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Danske Bank 2019 Fixed Income Top Trades

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4 December 2018

Important disclosures and certifications are contained from page 23 of this report

2019 Fixed Income Top Trades overview

1: Receive the 5Y USD swap in a 2s5s10s USD fly

2: Pay Mar-20 and receive Sep-19 Euribors

3: Buy callable 2'50 and sell DGB 0.5% 2027

4: Sell Dec 2028 SGBi's vs. Apr 2030 DBRi's

5: Pay 2Y2Y NOK vs euro and buy long-end NGB vs Bunds

6: Long 5Y Spain versus 5Y France

7: Long 10Y Finland versus 10Y Denmark

8: The ultimate carry trade: 10Y-30Y Steepener 5Y Forward

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Looking back on our Fixed Income Top Trades for 2018

- 18 of 21 Fixed Income Top Trades for 2018 were closed with profit*

Trades	Opened	Closed	Comment	P/L
#1: Sell 1Y10Y ATMS EUR straddle	05/12/2017	15/02/2018	Stop loss	**-125cts**
#2: 1Y forward 2Y-10Y flattening of the USD swap curve	05/12/2017	09/04/2018		**12.0bp**
#3: Pay 2Y3M USDOIS versus receive 1Y3M USDOIS	05/12/2017	18/05/2018	Hit target	**24.8bp**
#4: Buy Bund spread	05/12/2017	13/07/2018	Hit target	**9bp**
#5: Buying the new 10Y PGB and the new 10Y IRISH government bond at the expected syndication	05/12/2017	PGB 09-03-2018		**44bp/0bp**
#6: Buy 30Y 2% callable bonds against DGBs	05/12/2017	16/01/2018		**1.06pts**
#7: Buy 5Y non-callable bonds against DGBs (RD 2% Jan-22 vs DGB 1.5% 11/23)	05/12/2017	26/11/2018	Closed with profit	**0.11%**
#8: Buy DGBi 0.1% 2023 vs DGB 1.5% 2023	05/12/2017	23/03/2018	Hit target	**20bp**
#9: Buy DGB 0.5% 11/27 relative to EU peers such as Bund 08/27(open) and DSL 11/27 (closed)	05/12/2017	07/11/2018	vs DSL closed	**0bp/5bp**
#10: Buy SGB 1.5% 11/23 (SGB1057) vs Bobl	05/12/2017	17/08/2018	Closed with profit	**4bp**
#11: Receive MAR-19 SEK RIBA	05/12/2017	07/09/2018	Closed with profit	**22.0bp**
#12: Receive 1Y1Y USDSEK CCS	05/12/2017	18/05/2018	Stop loss	**-6.1bp**
#13: Receive 1Y1Y SEK vs EUR and pay 5Y5Y NOK vs EUR	05/12/2017	28/05/2018	Hit target	**31.3bp**
#14: Receive 1Y1Y USDNOK CCS	05/12/2017	18/05/2018	Stop loss	**-8.6bp**
#15: Receive EUR 1Y1Y-2Y1Y-3Y1Y EUR swap fly	20/12/2017	25/05/2018		**12.5bp**
#16: Receive Dec-18 to Mar-19 EONIA swap	11/01/2017	20/03/2018		**5.2bp**
#17: Reveive 1Y1Y EUR real rate	01/03/2018	09/04/2018		**11.5bp**
#18: Sell 1Y5Y ATMF EUR payer swaption	01/03/2018	20/03/2018		**23.9cts**
#19: Tactical 5Y-30Y EUR steepener 5Y fwd	01/03/2018	15/06/2018		**15.9bp**
#20: Sell 10Y10Y vs buy 1Y1Y euro HICPxt inflation swap	01/03/2018	25/05/2018		**16.0bp**
#21: Receive 2Y2Y EUR swap	20/03/2018	25/05/2018		**18.5bp**

* Trades were also added during the year

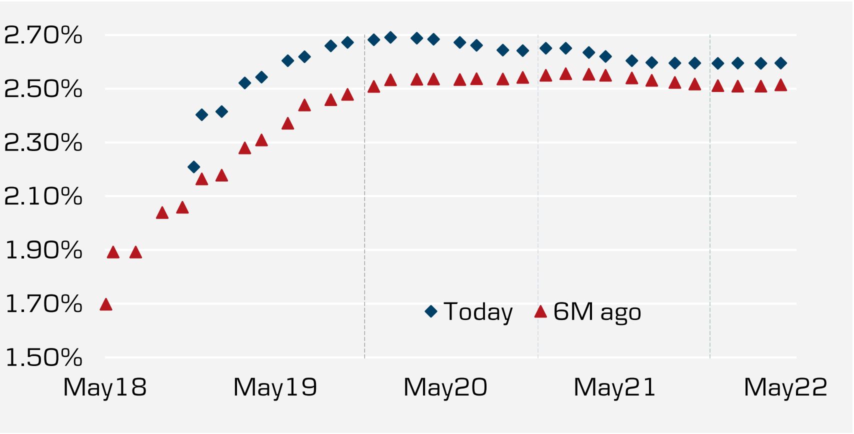
Source: Danske Bank

Central bank and market overview

Fed and USD yield outlook
- Fed hikes to continue … long-end to remain under pressure

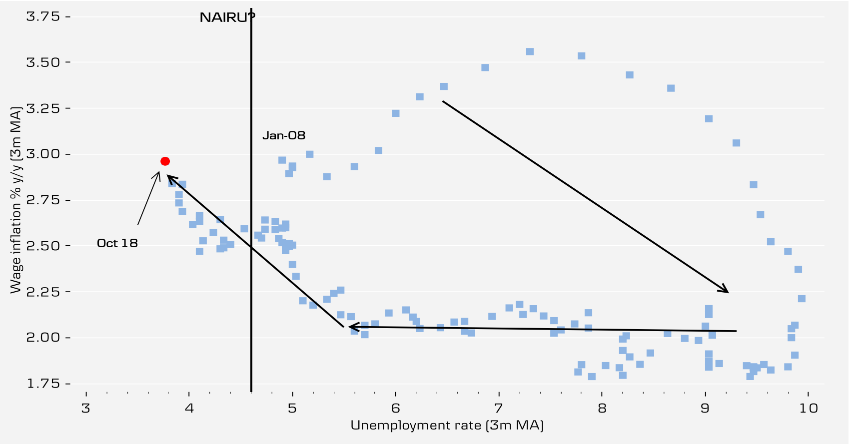
- The Fed is on track to hike in December. For 2019, the uncertainty is greater, especially after the recent comments from Fed Chairman Powell and the FOMC minutes. However, growth is strong, optimism is high, the unemployment rate is low, wage growth is increasing and core inflation is running near 2%.
- Hence, we expect the Fed to hike in March, June and possibly once in H2 next year. This would bring the fed funds rate to 3.25% - above the neutral rate.
- However, the money market curve is likely to invert further in 2019. Flat yield curves, low unemployment and trade jitters, combined with the fiscal policy running out of steam in 2020, will fuel recession fears.
- Therefore, we expect the 5Y point on the yield curve to outperform the 2Y and 10Y segments. 2Y yields would be pushed higher by the Fed and 10Y yields are sensitive to a higher term-premium. The combination of higher supply and waning demand from abroad due to the 'expensive' FX hedge could create upward pressure on 10Y yields.
- In Trade 1 we recommend to receive the 5Y USD swap vs 2Y and 10Y swaps in a fly.

