Rates Spark: Even worse before it gets better

Brexit will likely grab the headlines again, but the broad rally of core bonds yesterday signals it is not the only worry for rates markets. US stimulus talk is caught up by partisan politics aagin, and stubbornly high infection rates foreshadow more containment measures even as the vaccine roll-out has begun.

Source: Shutterstock

Overnight: Last-ditch Brexit maneuvres

EU's chief Brexit negotiator Barnier said yesterday that no deal was now the more likely than an agreement. In a last-ditch effort PM Johnson will travel to Brussels this evening to meet the EU's von der Leyen in a final attempt to reach a breakthrough. Contentious passages from the internal markets bill had been dropped earlier, but sticking points remain around the level playing field.

In the US it is still hard to gauge the odds of a fiscal stimulus deal emerging before the Biden administration is sworn in on January 20th, but a $916bn counter-proposal by Treasury Secretary Mnuchin highlighted that both sides remain far apart, even on matters such as the amount of the one-off cheque payment.

Price action in Asian hours saw an extension of recent trends, with EUR bond futures outperforming their USD counterparts, while stock futures pushed higher following Wall Street's lead yesterday evening.

Near term reality check

It appears that after the euphoria of the past week rates markets have taken a step back to realize that not just Brexit, but indeed multiple issues still cloud the near- to medium-term outlook. A significant rough patch still has to be overcome that underscores the continued dependence on fiscal and/or monetary intervention.

Infection rates and hospitalizations remain stubbornly high, to a degree that some countries like Germany are mulling stricter containment measures again. And while the roll-out of the vaccines has begun, it will still leave large groups of the population vulnerable to infection for some time. In other politics the EU should soon know whether it has to resort to a plan B on the recovery fund, with Poland and Hungary momentarily still blocking the current framework. Given the EU summit in the coming days this could result in a catharsis of sorts on the political front, although European politics have had a habit of extending deadlines. Turning to the US, the initial optimism surrounding the restart of stimulus talks is being caught up by partisan politics, which would put the onus on the Fed again.

As rates markets turn gloomier, that ECB will have a hard time eliciting a dovish market reaction when it unleashes further stimulus tomorrow as widely expected, even as we expect the package itself to be generous. That should certainly be true for outright yields, with the 10Y Bund now trading below -0.6%. However, government spreads still have some room to retighten with the 10Y Italy/Germany spread having rewidened to 120bp over recent days.

Today's events: Final German bond supply, funding plans

Germany will issue €3bn in a 2Y Schatz today, marking the final bond supply for the year.

Concluding the supply activities turns the focus to the release of bond funding outlooks for 2021. Belgium released its outlook yesterday, penciling in €36bn of bond issuance in 2021 after €44.5bn this year. The lower target for bonds is not solely down to a lower overall financing requirement, but also result EU SURE loans received. Looking ahead the Netherlands is scheduled to release its outlook on Friday.

Authors

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Disclaimer