore, before the ECB must abandon the optimism that pushed it to prefer incrementalism in December over shock-and-awe, in our view. The chart below invites thoughts of how the ECB might react if it marks-to-market its inflation views.

How does the ECB mark-to-market its inflation forecasts?



Source: RBS

2. Long term inflation perspectives? (a) Be very pessimistic on China

Andrew Roberts has already written extensively on China in his section. Activity indicators (PMIs, trade) all point in one direction: down. But the most decisive indicator of sentiment is surely that private capital left China at a record rate in December. I estimate that the $115bn fall in FX reserves implies private flight of $170bn (this figure adjusts fx reserves changes for estimates of FDI and current account earnings.) I suspect that, far from rebalancing smoothly toward domestic demand, Chinese demand will suffer as investment falls. China has no room to use fiscal policy to stabilise domestic demand. Monetary conditions must be eased, and quickly. China will be a late joiner to the EM currency war that began last year, and the result will be another disinflationary shock, in my view.

The BIS (inadvertently) adds to long-term concerns about China's longer-term contribution to global demand in a paper this week from Claudio Borio and co-authors. The idea is that financial booms cause productivity loss in both their build up and their busts because of the way they divert capital to less-productive industries, especially construction.

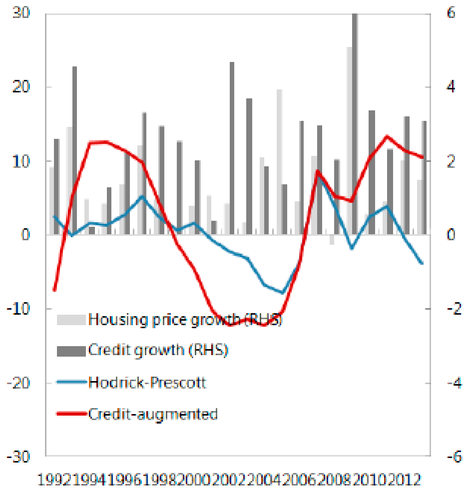
Borio et al. encourage policymakers to focus more on the role of the financial cycle, not just the 'real' business cycle as a result.

Although this sounds like an encouragement to the FOMC to keep doing what it's doing (although we note that financial excess doesn't look anything like as bad as it might have done a year ago) this most obviously looks like a warning about China. The IMF's Maliszewski and Zhang helpfully have a picture for the financial cycle in China (below).

This picture of financial overheating is not surprising, of course: it is well known that China's recent growth has been driven by one of history's fastest debt build-ups. But the BIS study does mean that we should worry that it will be a long, L-shaped recovery and serious ballast for world economic growth, when the bust is neigh.

The BIS warns that financial cycles can drive permanent productivity loss. We should worry about China's long debt-led boom then. What does this imply for longer-term Chinese growth?

China's output gap, deviations from sustainable output and related measures.



Source: Maliszewski and Zhang , IMF

Expansions don't last forever. Empirical probability of a recession within X months/year

Within	1954 on	1984 on
6 months	15%	16%
12 months	32%	35%
18 months	45%	47%
2 years	57%	59%
3 years	78%	77%

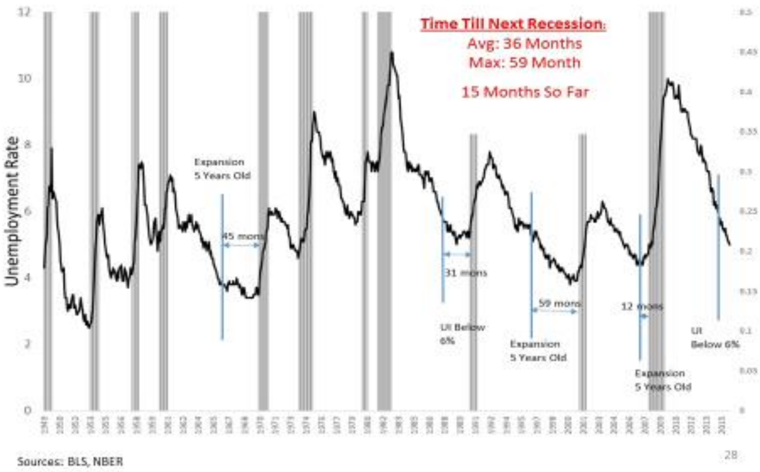
Source: RBS

3. Long term inflation perspectives? (b) Should a long US expansion be your base case?

On an investable horizon, we should also temper our optimism about the great medium-term hope for global growth – the US.

Whether you believe in the framework of Secular Stagnation or not, Larry Summer's empirical observation about the life expectancy of mature economic expansion should worry you. In this speech at the Central Bank of Chile he highlights that when an expansion is more than five years old and unemployment is below 6%, the probability of a recession within three years is over 75%. Unemployment hit 6% in the US 15 months ago.

Expansions don’t last forever. Once an expansion is 5 years old and unemployment is below 6%, a recession tends never to be far away.



Source: Larry Summers at the Central Bank of Chile

Michael Michaelides

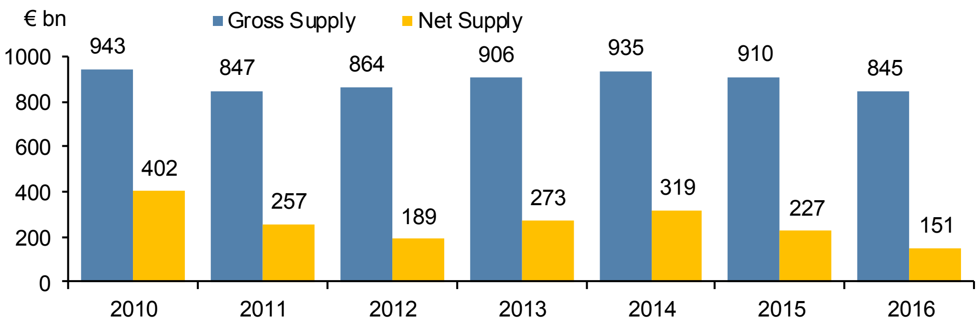
2016 EMU Supply picture

Down everywhere but in 20y and ultras

EMU supply is down €65bn this year (€845bn vs €910bn in 2015); the lowest level since 2011, with net supply down €75bn. The fall is steepest in Spain, Netherlands and Italy, meaning the weight of German and French supply in indices will rise. On our estimates, most of the fall will be in the 2-5y sector but there will also be less 10y and 30y. There are no new 30y benchmarks from Germany, France or the Netherlands but instead there will be more 50y supply and a near doubling of 20y supply in 2016.

- **Gross EMU supply down:** Issuance across EMU down notably (€65bn) from €845bn from €910bn in 2015: this is the lowest level since 2011.
- **Net supply back to pre-crisis levels:** The reduction in deficits means net supply down by a third (€75bn) and back to pre-crisis levels. Net needs from EMU-11 sovereigns from the market amount to only €151bn in 2016 (2015: €226bn), with net supply falling in all countries bar Austria.
- **The fall in supply is heaviest in major periphery countries and the Netherlands:** The reduction is explained almost entirely by these three countries: (Spain -€28bn, Italy -€23bn, and Netherlands -€22bn). Irish supply will also be scarce with €8bn of supply (€3bn already done), plus €3bn of exchanges in our view.
- **Weight of German/French supply rising,** German supply net supply is negative but €8bn higher in gross terms driven by higher redemptions. French supply is barely changed but the share of both countries will rise in market-weighted bond indices.
- **Once coupons are taken into account, net supply is minus €35bn across EMU**; far less than +38bn in 2015 and is only positive in France, Spain and Portugal
- **Reduced supply is concentrated in short-dated maturities**: On our estimated maturity breakdown, issuance is cut most year/year in 2-5y supply, as debt offices continue to lengthen maturities 10y and linker supply are only down marginally.
- **In the long-end supply will rise in 20y and ultras will rise:** New benchmarks can be expected in 20y from France and Finland, whilst there will be no new 30y benchmarks from Germany, France or Netherlands.
- **A Greek market return is possible in H2 2016,** assuming (a) ongoing (though not smooth) programme implementation, (b) inclusion in QE programme (post the ECB reinstating the 'waiver') and (c) a deal on OSI. Ahead of full market return, a switch operation of the 2017 bond into the 2019s, to increase the 'QE-eligible' stock is likely.

EMU-11 Gross and Net Supply



Source: Debt agencies, Bloomberg, RBS

2016 Gross Issuance Forecasts

Gross Supply 2016 vs 2015 (€ bn)

	RBS 2016 projection	2015 Final	Change	DMO 2016 projection	Issuance Outlook
Germany	164	156	8.0	162-166	Outlook
France	217	220	-3.0	187	Outlook
Italy	225	248	-23.0	n/a	n/a
Spain	112	140	-28.0	n/a	n/a
NL	25	47.5	-22.5	25-30	Outlook
Belgium (OLO)	33.5	35.5	-2.0	33.5	Outlook
Austria (RAGB)	21	18.5	2.5	21	Outlook
Finland (RFGB)	11	9	2.0	13	Outlook
Portugal	22.5	22.5	unch.	18-20	Outlook
Ireland	11	13	-2.0	6-10	Outlook
Greece	3	0	3.0	n/a	n/a
Total EMU-11	**845**	**910**	**-65.0**		

Source: Debt offices, Bloomberg, RBS

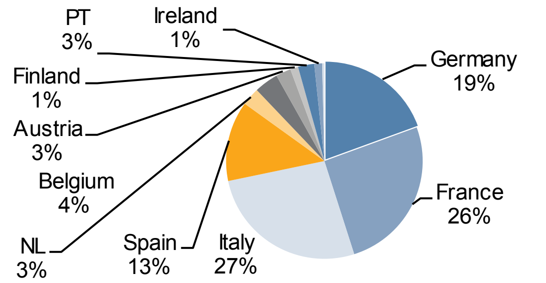
Coupons & Redemptions (€ bn)

	2016	2015	Chg.
Redemp.	650	649	+1
Coupons	186	189	-3
Total	**836**	**837**	**-1**

Source: Debt offices, Bloomberg, RBS

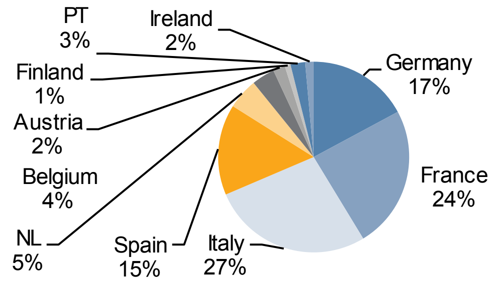
The increase in German supply means there will still be an increase in the relative share of German issuance and relative weight in indices in 2016. France will also rise as it falls less on a relative basis than overall supply number, whilst gross supply in Spain and Netherlands is falling sufficiently that their share of total issuance will also fall. The share of Italian sovereign issuance within 2016 EMU-11 supply is flat.

EMU-11 Gross Supply 2016 expected



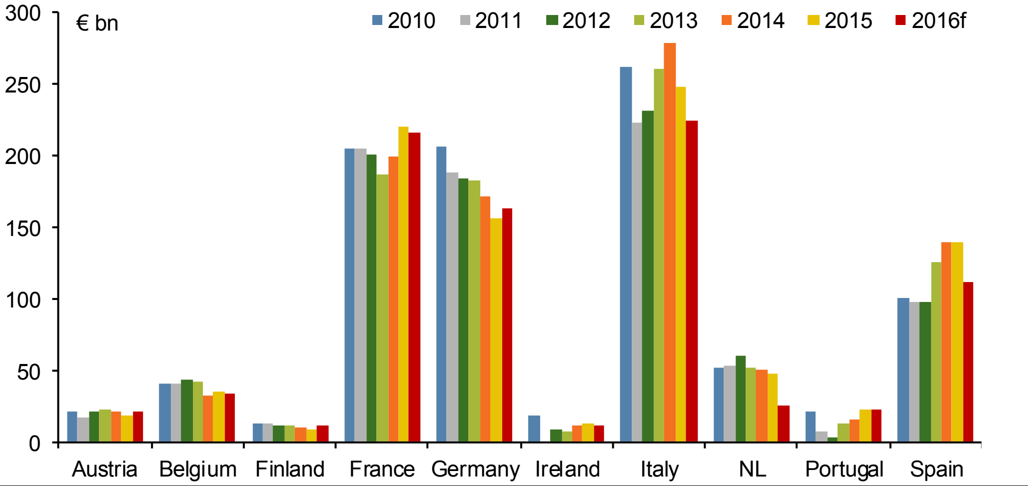
Source: Debt offices, Bloomberg, RBS

EMU-11 Gross Supply 2015



Source: Debt offices, Bloomberg, RBS

Historical EMU-11 Gross Supply



Source: Debt offices, Bloomberg, RBS

2016 Net Supply and Maturity Breakdown

EMU-11 2016 Net Supply (ex-Redemptions)

Country	2016 Redemptions	2015 Redemptions	2016 Net supply	2015 Net supply	Change
Germany	169	155	-5	1	-5.5
France	127	119	60	71	-11.0
Italy	184	197	41	51	-10.4
Spain	80	85	32	55	-23.1
NL	28	44	-3	4	-6.7
Belgium	24	23	5	8	-3.0
Austria	14	13	7	5	1.4
Finland	10	5	1	4	-2.9
Portugal	7	6	11	16	-5.0
Ireland	8	2	0	11	-11.0
Greece	0	0	2	0	1.5
Total EMU-11	**650**	**649**	**151**	**226**	**-75.2**

Source: Bloomberg, Debt offices, RBS

EMU-11 2016 Net Supply (ex-Coupons & Redemptions)

Country	2016 Coupons	2015 Coupons	2016 Net supply (ex-C&R)	2015 Net supply (ex-C&R)	Change
Germany	23.9	26.8	-28.4	-25.8	-2.6
France	40.7	40.4	19.3	30.7	-11.4
Italy	56.2	55.1	-15.3	-3.8	-11.5
Spain	27.7	28.4	4.2	26.6	-22.4
NL	8.3	9.0	-11.4	-5.5	-5.9
Belgium	11.0	11.4	-6.1	-3.5	-2.6
Austria	6.5	6.5	0.3	-1.2	1.4
Finland	2.2	2.1	-1.1	1.9	-3.0
Portugal	4.5	4.2	6.9	12.2	-5.3
Ireland	4.9	4.6	-5.1	6.2	-11.3
Greece	0.0	0.0	1.5	0.0	1.5
Total EMU-11	**186.0**	**188.6**	**-35.3**	**37.8**	**-73.2**

Source: Bloomberg, Debt offices, RBS

EMU-11 Supply by Bucket (RBS Estimates)

Country	2/3y	5y	7y	10y	15y	20y	30y	Ultra	Linkers	CCTeu	CTZ	Total
Germany	53	41		51			9		10			**164**
France	33	45	20	60	25	6	6	3	19			**217**
Italy	25	30	30	36	16		14		28	20	26	**225**
Spain	16	20	6	38	16	5	2		9			**112**
NL		7.5		15		1	1.5					**25**
Belgium		3	2	17	4	3	4.5					**33.5**
Austria		3	1	10		1.5	4	0.5				**20**
Finland		1	1	6		2	1					**11**
Portugal		4	4.5	10.5		2.5	2					**23.5**
Ireland			3	6			2					**11**
Greece	1			2								**3**
Total	**127**	**154.5**	**67.5**	**251.5**	**61**	**21**	**46**	**3.5**	**66**	**20**	**26**	**845**

Source: Debt offices, RBS

Issuance breakdown by country

Germany

German bond supply is marginally up driven by higher redemptions (€169bn in 2016 vs. €155bn in 2015). Bill supply is also rising significantly €31bn to €48bn reflecting (a) part of the rise in redemptions (these increase €14bn, which only €8bn absorbed in bonds), (b) pushing forward of December's cancelled bill issuance and (c) potential unforeseen expenses (i.e. potential migrant crisis costs), which is (literally) a no-cost option given potential unknown magnitude.

