

## Rates Spark: A game of two halves

The ECB tomorrow should bring an early end to a busy supply slate in EUR. We think this will bring a bull-flattening of the EUR curve. The re-tightening of sovereign spreads is justified.



European Central Bank HQ, Frankfurt

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### Overnight: sovereign spreads under control

Conte survived a confidence vote in the senate yesterday evening, allowing him to stay on as Italian PM. The 156 votes he tallied fell short of a 161 absolute majority. This precarious situation might call for a reshuffle of his cabinet but the threat of elections before the start of the white semester in August is looking ever more remote.

Bloomberg is quoting sources inside the ECB as saying the central bank is conducting its asset purchases with specific sovereign spread targets. The central bank has never admitted to such fixed targets but has highlighted many times that it sought to keep the average yield on Euro government bonds low outright and against OIS. On balance the two stories give a political and monetary rationale to the re-tightening in Italian spreads this week. We doubt the ECB will confirm the Bloomberg story, indeed a denial might emerge soon, but the ECB's role in suppressing spreads volatility will remain, and so the incentive to move into higher yielding bonds.

## A game of two halves

The approaching ECB meeting tomorrow should bring an early end to this week's busy supply activity, at least for most EUR deals. For instance, we now expect the EU's next 7Y/30Y dual tranches deal to only take place next week. As we stressed earlier, the amount of duration on offer has been significant, culminating in the sale of €7bn 50Y French debt to investors, and explaining the weakness at the EUR long-end.

We expect EUR rates and government bonds to recover from this supply-induced weakness after this morning's 30Y Germany auction. This is not strictly speaking the last sale of the week but we do not expect tomorrow's French (focused on the front-end) and Spanish (more likely to weigh on spreads) auctions to be very relevant for the EUR long-end. The strong demand at the French 50Y syndication reinforces our bullish view on the long-end. With a longer timeframe in mind, it also reinforces our view that more issuers will want to tap into this pool of demand.

## Today's events and market view

This morning's Eurozone CPI is a final release so unlikely to register in price action in our opinion. The sole release of interest in the afternoon is the US NAHB housing index. We expect the housing market to remain one of the bright spot of the US economy thanks in part to low mortgage rates.

Issuance also slows down with only 30Y Germany auction to report in Europe. The US Treasury will sell 20Y T-bonds.

Easing supply pressure and the approaching ECB meeting should help EUR rates retrace their recent rise in our view. We regard USD rates as equally range-bound going into next week's FOMC meeting.

## Authors

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

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