

13 December 2018



Trade Idea: Long NZGB 2029 vs. Pay Swap

- **NZGBs have sharply underperformed swaps over the past week.**
- **We think NZGBs should outperform swap into year-end, given the pause in tender issuance of NZGBs from next week. This has been the historic pattern.**
- **We continue to see the supply backdrop as supportive of NZGBs and outperformance vs. swap, especially heading into the maturity of the Mar-19s. Net issuance of NZGBs is forecast to be negative in 2019.**
- **We enter a long position in NZGB 2029 versus matched maturity swap at an I-spread of -31bps. We target a move to -42bps, and set a stop loss at -24bps.**

Strategy	Entry	Exit	Stop	C&R (1m)
Long NZGB 29 v swap	-31bps	-42bps	-24bps	flat

After reaching new wides just over a week ago, swap spreads have snapped back over the past week (see Chart 1). The long-end of the NZGB curve has led the underperformance over the past week. The 2020s swap spread is unchanged over the past week, the 2027s have tightened 8bps and the 2037s have tightened 10bps (see Chart 2). The 2027 swap spread has approached the target levels we [highlighted](#) last month.

We think part of the reason for the underperformance of the long-end of the NZGB curve may have been related to the market pricing a risk that New Zealand Debt Management (NZDM) might have announced its intention to syndicate a new long-end bond today. A long-end syndication would have meant a lot more duration for the market to absorb over the next six months.

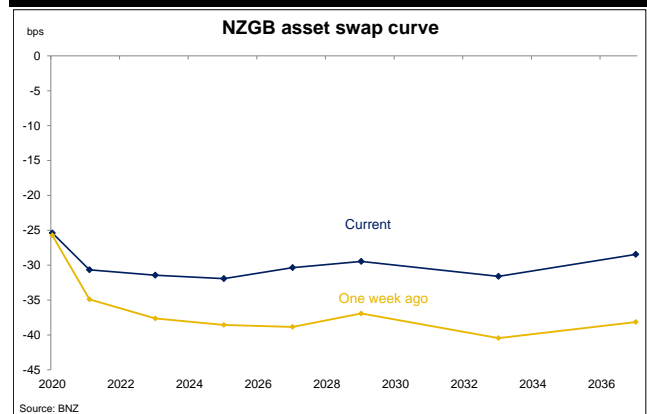
We think the risk-reward favours NZGB outperformance vs. swap (i.e. swap spread widening) from present levels:

- With NZDM choosing to stick to tender issuance over the next six months (i.e. no bond syndication the next six months), we expect the moves in swap spreads over the past week to at least partially unwind;
- The last tender of the year is tomorrow before issuance pauses until mid-January. Swap spreads have had a seasonal tendency of widening in December, probably related to this pause. We expect the tender of 2029s tomorrow to be strong.
- Net issuance of NZGBs and T-bills is forecast to be negative this fiscal year. Swap spreads have tended to widen into previous bond maturities, and we expect a similar movement into the Mar-19 maturity.
- Our model puts fair value for 10 year swap spreads around 45bps (i.e. an I-spread of -45bps).

Chart 1: NZGBs underperformed swap over the past week



Chart 2: Long-end has led the swap spread narrowing



We had initially targeted buying the 2027 NZGB vs. swap, but now have a marginal preference for the 2029s. The 2029s have cheapened up relative to the 2027s on an ASW basis since the end of last month. There will be consistent supply of the 2029s next quarter (\$250m per tender), however, that hasn't been an impediment to performance over the past six months.

As discussed in our previous note, the main risks to the position are (a) an increase in foreign selling of long-dated NZGBs from offshore (b) a global-led rates sell-off, with swaps lagging bonds on the move. However, as things stand, we think there are more convincing arguments for NZGBs to outperform swap from here. While we haven't quite achieved our target entry levels, we still see an opportunity to position ahead of the last tender of the year tomorrow. We set a target of -42bps in the 2029 I-spread, with a stop loss at -24bps.

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