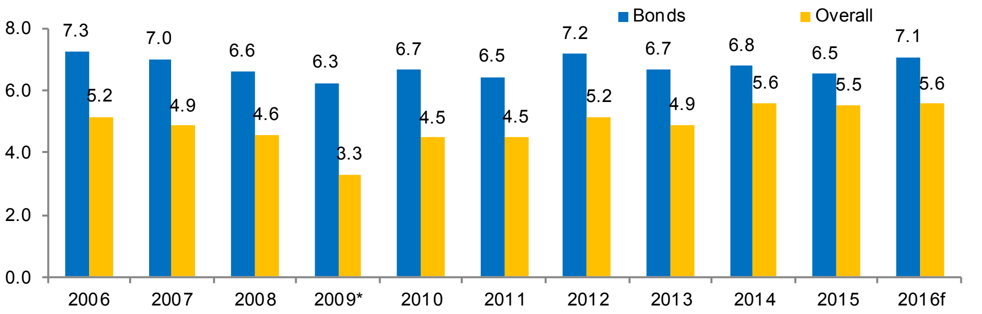
German historical issuance breakdown

Year	Nominals	Linkers	Bond total	Bills	Overall total
2008	141	7	148	75	223
2009*	153	5	158	176	334
2010	196	11	207	116	323
2011	181	8	189	94	283
2012	175	9	184	80	264
2013	173	10	183	74	257
2014	161	11	172	40	212
2015	144	12	156	30.5	186.5
2016f**	154	8-12	164	48.5	212.5

Source: Finanzagentur, Bloomberg, RBS

Germany is not taking the opportunity to increase the *share* of bond issuance in overall funding but the higher bond supply is split between 10y and 30y issuance. This means bond supply duration is rising, even if the overall number is not.

German issuance: Overall supply lengthening more than bonds alone



Source: Finanzagentur, RBS

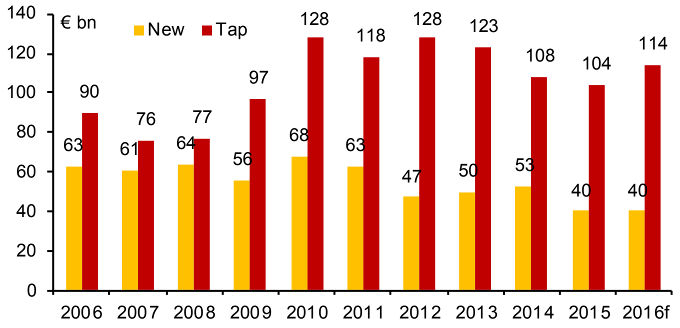
German historical issuance (€ bn)

	2-year	5-year	10-year	30-year	Linkers	Total
2008	59	33	41	8	7	**148**
2009*	64	36	47	6	5	**158**
2010	74	52	60	10	11	**207**
2011	69	50	54	8	8	**189**
2012	58	50	56	11	9	**184**
2013	60	51	54	8	10	**183**
2014	52	48	54	7	11	**172**
2015	53	39	46	6	12	**156**
2016f**	53	41	51	9	8-12	**164**

(*we exclude the USD bond, **we take the midpoint of the €8-10bn inflation forecast) Source: Finanzagentur, Bloomberg, RBS

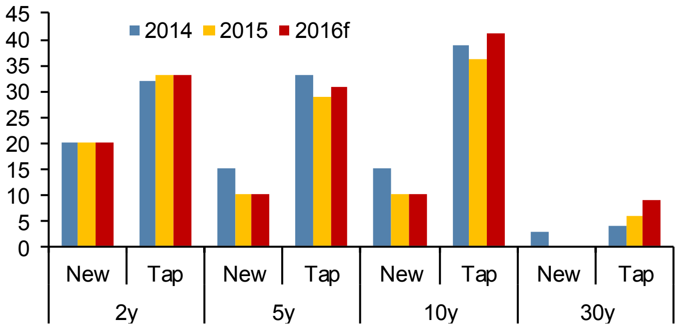
Interestingly there will be no new 30y issue, despite the supply increase from €6bn to €9bn. Long-end supply will also be focussed on a monthly €1bn rather than only three focussed points for supply in 2015. Also there will be 3 €1bn taps of the off-the-run' (other €6bn is for 30y on-the-run): a first for the usually rigid Finanzagentur.

Historical German supply: New issues vs. taps (€ bn)



Source: Finanzagentur, RBS

Breakdown of German Issuance by Bucket



Source: Finanzagentur, RBS

Given the long-awaited 30y Bundei was finally issued this year, we pencil in the middle (€10bn) rather than the upper end of the inflation linked supply range.

France

French supply is slightly down year/year from €221bn to €217bn. Deficit financing is broadly flat year-on-year (€72.3bn for 2016 vs. €73.0bn in 2015) but the AFT faces much higher redemptions in 2016 (€8.5bn more than 2015). This is offset by running down the Treasury cash balance by €9bn.

2016 New Issues

Tenor	# New Issue
3y	1
5y	2
10y	2
20y	1
50y	1*

(Unlike other tenors, this is *to "be explored", the AFT has not committed here) Source: AFT, RBS

The European Commission estimates a higher cash deficit need than the French budget but if this materialises any overshoot will be largely absorbed through an increase in net bills, which have been falling in recent years.

The AFT plans to issue one 3y (a February 2019 bond), two 5y, two 10y and one 20y new benchmark bonds in 2016. The AFT has also stated it will "examine the possibility to issue a 50y syndicated bond in close consultation with the primary dealers", depending on market conditions."

Japan and UK regularly issue ultra-long bonds. Austria and France have sold ultras in the past; France issued new 50y benchmark OATs in 2005 and 2010. Belgium is also investigating the possibility and placed 50y private placements in 2015. *Longer-term we would not rule out the ECB buying beyond 30-years point if supply increases notably*.

Historical Ultra Long dated supply

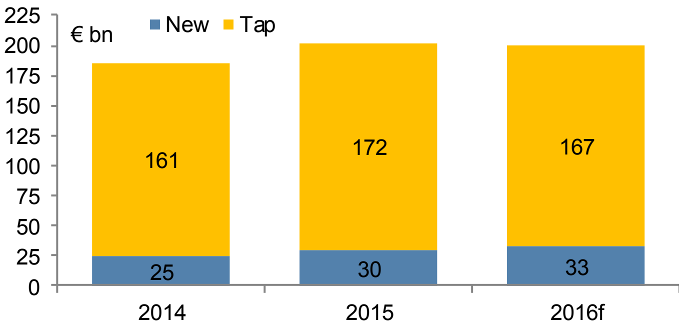
Date	Country	Issue type	Bond	Amount issued
10-Jan-06	France	Tap	FRTR 4 04/25/55	1.6
11-Apr-06	France	Tap	FRTR 4 04/25/55	0.9
06-Feb-07	France	Tap	FRTR 4 04/25/55	1.6
13-Nov-07	France	Tap	FRTR 4 04/25/55	0.7
08-Jan-08	France	Tap	FRTR 4 04/25/55	1.3
09-Nov-10	France	New issue	FRTR 4 04/25/60	3.2
19-Jan-12	Austria	New issue	RAGB 3.8 01/26/62	2
07-Jun-12	France	Tap	FRTR 4 04/25/60	0.7
12-Jun-12	**Austria**	Tap	RAGB 3.8 01/26/62	0.4
08-Jan-13	**Austria**	Tap	RAGB 3.8 01/26/62	0.6
09-Jan-14	**France**	Tap	FRTR 4 04/25/60	1.8
04-Feb-14	**Austria**	Tap	RAGB 3.8 01/26/62	0.5
06-Aug-15	**France**	Tap	FRTR 4 04/25/60	1.3

Source: Debt offices, RBS

Total French sovereign buybacks have risen in recent years due to rising redemptions. Gross issuance in 2015 was €34bn above bond supply net of buybacks. This year, we pencil in a lower (but still historically high) €30bn gross supply to fund 2016's buybacks.

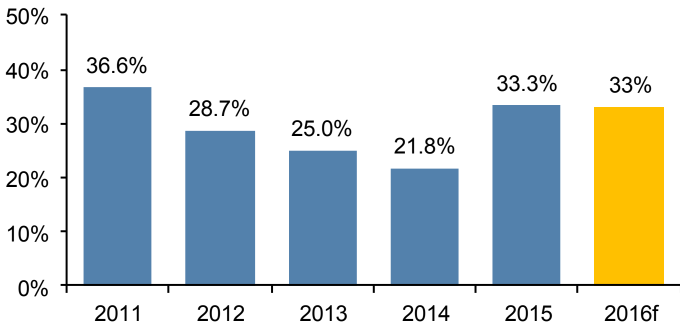
Moreover, given the more populated OAT curve, French issuance of both taps and off-the-run debt has been increasing in recent years. Off-the-run issues were the highest levels in 2015 since 2011; accounted for 33.3% of total issues last year compared to 21.8% in 2014. This practice will be kept in place in 2016.

New Issues vs. Taps (ex-linkers)



Source: AFT, Bloomberg, RBS

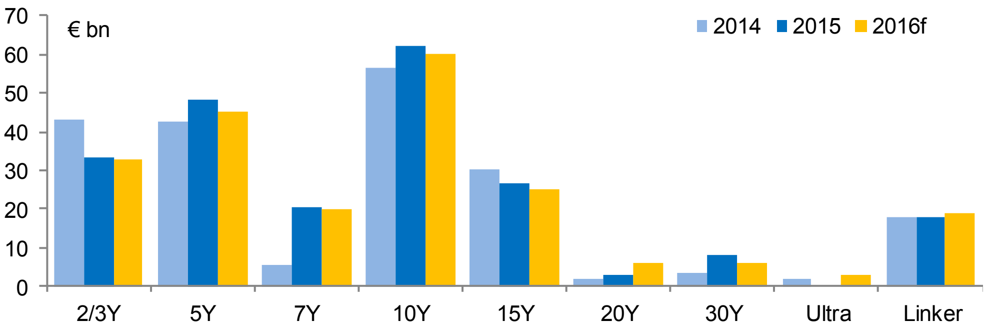
Proportion of net issuance issued in off-the-run debt



Source: AFT, Bloomberg, RBS

In terms of supply across buckets, we expect the issuance of the ultra-long and the 20y to reduce the issuance of shorter dated bonds;; however the balance between issuance at the 2-7y tenors and paper issued in the longer-term auctions (10y and above) is broadly maintained. Linkers will remain 10% of supply net of buybacks (€19bn).

French Issuance by Bucket

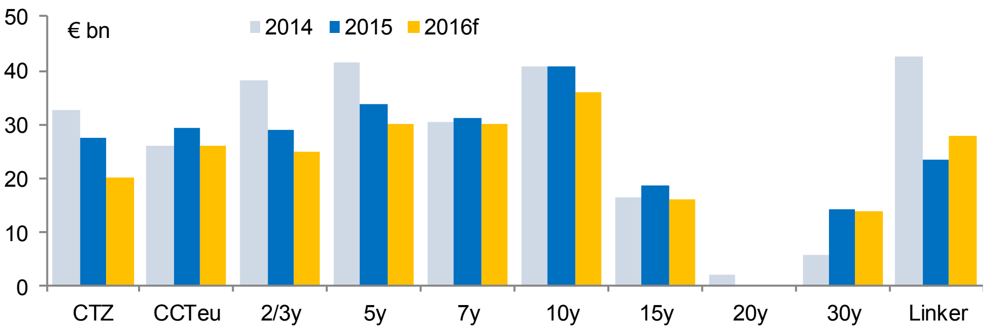


Source: AFT, Bloomberg, RBS

Italy

We expect Italian gross supply to fall by €23bn in 2016, with the sub-5y sector bearing the brunt of the fall. Demand for CCTeu should be healthy as investors worried about rising rates are enticed by the floating rate, especially those unable to trade derivatives.

Italian Issuance by Bucket



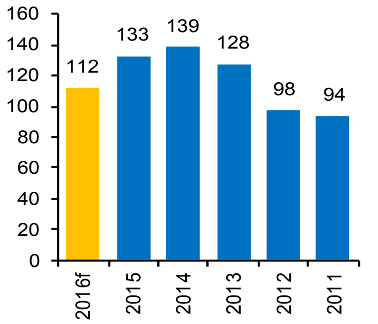
Source: RBS

We expect BTPei issuance to remain in line issuance of recent years, whilst with €27bn of BTP Italia maturing in 2016, we expect the Tesoro to issue at least two BTP Italia this year, their size depending on demand.

Spain

Gross issuance from Spain is expected to fall by €21bn in 2016 to €112bn. This is the lowest level since 2012. The Tesoro requires €10bn less in cash deficit needs and €5bn less for SPGB redemptions. We expect the central government will roll over the €2.5bn bond redemption of the FROB (the former bad bank), as well as a significant proportion the ~€5bn regional bonds coming due (we expect only BASQUE and NAVARRA to issue in 2016).

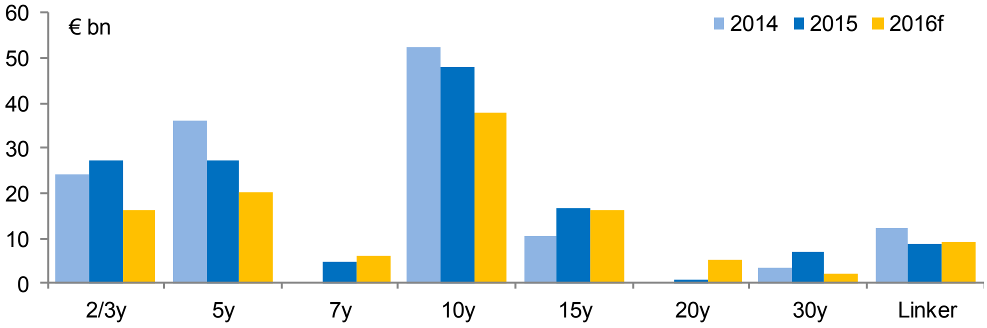
SPGB issuance (€ bn)



Source: Tesoro, Bloomberg, RBS

Spain had already significantly curbed supply in 2015: the Tesoro expected €142bn in January and ended up issuing €133bn, as Spanish growth and budget revenues have surprised to the upside. 2016 Issuance next year is converging back toward pre-crisis levels after the higher supply of 2013-2015.

Spanish Issuance by Bucket



Source: RBS

Netherlands

The DSTA's 2016 funding target is down significantly on 2015 with a reduction from €48bn to the €25-30bn range. This is driven by three factors: (a) lower redemptions, (b) a falling cash deficit and (c) the cash/collateral inflow due to the DSTA's heavily in-the-money long-end 'receiver' positions from their pre-2012 swaps hedging policy. The latter is worth a very hefty €19.4bn at the moment.

Despite the aggressive drop; risks to Dutch issuance are still to the downside since the forecasts do not even consider potential cash inflows from sales of further tranches of ABN.AMRO through its privatisation programme. As such, we expect the DSTA to issue only €25bn in 2016: the lower end of its issuance range. The further revision downward of funding needs yesterday (07 January) due to a lower deficit outturn makes us stronger in our conviction.

Dutch issuance in 2016 will be broken down as follows:

- A new 5y DSL: €7.5-10bn
- A new 10y DSL: €15bn. This will be a July 2026 in March.
- Two re-openings of longer dated DSLs (€2.5-5.0bn).

On longer-end, one re-opening will be the DSL 2.5% 2033 for €1.0-1.5bn on 12 January 2016. We would expect the other re-opening will be in the 2.75% Jan 2047 given this is a smaller issue with a more current coupon (vis-à-vis the Jan 2042 and Jan 2037s).

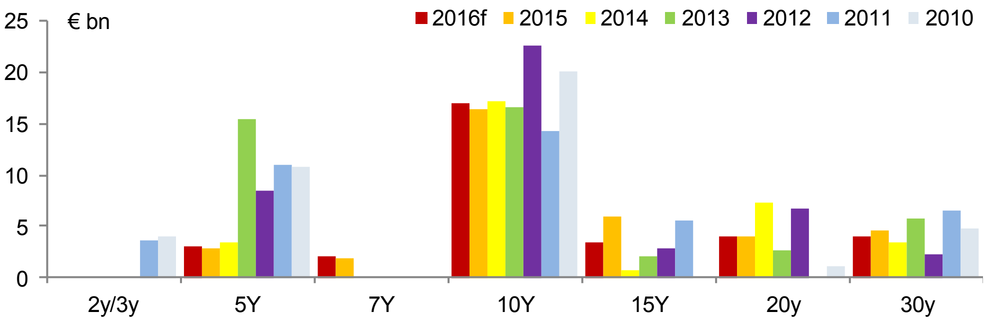
Belgium

Belgium is marginally reducing gross funding in OLOs to €33.5bn from €35.5bn in 2015 (back to 2011 levels) but the Treasury expects to launch three new benchmarks via syndications, alongside ten auctions (all months ex August and December). Some auctions may be cancelled depending on the size of new benchmarks or if syndicated taps are used for longer bonds.

