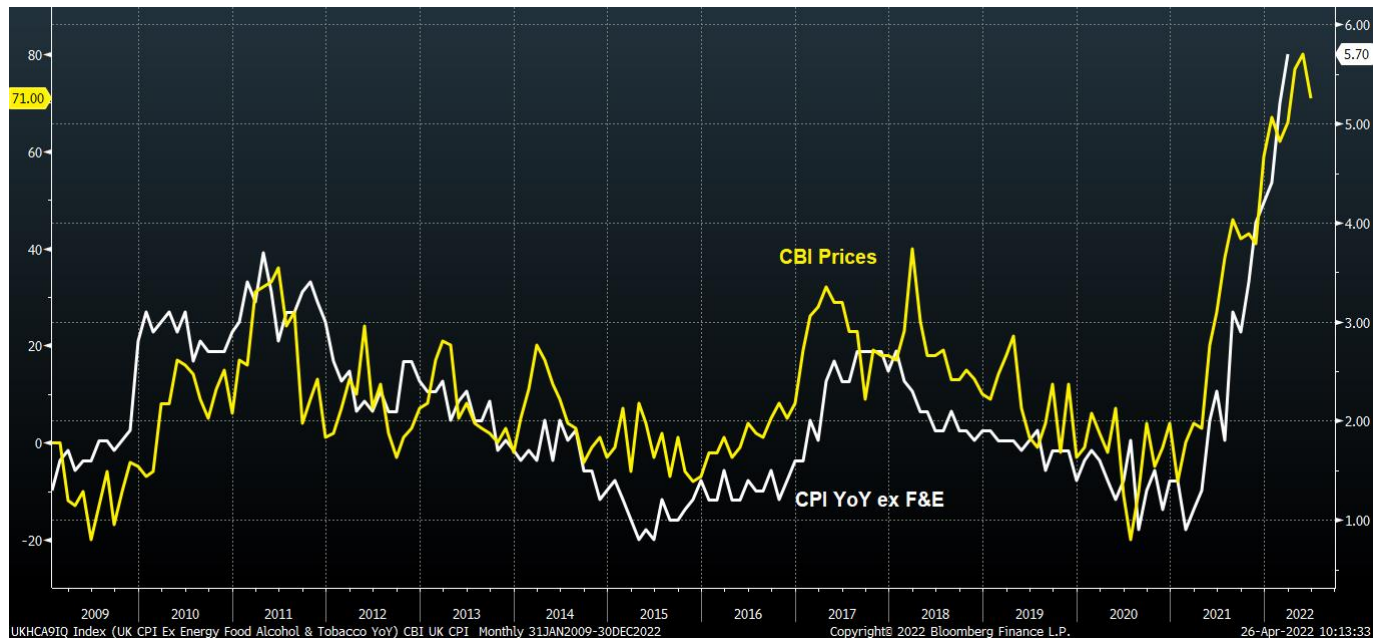


MI2 Trader: Fading UK Rates

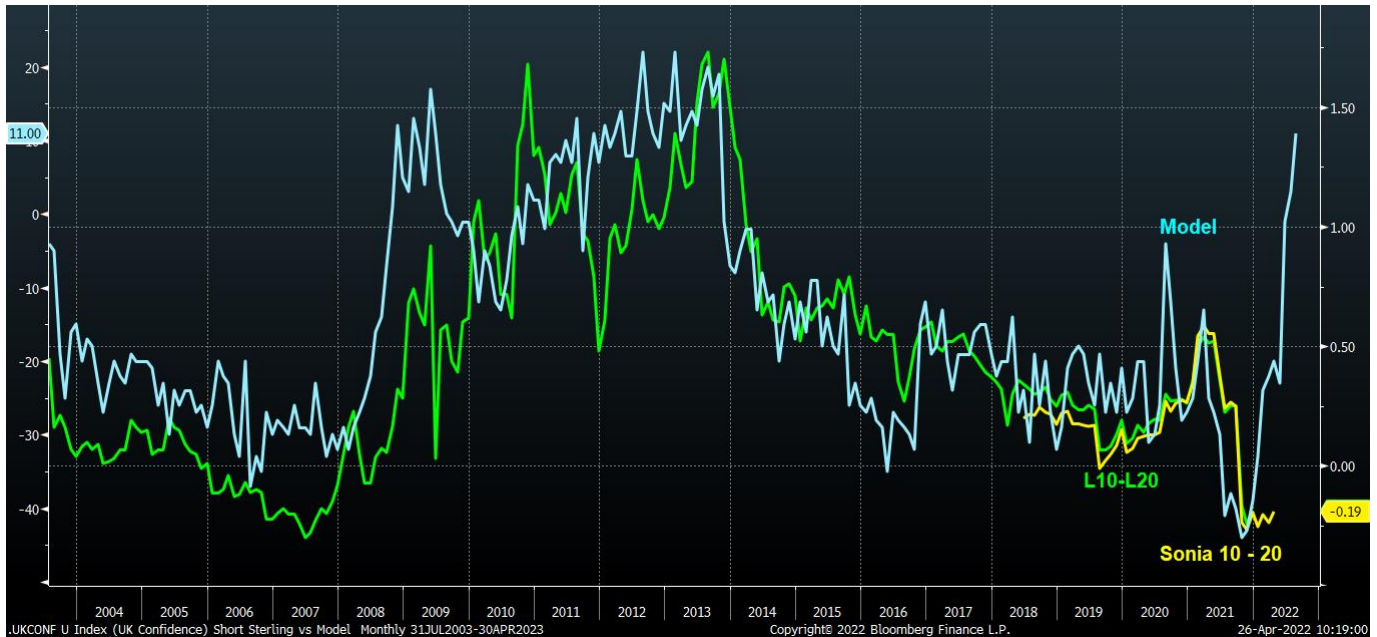
26th April 2022

Comment

With inflation skyrocketing, markets are logically questioning the resilience of consumers and how central banks will juggle their mandates without upsetting their political paymasters and the electorate. Front and centre of that debate is the UK, where the currency certainly suggests that the BoE will struggle to achieve this delicate balance. In terms of rates, we expect a fourth hike next month. But beyond that, things may get a little more complex as the Old Lady tries to find a level of rates that doesn't add to the consumers' woes and raise the risk of recession, yet prevents inflation from becoming ingrained. The good news is that for now, at least, and until the full impact of Ukraine-induced prices filters into the system, our work suggests a respite in inflation's surge.



This lull may enable the Bank to take a pause. If they do, our models, which have deteriorated at an unprecedented rate, suggest that UK rates may be ripe for a correction. In particular, the 2yr vs. 5yr part of the curve, in this case, proxied by the rolling 10th vs. 20th 3-month Sonia, is far too flat. To put that into perspective, if we use the old short sterling contracts, the spread is within spitting distance of the absolute lows achieved in 2007.



Trade

Buy Dec 23 Sonia (SFIZ3) with an initial target of 98.50, where there is a gap and possibly even 99.00 if equities or UK consumers really get into trouble. We would set the stop at 97.10.



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