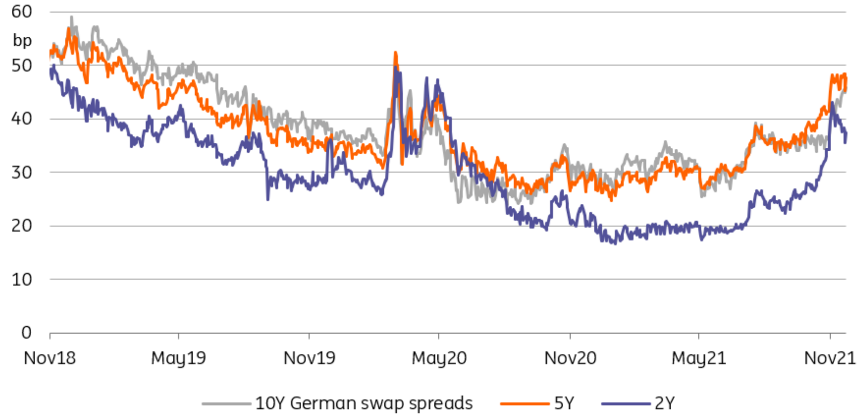
Rates Spark: Super Friday

Economic releases have an opportunity to get back in the driving seat today. Recent Fed comments have set the stage. Omicron seems to be delivering the bad news first, so safe havens will remain popular, and risk assets on edge

Bad news first: Omicron is spreading

The steady drumbeat of yet more Covid-19 Omicron variant infections, and of possible community transmission, continues. The number of large one-off reactions to those headlines is diminishing but the direction of travel is clear to us: risk sentiment is deteriorating. We think this is the correct path in the short run. Much of the hopes for an improvement in risk sentiment hinge either on the variant being milder than previous ones (something that could be offset by increased transmissibility), or on good vaccine efficacy. None of these is likely to be confirmed in the near term, leaving high-rated bonds with a steady underlying bid. This has kept EUR swap spreads on a widening path from already elevated levels.

Risk aversion is keeping safe havens in demand



Source: Refinitiv, ING

> *Markets conclude that a faster taper schedule would be implemented to leave room for earlier hikes*

This isn't to say that 'normal' markets drivers should be ignored today. Powell and his acolytes have raised the stakes this week by pushing in favour of an accelerated tapering timetable. The next chance for them to do so is in a little under two weeks. No one knows what the world will look like then but another strong jobs report today will reinforce that conviction. Markets conclude (probably rightly) that a faster taper schedule would be implemented to leave room for earlier hikes but next week's auctions should also add to volatility at the long-end.

A look at next week: US CPI and ECB talk

The Fed's quiet period will start this weekend but data will do the talking next week. Next Friday's CPI release is the most important by a long way. For context, the 6.2% October reading one month prior seems to be what has tipped the scales in favour of a faster taper pace at the Fed. Needless to say that a further acceleration (our economics team thinks headline inflation could have a 7% handle in the coming months) would only reinforce the market's conviction.

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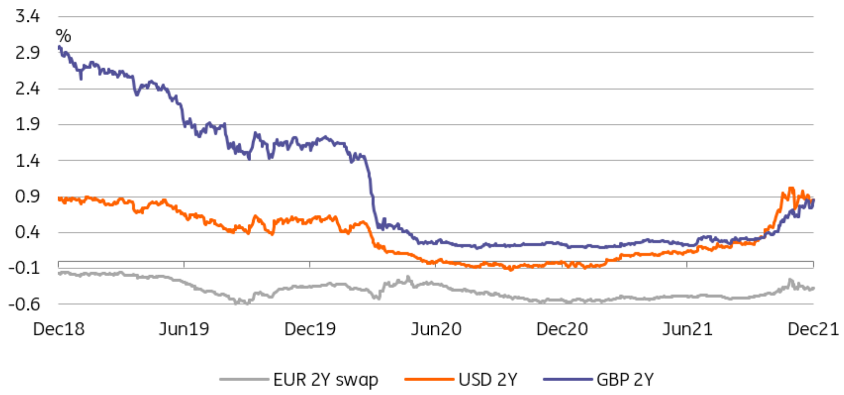
The front-end is already close to its most hawkish pricing configuration prior to the Omicron scare. The most likely driver for front-end to break above its recent range is in case of a CPI beat. But we could get there earlier. The risk of the new variant adding to, not subtracting from, the Fed's inflation worries was brandished by Mester in an interview overnight. Her concern is that a new wave would constrain supply further, while not necessarily dampening demand. If this is indeed the Fed's thinking, then an even flatter curve is in the cards.

Amid Covid-19 uncertainty, US CPI is most likely to push front-end rates higher



Source: Refinitiv, ING

The ECB's own quiet period only starts next Thursday so there is still space for governing council members to make their views known. One of the most interesting topics will no doubt be their assessment of the risks posed by the current Covid-19 wave. So far the tone has been relatively relaxed, although they could continue to flag it as a risk. Reading between the lines, piling yet more purchases on top of the ones scheduled for next year would reduce the ECB's room for manoeuvre next year if inflation continues to overshoot. This should keep risk assets on edge, and safe havens in demand. The upshot is wider sovereign spreads still.

Today's events and market view

In the morning, the release of the November PMI services for Europe will be the main event. Spain and Italy's reports are first readings but it is possible that the current Covid-19 wave, and additional measures it triggered, affect PMIs in other countries too. It might be too early for the impact to be fully felt however, and manufacturing PMIs earlier this week failed to register the new worries. This being said, services are more likely to be affected than manufacturing at this stage.

Christine Lagarde and Philp Lane, of the ECB, are both due to speak today. Markets will be paying particular attention to any sign that the Covid-19 wave is affecting their policy thinking. On the other hand, a repeat of the recent inflation comments, stressing upside risk to the ECB's forecast, would be unnerving for markets, especially if voiced by Lane, traditionally a dove.

The November US jobs report looms large on today's calendar with a consensus of above 500k job creation likely skewed higher by this week's other employment economic releases. This will not be the only important US data release however, with ISM services and factory orders also due.

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