A new 10y and 30y are likely in our view since Belgium introduced both new 15y and 20y OLOs last year.

Buybacks will step up back to historical levels in 2016 (€4.5bn), up from €3bn in 2015. Net supply of OLOs is only €5bn (€33.5bn minus €4.5bn for buybacks and €24bn for OLO redemptions), down on €9bn expected for this year. Once coupons are included (~€11bn in 2016), then net supply on this measure will be - €6bn.

Historical Belgian OLO supply



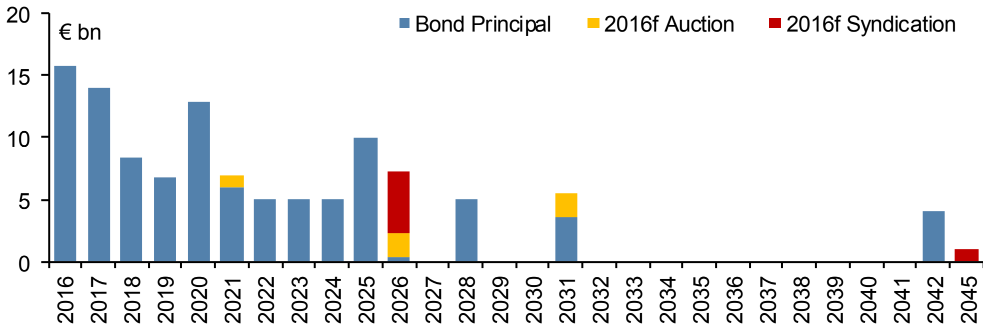
Source: Belgian Treasury, Bloomberg, RBS

A new floating rate OLO is also a possibility, while Belgium will also undertake an additional €4bn of EMTN issuance, potentially including foreign currency and linker issuance, though the BDA has left door open for these funding types in the last few ye3ars without them ever materialising.

Finland

Finland's funding requirement is likely to rise by €2bn of issuance taking, RFGB issuance to €11bn. We expect two syndications from Finland, one in 10y for €5bn and one in 30y (or potentially but less likely in our view a 20y). A 10y is more likely than a 5y in our view given the already high level of redemptions of RFGBs in 2020. We would also expect further long-end taps.

Finland Redemption Profile including 2016 RBS Gross Supply split



Source: Bloomberg, RBS

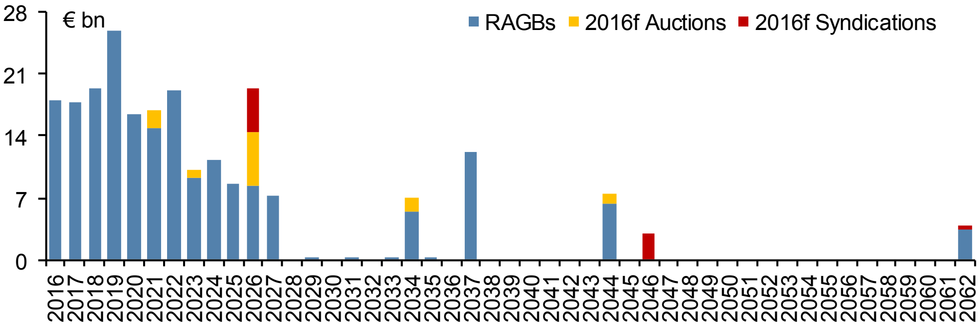
Austria

Austria gross medium-to-long funding is expected to be €27-30bn, rising from €23bn this year. In RAGBs, this range is €20-22bn, up from €18bn this year. The funding figure contains upside risks as Austria may issue longer term debt for the region of Carinthia to fund resolution of bad bank Heta Asset Resolution. However, such increased funding needs could also be absorbed in Treasury bills.

Austria will launch at least two syndications in 2016. With are no major RAGB redemptions until September 2016, meaning an early year syndication is not a necessity. Indeed Austria has not done a syndication in January since 2012. There are also 11 monthly scheduled auctions, with a reserve date in August.

New 10y and 30y syndications are probable in our eyes, whilst we pencil in an ultra-long 2062 bond, particularly if the French 50y issuance is taken down well.

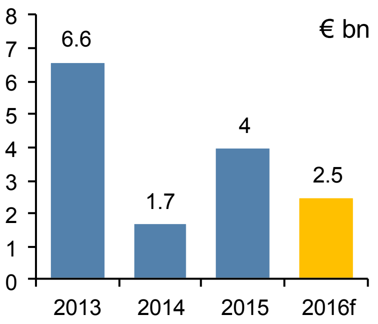
Austria Redemption Profile including 2016 RBS Gross Supply split



Source: Bloomberg, RBS

Portugal

Portugal Buybacks/Exchanges



Source: RBS

The IGCP has announced supply of €18-20bn this year. We expect this to come in at the higher end of the range but also expect a further ~€2.5bn of exchange operations. This pushes pushing RBS' gross supply estimate to €22.5bn for this year, unchanged on 2015. With redemptions of only ~€7bn and net supply at €11bn, this remains high in relative terms.

The IGCP has stated its intention to undertake a minimum of one syndication per quarter; we expect this to be the minimum, with syndicated taps on longer dated bonds probable in our view. The funding will be supplemented by monthly auctions.

We expect a 10y syndication to kick things off, which will be increased to reach at least €5bn in 2016; potentially even by syndicated tap. Further issuance via syndicated taps across the curve is probable in the 7y (PGB 3.85 Apr 21) and 15y (PGB 3 7/8 Feb 2030) sectors. We also pencil in a 30y (PGB 4.1 Feb 2045) tap as we consider that ongoing maturity extension will remain a key Treasury objective.

Risks to PGB supply

Of all EMU sovereigns, Portuguese supply could be, proportionally, the most variable depending on market developments. Portuguese gross issuance needs could certainly rise if market conditions are particularly favourable for PGBs; certainly not impossible since we expect the ECB to further cut the deposit rate and increase QE in 2016.

Moreover, in terms of higher cash needs for the IGCP; the scheduled sale of Novo Banco that is pencilled in may struggle to raise the intended €4bn, whilst repayment of Cocos from Portuguese banks sector is subject to risks given the weak profitability of the sector. The IGCP has some tools to manage this, namely it could (a) run down some of the state's sizable cash buffer (~€8.5bn at end 2015) or (b) slow the pace of €10bn of IMF repayment (further IMF reimbursements are not legally due until 2018; though we expect the Portuguese authorities to be reluctant to take either step .

Ireland

The National Treasury Management Agency intends to issue €6 to €10bn of long-term bonds during 2016, with at least one syndicated deal.. The NTMA issued Ireland's first 30ybond in 2015 (IRISH 2 02/18/45), we estimate they will tap it by €2bn in 2016. We also envision a tap of the 7y (IRISH 0.8 03/15/22) of €1bn as the year of maturity (2022) has relatively low Irish government bond redemptions at present. Overall, we think that the total supply will reach €8bn vs €13bn last year.

RBS is acting as joint Bookrunner on Ireland acting through the National Treasury Management Agency bond issuance.

Greece

We pencil in a potential market return in H2 2016, assuming three conditions are in place: (a) ongoing (even if not smooth) programme implementation (b) inclusion in the ECB QE and (c) a deal on the debt (OSI). The latter is in any case, a pre-requisite of the IMF's participation in a third bailout.

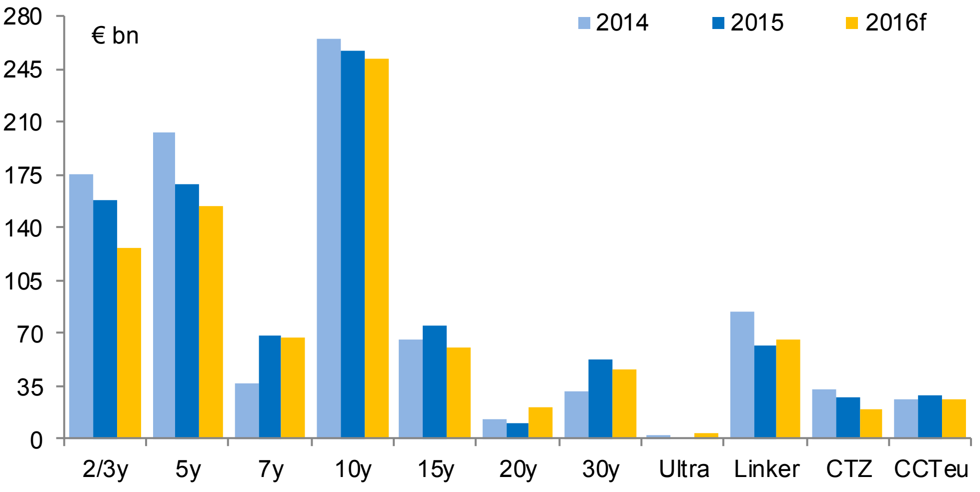
A switch operation of the outstanding 2017 bonds into the 2019 issue is a likely first step, both to increase the size of eligible QE debt and as an initial test of market appetite. We tentatively pencil in €1bn from such an operation and a €2bn issue later.

Issuance breakdown by bucket

In summary, the reduced supply is concentrated in short-dated maturities: On our estimated maturity breakdown, issuance is cut most year/year in 2-5y supply, as debt offices continue to lengthen maturities 10y and linker supply are only down marginally.

In the long-end supply will rise in 20y and ultras will rise: New benchmarks can be expected in 20y from France and Finland, whilst there will be no new 30y benchmarks from Germany, France or Netherlands.

EMU-11 Issuance by Bucket



Source: Debt, offices, Bloomberg, RBS

Historical EMU-11 Issuance by Bucket

	2/3y	5y	7y	10y	15y	20y	30y	Ultra	Linker	CTZ	CCTeu	Total
2014	175	203	37	266	66	13	31	2	84	33	26	**935**
2015	158	168	68	258	76	11	53	0	62	27	30	**910**
2016	127	155	68	252	61	21	46	4	66	20	26	**845**

Source: Debt, offices, Bloomberg, RBS

Marco Brancolini

Three Kings[1] Bring Two Elections to Spain

SPGB spreads do not price in enough political risk

The market is much too complacent about Spanish politics. We think the parliamentary deadlock in both Madrid and Barcelona will result in Catalan elections in March and national elections in Q2 2016. Both are important risk events and SPGB can come under pressure once it becomes clear political risk is rising. We think Spain's underperformance vs Italy in 2015 was explained by political developments to a large extent by political uncertainty, which has since intensified.

We view Spanish fundamentals as more similar to semi-core than to periphery, while we expect SPGB supply to be low in 2016. However, we wait for political risk to ebb, or at least be priced into SPGB spreads, before re-entering longs in Spain.

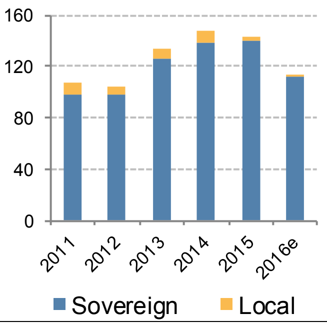
We therefore like to hold our periphery longs in 10y BTPs and 4y PGBs.

Recent developments in China open the way for material yuan devaluation. The resulting deflation wave will force more easing for the ECB: our economist Andrew Cates expects -0.70% depo and €100bn monthly PSPP by the end of 2016.

Fresh Elections can weigh on SPGB valuations

The 20 December elections delivered a much more fragmented parliament than we or the polls anticipated. As we discussed the day after elections (see here for more) our base case now is for new national elections in Q2. We worry that the event risk is not being priced in by the markets. (As such, we closed at a loss the long SPGB we had re-entered before the vote, after stopping out on the December ECB.)

Spanish issuance is the lowest since 2012



Source: RBS, Tesoro, Bloomberg, Dealogic

We wrote in our year ahead that SPGB were our #1 long for 2016. We still like Spanish fundamentals and we expect gross SPGB supply to be the lowest since 2012 at €112bn (despite a lot of regional debt being recentralised).
Spanish fundamentals have been solid in 2015 as well, but we preferred to be long BTP vs SPGB, waiting for political risks to dissipate before going long Spain.

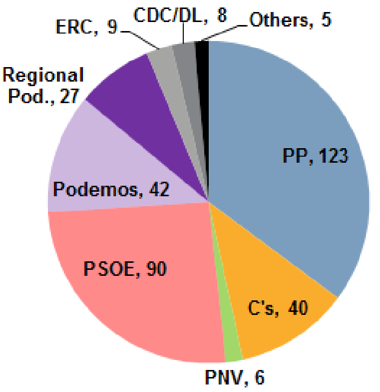
We find ourselves in a similar situation right now: we would be willing to be long SPGB expecting the bonds to tighten towards semi-core levels, but we think a repricing of the political risk is needed first. For now, we hold our peripheral longs in 10y BTPs (targeting 0.75%) and 4y PGBs (targeting 0.40%, with 11bp in 3m carry+roll).

The only trade we are currently running in Spain is the long 5y Andalucía vs SPGB, which we entered in November last year as a pure play on future inclusion of regional debt in ECB PSPP.

[1] Santa Claus is a relatively recent tradition in Spain: kids more frequently receive their Christmas presents from the Three Kings on 6 January.

1. Gridlock in Madrid: elections in Q2

The December elections resulted in a fragmented parliament



Source: Congreso

The first and most obvious conclusion from the election results is that no coalition would be able to gather an outright majority of 176 seats. There is a way around that: if no candidate can gather 176 votes, a simple majority would be sufficient to elect a President. Abstentions become key.

The major impediment to a PP-led coalition is that it requires PSOE's cooperation, either via a grand coalition or a marginally more likely abstention. We think both solutions would be politically unpalatable to the Socialists.

As Podemos and Ciudadanos would never agree to enter a coalition, only one alternative is available – a left-wing coalition. Ciudadanos' leader Rivera has already confirmed that his party will vote down any coalition that includes Podemos – or Catalan nationalists, for that matter. If Ciudadanos do not play ball, Catalan separatists will have to support a PSOE+Podemos government, at least via abstention.

It is important to note that any of these minority governments would rely on a vast number of stakeholders, all of whom have conflicting agendas. As was the case in Belgium, a political stalemate would not be a major issue for Spain given that the country has already made a lot of progress reform-wise; however, we think that any minority government could be quickly voted down. Even if a government is formed, we think it would likely be overthrown by the end of 2016.

PSOE: the reluctant kingmaker

A PP-led coalition is numerically all but impossible

PP was the most voted party, but it seems all but impossible for it to form a government. Even if the party managed to woo all its possible partners in parliament (Ciudadanos, PNV and CC), in order to have a solid majority an agreement would still be required between PSOE, Podemos and the Catalan separatists to abstain in the investiture vote, something we regard as extremely unlikely. Parallels can be drawn with Portugal: centre-right PáF was the most voted party, but it fell short of a majority and could not find allies in parliament, so a left government emerged.

Frenemies: PP and Podemos offer perilous alliances to PSOE

Both PP and Podemos have asked for PSOE cooperation. The important point here, however, is that both parties' #1 strategic priority is the weakening of PSOE. Podemos has never hidden its intent to become the main point of reference for the Spanish left, a situation the PP would cherish, hoping it would push centrist vote towards the right, fearing a Podemos-led government.

PSOE's risk in supporting PP: the Greek scenario

The main message of Podemos leader Iglesias during the electoral campaign was that Podemos was the only alternative to PP: voting for the Socialists would not have prevented a PP government. If the Socialists allowed Rajoy to take office by abstaining, Iglesias' claim would be vindicated and Podemos could legitimately claim to be the main leftist party in Spain. Note that PSOE had only a 1.5% edge over Podemos in the vote, so even small vote transfers can have momentous consequences. The risk for PSOE would be to be cannibalised by Podemos, in the same fashion as Pasok was cannibalised by Syriza in Greece.

Socialist PSOE seems aware of the risks and senior members keep repeating there is no chance of a grand coalition.

The Socialists' heartland is in the South-West – the regions that would stand to lose the most from more fiscal autonomy to Catalonia

Source: Congreso, El País

Enter the donkey: left coalition hard without a Catalan referendum

Podemos has undertaken two main strategies in its coalition-building negotiations. Both put PSOE in a difficult spot. The first is to call for a split in PSOE: Iglesias claims there are two PSOEs: one should join PP and the other should join Podemos.