The money market curve has started to invert, 1M USD OIS forwards



Source: Danske Bank

The Phillips curve is alive and kicking



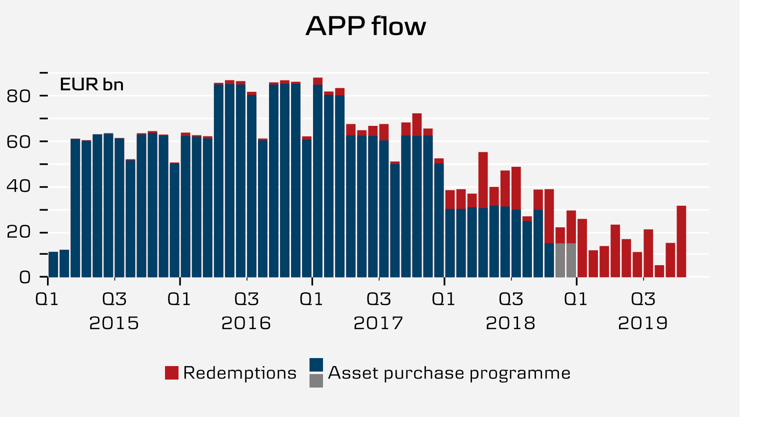
Source: Bloomberg, Danske Bank, Macrobond Financial

ECB and EUR yield outlook: dovish tightening

…but very soft pricing and value in 5Y periphery

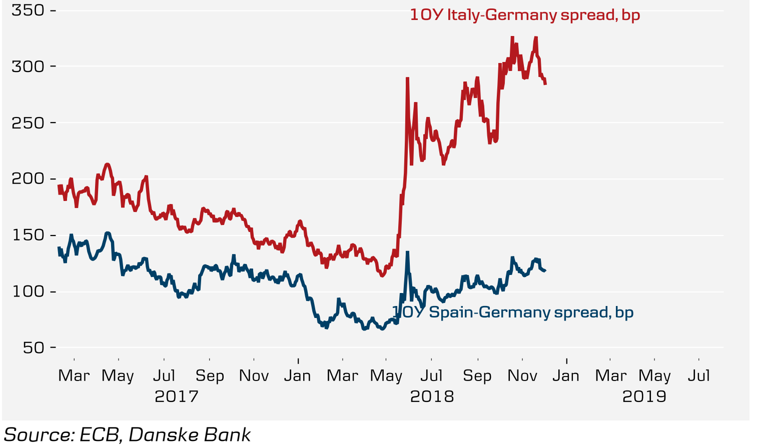
- The ECB will end QE purchases by end-2018 and start a very gradual hiking cycle in late 2019 despite signs that the growth cycle is weakening. We expect the ECB to deliver the first 20bp deposit rate hike in December 19, which would be above and before the market pricing.
- We recommend in Trade 2 to pay Mar-20 and receive Sep-19 Euribors.
- Despite the end of QE from the ECB, we do not expect a 'tapering sell-off' in Bunds. The net supply is negative for the AAA counties Germany and Netherlands and reinvestments would be sizeable.
- A slow ECB normalisation, a possible new TLTRO and range-trading in Bunds for the next 3-6 months would create opportunities for the periphery after the 2018 underperformance. Italy is still highly volatile and we prefer Spain, where we like the 5Y point on the curve, as the curve is steep here.
- We argue that the fundamentals are strong in Spain and recommend in Trade 6 to buy 5Y Spain vs 5Y France. Semi-core has also been under pressure in 2018. But Finland is moving towards AAA status and we go long 10Y RFGB vs 10Y DGB in Trade 7.

End to QE but large reinvestment need in 2019



Source: ECB, Danske Bank

Spain to tighten vs core on strong fundamentals despite Italy concerns

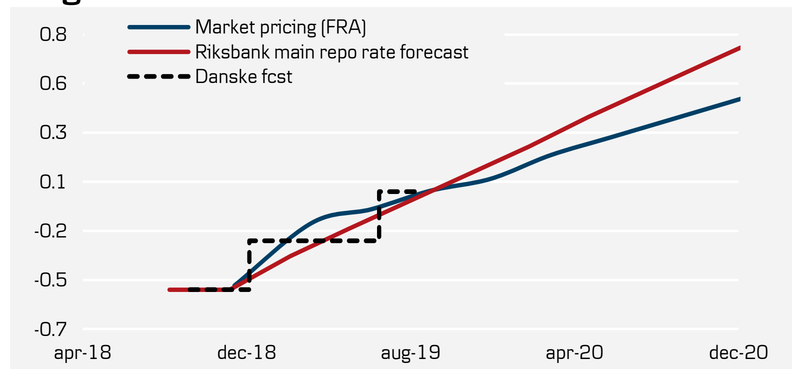


Source: ECB, Danske Bank

Riksbank and SEK yield outlook: ending negative rates

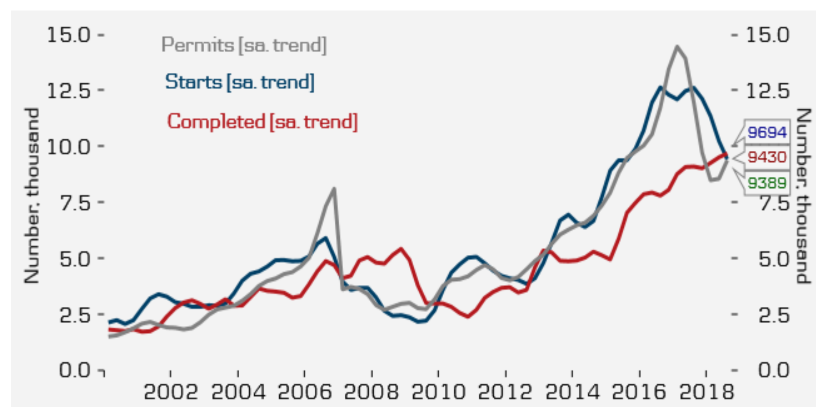
- We expect the Riksbank to deliver a first 25bp rate hike at the December 2018 meeting, followed by a second hike in July 2019.
- In addition, we expect the RB bond purchases to end in June 2019 as planned without any reinvestments beyond that date.
- However, over time the RB is likely to face increasing headwinds from an expected growth slowdown. Construction will likely be a significant drag in the coming quarters. While prices have stabilised, sales of new apartments remain sluggish and housing starts have dropped markedly. A possible growth slowdown in Europe is likely to affect Sweden as well.
- Though somewhat below the RB's October forecast (partly due to energy prices), our inflation forecast is relatively consistent with the 2% target. However, the RB may once again be over-optimistic about wage growth in 2019.
- Thus, beyond July, we think the sustainability of the rate hiking cycle may be in doubt.
- In Trade 4 we recommend to sell 10Y SGBi's vs. German linkers.

