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Rates Spark: still counting

The new political landscape may well prove supportive for risk assets, but USD rates are justified in staying low. We also see downside risk for GBP rates, as the BOE out-doves markets and the economic outlook worsens.

Overnight: still counting, Fed unchanged

One would be hard pressed to find any difference between the September and November Fed communications. Rates were left unchanged, and so was the pledge to continue bond purchases at the current pace. The central bank discussed its Quantitative Easing (QE) programme but (slim) hopes of an increase in the average maturity were disappointed.

As our economics team highlighted, this is hardly a surprise with votes still being counted in four states. Trump's lead in Georgia and Pennsylvania has shrunk further overnight. As things stand, Biden needs to win only one of the remaining states (the other two are Nevada and North Carolina) to be elected.

There was hardly any market move overnight. Risk assets held on to their gains.

Silver lining or sweet spot, USD rates to remain low

As the US election vote proceeded at a snail's pace over the past two days, we observed a shift in the dominating narrative in financial markets. It seems that risk assets have used that time to come to terms with a Biden 'lame duck' presidency, and some have even hailed it as the sweet spot in terms of removing a key risk on trade (Trump) while greatly reducing the risk of tax hikes (in case of a "blue wave").

As our colleagues have highlighted in our post-US election market reaction summary, there is even a silver lining in disappointed fiscal support hopes. With a more parsiminous Republican senate (assuming the Georgia run-off delivers a Republican majority), odds of a step-change in growth expectations, and therefore of higher rates, are greatly diminished. This is good for rates-sensitive asset classes, and for carry trades.

A further relief rally in risk assets can act as a brake on the move lower in rates, but we think downside is still prevalent. Our economics team has a lower than consensus call on today's US job report, and we argue that the US election has somewhat directed attention away from the covid epidemic. The resulting price action we envision for USD rates into year-end is a muted one, at least until the economic outlook brightens and a vaccine is distributed.

Adding to the case for lower GBP rates

The Bank of England (BOE) is the latest central bank to add to the case for lower rates. Yesterday morning it "out-doved" consensus and delivered a £150bn QE increase compared to £100bn expected. Market reaction might have seemed surprising with Gilt yields ending the day higher. To be sure, the influence of USD rates (see above) was felt after the strong rally earlier this week. There was also a fair amount of disappointment at no further signal being given on negative rates. As we have highlighted previously, cutting rates below zero would have a greater impact on long-dated yields than QE.

That disappointment may only be temporary. As our economics team highlighted, downside risks to the economy might require further support from the central bank. There is no certainty as to what form it may take but by next year, the BOE consultation on negative rates would have concluded. There is also a fair amount of Brexit optimism that has chipped away at market confidence that rates will move below zero. Our base case is still for a deal to be reached but we feel a fair amount of this is priced in already.

Today's events: US job report

The US job report dominates an otherwise quiet economic agenda. September industrial production releases from Europe are the other notable item.

Italy carries out a bond buyback operation this morning, of 5 short-dated issues.

Holzmann, from the ECB will be speaking.

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