The second move was to call on PSOE to form a left-wing government, along the lines of what happened in Portugal. However, Podemos conditioned its proposal on the new government approving an independence referendum in Catalonia – a proposal clearly unacceptable to PSOE.

Podemos' red line: Catalan referendum. PSOE's red line: no referendum.

Since 1979 Spanish Socialists adopted a federal structure, in which regional federations hold a prominent place. It is unsurprising that the "red line" of regional federations is that junior allies should renounce the Catalan referendum. PSOE regional '*barons*' cannot accept measures that risk curbing financing to their regions by 10-15% and would alienate a large swathe of the electorate.

PSOE+Podemos would still need Catalan separatists to play ball

A left-wing government might be able to get the vote of leftist IU, Basque PNV and Canarian CC (168 seats), but would be opposed by PP and C's (163 votes). This makes the 17 votes of Catalan separatists crucial. The left-wing government would either need both to abstain, or at least one of the two (ERC) to vote "*yes*" in the investiture vote. A left-wing government would have to concede something to Catalan separatism.

Bottom line: new elections are our base case

In a nutshell, a PP-led majority needs help from the Socialists, but the PSOE does not seem to be ready to do that: the risk is ending up being cannibalised by Podemos, like Pasok was in Greece.

A left-wing coalition would be voted down by PP and Ciudadanos and will, therefore, require cooperation of Catalan parties, not to mention that Podemos has made a referendum in Catalonia a '*red line*' for entering into a government with the Socialists. However, any opening to a Catalan referendum is a non-starter for large swathes of the PSOE and is now triggering a major internal conflict within the party, with regional PSOE leaders led by Ms Díaz openly defying Mr Sanchez.

Both options seem unappealing and would in any case result in a weak government that is unlikely to last long. New elections in Q2 2016 are therefore our base case.

Timeline: If no government by March, new Q2 elections

1. The new parliament (Cortes) will take office on 13 January, and will then elect the House Speakers.

2. The King names a candidate, who tries to rally enough support from other parties.

3. Traditionally, within a couple of weeks after the new parliament takes office, the candidate proposed by the King undergoes a confidence vote (*investiture vote*) where 176 votes are required. (*end of January*)

4. If the vote fails, a second round is undertaken two days later, and a simple majority is sufficient. Abstentions will be key here.

5. If both votes fail, the process restarts from point 2.

6. If within two months of the first vote a PM cannot be elected, the King will have to dissolve parliament (*end of March*) and call for new elections (*Q2*).

2. Gridlock in Barcelona > Elections in March

If the parliament in Madrid is stuck, the one in Barcelona is not faring any better. Separatist Junts pel Sí aimed to turn the September elections into a pro-independence de facto referendum, but had to rely on radical CUP to form a government.

No alternative majority is available, as no other party would be ready to support neither JxSí nor CUP.

CUP is a leftist organisation "*working for a nation independent, socialist, ecologically-sustainable, territorially equilibrate and free of any form of patriarchal domination*". It wants 'Greater' Catalonia (Països Catalans) to become a socialist country outside the EU.

Catalan separatists cannot agree: new elections loom in March

We expected members of radical pro-independence CUP to approve the agreement with the other Catalan separatists over the festive period, allowing Mas to be elected as President of Catalonia for another term. CUP members instead rejected the agreement and proposed an alternative candidate. We were taken aback by the choice, but we're not the only one: the leader of CUP Baños resigned after the vote.

If the Catalan parliament cannot name a President by next Saturday, the house would be automatically dissolved on Sunday and new elections will be held in March, adding a further (major) political risk to the Spanish calendar.

Timeline: new elections likely on 6 March

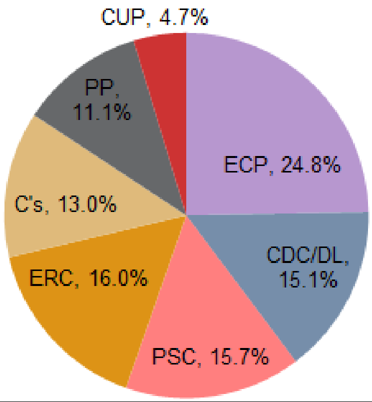
The Estatut establishes that "*If, after two months from the first investiture vote, no candidate is elected [President], the Parliament is automatically dissolved and the acting President immediately calls elections, to be held between 40 and 60 days*".

- 10 Nov: First investiture vote
- 10 Jan: If no agreement is found, the Parliament is dissolved
- 19 Feb-10 Mar: Electoral window

As things stand, 6 March seems the most likely date for Catalan elections.

A new political chessboard in Catalonia

Results of the December elections (CUP is assumed unchanged since Sep).



Source: RBS, Congreso, Generalitat

Recent developments have had a momentous impact on Catalan politics. The unorthodox experiment of Junts pel Sí (centre-right, radical left, greens, members of civil society forming a single list) may well be over. Note that in the December national elections, ERC and the new incarnation of Convergencia (CDC/DL) ran separately.

The December results can therefore be used as a relatively reliable poll. Note that CUP did not participate in the national elections, in order not to "legitimise" the institutional framework of the Kingdom of Spain. We therefore leave them on 4.7% (the results of the last election)[2].

There is a 60% pro-referendum majority now that Podemos is on side

There is a clear majority pushing for an independence referendum. The parties demanding a vote on independence (ECP, CDC/DL, ERC, CUP) would make up over 60% of the vote. Only PP and Ciudadanos (24%) oppose the vote, while the Socialists (16%) would like a referendum only if it is agreed with Madrid.

As we noted in the past, Catalan separatism will not go away: holders of Spanish assets should get familiar.

[2] The total ends up rounding up to more than 100%

Podemos has demanded to create four separate groups in Parliament

	Region	MPs
Podemos	Main	42
En Comú Podem	Catalonia	12
Compromís /Podemos	Valencia	9
En Marea	Galicia	6
Total		**69**

Source: Congreso, RBS

Barcelona's new mayor Colau back in 2007 – the sign reads "*Housing out of the market, like education and health*"

Source: Wiki

3. Podemos 2.0: a regionalist party

Local movements propelled Podemos' electoral results…

As with most new parties, Podemos appears to have a disadvantage vis-à-vis established competitors in terms of presence on the territory. Recognising this, Iglesias teamed up with local leftist powerhouses in order to boost its performance in the national elections. The results were stunning: Podemos Catalan brand CSP received 8% in the September elections; less than two months later the newly established *En Comú Podem* obtained 25% of the vote. Local movements in regions such as Catalonia, Valencia, Galicia (all at ~25%) were instrumental in Podemos electoral triumph. But at what price?

… but their rising power is making Podemos less centralised

Podemos is no longer a centralised party – to the extent that the entity is lobbying to create four separate groups in parliament. We see three main consequences:

(i) A further multiplication of narrow interests in an already extremely fragmented parliament makes compromising even more difficult

(ii) Podemos cannot backtrack on its new regionalist programme (the main obstacle to an agreement with PSOE), as it risks alienating its Catalan and Galician MPs

(iii) The balance of power has shifted away from the original founders

Podemos now supports an independence referendum in Catalonia

Podemos had maintained a somewhat equivocal position on Catalan separatism. However, in order to get the support of the groups coalescing around *En Comú,* the movement led by Barcelona mayor Colau, Iglesias came off the fence spectacularly: now a Catalan referendum is the main condition to enter a coalition government.

The Catalan case exemplifies the shift in the balance of power within Podemos: in the new-born *En Comú* Podem the driving seat has been taken by Ms Colau's *En Comú*.

The other parties in Spanish Congress: a cheat sheet

Discussions always involve the four main parties, but alliances will likely have to involve smaller parties. Who can help who?

What could a left government promise ERC to get its tacit support?

		Seats		Position	Potential alliance with		Comments
		2015	2011		PP?	PSOE?	
CDC	Catalonia	8	16	Centre-right turned ardent Catalan separatists	Very unlikely	Very unlikely	Frequently cooperated with PP in the past, recent conflict in Catalonia makes it unlikely to cooperate with anyone at national level
ERC	Catalonia	9	3	Radical left, Catalan separatists	Impossible	Possible for concessions	Could support a left government in exchange for meaningful concessions to separatism
PNV	Basque	6	5	Christian-democrat, nationalist	**Yes**	**Yes**	Traditional PP backer, leader Urkullu suggested he'd prefer to support PSOE this time
Amaiur / Bildu	Basque	2	7	Extreme left, nationalist	Impossible	Very unlikely	Strong stigma for positions on terrorism, PP and PSOE said they will never cooperate with them.
IU/ICV	National	2	11	Green/Communist	Impossible	Possible in left coalition	Traditionally to the left of PSOE, crowded out by Podemos
CC	Canary Is.	1	2	Centre-right, mild nationalism	**Yes**	**Yes**	Currently voting with PSOE at regional level, with PP at national

Source: RBS

Simon Peck

UK: BoE buybacks and Gilt cash-flows

Early 2016 price action looks just like that at the start of 2015: As investor conviction remains weak, we expect supply dynamics to return into the limelight. Gilt cash flows are supportive near term, but net supply soon picks back up. We hold our relative GBP undperformance views and highlight concerns over simultaneous weakness in both equities and bonds.

UK data doing ok, UK referendum on EU membership shifting into focus: The December UK PMI's provided no major surprises, but a backdrop of benign wage inflation, concerns over global growth and political uncertainty potentially impacting capex considerations means risks are likely skewed towards later rather than sooner BoE lift-off.

January cash flows: We run through the details of the coming Gilt cash flow events (redemption, coupons and BoE QE re-investment buybacks). Buy UKT 2% 2025 on the UKT 3.75% 2020/ 2% 2025/ 3.5% 2045 1:2:1 fly, positioning for 5bp of 10y outperformance

Déjà vu? Are we in for a repeat of 2015?

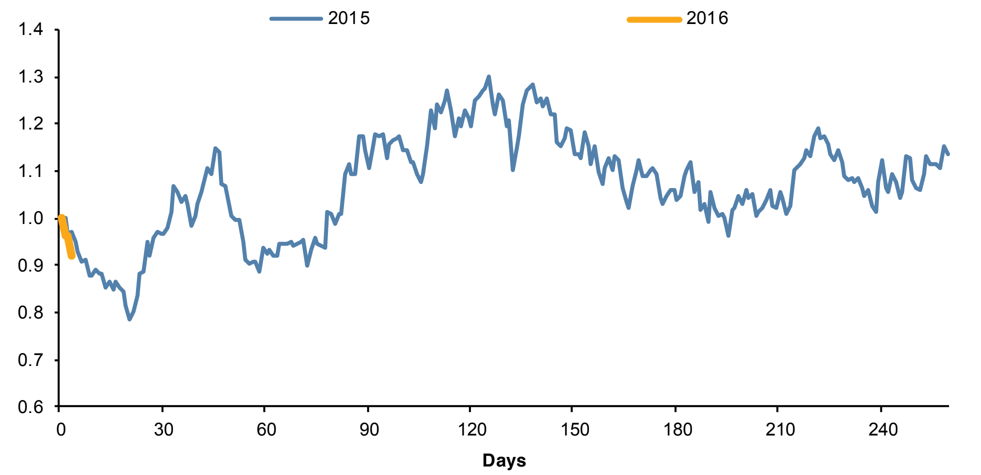
Since publishing our Year Ahead 2016 outlook on 24th November 2015, fixed-income price action has been volatile, with moves exacerbated by reduced trading volumes. A risk-off tone has come to characterise trading in early 2016 (Gilts have been a clear beneficiary of flight to quality demand) but a trend has yet to be established.

Yield changes (7-Jan-16 vs. 24 Nov-15)

	5y	10y	30y
UKT	-3bp	-3bp	-
DBR	7	8	12
UST	-6	-9	-7

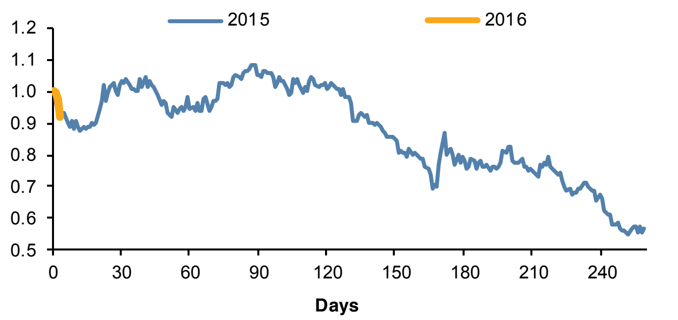
Source: RBS

10y Gilt yield as proportion of yield on Jan 1st (constant maturity)



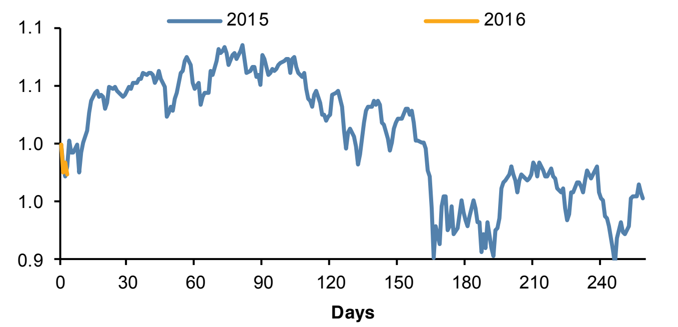
Source: Bloomberg, RBS

Brent Crude Oil ($/barrel price as proportion of level on Jan 1st)



Source: Bloomberg, RBS

FTSE 100 (level as proportion of that at Jan 1st)



Source: RBS

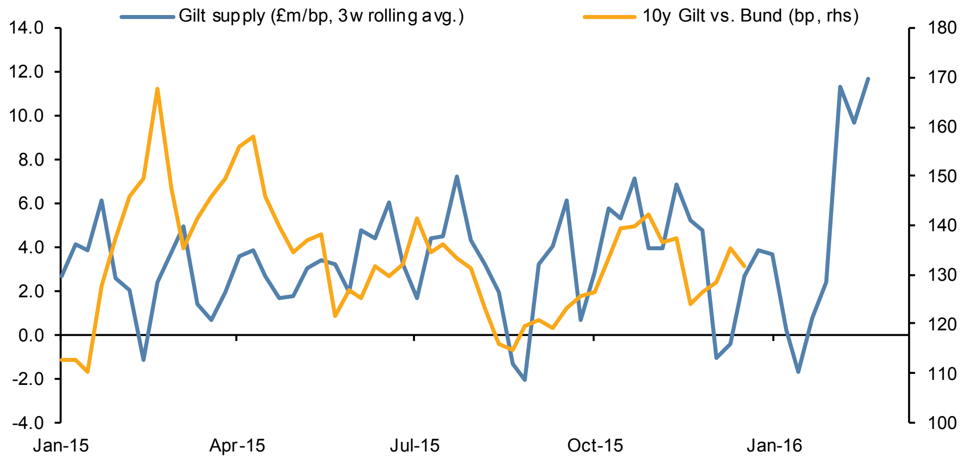
Despite 10y Gilt yields having rallied ~20bp in the first six trading sessions of the year, yields are now where they were at the start of December. **And particularly striking, as the above charts highlight, is that the backdrop in early 2016 is very much reminiscent of that in early 2015**.

From a strategy perspective, we believe the relevance of the above observation is two-fold.

1. Light conviction = supply dynamics play a greater role

Firstly, with investor conviction reduced as equities and risk-assets are whipsawed around, bond supply dynamics once again shift into focus. In a similar fashion to 2015, core fixed-income markets have rallied aggressively in the early trading sessions of the year against a backdrop of reduced trading volumes and limited supply thus far. The fundamental macro backdrop will clearly be the over-ruling medium-term driver of price action, but more strategically and near term, supply/demand dynamics are relevant. This is particularly likely to be the case given that the £1.5bn supply of UKT4% 2060 was met with soft demand, tailing 1.5bp as the auction was only covered 1.25x (1.8 previously).

Rising net Gilt issuance has previously been a driver of underperformance vs. DEM



Source: UK DMO, Bloomberg, BoE, RBS

The coming 22nd January Gilt coupon and redemptions bring BoE QE re-investment buybacks and thus net negative issuance later this month (discussed later in the note), but supply picks up notably in February with the anticipated long IL syndication, which will likely equate to a risk equivalent of >£20m/bp.

2. Is there a warning sign from coincident bond/equity weakness?

One of the discernible and memorable characteristics of the price action in late January 2015 (before the dramatic fixed-income sell-off) was the somewhat counterintuitive simultaneous weakness in both equity and bond markets. The fact that core fixed-income failed to receive a bid as European equities fell >10% was indicative of a more dramatic shift in demand.