The market remains sceptical of RB hikes in the longer run



Source: Riksbank, Danske Bank

Housing starts point to a significant decline in construction



Source: Macrobond Financial

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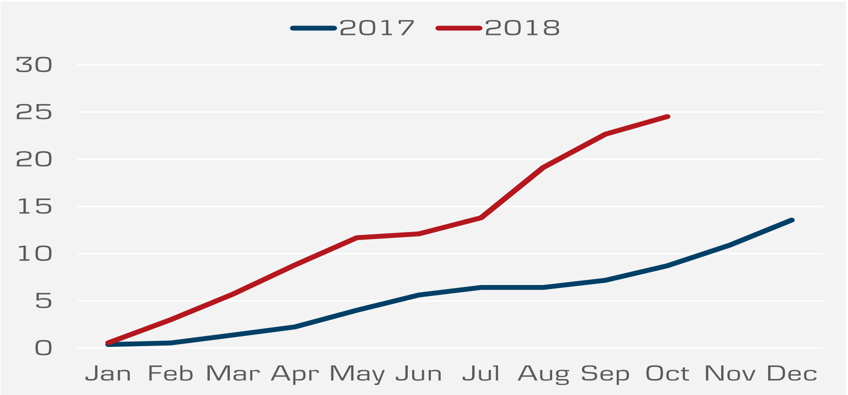
Danish central bank and yield outlook: Value in mortgage bonds

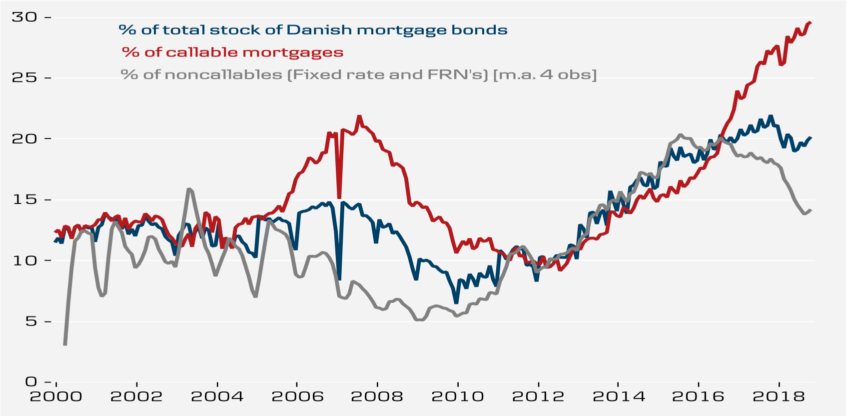
- We expect the Danish central bank to mirror the ECB throughout 2019, and expect no independent rate hikes despite EUR/DKK currently trading above central parity and the 'relatively' high EUR/DKK FX forward discount. The latter is positive for the short-end of the curve, as EUR-based investors can get an extra pick-up adding a hedge.
- The Danish funding requirement will be larger in 2019 as the government will conduct buy-backs for more than DKK50bn in the new government guaranteed mortgage bonds. The funding will likely come from an unchanged bond (DKKK65bn) and t-bill (DKK30bn) supply and a significant draw on the government cash buffer (DKK55bn). This will add liquidity to the market and keep short-end fixings low. However, contrary to 2018, it will leave little room for buy-backs in DGB's also, as pension taxes are lower. Bunds are supported by low supply and we take a neutral stance in respect of the spread towards Germany, and in Trade 7 we recommend to sell DGB 0.5% 11/27 vs RFGB 0.5% 9/27.
- We prefer to 'earn' our carry in the Danish covered bond market, which is supported by foreign demand, higher carry and little supply given the 'buy-backs'. In Trade 3 we buy RD 2% 2050 vs DGB 0.5% 11/27.

No room for same amount of DGB buy-backs in 2019; buy-backs ex. bonds maturing same year, acc. ytd., DKKbn



Source: Danske Bank

Foreign demand for Danish callable bonds to rise again in 2019 (foreign ownership, %)

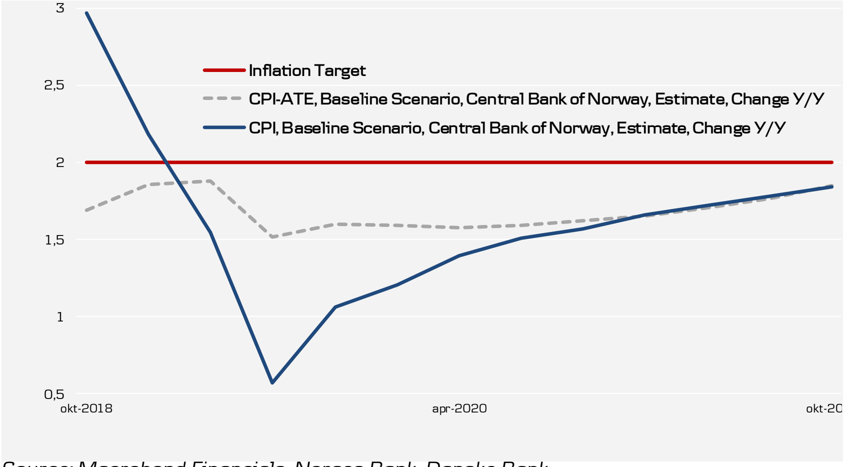


Source: Nationalbanken, Danske Bank

Norges Bank and NOK yield outlook: gradual normalisation

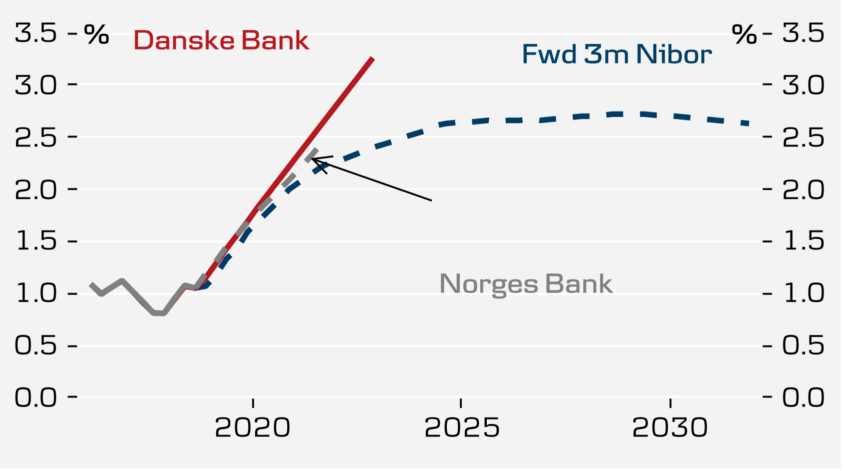
- Norges Bank's 20 September sight deposit interest rate hike of 25bp to 0.75% was the first hike in over seven years. Norges Bank's board recently reiterated the message that the key policy rate would likely be increased further in Q1 19. That is, the next likely hike would be on 21 March.
- Norges Bank's interest rate path suggests roughly two hikes per year going forward. Norges Bank's sight deposit interest rate path ends Q4 21 at 2.1%. We believe that Norges Bank will have to hike interest rates beyond this level. We believe the neutral risk free real rate of Norway is significantly above zero. Given a 2% inflation target, we believe the neutral nominal interest rate level is above the current end-point of Norges Bank's path
- According to Norges Bank's own calculations, the output gap is closed at present. The oil industry investment survey suggests c.13% growth in investments in 2019, which adds 0.5pp to 2019 GDP. Unemployment is low and stable. We see higher wage growth going forward. Relative to market prices, we see a larger potential for higher Norwegian interest rates than for most international peers. In Trade 5 we recommend to pay 2Y2Y NOK vs euro and buy long-end NGB vs Bunds.

