Rates Spark: Just a tweak

FOMC minutes reference the IOER (again); with SOFR stuck at 1bp. We think the Fed should hike it already. Just a technical thing, no more. The ECB's detailed purchase data for Feb/Mar shows little change of strategy beyond the pick-up in purchase volumes of late. Today's ECB minutes might document some controversy behind the decision taken in March.

Source: Shutterstock

FOMC minutes keep a lid on the front end

The central interpretation of the FOMC minutes is of a Federal Reserve that remains doggedly dovish. Policy rates will remain low until there has been a material recovery on the labour market. Forecasting recovery is not enough; it needs to actually happen.

That clearly implies that the Fed will have its blinkers on as PPI and CPI readings start popping like corn on a pan on releases due in the coming couple of weeks. By that time the inflation story at least will be more reality than a forecast. But even then, the Fed expects inflation to rise some more and then to ease lower again, but won't know that for sure until it does. A real waiting game this is.

There is clearly underlying downward pressure on front end rates

Another notable aspect of the FOMC minutes for the money market geeks is the reference (again) to the potential for a tweak in the Interest Rate on Excess Reserves (IOER), if needed. We think it is (needed that is). SOFR has been flat-lining at 1bp for a couple of weeks now. It has not been this low for this long ever before. There is clearly underlying downward pressure on front end rates. The enlarged Fed reverse repo facility at an implied zero stands between SOFR at 1bp and a dip to zero. It likely won't go negative, but it is too close for comfort.

0.01% The current SOFR fixing

too close to 0% for comfort

An IOER hike of not 5bp, but 10bp, is needed to help put that to one side as a story so that the Fed can get on to worry about other stuff. It would be purely a technical thing, to coax liquidity into that bucket, and in so doing to help frame where surrounding alternatives should trade, including the likes of SOFR.

Support for rates markets likely to fade again

Rates markets have been trading more supported over recent sessions. Whether this is a reflection of deeper concerns such as surrounding the role of the AstraZeneca vaccine on the path towards herd immunity or just a post Easter hangover in a shortened week is difficult to say. We think that the broader macro backdrop still supports higher yields from here on. The stronger than anticipated final Eurozone PMIs are another case in point, but steepening pressure in EUR rates seemed more confined to the back end which we blame on the long end periphery deals yesterday and the prospect of further supply from France and Spain today.

Detailed ECB purchase data reveals little change for now

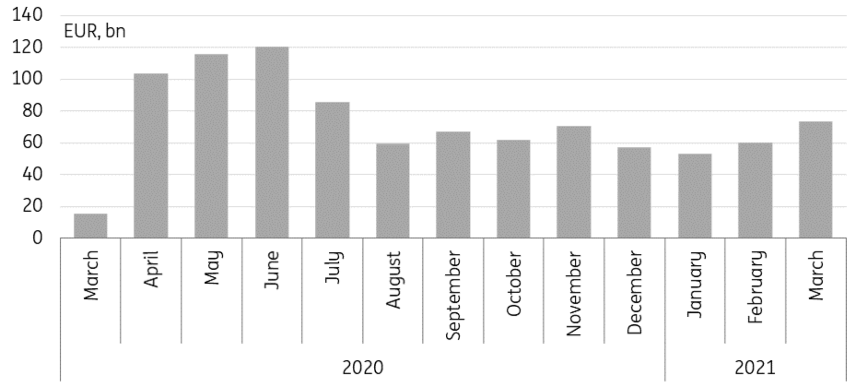
The ECB's weekly purchase volume under its Pandemic Emergency Purchase Programme (PEPP) dropped to €13.1bn from €19bn in the week before. But this is mainly down to the Easter holiday shortening the week by a day (trades executed on Wednesday will have only settled this Tuesday, instead of last Friday) and today's weekly financial statement will show what additional impact redemptions will have had. On the month, PEPP purchases increased from close to €60bn in February to over €73bn in March.

Meanwhile the ECB also provided another two months' worth of detailed data for the PEPP. It likely received more scrutiny given the rise in rates more generally over that period and more specifically given the decision to ramp up PEPP purchases taken at the last ECB meeting. The accounts for the March ECB meeting will be released today and could provide more background to ECB communication surrounding the decision, which did indicate some differences within the governing council.

PEPP details for the past two months show very little change in the ECB's approach beyond the pick-up in volume

The broader PEPP details for the past two months show very little change in the ECB's approach beyond the pick-up in volume. Where there were any (minor) deviations from the ECB's capital key guiding the distribution of purchases between countries, they were little changed from the previous two months. There was a small increase in the overall weighted average maturity of the PEPP's public sector portfolio versus end of January, though this may also reflect a roll-off of shorter dated paper. If any indication, we do note that ECB has let its short dated commercial paper holdings decline further by €3.9bn to now below €13bn at the end of March.

ECB PEPP purchases begin to increase



Source: ECB, ING

Today's events and market view

Given little other economic data today the focus remains on central banks with the ECB publishing the minutes of the March meeting where it raised the pace of PEPP buying for the current quarter. The press conference and subsequent reporting had suggested some controversy surrounding the decision within the governing council. In the evening the Fed's Powell takes part in an IMF hosted panel on the global economy.

Upward pressure on long end EUR rates could come from supply with France auctioning up to €11bn including the launch of a new 10Y OAT and Spain auctioning up to €7bn across 5Y, 7Y and 23Y bonds as well as an inflation linked bond.

Authors

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

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@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 http://www.ing.com.