With supply picking up and market volumes likely continuing to rise back to “normal” levels in the coming week, we do question whether recent price action is indicative of something more concerning for core FI, particularly if positioning is now less short/ marginally long as indicated by recent surveys.

UK data doing ok, referendum in focus

From a domestic perspective, the UK data over the holiday period has marginally disappointed consensus expectations, though we note that the latest set of PMI figures were ok, with the December composite PMI falling slightly to 55.3 (vs. 55.8 in November) but still above the long run series average of ~54.

As we highlighted in the Year Ahead 2016 outlook, the UK's "Remain-Leave" EU referendum is likely to be one of the most important price drivers for GBP assets in 2016. Prime Minister David Cameron has cleared the way for a UK referendum on EU membership this summer in saying that **2016 would be the time "*when we finally address the concerns of the British people about our membership*"** though a date has still not yet been set.

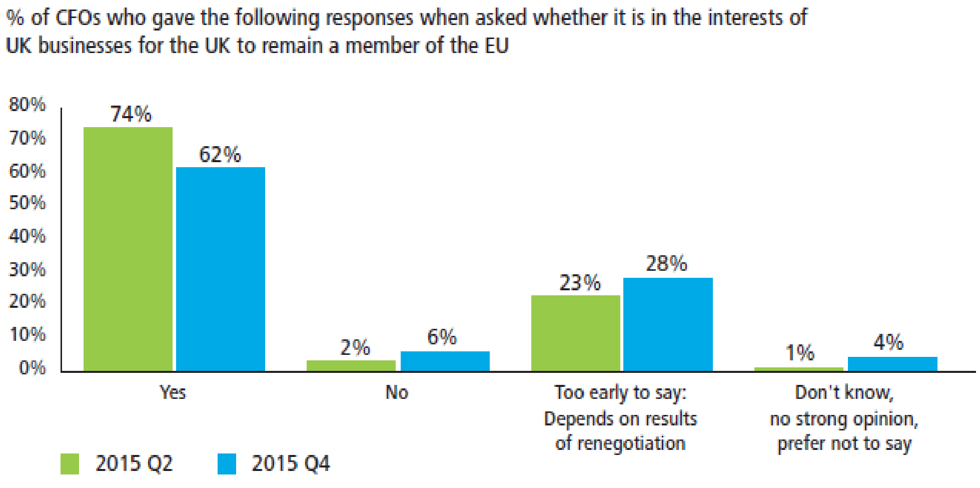
The Telegraph has reported that the outlines of a deal between Britain and the EU is emerging on Brexit, which would allow Cameron to meet one of his key aims of preventing EU workers claiming in-work benefits for four years. But the Guardian reports that campaigners on both sides of the Brexit debate are working on the basis that any deal will most likely be agreed at the March, rather than the February EU summit, which would pave the way for a referendum in September, rather than June. The discussion remains in flux.

As we discussed in the Year Ahead, markets tend only to focus on political risk events in the last few trading days before the event, with term premia rising as political uncertainty is factored in. However, once a date is set, market focus on the referendum (and thus any tangible impact on pricing) could well become evident further in advance than just a few weeks.

As Ross Walker highlights in his 2016 economic outlook, Brexit risk may induce some postponement of capex and hiring by multi-national companies, with any resultant deterioration in global trade and sterling appreciation potentially dampening export growth.

The key message from the latest Deloitte CFO Survey is that UK corporates have become much more cautious, with confidence dropping to its lowest level since the euro area was in recession in mid-2012. Risk appetite has continued to wane, with just 37% of CFOs saying now is a good time to take risk onto their balance sheet, half the level seen at the peak in late 2014.

CFO attitudes to EU membership



Source: Deloitte CFO Survey Q4(15)

Specifically on the referendum, a clear majority of CFOs favour staying in the EU, but those expressing unqualified support for membership has fallen from 74% in Q2-15 to

62% in the latest survey (Q4-15). Only 6% of CFOs favour leaving the EU. But 32% are undecided, with most saying that they would make up their mind when the results of the PM's renegotiation of UK membership are known. This finding suggests that the outcome of the renegotiation could significantly affect business attitudes to the EU.

The narrowing of the lead for the "ins" among CFOs coincides with a more marked decline in public support for EU membership (The average lead for the "ins" over the "outs" in public opinion polls has dropped from +18 to +6 percentage points in the last 6 months, source: Deloitte CFO survey).

Trades

We stick with our existing trades from the 2016 Year Ahead, with our favourite trades outlined below. Additionally, we have recently entered a new trade, buying 10y Gilts on the 5s10s30s fly to position for the coming BoE QE re-investment buybacks.

- **GBP 1F1Y/2F1Y steepener.** Entered at +35bp, currently +35bp, target +65bp and place a stop at +27bp. Roll-down is favourable to the tune of +3bp/quarter.
- **Pay GBP 5F 5Y vs. EUR**. Entered at +75bp, currently +71bp, target +130bp and stop at +55bp. Roll-down is favourable and pays you +4bp/3m period.
- **Pay GBP 20F 10Y vs. USD**. Entered at +88bp spread, currently +80bp, target 0bp and place a stop at +120bp. Roll-down is neutral (pays +0.4bp/3m period)
- **Buy UKT 2% 2025 vs. UKT 3.75% 2020** and UKT 3.5% 2045 in a 1:2:1 fly. Enter at a fly spread of -3bp, currently -5bp, target -8bp and place a stop at 0bp

Gilt cash-flows: Buy 10y in a 5s10s30s Gilt fly

This note was previously published here on 5th January.

The January/July Gilt coupon streams often get less attention than the June/December streams, but buybacks and index shifts this month mean that January cash-flows are potentially more interesting than usual. We calculate that the combined impact of the redemption of UKT 2% 2016, coupon flows and bond constituent shifts (UKT 1.75% 2017 dropping <1y residual maturity, 1.5% 2021 dropping <5y maturity) extend the all stocks index by +0.26 and the 0-5y by +0.21. £8.4bn of BoE QE re-investment buybacks are likely to drive 10y outperformance (as free float in the medium 7-15y maturity sector is squeezed). We tactically buy UKT 2% 2025 on the UKT 3.75% 2020/ 2% 2025/ 3.5% 2045 1:2:1 fly, positioning for 5bp of 10y outperformance.

Coupons: In total there are 13 coupon paying bonds, with cash flows totalling £3.6bn. Excluding BoE, DMO holdings there is £2.9bn coming back to the market. With an average weighted maturity on a market-weighted basis of 23.2 years (excluding DMO, BoE holdings) coupon payments should provide some support for longs, but the bigger cash-flow story for index followers is the redemption of UKT 2% 2016 and the bond index-shifts (below)

Redemption and buybacks: On 22nd January 2016, UKT 2% 2016 redeems with £32.5bn outstanding. Of this, the BoE hold £7.98bn of the issue, but the BoE paid £8.4bn in cash during previous buybacks. The latter amount will therefore be re-invested to keep the APF stock unchanged. We assumed two weeks of buybacks beginning on 25th January (average buyback size of £1.4bn). On average, 10y bonds outperformed 5y and 30y on the 5s10s30s fly by ~5bp during 2015 re-investment buybacks. We enter a new RV trade: buy UKT 2% 2025 vs. UKT 3.75% 2020 and UKT 3.5% 2045 in a 1:2:1 fly to position for 5bp of 10y outperformance on the fly.

Bond Index shifts: Of note is the redemption of UKT 2% 2016, which extends the all stocks index by +0.26 and 0-5y by +0.21. 1.75% 2017 drops below 1y residual maturity, extending the >1y index by +0.23 and as a result of UKT 1.5% 2021 dropping below a 5y residual maturity, 0-5y extends +0.07 and >5y by +0.12.

Net supply: Buybacks and coupon flows see net supply turn negative in the final week of January and the first week of February, before issuance picks up again in w/c 22nd February.

1. Coupons

At the close of business on 13th January, the January 22nd coupon-paying Gilts go ex-dividend. Typically, the market impact and associated Gilt demand is apparent on this day and in the period between the bond going ex-div and the cash payment date.

In total there are 13 coupon paying bonds, with **cash flows totalling £3.6bn**. Excluding BoE, DMO holdings there is **£2.9bn coming back to the market**.

With **an average weighted maturity on a market-weighted basis of 23.2 years** (excluding DMO, BoE holdings) coupon payments should provide some support for longs. The coupon flows to the market are the same size as those in December 2015, but smaller than the £5.4bn from September 2015 coupon events.

22nd January 2016 coupon payments; weighted average maturity (market basis) = 22 yrs

	Nom Outst (£bn)	BoE Holding (£bn)	DMO Hold (£bn)	Free Float (£bn)	Total Coupon	Market Coupon
UKT 2 01/22/16	32.47	7.98	1.56	22.93	0.32	0.23
UKT 1 3/4 01/22/17	28.90	11.16	0.98	16.76	0.25	0.15
UKT 1 1/4 07/22/18	34.47	2.87	0.47	31.13	0.22	0.19
UKT 1 3/4 07/22/19	30.21	3.62	0.41	26.18	0.26	0.23
UKT 2 07/22/20	31.81	3.19	0	28.62	0.32	0.29
UKT 1 1/2 01/22/21	11.90	0.704	0.001	11.19	0.09	0.08
UKT 3 1/4 01/22/44	27.05	2.79	0.36	23.90	0.44	0.39
UKT 3 1/2 01/22/45	23.67	0.64	0.07	22.96	0.41	0.40
UKT 3 3/4 07/22/52	21.96	6.75	0.59	14.62	0.41	0.27
UKT 4 01/22/60	20.97	7.72	0.89	12.36	0.42	0.25
UKT 2 1/2 07/22/65	4.75	0.16	0	4.59	0.06	0.06
UKT 3 1/2 07/22/68	19.28	0.89	0.13	18.26	0.34	0.32
UKT 8 3/4 08/25/17	32.47	7.98	1.56	22.93	0.32	0.23
					£3.55bn	**£2.86bn**

Source: BoE, UK DMO, Bloomberg, RBS

2. Redemptions and BoE Buybacks

On 22nd January 2016, **UKT 2% 2016 redeems with £32.5bn outstanding.** Of this, the BoE hold £7.98bn of the issue, but **the BoE paid £8.4bn in cash during previous buybacks. The latter amount will therefore be re-invested to keep the APF stock unchanged.**

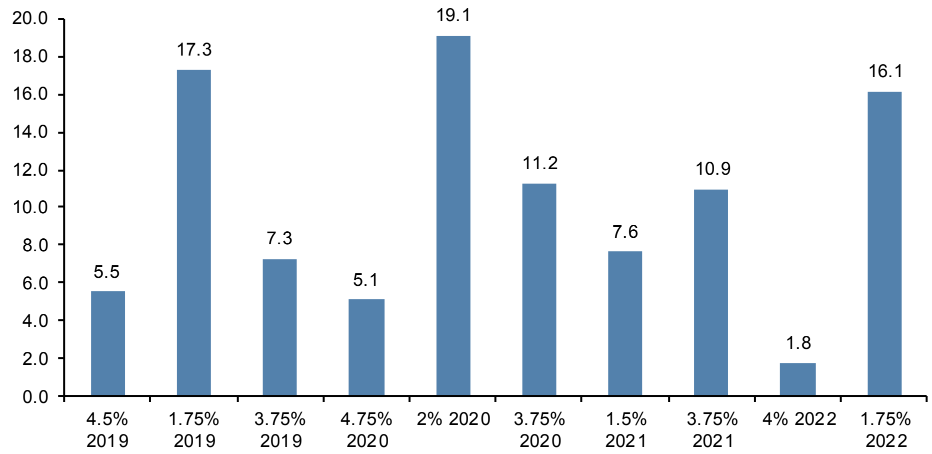
We anticipate the release of a market notice detailing the buyback process shortly after the publication of the January MPC decision & Minutes on 14th January 2016. However, **we expect buybacks to take place over a two week period, commencing on 25th January**.

An **average buyback size of £1.4bn would seem likely**, with the regular protocol of shorts (3-7y), longs (15y+) and mediums (7-15y) on Monday, Tuesday and Wednesday respectively likely to be repeated.

In terms of the market impact, **once again it is the medium (7-15y) maturity sector that is likely to feel the benefit of re-investment cash-flows**, with just seven bonds available to purchase and therefore a much smaller free-float available for BoE buyback operations.

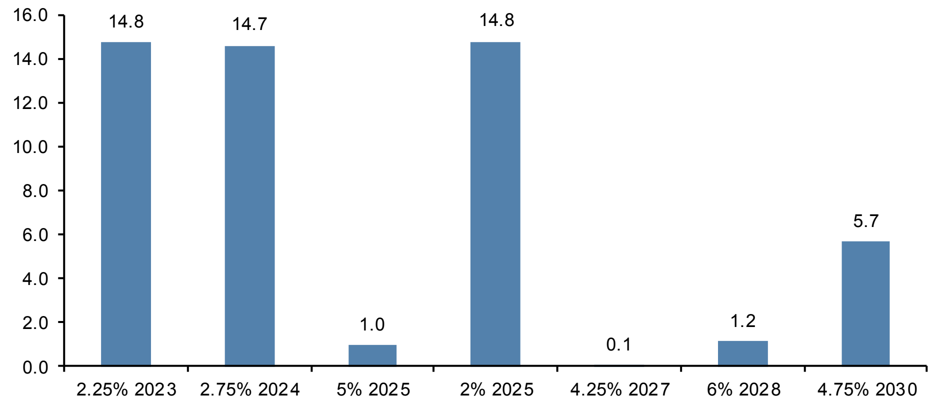
How much of each bond can be purchased before the free-float limit?

Short dated Gilts (3-7y): £102bn available to purchase



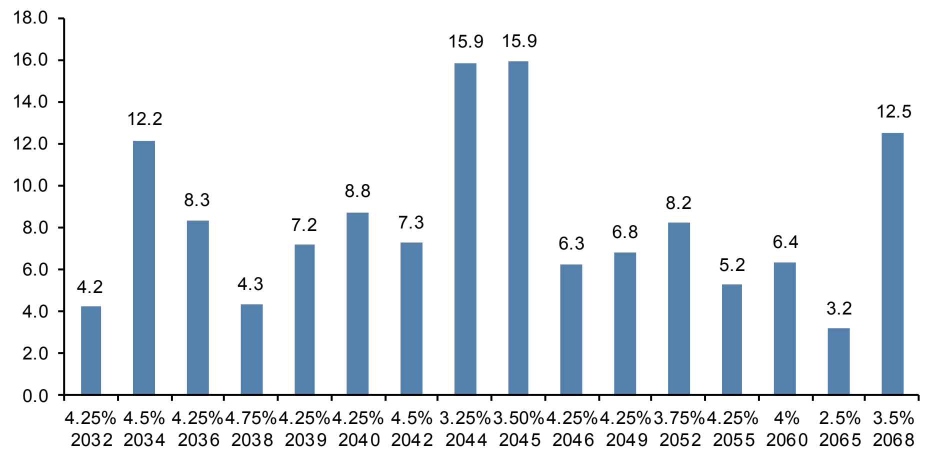
Source: BoE, Bloomberg, RBS

Medium dated Gilts (7-15y): £52bn available to purchase



Source: BoE, Bloomberg, RBS

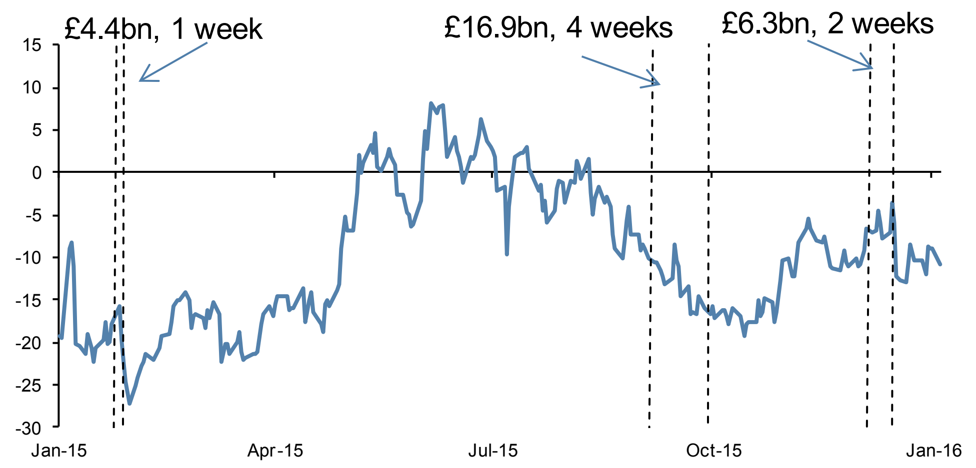
Long dated Gilts (15y+): £133bn available to purchase



Source: BoE, Bloomberg, RBS

The potential for a squeeze in the medium sector is therefore **likely to result in outperformance of the 10y sector on the curve**. The below chart shows the performance of 10y Gilts on the 5s10s30s fly before, during and after previous BoE QE re-investment buybacks.

