

## Rates Spark: keep an eye on the long-end

A calendar light on event risks today should not prevent an extension of the move lower in EUR rates. As they drop below their recent range, we expect hedging activity to benefit 30Y EUR swaps the most.



### Overnight: no improvement in sentiment

The gloom pervading in financial markets was uninterrupted overnight as further covid-related restrictions dominated the headlines in Germany and France. There was little to challenge monetary easing expectations either with Villeroy and De Cos both raising the possibility of more stimulus. 10Y German yields are on track to fall below our pre-ECB target of -0.60%, making a move to -0.70% increasingly likely.

In the US, the expectations of near term fiscal stimulus were kept on life support by comments from both camps, likely because no one wants to be seen as pulling the plug on the talks. As US Treasuries seemed happy to rally alongside Bund of late, we surmise expectations remain fairly low.

### No news good news, for EUR rates receivers

There is very little on today's calendar to provide new impetus to markets save for potential headline risks around the EU summit starting this afternoon and concluding tomorrow morning. This can suggest two things. Either the lack of headlines will contribute to a reassessment of the

record low levels reached by EUR rates in the past sessions, or it will see an extension of the existing trend.

We're in the latter camp. The basis for the rally (by which we mean move lower) in EUR rates is a combination of dovish central bank tone and deteriorating economic outlook on the back of more stringent social distancing/lockdown measures imposed to European economies. We do not expect any of those narratives to reverse in the near future. On the contrary, recent public comments suggest even hawks are coming around to the idea of easing (but there will be an intense debate about its form).

## Long-end EUR convexity threatens to kick in

Our economics team, and the vast majority of its peers still has December as the most likely date for ECB easing but we would not be surprised that some portfolios with a large interest rates exposure hedge against the risk of easing in October. Even if a low probability event, the impact a dovish surprise could have on participants with a structural long-end paying position would be significant enough that some receive at the long-end into the meeting.

This environment of EUR rates breaking out of their recent ranges warrants monitoring the curve for non-linear dynamics. We expect that while rates were range-bound, roughly speaking since June, dynamic hedging of large rate portfolio was fairly muted. We are on the lookout for these to resume, which would benefit 30Y EUR swaps the most in our view.

**5bp** from 12bp currently  
is a likely tightening of 30Y swap spreads if rates move lower

Two market indicators in particular seem at risk of reversing in our analysis. We're expecting a re-tightening of 30Y asset swap spreads (swaps outperforming cash) to 5bp, from 12bp currently, in case of a resumption of long-end swap receiving activity. The same dynamics would cause a re-flattening of EUR 10s30s to 18bp, from 23bp.

**18bp** from 23bp  
the likely flattening of EUR 10s30s on the same driver

## Today's Events: EGB supply

Austria mandated banks yesterday for the sale of a new 20Y issue. This will come on top of Spanish (new 5Y) and France (5Y/6Y/7Y and Linkers).

The calendar is void of tier one European economic releases in the morning but the afternoon brings US jobless claims and some regional surveys (Empire manufacturing and Philly Fed).

Lagarde is the sole ECB speaker scheduled today, among more numerous Fed officials.

The EU council starts its two days meeting this afternoon with Brexit high on the agenda.

## Author

### **Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

### **Benjamin Schroeder**

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### **Antoine Bouvet**

Head of European Rates Strategy

[antoine.bouvet@ing.com](mailto: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](http://www.ing.com).