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Rates Spark: darkening near term outlook

Yields continue to grind lower as more warning signs flash about the near term outlook. The positive vaccine news now seems but a faint echo and not the game changer many hope it to be. Eurozone spreads appear to have eyes only for QE, shrugging off volatility and EU setbacks.

Source: Shutterstock

Overnight: the grind lower continues

Despite news that Pfizer has completed its vaccine safety review and will apply for FDA approval, government bond futures continued their rally overnight, pushing implied yields closer to our year-end forecast of -0.60% for 10Y Bund and 0.75% for 10Y Treasuries.

In a further confirmation that the near term shock from a broadening covid pandemic trumps the medium term outlook, Powell rung a characteristically cautious tone. He emphasised significant downside risks, saying the economy has a long way to go on its path to recovery. The Bank of England's Ramsden also stressed it was not clear whether vaccine news would change official economic forecasts. As we have stressed earlier, it has been a widespread assumption for a while that a vaccine would be deployed next year.

More warning signs flashing, also in the US

It is not just the Eurozone that is feeling increasing pain from the covid surge and, accornding to our economists, warning signs are also flashing in the US. Industrial production and retail sales data for October released yesterday still held up well, but the next months are very likely to get tougher. Containment measures are bound to become more widespread and will weigh on consumer spending going forward. "Core" retail sales excluding volatile auto, building material and gasoline sales are already softer. This chimes with indications from alternative real-time data such as credit card payments and mobility indices. Add to that the tapering of Federal unemployment benefits and expiry of state benefits.

> *More Fed officials might signal readiness to bridge the gap*

It not unsurprising to hear some voices at the Fed, such as Atlanta's Bostic saying the central bank may need to repurpose its instruments to get the help to where it is needed. Negotiations about added fiscal stimulus remain stalled in Washington, and more Fed officials might signal readiness to bridge the gap.

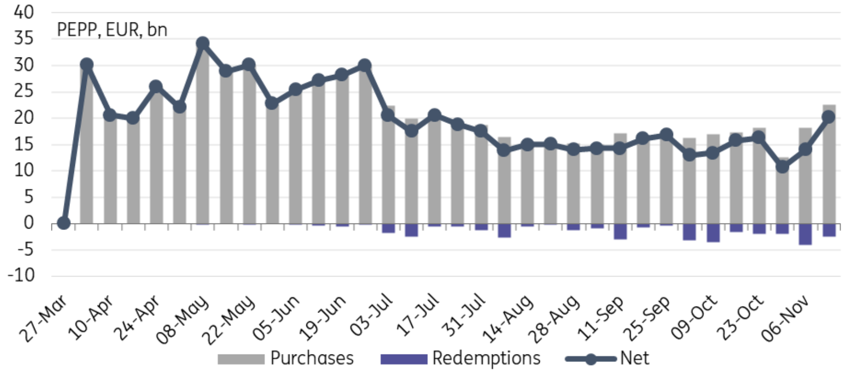
Eurozone spreads: eyes only for QE?

The volatility injected into markets by positive vaccine news has so far not impacted the tightening trend in eurozone government bond spreads. Political setbacks to get the EU recovery fund on the road have also not left much of a trace. The 10Y yield spread between Italy and Germany has remained below 120bp this week.

> *The near term focus remains on the ECB*

While clearly a disappointment, Hungary and Poland blocking the EU budget and EU fund may not have come as much of a surprise. But with payouts from the recovery fund only expected to commence in the latter half of next year in any case, the near term focus remains on the ECB. Here the central bank's determination to recalibrate the instruments in December still stands. And the positive vaccine news? This is not a game changer to the ECB outlook, as President Lagarde confirmed yesterday.

Weekly PEPP purchases increased to their highest since July



Source: ECB, ING

ECB officials have been very clear that their aim is to maintain stable and supportive financial conditions. Markets may well interpret this as a promise to also intervene in the near term, with asset purchases to smooth out market spikes. One may conclude that we have seen a bit of that last week already. Net purchases under the pandemic emergency programme (PEPP) increased to over €20.1bn last week, the highest volume since July.

€20.1bn net ECB purchases last week

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Today's events: 10Y Bund tap, Fed speakers

The data calendar is relatively thin, leaving the spotlight on Fed speakers later in the day as well as on today's supply in the form of a 10Y Bund tap for €3bn.

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