1:2:1 5s10s30s Gilt fly: buybacks result in relative 10y outperformance



Source: RBS

During September 2015 the BoE re-invested £16.9bn during buyback operations, resulting in a notable outperformance of the 10y sector on the curve (6bp on the 5s10s30s Gilt fly). And while 10y underperformed during buyback operations in January 2015 and December 2015, **we note the outperformance of 10s over the period starting 3d before buybacks and 3d after buybacks finish**.

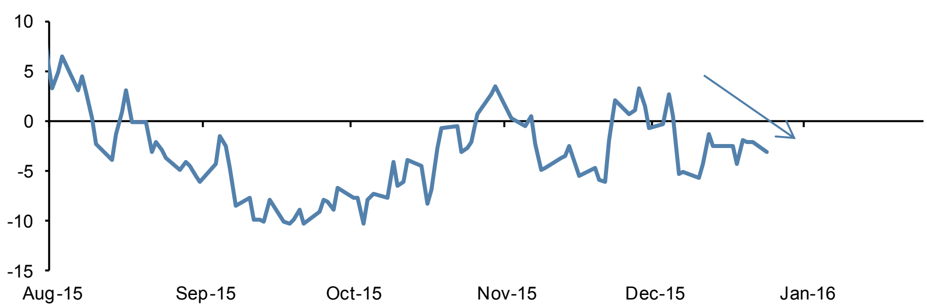
10y outperformance resulting from previous re-investment buyback operations

	Start	End	# weeks	bp outperf of 10y on 5s10s30s fly (3d after buyback end vs. 3d prior to start)
£4.35bn	26-Jan-15	28-Jan-15	1	4.8bp outperf.
£16.9bn	07-Sep-15	30-Sep-15	4	7.7bp outperf.
£6.3bn	07-Dec-15	16-Dec-15	2	1.9bp outperf.

Source: RBS

RV Trade: To position for the anticipated squeeze in the medium maturity sector, we recommend buying UKT 2% 2025 vs. UKT 3.75% 2020 and UKT 3.5% 2045 in a 1:2:1 fly. Enter at a fly spread of -3bp, target -8bp and place a stop at 0bp.

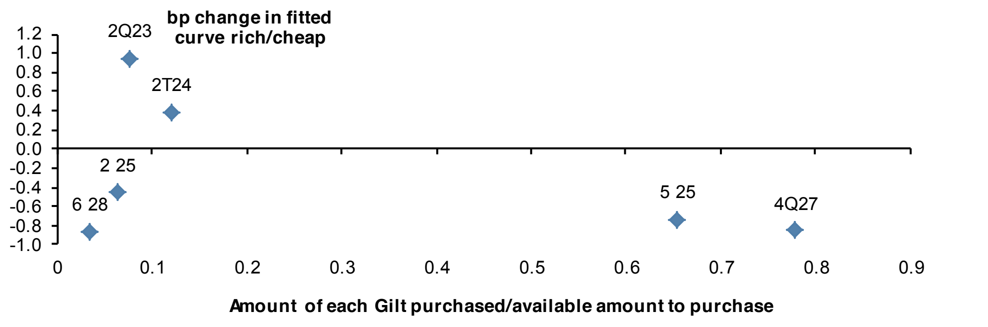
UKT 3.75% 2020/ 2.75% 2024/ 3.5% 2045 1:2:1 fly



Source: RBS

In terms of the performance of individual bonds, as we have noted in the past, **issues that are close to the free-float limit, but with some "buying room" remaining tend to outperform** during the buyback period.

Bonds that feature heavily in buybacks richen vs. a fitted yield curve



Source: BoE, DMO, RBS

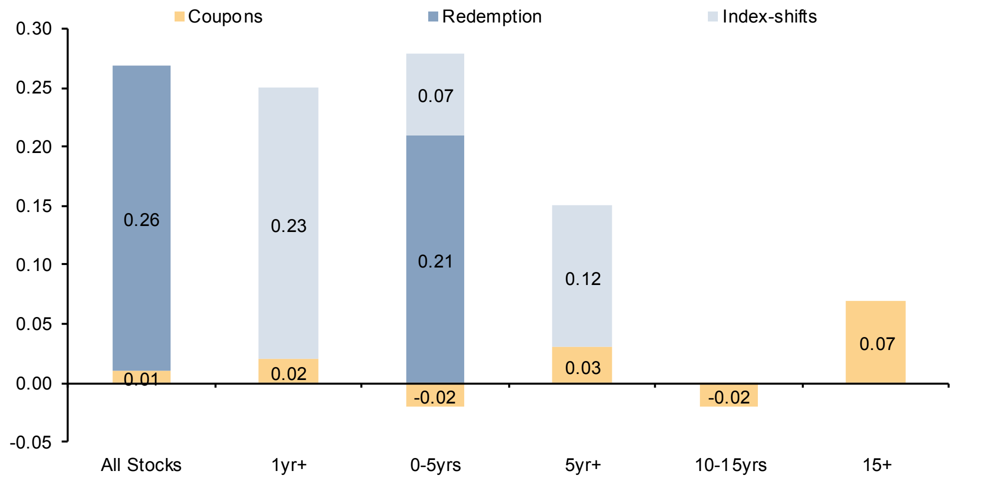
The above chart plots the amount of each Gilt purchases (as a proportion of the available free float at the time, x-axis) against the change in relative richness/cheapness versus a fitted curve between the first and last day of buybacks in September 2015. Bonds that feature heavily in buybacks clearly richened during the process.

We note that 1.5% 2021 will likely be excluded from the first week of buybacks, having been auctioned within one week of a re-opening (scheduled for 20th January).

3. Bond index shifts

The chart below shows the relevant index impacts of the fourth-coming cash-flow events.

UK FTSE Gilt Indices: Anticipated impact of coupons, redemption and constituent changes



Source: RBS

Of note is the redemption of UKT 2% 2016, which extends the all stocks index by +0.26 and 0-5y by +0.21. 1.75% 2017 drops below 1y residual maturity, extending the >1y index by +0.23 and as a result of UKT 1.5% 2021 dropping below a 5y residual maturity, 0-5y extends +0.07 and >5y by +0.12.

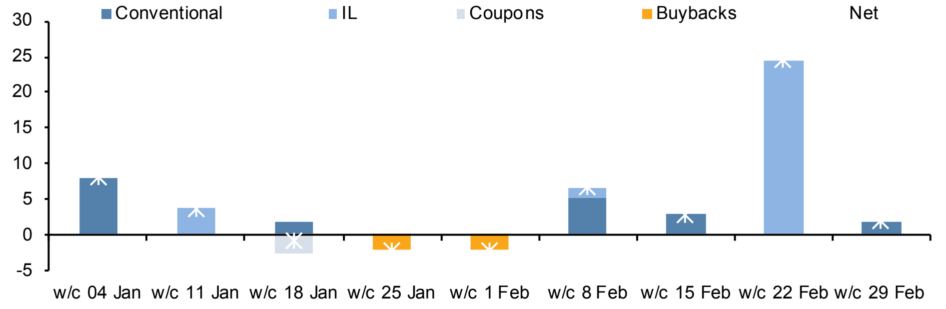
The index impact of the bond redemption takes place at the COB on the redemption date (22nd January 2016) and the impact of bond index constituent shifts takes place on the close of business of the prior day, so 21st January 2016.

Gilts with a similar modified duration to those of the extended indices are likely to outperform surrounding issues. For example, **UKT 1.25% 2018 has a similar modified duration to that of the extended 0-5y index,** however the issue already appears rich versus a fitted yield curve.

4. Net supply

Buybacks and coupon flows see negative net supply (£m/bp) in late January/early February. This should provide some relative support for Gilts, but from a bigger picture macro perspective we continue to see cross market value in paying 5F5Y GBP vs. EUR, particularly given the risks of political uncertainty and higher term premia. See our Year Ahead 2016 outlook here for more details.

UK Gilt Net supply (£m/bp)



Source: BoE, DMO, RBS

Giles Gale

Clement Mary-Dauphin

Volatility

GBP Volatility

The EU membership referendum remains the elephant in the room for the GBP vol market. We have suggested some insurance strategies to hedge against rising volatility in our Year Ahead 2016. These ideas were designed to also provide protection in case the most volatile scenarios do not materialise.

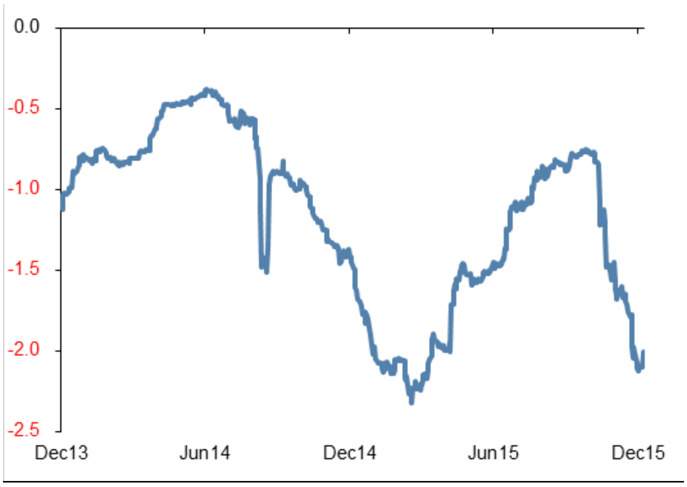
FX Option market implies higher volatility and weaker GBP

The FX options market is gradually building a premium to be protected against rising volatility. In terms of skew, investors are paying a higher premium to be protected against lower GBPUSD (rather than richer). We expect these trends to continue and potentially intensify as we get closer to the referendum date.

2y GBPUSD straddle implied volatility gradually rising. Investors pay more premium to be protected against volatility

Source: RBS, Bloomberg

2y GBPUSD 25D risk reversal: Investors paying higher premium to hedge against lower GBPUSD. (Call implied vol over put implied vol)



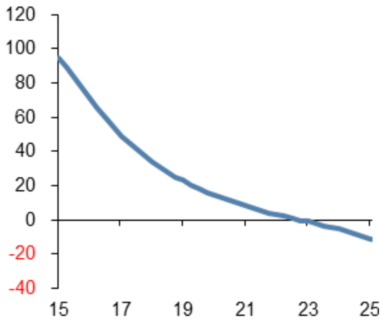
Source: RBS, Bloomberg.

Hedge against weaker GBP currency with GBPUSD Sharkfin

We introduced this strategy in our Year ahead to hedge against weaker GBP.

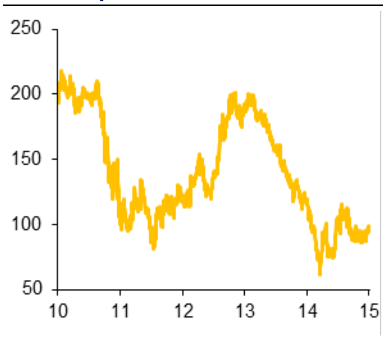
The options package offers a 1 to 8 payoff ratio and has the advantage of having both a known upside and downside. This bearish GBP trade is made cheaper by limiting the gains. The maximum payoff would occur if GBPUSD fixes between 1.35 and 1.30 at the end of 2016.

2s10s Forward curve is pricing a bear flattening



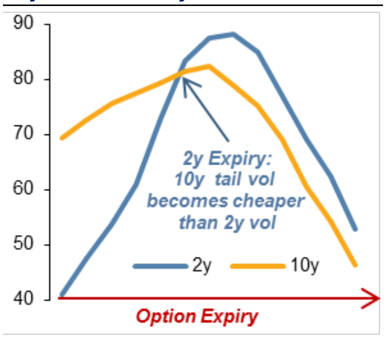
Source: RBS, Bloomberg

GBP 2s10s curve spread. Current level 99bp



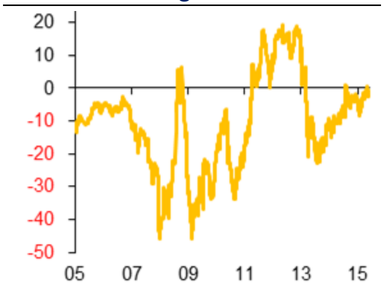
Source: RBS, Bloomberg

2y Expiry is a "sweet spot" to buy 10y vol versus 2y vol



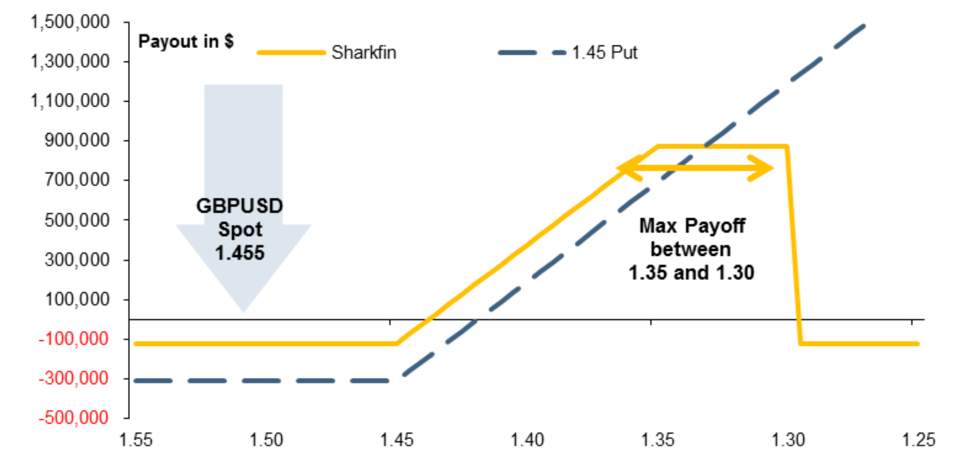
Source: RBS, Bloomberg

2y10y 2y2y volatility spread- 10y volatility has increased against 2y but is still trading at a discount



Source: RBS, Bloomberg

2Y GBPUSD Sharkfin payoff at maturity versus 1.45 Vanilla put for $125k Premium



Source: RBS

Opportunities in the rates options market

The GBP volatility surface is upward sloping and not well setup for outright long volatility position. We remain convinced conditional bear steepener are the most efficient protection against an adverse scenario.

Our strongest conviction trade is a zero cost conditional bear steepener, the rationale is the following:

1. In the event of Brexit, foreign demand for gilts may weaken

2. 10y sector is the most likely spot for underperformance as the natural domestic demand for duration is in the long end.

3. If the UK decides to leave the EU, we believe the BoE could maintain an even more accommodative policy stance.

4. Market pricing is attractive: the forward curve implies a 2s10s bear flattening.

5. The trade offers protection if rates stay where they are or rally even further.

This is the trade we recommended in our Year Ahead. Strikes were at the money when we published on November 24th 2015

Zero Cost 2y Forward 2s10s Conditional bear steepener

Buy 2y10y Swaption payer struck ATM (2.23)
Sell 2y2y Swaption payer struck ATM (1.72) PV01 weighted
Zero premium
Thanks to the forward differential and the volatility spread we enter into a conditional bear steepener at 51bp which is better than the then current spot level of 95bp

Trade risks: Losses are not capped and will occur in a scenario where the 2y rate moves higher than the 10y rate. The strategy provides some degree of protection against that scenario as it will only lose money in the event that 2s10s flattens under 51bp which is lower than the 5y historical low (61bp in Q1 2015)

EUR Volatility

Political Risks

EUR Markets are likely to be impacted by volatility coming either from political risks or monetary policy action.

2016 Main political events in the Euro Area

Portugal will elect a new President this month. A victory for the conservative candidate could create a difficult situation for the already fragmented left coalition. We believe that new parliamentary elections are probable in 2016.