Norges Bank sees range-bound inflation



Source: Macrobond Financials, Norges Bank, Danske Bank

Upside potential in Norwegian interest rates



Source: Norges Bank, Danske Bank

Government bond supply in 2019

Negative net issuance from Germany and Netherlands in 2019

Expected issuance	Deficit (% of GDP)*	Bond supply EUR bn**		Redemptions (EUR bn)		Net supply		ECB reinvestments
	2019	2019	2018***	2019	2018	2019	2018	2019****
Germany	1.0%	135	147	148	160	-13	-13	40
France	-2.8%	195	195	129	119	66	76	37
Italy	-2.5%	260	240	199	185	61	55	25
Spain	-1.8%	122	134	92	89	30	45	16
Belgium	-1.0%	25	34	25	25	0	9	5
Austria	0.1%	25	18	26	19	-1	-1	6
Netherlands	1.0%	23	24	30	40	-7	-16	7
Finland	-0.1%	10	10	5	5	5	5	2
Ireland	0.0%	16	18	13	9	3	9	2
Portugal	-0.2%	14.6	16	8	7	6	10	1
Greece	-0.4%	10	3	9	2	1	1	0
Total		836	839	684	660	152	179	140
Denmark	-0.1%	65	65	80	53	-15	12	0
Sweden	1.0%	39	39	114	0	-75	39	20
Norway	5.0%	50	47	70	0	-20	47	0

* Domestic Ministry of Finance/EU commission

** Nominal government bonds and inflation linked government bonds

*** Estimated sale in 2018

**** Estimated ECB reinvestments - only government bonds (no agencies, Länder etc.)

- There are some notable changes to the supply in 2019 . Germany, Austria and the Netherlands will have negative net issuance in 2019.
- Net issuance in Spain will decline by around EUR15bn, while increasing by EUR6bn in Italy.
- Net issuance will decline in Belgium, Ireland and Portugal.
- All three Scandinavian countries will see negative net issuance in 2019.

Source. European ministries of finance, Danske Bank

12M carry and roll-down in 2019

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2019 : The carry+roll-down is still best in the 5Y and 10Y segments across EU countries

GERMANY	Segment					
12mth horzizon	2	5	10	15	20	30
"Coupon" Carry	-0.63%	-0.27%	0.33%	0.58%	0.77%	0.99%
Roll-down	0.08%	0.52%	0.90%	0.66%	0.44%	-0.06%
Total carry	-0.55%	0.26%	1.23%	1.25%	1.21%	0.93%
Total carry + funding	0.06%	0.84%	1.76%	1.83%	1.36%	1.53%
Total carry + funding (riskadjusted)	0.02%	0.16%	0.18%	0.10%	0.06%	0.05%
Funding rate	-0.61%	-0.58%	-0.54%	-0.58%	-0.50%	-0.60%

FRANCE	Segment					
	2	5	10	15	20	30
"Coupon" Carry	-0.54%	-0.09%	0.69%	1.08%	1.30%	1.67%
Roll-down	0.05%	0.65%	1.15%	1.17%	0.34%	0.82%
Total carry	-0.49%	0.56%	1.83%	2.25%	1.64%	2.49%
Total carry + funding	0.01%	1.06%	2.33%	2.75%	2.14%	2.99%
Total carry + funding (riskadjusted)	0.01%	0.19%	0.24%	0.19%	0.10%	0.12%
Funding rate	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%

SPAIN	Segment					
	2	5	10	15	20	30
"Coupon" Carry	-0.16%	0.54%	1.49%	2.06%	2.27%	2.71%
Roll-down	0.25%	1.13%	0.86%	1.01%	0.61%	0.71%
Total carry	0.09%	1.66%	2.35%	3.07%	2.89%	3.42%
Total carry + funding	0.54%	2.13%	2.86%	3.49%	3.38%	3.99%
Total carry + funding (riskadjusted)	0.25%	0.39%	0.25%	0.26%	0.17%	0.19%
Funding rate	-0.45%	-0.47%	-0.51%	-0.43%	-0.49%	-0.57%

ITALY	Segment					
	2	5	10	15	20	30
"Coupon" Carry	1.04%	2.51%	3.39%	3.63%	3.55%	3.63%
Roll-down	0.63%	0.86%	0.64%	0.45%	0.93%	-2.09%
Total carry	1.67%	3.37%	4.03%	4.09%	4.48%	1.55%
Total carry + funding	2.08%	3.72%	4.21%	4.35%	5.07%	2.00%
Total carry + funding (riskadjusted)	1.05%	0.79%	0.46%	0.38%	0.37%	0.12%
Funding rate	-0.42%	-0.51%	-0.42%	-0.39%	-0.39%	-0.46%

NETHERLANDS	Segment					
12mth horizon	2	5	10	15	20	30
"Coupon" Carry	-0.61%	-0.14%	0.40%	0.75%	0.87%	1.09%
Roll-down	0.08%	0.86%	0.59%	1.02%	0.54%	0.70%
Total carry	-0.53%	0.72%	0.98%	1.78%	1.41%	1.79%
Total carry + funding	0.03%	1.20%	1.58%	2.27%	1.95%	2.49%
Total carry + funding (riskadjusted)	-0.01%	0.24%	0.13%	0.14%	0.08%	0.07%
Funding rate	-0.56%	-0.48%	-0.60%	-0.49%	-0.53%	-0.49%

BELGIUM	Segment					
	2	5	10	15	20	30
"Coupon" Carry	-0.55%	0.00%	0.81%	1.25%	1.53%	1.82%
Roll-down	0.09%	0.99%	1.13%	1.24%	0.50%	0.84%
Total carry	-0.46%	0.99%	1.94%	2.48%	2.03%	2.66%
Total carry + funding	0.03%	1.52%	2.41%	3.01%	2.54%	3.29%
Total carry + funding (riskadjusted)	0.00%	0.30%	0.25%	0.21%	0.14%	0.15%
Funding rate	-0.49%	-0.52%	-0.47%	-0.53%	-0.51%	-0.62%

