

Rates Spark: Building credibility

Bund yields decline again, just as the ECB needs to build credibility in its new efforts. But as struggles with the vaccination rollout and high infection rates sour general sentiment in the EU, the part played by ECB buying is hard to untangle. The curve feels supply pressure, but contained intra eurozone bond spreads are encouraging.



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More bad news on vaccines blurs the impact of the ECB's efforts

After its meeting last Thursday, the European Central Bank now has to build credibility in the announced measures and show that they are enough to reach the stated aim of maintaining favourable financing conditions. For now it cannot rely on the buying data to speak for itself. Yesterday's latest weekly data on net purchases of €14bn under the pandemic emergency purchase programme (PEPP) only reflects trades executed before the ECB's meeting.

The part the ECB plays in this latest yield drop is difficult to untangle

After eyeing the upside initially, 10Y Bund yields dropped to -0.34% yesterday, a tad below levels just prior to the ECB meeting. The part that the ECB plays in this latest yield drop is difficult to untangle, with no indication of the volumes at hand. General market sentiment souring and pulling equities lower as vaccination progress in the EU is hitting more stumbling blocks amid rising infection rates will have also pushed rates lower. The concerns surrounding the Astra Zeneca vaccination not only delay the rollout, but could risk public credibility in the vaccines and reduce the willingness of people to get vaccinated in the first place. And it adds to the general theme that the Eurozone is lagging behind in the recovery from the pandemic.

Supply adds to EUR 10s30s steepening pressure

The 10s30s swap curve has inched steeper towards 41bp, extending its recent dynamic and reaching its highest since last February before the pandemic hit. However, here the ECB has to contend with the announcement of the new green OAT out of France. It was announced with a 2044 maturity, slightly longer than the 20Y the markets had anticipated.

Containing EGB spreads is something we can clearly lay at the feet of the ECB

In intra eurozone bond spreads over Bunds we saw mild widening pressure. 10Y Italy widening by a bit more than a basis point and France closely following is in line with the deal announcement. But, in general, spreads remain relatively contained and are brushing off the bad news on the vaccine rollout and in particular stricter lockdowns again in Italy. Containing EGB spreads is something we can clearly lay at the feet of the ECB and its announcement on faster PEPP buying. Indeed, spreads is where we should direct our attention in order to gauge the impact of the ECB's buying, next to the widening USD-EUR rate differential.

Today's events and market view

The data calendars offer little distraction ahead of the looming FOMC meeting tomorrow evening. In the US the focus is on the February retail sales data. A pullback after the bumper January figure boosted by the stimulus payments looks certain, with the winter storms adding a further downside risk. In Germany we will see the release of the ZEW today; expectations are for a further improvement.

While we think the effects will be transitory, we have stated before that the ECB buying at a larger clip should prove bullish for Bunds initially, especially in a phase where the central bank needs to build credibility after the initial announcement. And if not in outright yield levels, then it should at least manifest itself in wider spread differentials versus US Treasuries. Today we look for limited direction from the US itself though just ahead of the FOMC meeting and with another longer tenor UST auction lined up.

Supply in the Eurozone may well keep the 10s30s curve under steepening pressure with the green OAT likely today's business. Germany will sell €5bn in 2Y paper and Finland reopens 10Y and 30Y bonds for a total of €1bn. The US Treasury sells US\$24bn in 20Y bonds.

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