# Rates Spark: Diamond hands

The technicalities from the FOMC minutes were more important than the taper reference. This Fed can take more control of the front end if they wish to. We think they will, and they should. Big players have a big stake, and rightly so.

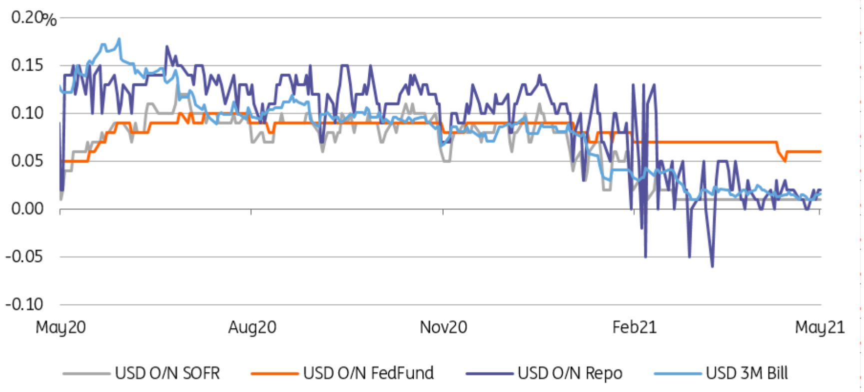
## FOMC minutes - some key nuances

There wasn't a whole lot in the April FOMC minutes to sway the macro debate. Some talk of tapering at some point was the feature picked up by the marketplace, but there was not a whole lot of substance to this. When there is a proper tapering discussion, it will happen when the economy is much closer to being healed in the labour market in particular; we are not there yet. The taper hint was enough to tempt both nominal and real yields higher though, which pushes in the same direction as the ongoing macro recovery narrative.

*Some coaxing upwards of rates remains a viable policy possibility*

The more interesting aspect to the minutes centres on more technical factors. It is clear that the Fed has been monitoring the progress lower in ultra front end rates e.g. SOFR at 1bp. The reverse repo facility at zero is effectively acting as a floor, preventing key rates from turning negative. The Fed is keenly aware that there is a negative rates environment out there for repo and front end bills. Some coaxing upwards of rates remains a viable policy possibility, through a hike in the rate on excess reserves, and on the reverse repo facility.

## Whether it likes it or not, the Fed has become a key player in the repo market




Source: Refinitiv, ING

Some permanence to the Fed's presence on the repo market was also a discussion point. In our opinion this makes eminent sense. The Federal Reserve, by virtue of its very elevated holdings of Treasuries, should be a key player in the repo market. By doing so the Fed has the capacity to both add liquidity and drain it at will. It would mean a controlling influence, but let's face it, that's the environment we live in these days. We're convinced that the Fed will want more control of the front end, and to be ready the next time we have crisis conditions.

## The Fed's diamond hands

A feeling of unease surrounding the froth in financial markets has been accompanying market participants for some time as they eyed lofty valuations in risk assets. For lack of alternative, and having the backing of the Fed’s steady guidance, that unease was often put aside, but sometimes it resurfaces.

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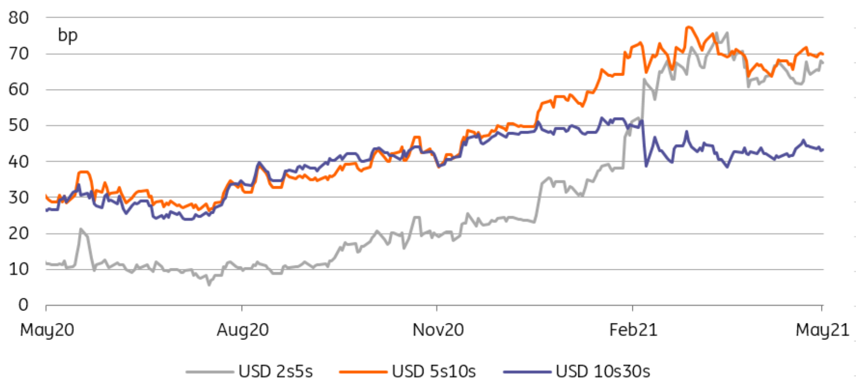
Yesterday markets took their cue from an unlikely corner in that regard. Crypto assets experienced an eyewatering collapse that stirred concerns over wider financial market stability, a more direct channel weighing on tech stocks. By the end of the day, the fall-out was contained and even crypto prices have recovered somewhat from their lows. In rates markets however the brief flight-to-safety has taken 10Y UST yields down 4bp from their peak yesterday, and it ended the rise in 10Y Bund yields that initially soared beyond -0.08% early in session.

In the end taking some of the froth out of financial markets might even play into the hands of the Fed that wants to see evidence of progress first before even thinking of altering its course - "diamond hands" that even Elon Musk will envy.

## Financial stability concerns have reinforced the USD flattening bias




Source: Refinitiv, ING

## EUR rates are back to (supply) business after crypto gawking

In EUR rates the focus should pretty quickly turn back to supply with France and Spain auctioning bonds today. Usually a transitory technical factor for rates valuations, supply has aggravated the upward dynamic in EUR rates of late.

As of now the increase in rates does not seem to have unnerved ECB officials who closely monitor the financing conditions to assess whether intervention is necessary. ECB VP de Guindos commented yesterday that the central bank would act if the rise in yields were unwarranted, but he felt comfortable about the present level of yields. While disappointing to those hoping to see a change of tune and very likely also not the end of the discussion, we agree with the assessment as the fundamental backdrop in the Eurozone has been improving amid the vaccine roll-out and the prospect of easing restrictions. We continue to see more upside with a 10Y Bund yield at 0% still likely this quarter.

## Today's events and market view

In the absence of notable data releases the focus in Eurozone markets remains on bond supply and ECB speakers. With ECB president Christine Lagarde and chief economist Philip Lane both appearing in public today markets are on the look-out for any hint that yield dynamics might unnerve the central bank.

In supply France is selling shorter dated bonds as well as a new inflation linked bond, overall for up to €13.5bn. Spain will sell up to €6bn. Overall the shorter maturity of today's sales should lessen the pressure compared to the past day's longer deals but absent warm words from ECB officials, the rise in yields should resume.

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