IRELAND	Segment					
	2	5	10	15	20	30
"Coupon" Carry	-0.46%	0.14%	0.97%	1.45%	1.64%	1.89%
Roll-down	0.03%	0.78%	1.19%	1.11%	0.61%	0.43%
Total carry	-0.43%	0.92%	2.17%	2.56%	2.25%	2.32%
Total carry + funding	0.07%	1.41%	2.76%	3.19%	2.76%	2.75%
Total carry + funding (riskadjusted)	0.02%	0.25%	0.29%	0.24%	0.16%	0.11%
Funding rate	-0.49%	-0.49%	-0.59%	-0.63%	-0.52%	-0.43%

PORTUGAL	Segment					
	2	5	10	15	20	30
"Coupon" Carry	-0.13%	0.70%	1.89%	2.38%	2.76%	3.19%
Roll-down	0.14%	1.35%	0.96%	0.88%	1.08%	0.42%
Total carry	0.01%	2.05%	2.85%	3.27%	3.85%	3.60%
Total carry + funding	0.52%	2.58%	3.47%	3.99%	4.24%	4.02%
Total carry + funding (riskadjusted)	0.24%	0.46%	0.37%	0.32%	0.25%	0.17%
Funding rate	-0.52%	-0.53%	-0.61%	-0.72%	-0.39%	-0.41%

Source. Danske Bank

Danske Bank Fixed Income Top Trades 2019

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1: Receive the 5Y USD swap in a 2s5s10s fly

- Fed to continue hiking, money market curve to invert and pressure on long-end

- We expect further upward pressure on the short end of the US curve, as we see at least two Fed hikes in 2019 on top of the widely expected December hike. This is well above market pricing.
- The uncertain outlook for the global economy, the stronger USD, the dwindling growth impact from fiscal policy in 2020, the recent rhetoric from Feb Chairman Powell and the flat 2s10s curve is likely to fuel market talk that the Fed is ahead of the curve. This will tend to invert the money market curve and the market may increasingly start to price in rate cut(s) in two to three years' time.
- The 10Y point in the fly is likely to come under renewed pressure. The combination of rapidly rising supply and dwindling foreign demand due to an expensive FX hedge would weigh mainly on the long-end of the curve through a higher term-premium.

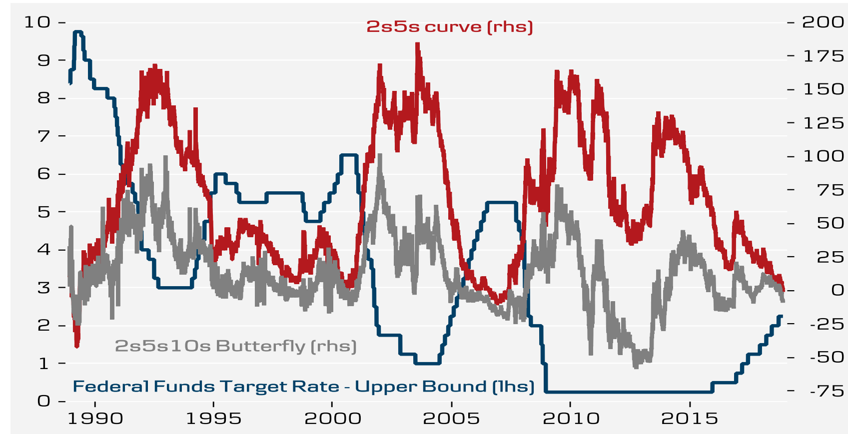
Conclusion

- Receive 5Y USD swap versus 2Y and 10Y in a fly at -7bp. P/L -21bp /8bp. 3M carry -2bp.

Risk factors

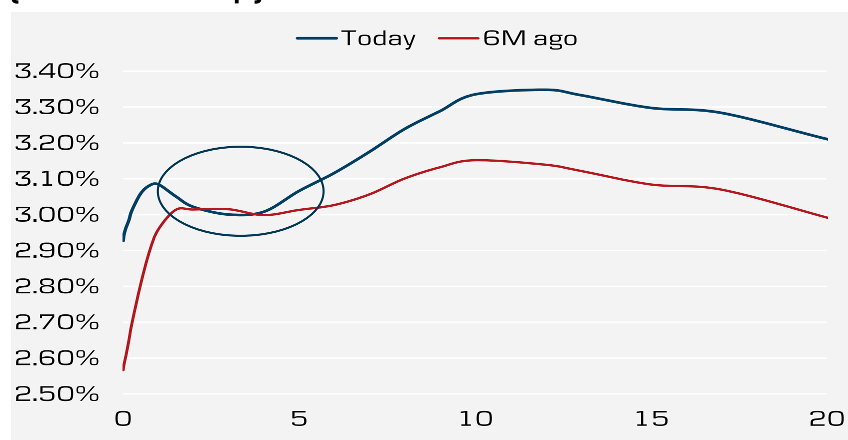
- Fed stops hiking/starts to cut, which would steepen 2s5s markedly.

2s5s10s to become more negative in 2019



Source: Bloomberg, Danske Bank

Forward curve to invert further up to 5-year, 1Y fwd (USD3m swap)



Source: Federal Reserve, BEA, Danske Bank

2: Pay Mar-20 and receive Sep-19 Euribors

- Momentum in the Eurozone should steepen front-end as ECB hike approaches

- ECB pricing remains dovish in the front-end. Draghi, Praet and Coeuré's comments show a goal to exit crisis-mode policies. Therefore, we expect the ECB to hike rates to 0% (depo) as long as growth, core inflation and wage growth dynamics are solid.
- In fact, wage growth is picking up and is currently at the highest level since 2009, which is a comforting sign for the ECB. Further, we expect a new round of TLTROs in H1 making it possible for the ECB to continue a 'dovish tightening' approach.
- We expect the ECB to hike rates by 20bp in Dec-19 and Mar-20, while the market prices only 13bp between Sep-19 and Mar-20 (EONIA).
- We prefer to do the trade against 3M Euribors due to current low FRA/Eonia pricing. This should provide some downside protection in case our base case scenario does not materialise.

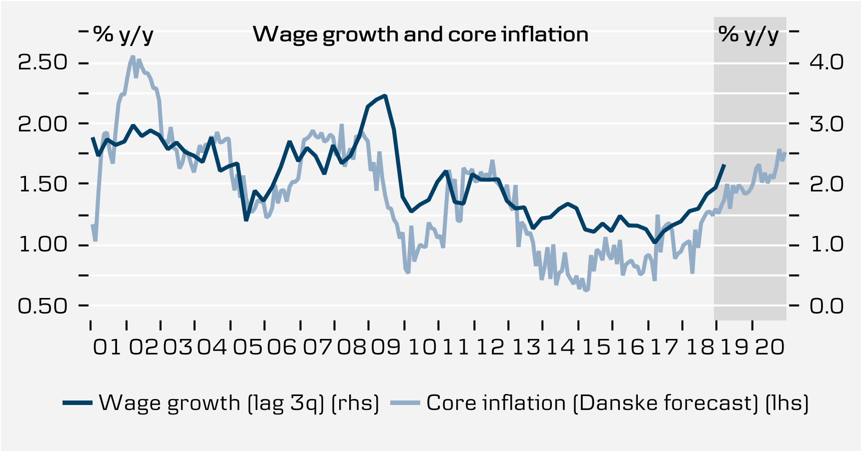
Conclusion

- Buy Sep-19 and sell Mar-20 Euribor futures at 12bp. P/L at 20/5. 6M carry/roll at -7bp.

