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Rates Daily: More to come

While the pop in equity markets is welcome, it’s but a veneer smoothing over ongoing plumbing issues under the bonnet of the financial system. Europe is closer to getting the ESM involved, where Italy would be the main beneficiary as the door to ECB OMT purchases opens.

Waiting for the medicine to work

The US Senate reached an agreement on the third coronavirus relief package in the wee hours of the night. The measures reportedly add up to over $2tn, roughly 10% of GDP, and comprise income support for households, loans to companies, tax deferrals, and additional funding for the health sector.

The bounce in equity markets was fully warranted yesterday. At the very least a tip of the hat from equity markets to the official sector was overdue; there is no doubt that the Federal Reserve and other central banks have stepped up alongside governments to soften the blow coming from the macro shutdown.

That said, signs of angst are still very evident. High yield has continued to struggle. And Libor elevation too is a sign that the system continues to struggle. That’s down to the market plumbing, and partly on ongoing perceived pressure on the banks to provide excess credit lines to corporates and other players that find themselves in a stressed state.

The issue here is it takes time for the initiatives the Fed has set up to take real effect. The SPV structures to support short dated primary lending and secondary market credit will need some time before they are fully operational. Even the commercial paper support programme announced in the previous week is not fully functional. Things should improve as these facilities do get fully up and running.

Each part of the Fed's rollout has a clear target agenda. If the Fed is buying or supporting an asset class then something has most probably gone wrong there. So, the Fed's mortgage-backed buying programme announced at the weekend was not by chance; the trail leads back to stressed REITs which have found themselves in a panic client-driven liquidation of mortgage backed bonds.

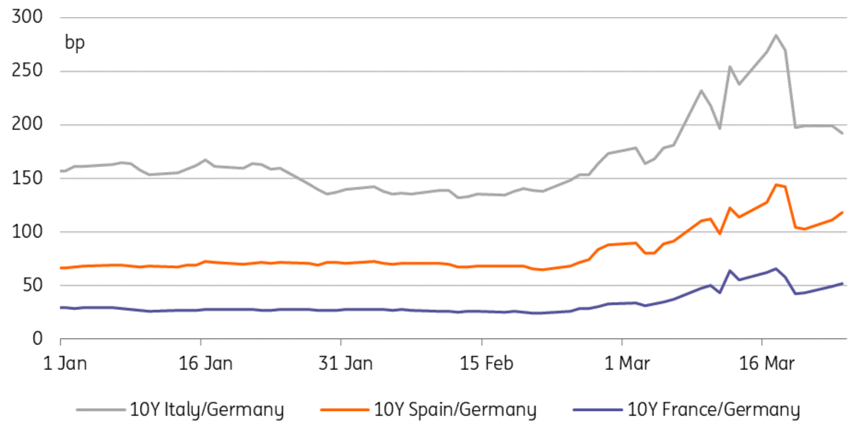
Want to know where the stress is? List off the Fed's focused rescue programmes to date, and there it all is.

ESM credit lines in the making

In Europe a risk remains of additional debt issuance sending ripples through government bond markets. But one eye will stay on the discussions surrounding the involvement of the European Stability Mechanism (ESM), as this would also raise the prospects of bond purchases via the ECB's OMT. A consensus seems to be forming around offering all countries precautionary credit lines worth 2% of each country's GDP. A sticking point is the conditionalities attached to the credit lines. EU leaders are expected to reach a decision tomorrow.

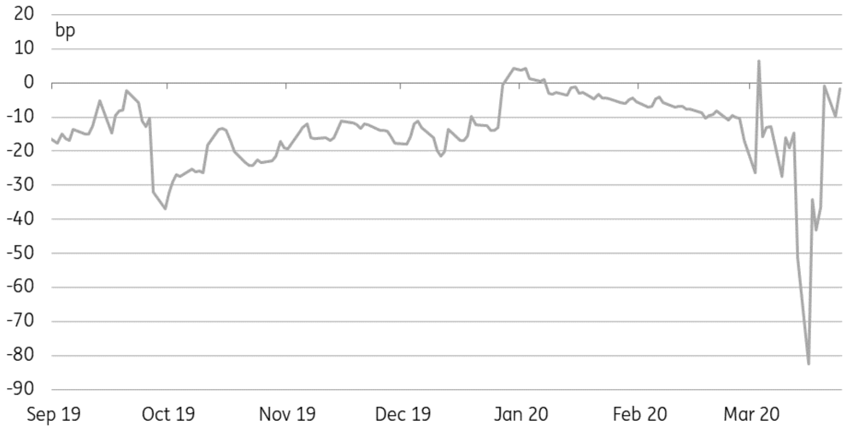
Government bond markets have seen one clear outperformer since the start of the week: Italian 10Y bonds have tightened by more than 7bp versus Germany, while Spanish peers have widened by more than 14bp. To be fair Spain was in the market yesterday selling a new 7Y bond. Demand for the transaction was large with order books topping €36bn and €10bn eventually sold. Attractive pricing and the backing of the ECB via its increased asset purchase envelopes should have provided the necessary incentive.

10Y government bond spreads versus Germany



Source: Bloomberg, ING

3m USD/EUR cross currency basis



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