

Rates Spark: Bond spreads return to the spotlight

French government bonds led a rewidening of eurozone government bond spreads versus Bunds as political uncertainty looms large again. But the wider fallout looks more contained, with Bund ASWs only moderately wider and ECB pricing little changed. We think US data will remain relevant for direction, biased to the upside this side of the Fed and CPI data



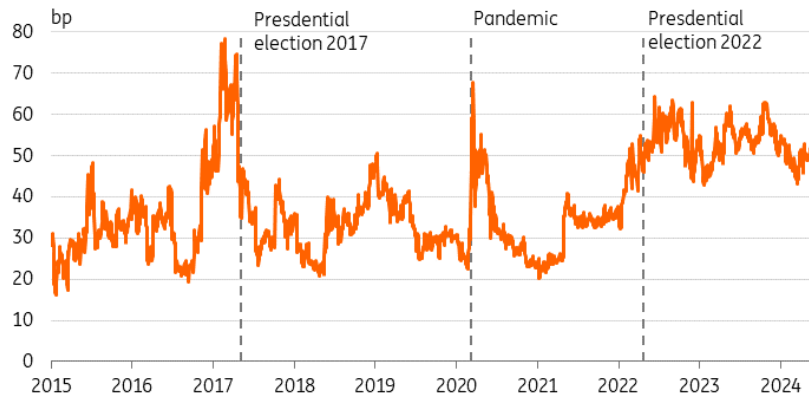
National repercussions of EU vote widen European bond spreads

Monday was all about digesting this weekend's news, starting with a shift towards Eurosceptic parties in the EU parliament and then French President Emmanuel Macron calling for an election. At face value, the changes in the EU parliament will not have a material impact in the near term. But we do think that the shift to the (radical) right at the national level could have repercussions on the eurozone economy and financial markets. The French elections are therefore the next event to look out for.

Notably, the market impact was felt mostly in sovereign spreads, where 10Y French bonds

widened by more than 7bp versus German Bunds. The widening was not confined to France however, but observed across the entire EGB space to varying degrees. 10Y Italian spreads widened by close to 7bp, Spain's still by over 4bp. These moves are a reflection of the heightened uncertainty in the weeks leading up to the French elections on 30 June and 7 July, and additional compensation investors now demand to hold spreads risk. However, the overall flight to safety usually observed amid spread turmoil was very muted. Bund spreads versus swaps did widen, but not materially so - while at their widest since late May at 25bp, we are still eyeing levels closer to long term lows.

French yields spreads over Bunds widen amid political turmoil



In outright terms, Bund yields continued to rise, with the 10Y extending its ascent from last week and climbing toward 2.68%. But the short-end of the curve remained anchored as markets also did not get anything from yesterday's European Central Bank speakers that would give them any feel for further ECB cuts.

While underperforming versus US rates yesterday, we see reason for euro markets to also rely on the US for direction. Leading up to the Federal Reserve meeting, the US CPI number on Wednesday will be the number to watch. In our view, a consensus reading of 0.3% month-on-month for core CPI is not a number that market should be happy about and we therefore have a continued bias for yields to nudge higher in the short term.

Tuesday has a fair bit of bond issuance lined up, so this pressure may continue a bit longer. Certainly in the US where a soft 3Y Treasury auction already added upside pressure on yields last night and now a 10Y tap looms large today. The eurozone and the UK also see their fair share of supply via government auction, supra and Gilt syndications.

Today's events and market view

No notable data from the eurozone, but we do have plenty of ECB speakers. Monday's speakers were unable to move markets, but perhaps Francois Villeroy from the Banque de France or Robert Holzmann from the Austrian central bank will have more to tell us. From the US, we have the NFIB Small Business Optimism indicator, which is not considered tier one data and markets will likely remain in a holding pattern for the CPI numbers on Wednesday.

Plenty of issuance expected. The EU has a syndication lined up for a new 15y issuance

estimated for €7bn. Eurozone auctions include a Dutch €2bn 10y DSL and Finnish 10y and 31y RFGBs for €1.5bn. From the UK we also have a syndication, with new 10y Gilt estimated for £10bn. The US will auction a 10y Note for a total of \$39bn.

Author

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.