Risk factors

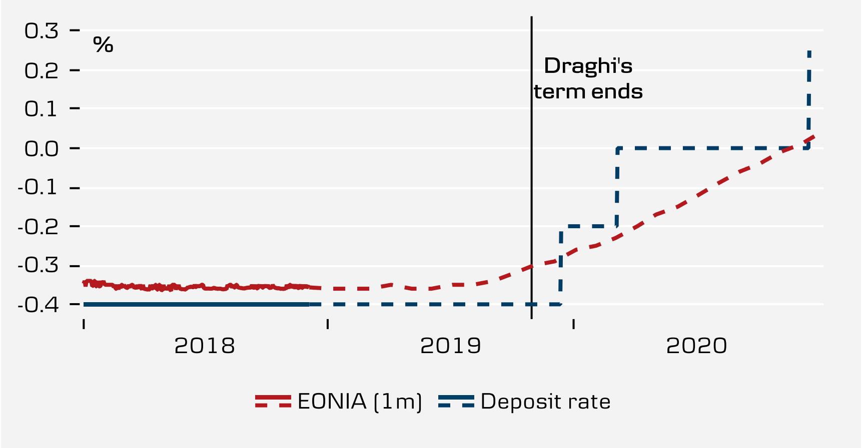
- Significantly lower growth/depressed PMIs and failure of wage growth pick-up to translate into higher core inflation, thereby postponing the first rate hike.

Core inflation and wage growth picking up...



Source: Macrobond Financial, Danske Bank

... but market pricing remains dovish



Source: Danske Bank

3: Buy callable 2'50 and sell DGB 0.5% 2027

- Less buy-backs in DGB and high excess carry in 2'50 along with plenty of demand

- Less room for buy-backs in DGBs in 2019, since the Danish central bank has announced buying of DKK51bn government guaranteed mortgage bonds – and we expect up to DKK66bn. This could lead to buy-backs in 1.5'47 from subsidised borrowers and investors in 1.5'47 may buy 30Y 2% bonds to keep high duration.
- Carry in 2'50 vs. DGBs has increased and entry levels look attractive.
- The case for foreign investors buying callable bonds seems unchanged. However, recent buying has reduced slightly compared to 2016-17. We still expect foreign investors to be dominant buyers in 2019 and add to high demand vs. expected supply.

Conclusion

- Buy 2'50 nom. 100 @99.50 vs. DGB 0.5% 2027 nom. 97 @102.15. P/L 150bp/-125bp

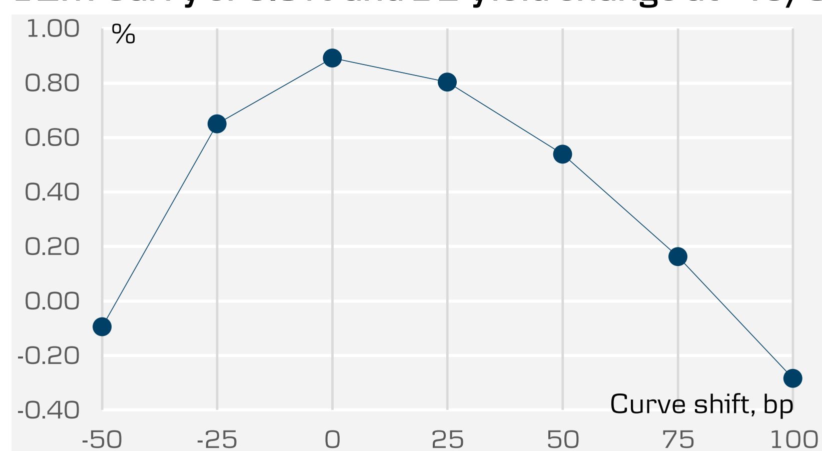
Risk factors

- Rising credit premiums in EUR assets (covered bonds, etc.), significant increase in rates and high supply if falling rates bring 1.5'50 to 98-99.

Callables have underperformed DGB spread-wise, GovOAS bp.

Source: Danske Bank

12M Carry of 0.9% and BE-yield change at -40/80bp



Source: Danske Bank

4: Sell Dec 2028 SGBi's vs. Apr 2030 DBRi's

- Long-dated SEK linkers still stuck close to all-time low real rates

- The end of Riksbank QE, which is set to occur in June 2019, is likely to put upward pressure on risk premiums in the long end – 10Y SEK real yields trade some 20bp from their all-time low, while nominal rates have risen by around 60bp.
- The 10Y spread vs DBRi's has tended to follow the policy rate spread – we expect the Riksbank to start hiking a year before the ECB.
- Long USD real rates have been trending higher, and have often been a leading indicator for long-dated SEK real rates.

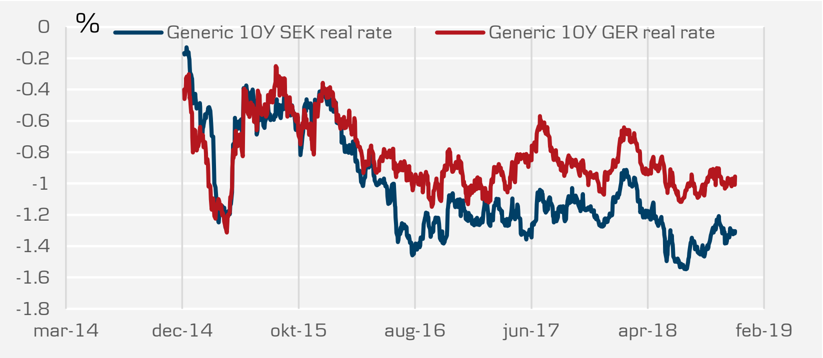
Conclusion

- Sell SGBi 3104 (Dec 2028) vs. DBRi 2030 at -53bp. P/L : -15/-70bp.

Risk factors

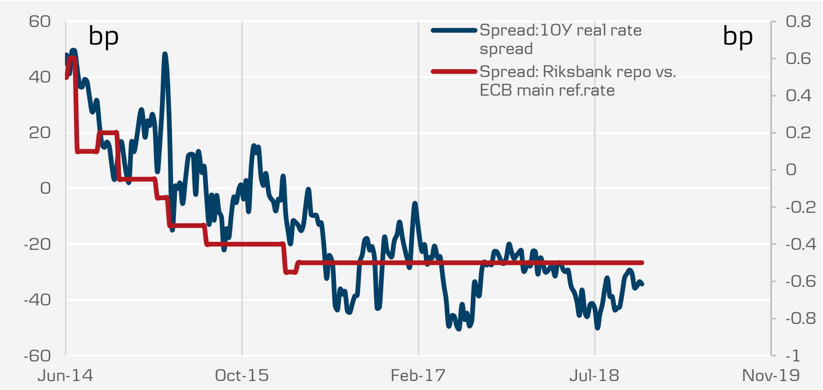
- Strong downturn in the Swedish economy that would force the Riksbank to abandon its plans to slowly normalise monetary policy.