Spain is in a political gridlock. At a regional level Catalonia is unable to elect a new president and will likely organise new elections as soon as March. At national level the parliament is fragmented and new elections in Q2 2016 are our base case

UK/EU membership referendum: A UK exit from the EU could have consequences on the integration process and create turbulence in the EUR market

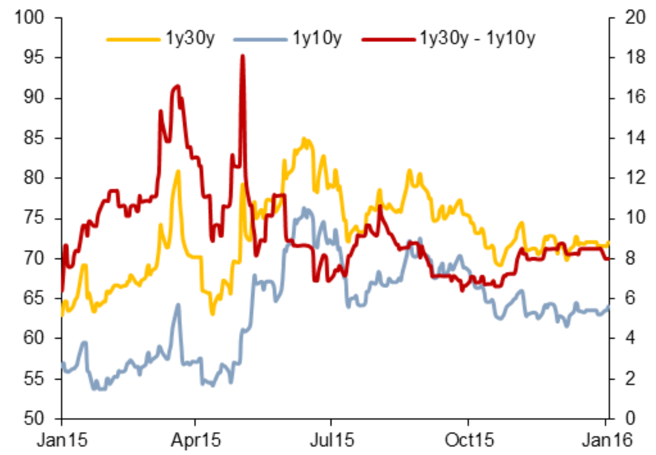
ECB Monetary policy: We think that EUR inflation will keep undershooting, due continued weakness in commodity prices and the Chinese economy. We think the ECB will have to implement more easing. Our base case is for an extra 40bp cumulative cut in the deposit rate, as well as a €40bn extension of QE purchases.

Liquidity will remain a concern in 2016

We believe liquidity will remain shallow in 2016 and expect numerous highly volatile trading sessions. ECB QE marathon will leave fewer bonds on the table to trade; this is especially true for Sovereigns with negative net supply such as Germany and the Netherlands.

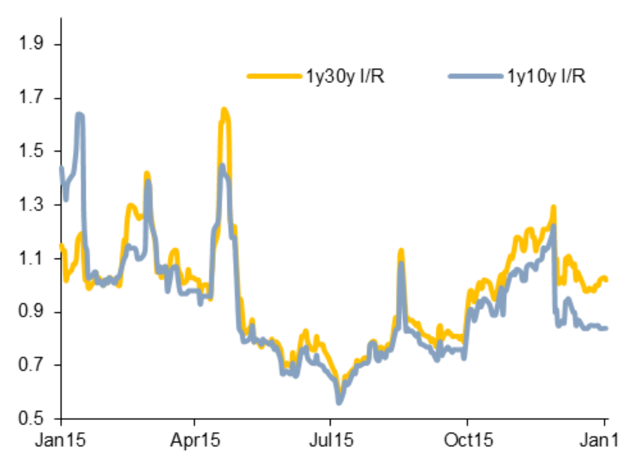
We prefer running long gamma position in top right but believe that levels still a bit rich at the moment

EUR 1y30y implied volatility has cheapened relatively against 1y10y… Implied norm vols



Source: RBS, Bloomberg

… but still look too rich versus 1y10y on an implied realised measure to enter longs



Source: RBS, Bloomberg

We are targeting to buy 1y30y over 1y10y at a 5 norm volatility spread. The current volatility spread is +8.

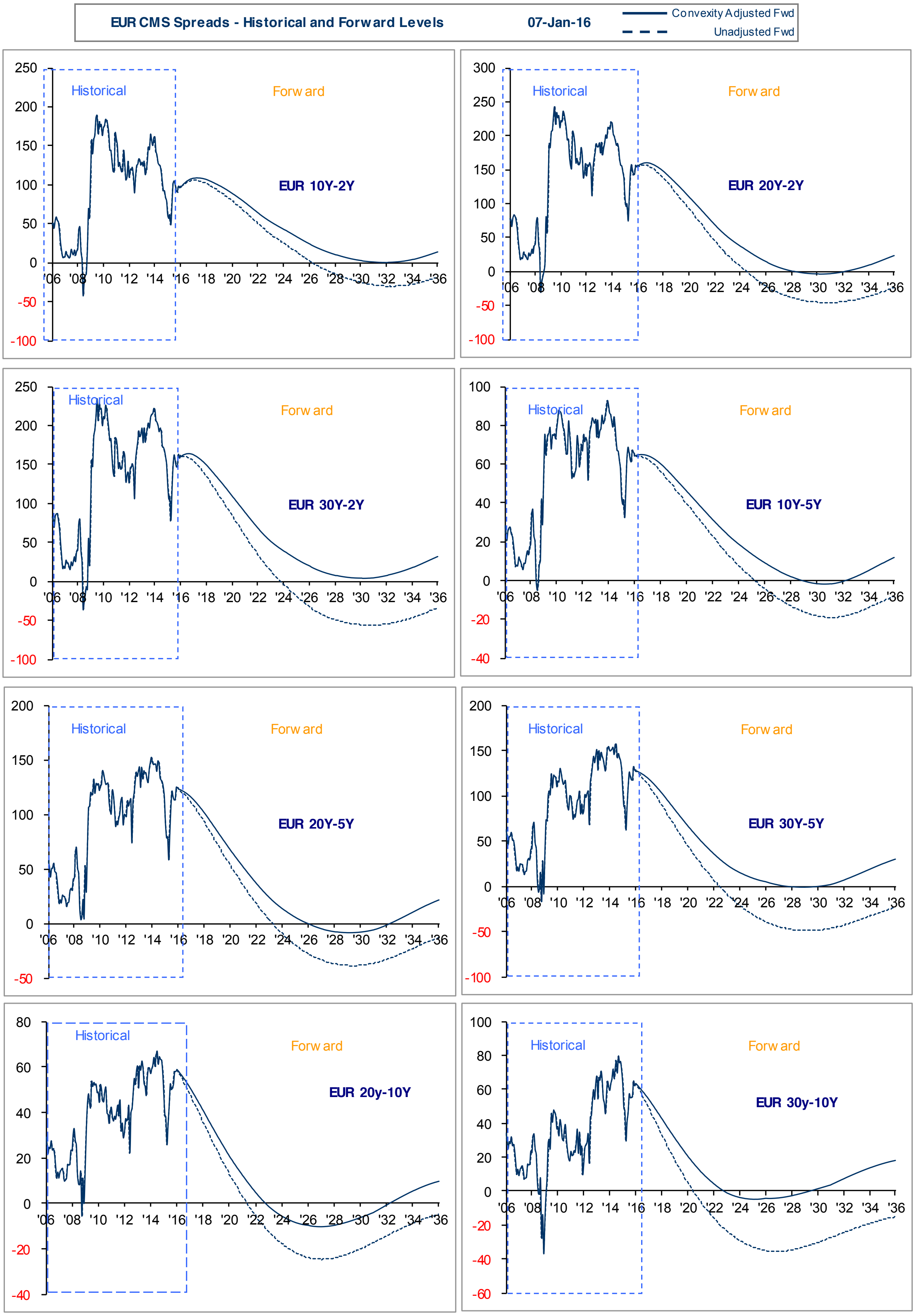
Our favourite trade in EUR Options remains our bullish front end play

We think there will be more deposit rate cuts coming from the ECB and think the most efficient way to be positioned for it was the following trade:

Trade Recommendation: Leverage Bullish ECB play
Sell 1y2y 0.25% payer swaption
Sell 1y2y -0.25% receiver Swaption
Receive 1y2y IRS at 0.10%(par 1y2y swap is 0%)
Pay 4bp premium (2bp PV01 weighted)
Maximum payout is 35bp (1:17.5 payoff ratio) but losses are not capped

Receivers are expensive in EUR, as market is positioned to benefit from an ECB rate cut. Payers have cheapened too much to be sold in collars in order to finance the receiver. We recommend selling the +0.25% -0.25% 1y2y strangle and use the premium to enter a long 1y2y forward IRS 10bp above par.

EUR CMS Chart Pack 1/2



Source: RBS, Bloomberg

EUR CMS Chart Pack 2/2

Spread	10y-2y
Most recent inversion	Sep-08
Fwd Inversion	NO
Inversion Risk	LOW
Comment	

Historically popular swap pair embedded in range accrual and leveraged Steepener notes. Positions in 2s10s spread option are smaller now, but are still causing a inverted correlation term structure after 10y maturity (buying flow of 10y-2y 0.00% strike floor pushes the spread volatility up and correlation down). We see a low risk of inversion in the short to medium term as we believe the front end of the EUR curve will remain at low levels due to weak growth and inflation.

Spread	20y-2y
Most recent inversion	Sep-08
Fwd Inversion	No
Inversion Risk	LOW
Comment	

Another popular spread among investors, 20y-2y does have similar properties to 10y-2y. The correlation term structure is also distorted by market position even if once again positions are lighter than they use to be.
Insurers are under less pressure to receive the long end of the curve however we expect the need for yield grab will cause the curve to flatten as the rally continues. Nevetheless we maintain our view that the inversion potential is low given the absolute level of 2y swap

Spread	30y-5y
Most recent inversion	Dec-08
Fwd Inversion	NO
Inversion Risk	LOW
Comment	

30y-5y swap pair positioning is relatively low, and doesn't exhibit the same extent of distortion as other pairs. 30y-5y forwards are flatter than 20y-2y, which makes it comparatively more attractive as a yield enhancement product. In our view, inversion risk is remains low because of the yield crush at the front of the EUR curve

Spread	30y-10y
Most recent inversion	Feb-09
Fwd Inversion	YES
Inversion Risk	MILD
Comment	

More popular than 30y-5y, 30y-10y forwards are unsurprisingly even flatter. This works in favour of yield enhancement, however the relatively high correlation does mitigate a bit this relative pickup in a range accrual format. Our view is that the 30y-10y spread will remain steep in the foreseeable future. However we would qualify the inversion risk as mild given 30y-10y has been more inverted and for a longer period of time than the other spreads above. We also have the view that 10s30s spread will flatten in a rally and the yield grab continues

Historical Forward CMS spreads as of 07-Jan-16

Steeper
100
50
20
0
-5
-30
Flatter

FwdStart	Historical	2s10s	2s20s	2s30s	5s10s	5s20s	5s30s	10s20s	10s30s
2y	0d	107	147	149	61	101	102	40	42
	3m Ago	101	137	139	56	92	94	36	38
	6m Ago	112	146	149	59	93	96	34	37
	1y Ago	75	113	125	47	85	97	38	50
	2y Ago	138	165	161	66	93	89	28	23
	5y Ago	108	121	97	49	62	38	13	-10
5y	0d	77	89	87	38	50	49	12	11
	3m Ago	69	78	78	33	43	43	10	10
	6m Ago	67	74	76	30	38	40	8	9
	1y Ago	67	90	97	33	56	63	23	30
	2y Ago	73	73	65	31	31	23	-1	-8
	5y Ago	56	32	6	29	4	-22	-25	-50
10y	0d	23	14	19	9	-1	5	-10	-4
	3m Ago	23	13	17	10	-0	4	-10	-6
	6m Ago	18	7	12	10	-1	4	-11	-6
	1y Ago	42	51	54	22	30	33	8	11
	2y Ago	13	1	-2	1	-11	-15	-12	-15
	5y Ago	16	-42	-53	-2	-60	-71	-58	-69
20y	0d	14	23	31	13	22	29	9	17
	3m Ago	20	29	36	16	24	32	8	16
	6m Ago	27	29	37	24	26	34	2	10
	1y Ago	71	83	79	51	63	59	11	8
	2y Ago	18	28	31	13	22	25	10	12
	5y Ago	7	-2	28	6	-3	27	-9	21
30y	0d	37	39	66	22	24	50	2	29
	3m Ago	42	38	65	24	20	47	-4	23
	6m Ago	49	32	62	35	18	48	-17	14
	1y Ago	84	43	62	64	24	43	-40	-21
	2y Ago	65	92	94	42	69	71	27	29
	5y Ago	79	114	150	49	84	120	35	71

Source: RBS

This table shows the historical level of the forward spreads. It highlights the historical evolution of a given index and a sense of its historical range .

Forward CMS Spreads zScores

Steeper
2
1
-1
-2
Flatter

FwdStart	zScore	2s10s	2s20s	2s30s	5s10s	5s20s	5s30s	10s20s	10s30s
2y	6m	0.11	0.73	0.54	0.81	1.18	0.99	1.38	1.06
	1y	0.85	1.02	0.96	1.02	1.17	1.05	1.30	0.71
	2y	0.03	0.19	0.12	0.19	0.39	0.27	0.65	0.25
	5y	-0.18	0.31	0.38	0.39	0.84	0.78	1.18	0.90
5y	6m	1.44	1.41	1.40	1.70	1.55	1.57	1.21	0.26
	1y	1.33	1.24	1.00	1.64	1.15	0.54	0.01	-0.64
	2y	0.38	0.38	0.26	0.75	0.57	0.30	0.10	-0.16
	5y	0.78	0.95	0.81	1.02	1.10	0.84	0.92	0.61
10y	6m	0.62	0.30	0.17	-1.36	-0.66	-0.50	-0.15	-0.21
	1y	-0.28	-0.60	-0.66	-0.87	-0.86	-0.89	-0.83	-0.84
	2y	-0.45	-0.56	-0.39	-0.55	-0.59	-0.38	-0.55	-0.22
	5y	0.18	0.23	0.13	0.19	0.21	0.10	0.15	0.03
20y	6m	-1.26	-1.26	-1.16	-1.15	-1.15	-1.03	0.96	0.57
	1y	-1.30	-1.13	-1.25	-1.31	-1.07	-1.21	0.32	0.55
	2y	-1.44	-1.14	-1.07	-1.34	-0.94	-0.79	0.40	0.62
	5y	-1.18	-1.14	-1.24	-1.12	-1.04	-1.12	-0.62	-0.75
30y	6m	-1.23	0.21	-0.25	-1.10	0.59	-0.09	1.28	1.14
	1y	-1.21	-0.49	-0.46	-1.21	-0.41	-0.39	1.37	1.07
	2y	-1.35	-0.43	-0.06	-1.44	-0.42	0.01	0.68	1.21
	5y	-1.91	-1.23	-1.03	-2.08	-1.22	-0.98	-0.66	-0.39

Source: RBS

zScores are an easy way to rank the level of the different spreads compared to their own history. It shows which spreads are steep or flat on an historical basis.

Term Structure of Implied correlation versus realised correlation

	Maturity	2s10s	2s20s	2s30s	5s10s	5s20s	5s30s	10s20s	10s30s
	Realised*	81%	70%	66%	96%	87%	82%	95%	91%
Implied ATM Correlations	6m	60%	48%	39%	93%	82%	72%	95%	92%
	1y	63%	51%	41%	92%	81%	74%	95%	92%
	2y	73%	63%	55%	94%	83%	75%	95%	92%
	3y	79%	71%	64%	95%	86%	78%	96%	93%
	4y	82%	75%	69%	96%	87%	81%	97%	94%
	5y	85%	79%	74%	96%	89%	83%	97%	95%
	10y	84%	81%	79%	96%	89%	87%	97%	96%
	20y	77%	72%	68%	94%	85%	82%	97%	96%

**Realised correlation is calculated as the 5y average of 180days rolling window*   *Source: RBS*

Implied Correlation has an inverse relationship with spread volatility (a high correlation is associated with low spread volatility). A note where the coupon accrues daily as long as the curve is steeper than a given boundary, the note buyer is selling selling spread volatility. The higher the spread volatility (lower correlation) the higher the yield enhancement

Source: RBS

Next 6 Months event calendar

January-2016

Mon	Tue	Wed	Thu	Fri
				01 JP -UK -US -GER -FR -TGT -
04 ISM Manu -	05	06 US Serv PMI -	07	08 US NFP -
11 JP -	12	13	14 UK MPC -	15
18 US -1w	19 UK CPI -	20 US CPI -	21 ECB Refi Rate -	22
25 2w Portuguese pres elec 1st round	26	27 FOMC -	28 US Dur Goods -	29 EC CPI - GER CPI -

February-2016

Mon	Tue	Wed	Thu	Fri
01 3w ISM Manu -	02	03 US Serv PMI -	04 UK MPC - InflaRep -	05 US NFP -
08	09	10	11 JP -1m	12
15 US - Portuguese pres elec 2nd round	16	17	18	19 US CPI -
22	23	24	25 US Dur Goods -	26 UK CPI -
29				

March-2016

Mon	Tue	Wed	Thu	Fri
	01 ISM Manu -	02	03 US Serv PMI -	04 US NFP -
07 Catalonia Reg elect (Provisional)	08	09	10 ECB Refi Rate -	11 2m
14	15	16 FOMC - US CPI -	17 UK MPC -	18
21 JP -	22 UK CPI -	23	24 US Dur Goods -	25 UK -GER -FR -TGT -
28 UK -GER -FR -TGT -	29	30	31	

April-2016

Mon	Tue	Wed	Thu	Fri
				01 ISM Manu -
04	05 US Serv PMI -	06	07	08 US NFP - Irish general election
11 3m	12 UK CPI -	13	14 UK MPC - US CPI -	15
18	19	20	21 ECB Refi Rate -	22
25	26 US Dur Goods -	27 FOMC -	28	29 JP -

May-2016

Mon	Tue	Wed	Thu	Fri
02 UK - ISM Manu -	03 JP -	04 JP - US Serv PMI -	05 JP -GER -FR - Scotland, Wales, North. Ireland. Parl. Elec.	06 US NFP -
09	10	11 4m	12 UK MPC - InflaRep -	13
16 GER -FR -	17 UK CPI -	18	19	20
23	24	25	26 GER - US Dur Goods -	27
30 UK -US -	31			

June-2016

Mon	Tue	Wed	Thu	Fri
		01 ISM Manu -	02 ECB Refi Rate -	03 US NFP - US Serv PMI -
06	07	08	09	10
13 5m	14	15 FOMC -	16 UK MPC - US CPI -	17
20	21	22	23	24 US Dur Goods -
27	28	29	30	

Source: RBS

Dmytro Bondar

Technical Outlook

Bunds: near term may see further correction to 0.57%/0.61%, but the view remains constructive. Treasuries: 2.11% - 2.30% range to remain in place. Gilts: 1.75% / 1.80% target area reached, the market remains bullish despite near-term correction possibility. Gilts-Bunds: change of view, we favour being neutral for now and see further tightening possible in the near term. BTPs: correction may be limited by 1.60%, as the market remains bullish. Brent: $34.40/bbl breakout leaves no significant support until our $26/bbl target.

