Rates Spark: a world of caution

A beginning of the end for the pandemic is pretty much priced in in our view. Central bank caution exemplifies why rates upside risk appears to be no concern to investors.

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More balanced news overnight

The latest series of Covid-19 restrictions were announced in the state of New York but a drop in the French hospital bed and ICU occupancy rates did help balance the mood. Bond futures did push higher in the Asian session but without taking yesterday's high. Implied rates remain close to their lowest level in two weeks.

Fed speakers voiced a range of opinions overnight about the necessity for more fiscal support. Bullard stood resolutely outside the consensus, hailing the US economy's resilience and the recovery in market-based inflation expectations. Williams was more cirumspect.

Central banks lean against rates upside

The dominant theme in the market is unlikely to change much but this week has brought significant data on how rate investors think the prospect of vaccine distribution will affect the outlook next year. Our conclusion is that, by and large, markets have already internalised significant progress in fighting the pandemic in 2021. It is possible that good news, in particular regarding the AstraZeneca/Oxford vaccine effort reinforce this state of play, but we would go as far as to say that this is already in the price.

Instead, we think the focus in the coming days should be squarely on the economic damage wrought by the pandemic and its longer-lasting impact including, but not limited to, long term unemployment, defaults, debt overhang and so on. To be sure, central banks are aware of the risks. Recently the contrast between vaccine optimism and central bank caution was striking. It is that very caution that is capping rates upside.

There is little new economic information to be gleaned today but the flurry of central bank comments should help confirm this view. The most likely path for rates in this context is lower, at least until tentative signs of a stabilisation in the number of cases allows markets to focus instead on a lifting of distancing measures. It is perhaps less intuitive to expect higher yielding (that term looks less and less appropriate) sovereign bonds to perform given current angst, but this is will continue unless investors have ground to doubt the ECB's resolve.

Today's Events: Spain and France supply

Spain (6Y/7Y) and France (3Y/6Y/7Y) are selling bonds today, although the duration amount will be limited.

US jobless claims and existing home sales are the highlight of the economic calendar. There is a profusion of central bankers' speeches scheduled today, including Lagarde's EU parliament hearing.

EU leaders will take part in a video conference today to discuss the EU's pandemic response. It is also likely the EU recovery fund will be discussed after two member states, Poland and Hungary, said they will veto the proposal.

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