Despite a nominal 10Y spread of +33bp, SEK 10Y real rates trade 36bp below corresponding German rate



Source: Danske Bank

The policy rate spread has tended to drive the 10Y spread in index-linked bonds



Source: Danske Bank

5: Pay 2Y2Y NOK vs euro and buy long-end NGB vs Bunds

- relative flattening vs international peers and 'currency demand' for long-end NGB's

- The FWD 3M Nibor curve is currently below Norges Bank's (NB) projection for end-2020 to end-2021. Market liquidity in the short-end is somewhat limited related to year-end effects, which in combination with a risk-off environment has pushed interest rates downward. We think the current low interest rates are inconsistent with the positive growth outlook for the Norwegian economy.
- International risk-off and limited liquidity have pushed Norwegian long-end NGB yields higher vs peers. NOK is excessively weak at present in the wake of the oil price drop and low interest rate spreads. We expect limited NGB supply in the long-end in Q1: NB probably seeks to create some pent-up demand ahead of potential syndication of a new NGB benchmark in Q2. We see long-end spread tightening vs international peers.

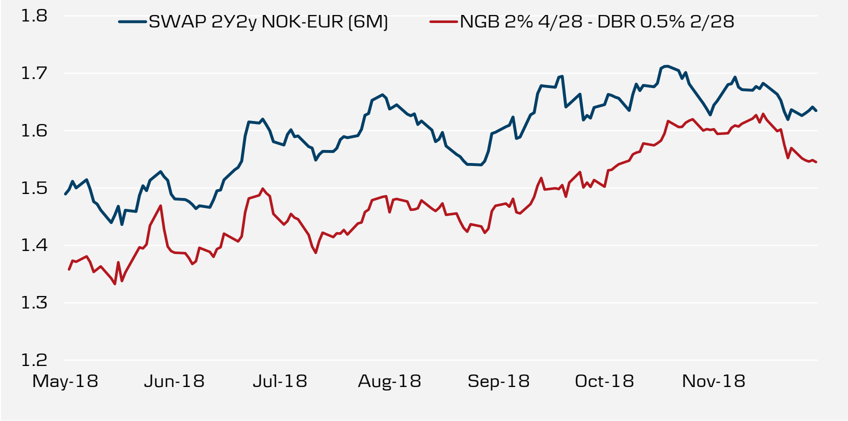
Conclusion

- Pay NOK IRS 2Y2Y and receive EUR IRS 2Y2Y both vs 6M and buy NGB 2% 4/28 and sell DBR 0.5% 2/28. Current relative steepness -7bp. P/L-30/10bp.

Risk factors

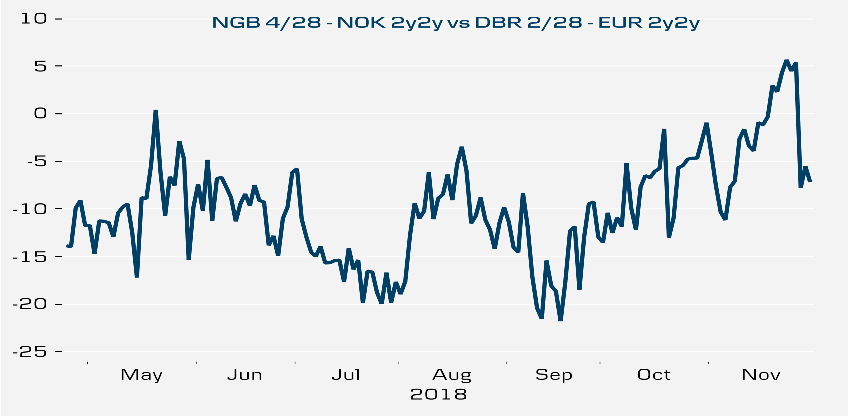
- Oil price drop or a housing market slowdown.

Pay NOK IRS 2Y/2Y and receive EUR 2Y/2Y and buy 10Y NGB vs Bunds, %



Source: Danske Bank

NOK IRS 2Y/2Y vs NGB 10Y steepness relative to German equivalent



Source: Danske Bank

6: Long 5Y Spain versus 5Y France
- supported by net issuance spreads and healthy carry

- Spain has been repriced against France despite better fundamentals in Spain. However, there has been some spill-over effect from Italy as well as the ECB is scaling down on QE. We are back to levels seen in late 2017/early 2018.
- If we look at net issuance in 2019 (slide 11), both Spain and France show a decline, but seen relatively, the net issuance will decline more in Spain than in France.
- There is significant roll-down on the Spanish curve relative to the French curve, as shown in slide 13. There is more than 100bp additional carry in 5Y Spain relative to 5Y France. In the other segments it is more like 50-60bp.

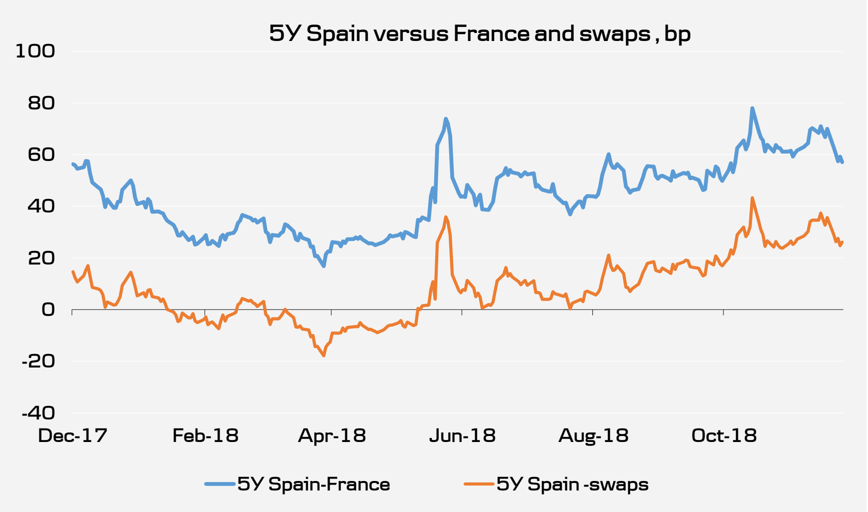
Conclusion.

- Buy SPGB 3.8% 30/04/2024 @ 0.66% versus FRTR 2.25% 2.25% 25/05/2024 @ 0.01%. P/L 40bp/80bp. Carry 110bp/yr.