Technical Levels

Bunds	Treasuries	Gilts
RES (%)	**RES (%)**	**RES (%)**
0.28	1.97	1.58
0.33	2.02	1.65
0.44	2.05	1.69
0.48	2.11	1.76
SUP	**SUP**	**SUP**
0.55	2.20	1.85
0.61	2.26	1.88
0.67	2.30	1.92
0.72	2.37	2.08

Source: RBS

10-yr Germany with Fibonacci projections, 20/5/5/3 slow stochastics and 20/200-day MA

Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

Bunds: The market has broken its range and traded below 0.55% on a sustained basis, confirming our strategic view for lower yields (targets include 0.44%, 0.33% and 0.16%). However the near term may see further correction after the formation of an outside session on Thursday.

This implies there may be a break below the 159.00 gap support area (or yield-wise, are turn move to the former range of 0.55% - 0.61%), which if broken, would see 158.50 and potentially 158.00 tested in the near term. From the long-term charting view, this correction does not alter the overall bullish picture and will be seen as temporary with yield unlikely to break above 0.61% support.

Overall, my bias is that the market will see a correction to 0.57%/0.61% in the near term, but remain bullish in the long run due to the Head and Shoulders pattern formed over Apr – Jul 2015 and a failed triangle pattern. We remain long from the past year from our buying area of 0.60% - 0.67% with a stop being a close above 0.82% and targets of 0.33%, 0.16%.

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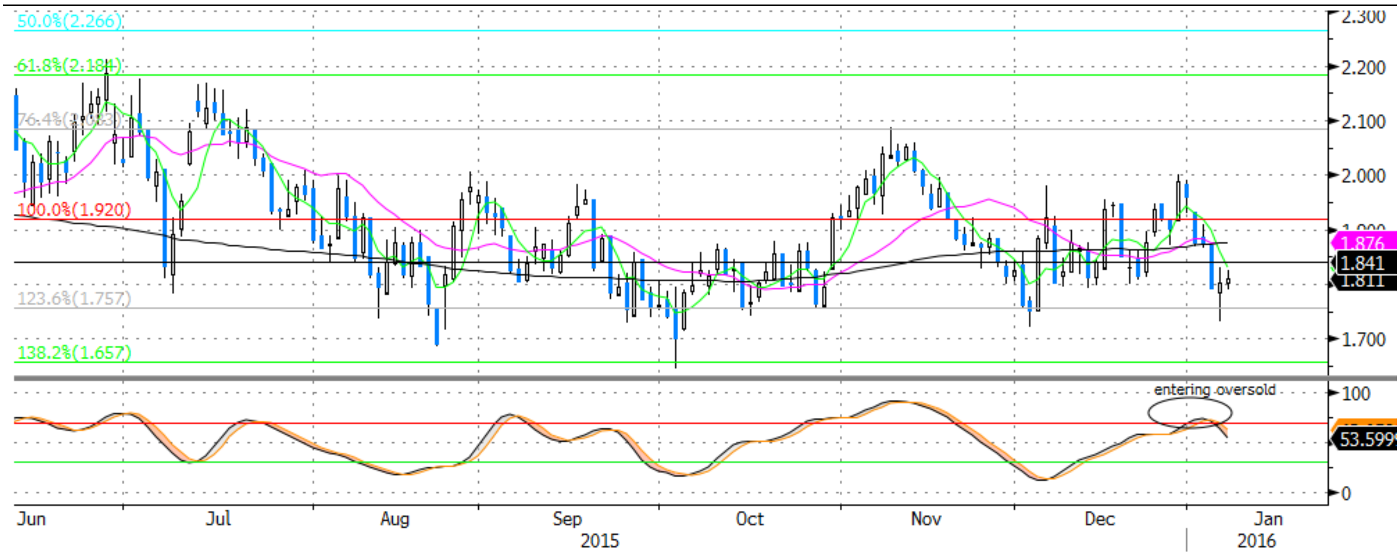
10-yr US generic yield daily candlestick chart with Fibonacci retracements, 20/5/5/3 slow stochastics and 20/50/200 day MA

Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

TY1 – The yield approached a strong resistance level of 2.11%, which sees potential bearish engulfing (or dark cloud cover, depending on the closing level) pattern on the daily candlestick chart, suggesting that the market will probably fail to break below 2.11% and will remain in the range of 2.11% - 2.30% (there is also quite a strong support at 2.26%). However, given the bullish signals from momentum oscillators, I believe that after consolidating in a range, there will be another move for lower yields back to 2.11% with potential break lower.

Gilts daily chart with Fibonacci projections, 5/20-day moving averages and 20/5/5/3 slow stochastics



Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

Gilts – we have been bullish Gilts after the formation of the inside session on the last trading day of 2015 with the target area of 1.75% / 1.80%, as momentum oscillators reached oversold conditions. This target area has now been reached and the market indicated there may be a near-term consolidation with 1.88% being a key support. As momentum oscillators remain clearly bullish, I believe there will be another push for lower yields and hence will use this correction to re-enter bullish trades. Given these outright bullish signals, I favour staying flat on the spread trade to Bunds for now, as discussed on the next page.

10-yr UK-Germany with Fibonacci retracements, 20/5/5/3 stochastics and 20-day MA

Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

Gilts-Bunds – given the view on the outright Gilt market and spread momentum indicating overbought conditions, we change the view and prefer being neutral for now, as the spread may see some further tightening back to the 123 bps support and potentially 114 bps. The widening theme (we closed a trade at 137 bps after entering from 117 bps on 17 Sep 2015, see Charting Fixed Income) strategically remains intact, but will probably need more time to accomplish a correction. Hence we favour staying flat for now and look for a base confirmation either at 123 bps or 114 bps before re-entering.

10-yr Italy daily candlestick chart with Fibonacci retracements, 20-day MA and swing extensions

Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

BTPs – We remain long from last year, as we saw the yield spike to 1.67% as a buying opportunity. The price action has been trading below the 20-day moving average and 1.60% gap after the formation of a bullish Head and Shoulders pattern. It is also worth noting that momentum oscillators remain bullish. These signals suggest that the correction may end soon (even without breaking above 1.60%) and the market will remain poised for lower yields to our targets of 1.40%, 1.26% and 1.03%. These targets are obtained by Fibonacci swing projections, as shown on the chart. Our stop remains to be a close above 1.87%

Oil Brent weekly with flag targets, 2-week moving average and 20/5/5/3 stochastics

Source: RBS, Bloomberg chart used with the permission of Bloomberg LLP

Brent – we have been oil bears for more than a year and lowered our $42/bbl 2015 target to $26/bbl and $16/bbl for 2016 with the only meaningful support on the way at $34.40/bbl. As the latter was broken on a sustained basis, it implies we don't have any significant obstacles on the way to our 2016 target of $26/bbl. There may be some near-term consolidation, as a reaction from the $34.40 support area, but the trend remains in place and, most importantly, 2015 bear flag has the measuring targets (Fibonacci swing extensions of that past trend after) at $26/bbl and $16/bbl. Therefore, we stay short to the abovementioned targets.

Clement Mary-Dauphin

Giles Gale

Trade Recommendation Performance

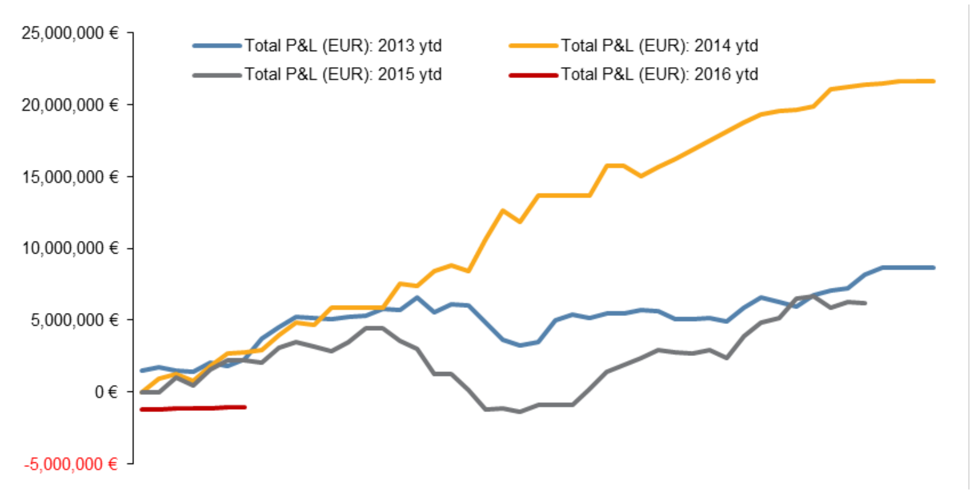
Please see below for details of our P&L history, new and closed trades, open trading strategies, and our portfolio risk profile.

Market data as of Thursday January 7th

YTD P&L: - €1.03m

We closed our long Spanish trades outright and the credit fly in which we were long Spain vs France and Italy.
We have switched our constructive periphery view into long BTPs and SPGBs

YTD P&L: -€1.03m . Open trades -430k, Close trades -600k



Source: RBS

Since simulated trades have not actually been executed, the results may under or overcompensate for the impact of certain market factors such as lack of liquidity. No representation can be made that any account will, or is likely to achieve profits or losses similar to those shown.

Past results are not indicative of future performance.

Open trade recommendations

Description	Entry Level	Target	Stop	Now	Entered	Closed	Publication	PnL (EUR)	Delta (EUR)	Vega (EUR)
Long Bearish GBPUSD Sharkfin	1.5125	1.35	1.65	1.4567	23Nov15	N/A	YA 2016	87,098	0	0
Long Bearish EURUSD Sharkfin	1.07	0.95	1.15	1.0845	23Nov15	N/A	YA 2016	-24,130	0	0
10s30s Contingent Bullish Flattener	0.0057	0.0027	0.008	0.0048	23Nov15	N/A	YA 2016	-17,000	0	0
ECB Rate cut trade in 1y2y options	0.00%	-0.25%	0.25%	-8.00%	23Nov15	N/A	YA 2016	26,835	-25,377	-10,719
Buy 1y2y 50bp payer spread vs EUR	0.00%	0.50%	-0.25%	(blank)	23Nov15	N/A	YA 2016	-19,693	-5,010	-2,850
2y 2s10s cond bear steep (Brexit hedge)	0.51%	1.01%	0.20%	439.00%	23Nov15	N/A	YA 2016	23,019	688	-409
buy 1y2y leveraged collar	1.36%	1.86%	1.06%	43.00%	23Nov15	N/A	YA2016	-28,171	15,444	-3,559
Sell SEK 3y1y 1% payer vs EUR 3y1y 1% payer	0.58%	0.25%	0.80%	15.00%	23Nov15	N/A	YA 2016	-236,134	-4,844	-2,239
Long Andalucia vs Spain	0.55%	0.25%	0.65%	0.53%	23Nov15	N/A	YA 2016	99,052	44	0
Receive 6m6m Eonia	-0.32%	-0.45%	-0.30%	0.00%	23Nov15	N/A	YA 2016	68,398	-76,708	0
Ireland to converge to semi core	0.21%	0.00%	0.31%	0.12%	23Nov15	N/A	YA 2016	490,193	-8,199	0
Finland underperformance	0.01%	-0.05%	0.04%	0.01%	23Nov15	N/A	YA 2016	-239	-1,212	0
Swap to outperform and Bunds target 0.10%	0.32%	0.10%	0.40%	-0.54%	23Nov15	N/A	YA 2016	25,992	-6	0
Long 10y IL Bono target -0.20%	0.53%	-0.20%	0.75%	0.74%	23Nov15	N/A	YA 2016	-468,705	-24,404	0
10y Sweden outperform UK	-1.04%	-1.30%	-0.81%	-0.95%	23Nov15	N/A	YA 2016	-283,584	-1,443	0
10Y Denmark outperform Bobls	0.92%	0.50%	1.10%	0.98%	23Nov15	N/A	YA 2016	-114,753	854	0
jul16/Aug16 Sonia Steepener	0.05%	0.17%	0.03%	0.00%	23Nov15	N/A	YA 2016	-71,641	-19	0
1y1y 2y1y UK steepener	0.35%	0.65%	0.27%	0.00%	23Nov15	N/A	YA 2016	49,417	-310	0
20y10y UK to underperform US	0.88%	0.00%	1.20%	0.00%	23Nov15	N/A	YA 2016	57,054	265	0
5y5y UK to underperform 5y5y EUR	0.75%	1.30%	0.55%	0.00%	23Nov15	N/A	YA 2016	-23,209	-2,322	0
10y and 30y asset swap convergence	0.54%	0.35%	0.62%	0.76%	23Nov15	N/A	YA 2016	-265,583	-319	0
10y Gilts to underperform 10y Swaps	0.05%	0.20%	-0.04%	1.80%	23Nov15	N/A	YA 2016	-228,362	191	0
receive 30y UK breakeven inflation	3.45%	3.70%	3.27%	0.00%	23Nov15	N/A	YA 2016	80,635	-22,947	0
Sell IL27 and Buy IL 46s on Breakeven	0.58%	0.80%	0.45%	0.58%	23Nov15	N/A	YA 2016	271,186	395	0
Switching our long Spain into Italy	1.59%	0.75%	1.80%	1.55%	21Dec15	N/A	Rates Special 18Dec15	108,689	-24,112	0
Switching our long Spain into Portugal	0.0073	0.004	0.011	0.00757	21Dec15	N/A	Rates Special 18Dec15	-39,159	-30,232	0

Source: RBS

Closed Trade Recommendations

Description	Entry Level	Target	Stop	Now	Entered	Closed	Publication	PnL (EUR)	Delta (EUR)
Buy 10y Germany Target 0.16%	0.53%	0.16%	0.75%		23Nov15	03Dec15	YA 2016	-320,299	
Buy 10y BTP Target 0.75%	1.53%	0.75%	1.80%		23Nov15	03Dec15	YA 2016	-276,800	
Buy 5y Spain target 0%	0.59%	0.00%	0.82%		23Nov15	03Dec15	YA 2016	-83,350	
Long Spain vs Italy and France in 10y	0.96%	0.40%	1.20%		23Nov15	21Dec15	YA 2016	-139,343	
Long 4y PGB Target 0.4%	0.80%	0.40%	1.10%		23Nov15	03Dec15	YA 2016	348,632	
Buy 10y Spain Ahead of elections	1.69%	0.75%	1.95%		18Dec15	21Dec15	Rates Special 18Dec15	-125,000	

Source: RBS

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