Rates Spark: hold your horses

Optimism is palpable, even in rates markets. We see any rise in interest rates as unlikely this side of the twin Fed and ECB meetings this week. Any failure to deliver new accomodation is likely to result in higher long-end rates in the second half of the week

Source: Shutterstock

Optimism abounds but hold your horses

Signs of optimism in financial markets are difficult to ignore. Besides the strength in equity markets that is hard (for non-specialists like us) to reconcile with dim economic prospects, indicators of financial stresses are also diminishing. Granted, we would be surprised if the declines in Libor and Euribor fixings were due to a return to 'normal' funding conditions for banks. What we can at least say is that central bank efforts to reduce systemic risks are bearing fruit, and that these continue to make exiting facilities more potent. The Fed's decision last night to make the Municipal Lending Facility accessible to a greater number of entitites, and lengthening the loans from 24 to 36 months, is the latest example of this.

The natural conclusion to draw from this optimism is that some of the risk premia embedded in USD and EUR rates should be priced out on account of the better risk appetite. Whilst we agree, this week's twin Fed and ECB meetings are a clear obstacle to higher rates. Taking one or two steps back, the economic outlook is as uncertain as ever and liable to significant downward adjustments.

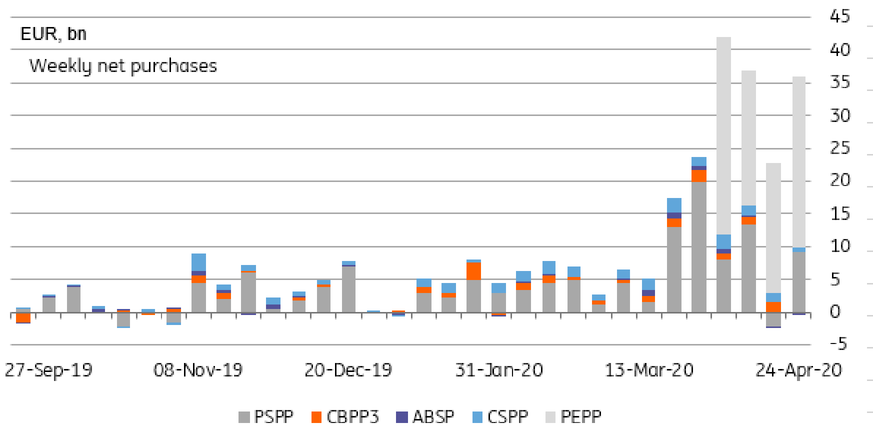
In this environment, we would easily understand why central bank want to keep financial conditions accommodative, and rates low, using all the tools are their disposal.

Not much to expect from the Fed and the ECB

This is the tone we expect will dominate the market until Wednesday at least. In practice, there is little that can be expected from this FOMC meeting so the event might prove a turning point for rates once the risk of further accommodation is out of the way. The ECB has room to deliver more but it is far from having spent the entirety of its Pandemic Emergency Prograamme 'envelope' so the meeting might also prove light on specifics. Both meetings should clear the way to a tactical rise in interest rates. This is all the more true if the post-meetings period coincides with discussions on a fourth stimulus package in the US that a White House adviser was touting last night.

The ECB's quantitative easing portfolios grew by €35.5 billion in the week ending on 24 April. Net purchases under the Public Sector Purchase Programme amounted to €9.5bn despite Irish and Italian debt repayments falling into the week. PEPP purchases were at €26bn, up from €20bn the week before and marking the second highest weekly amount since it started purchases at the end of March. If the ECB were to continue buying at the current pace then the €750bn PEPP envelope would be exhausted by the end of October. We hope the pace of purchases will accelerate in order to further reduce systemic risks.

Stepping on the gas: weekly ECB purchases



Source: ECB, ING

Today's events: ECB lending survey and US consumer confidence

Picking up a trend in today's ECB lending survey will not be difficult but it will be informative in assessing governments' efforts to prevent a tightening of financial conditions. US consumer confidence is expected to plumb new depths which is not entirely surprising. We argue that the readings immediately following the end of lockdown measures will be most interesting to pick up any lasting change in consumer behaviour.

The event most likely to have direct market impact, in the form of a further tightening of Euribor-OIS forwards, is the ECB's LTRO liquidity allotment today. The facility expiring in June has already €275bn outstanding and last week's allotment was €19bn. Some of the demand is expected to be rolled into the June TLTRO and should participate in easing financing conditions. Another sign of relief for EU banks should come today in the form of easier leverage ratio rules for EU banks, according to Bloomberg.

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