Risk factors

- A surprise in the funding requirement in Spain for 2019, where funding for the Social Fund is increased and net funding is raised from EUR30bn to EUR45bn in 2019. Renewed problems in Italy, which could have some spill-over effects to Spain.

5Y Spain versus 5Y France and swaps, bp



Source: Danske Bank

Spanish macrofundamentals (growth, deficit and current account) are better than France's

		GDP forecast, %			Budget deficit, % of GDP		
	10Y yield	2017	2018	2019	2017	2018	2019
France (AA)	0.72%	2.2	1.7	1.6	-2.6	-2.6	-2.8
Spain (A-u)	**1.55%**	**3.1**	**2.6**	**2.2**	**-3.1**	**-2.7**	**-2.1**
EU (AA)	0.83%	2.4	2.1	1.9	-0.9	-0.6	-0.8

Source: EU Commission, Danske Bank

7: Long 10Y Finland versus 10Y Denmark

- positive carry and no ‘buy-back’ support to 10Y DGB

- 10Y Danish government bonds have performed well relative to EU peers such as Netherlands, Finland and Austria. The performance has been driven by the modest issuance and a significant buy-back from the Danish Debt Office in the off-the-run DGBs, as shown in the chart on the right.
- However, this will change in 2019 as the government will spend its money on buying govt. guaranteed mortgage bonds rather than DGBs. Hence, the buy-backs are likely to decline significantly in 2019.
- Furthermore, looking at DGBs relative to Danish mortgage bonds, mortgages offer much better carry now relative to the start of 2018.
- Finally, if we look at the 12M carry on a 10Y DGB relative to EU peers, the Danish government bonds look expensive today compared with a year ago - as shown in the table to the right.

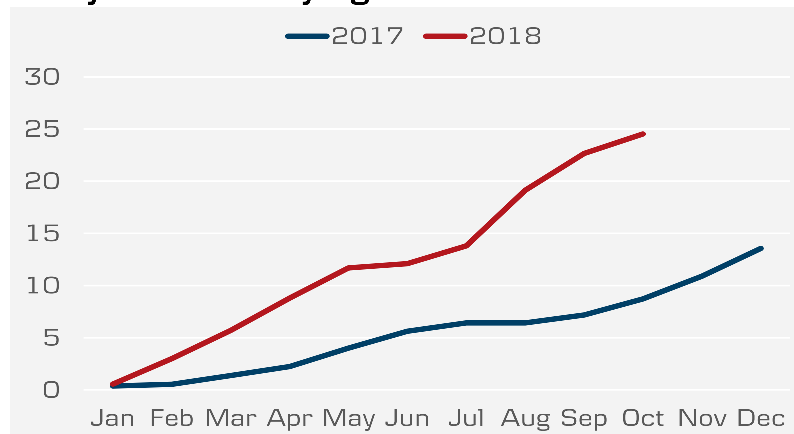
Conclusion

- Sell DGB 0.5% 11/27 and buy RFGB 0.5% 09/28 @ 34bp 0.59%. P/L 25bp/41bp. Carry 14bp/yr.

Risk factors

- Risk-off sentiment and strong Danish public finances, where the Debt Office increases its purchase of DGBs. Budget slippage in Finland.

The Danish Debt Management office has been very active in buying back DGBs in 2018



Source: Nationalbanken, Danske Bank

Danish government bonds have negative carry relative to EGB’s in 2019 relative to 2018

	12M carry		Excess return DGBs	
	Today	-1Y	Today	-1Y
Denmark	1.23%	1.52%	0.00%	0.00%
Germany	1.08%	1.35%	0.15%	0.17%
Netherlands	1.21%	1.42%	0.02%	0.10%
Finland	1.37%	1.51%	-0.14%	0.01%
Austria	1.33%	1.48%	-0.10%	0.04%
France	1.33%	1.46%	-0.10%	0.06%
Spain	2.21%	2.38%	-0.98%	-0.86%

Source: Danske Bank

8: The ultimate carry trade: 10Y-30Y Steepener 5Y Forward

- Bunds range-trading speaks in favour of carry trades

- Our traditional carry strategy 10Y-30Y 5Y forward steepener is again trading in negative territory as we enter 2019.
- There is still a wide gap up to the spot curve as the 10Y-30Y slope of the EUR swap curve is trading at 60bp.
- The 10Y-30Y 4Y forward is trading at +5bp. On only a few occasions has it been negative in the past three years. The most negative level of the 10Y-30Y slope 4Y forward has been -6bp.
- The level for the 10-30Y slope 5Y forward has been stable for the past 3 years, at between -14bp and +5bp. Currently, we are very close to the average level seen over the past 3 years.
- The trade offers some diversification for long-only investors with significant exposure in the 30Y-35Y segment of the curve as it performs well in a steepening scenario.

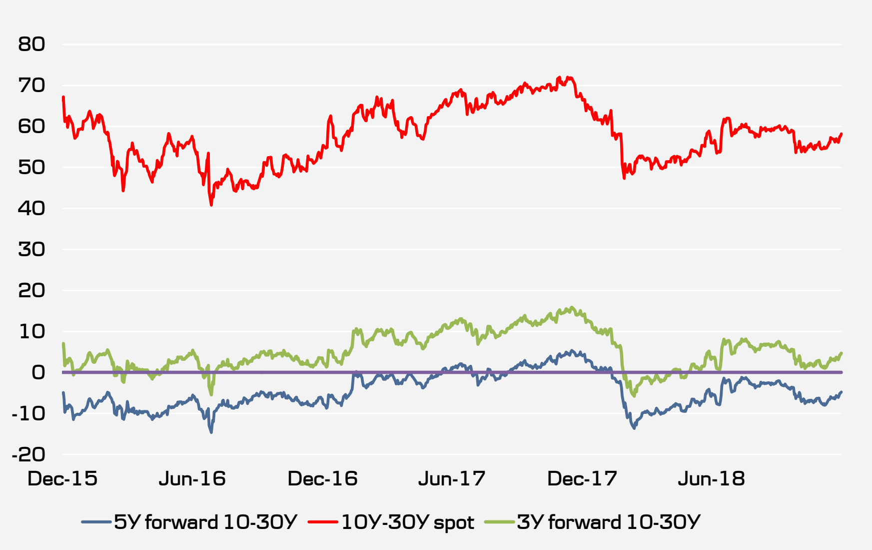
Conclusion

- Pay 5Y30Y EUR swap and receive 5Y10Y EUR swap @-4bp. Target 4bp. Loss -10bp. Carry 9bp/yr.

Risk factors.

- A significant flattening of the curve.

The slope of the 30Y-10Y EUR swap curve – spot and forward



Source: Danske Bank

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Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Arne Lohmann Rasmussen (Chief Analyst), Jens Peter Sørensen (Chief Analyst), Jostein Tvedt (Chief Analyst), Jan Weber Østergaard (Chief Analyst), Carl Milton (Senior Analyst) and Daniel Brødsgaard (Analyst).

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Report completed: 3 December 2018, 19:20 CET
Report first disseminated: 4 December 2018, 07:00 CET