

Rates Spark: Hello Brexit

Brexit risk is back at the forefront of European markets' worries, and threatens to remain there until at least this week's EU summit. Short-dated Sonia swaps have started pricing a Bank of England cut, but a move below zero is unlikely next week.



Overnight: not much progress

EU and UK teams remain far apart on the three remaining sticking points of their trade negotiations, according to a joint statement issued late yesterday. PM Johnson will travel to Brussels to meet EU Commission president von der Leyen. The House of Commons reinstated the controversial clause in the internal market bill but PM Johnson said it could be removed.

The lack of new significant development left bond futures close to their highs in the overnight session.

Brexit risk, another driver of rates divergence

After months of largely ignoring Brexit headlines, talks between the UK and EU are back at the forefront of international (ie non-GBP) investors' worries. With this week's EU summit approaching fast, no-deal Brexit is now a real near-term risk that threatens to add to an already worrying

macro backdrop for Europe, although this week's EU summit is likely not the final deadline for the talks. We expect Brexit news to remain relevant for EUR rates as well, adding another driver to our USD-EUR rates divergence view.

Translating this statement into a GBP rate view looks straightforward enough. The Gilt outperformance over EUR and USD counterparts should extend until more tangible signs of progress in the talks are made public. As is often the case there is a risk that this only occurs in the very last moment, in this case, just ahead of the December 10-11th EU leaders summit that should sign off on any trade deal.

December BOE in play? Not below zero

There has also been a noticeable drop in near-dated Sonia swaps (ie 1-3 months), in fact to their lower level since the series began. Earlier this year, when expectations of negative rates were rife, it was longer-dated Sonia forwards (ie 12-18 months ahead) that were typically affected. The recent move suggests that markets are starting to believe a no-deal Brexit could push the Bank of England (BOE) into emergency measures fairly quickly.

With the next BOE meeting being scheduled for December 17th, we would not wager that the central bank will have enough certainty about whether a deal is likely or not by that date. At a push, the Bank rate could be cut to just above 0%, but our economics team thinks ramping up the pace of QE purchases would be a more natural reaction.

Ramping up the pace of QE purchases would be a more natural reaction

It is less certain that the Bank will have concluded its review into negative rates policy (NIRP) by that date, as MNI reported yesterday. Be it as it may, a collapse in EU-UK talks would call for quick and aggressive action. It is debatable whether the BOE would refrain from providing the economy with the support it needs for that reason, but it has enough policy options to wait until the February meeting.

Today's events: Brexit Brexit Brexit

In between Brexit headlines, German/European Zew and US NFIB will provide some distraction.

The US Treasury will auction 3Y notes, followed by 10Y tomorrow, and 30Y on Thursday.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.