

Rates Spark: minute details

Various ECB officials' opinions are well known. We would downplay the relevance of divisions for rates markets. The EU has recently provided details of what will be a major issuance programme for supranationals, and for the social bond market. Meanwhile the uptick in core market rates globally has a clear US stamp on it. This can be good for Europe too.



Source: Shutterstock

Overnight: QE not on the back burner at the FOMC

If investors came out of the September FOMC minutes with the impression that forward guidance was now the tool of choice, and that the bar to adjust QE was now higher, they will have to think again. The minutes of the September FOMC reported that the committee is ready to consider changes to its asset purchases.

This comes at a time Mester spoke in favour of increasing the duration of the purchases, but could also mean their size could be altered to provide more support to the economy. There was not much new news on the shift to average inflation targeting, already discussed at length by committee members since the meeting.

ECB minutes: the bar to surprise is high

The main item on an otherwise quiet event calendar today is the release of the September ECB governing council (GC) meeting minutes. As is often the case in eventful periods, the discussion is likely to seem fairly dated, and their policy implication for rates markets should be well priced already. Since the meeting, a range of opinions have been voiced by members as to the appropriate response to a surge in the trade-weighted EUR.

In addition to the fact that these 'divisions' have been well advertised, we would argue that the focus in financial markets has now turned to the dismal inflation readings in September as the prime justification for pricing more ECB easing. We, and we think investors, would also be surprised to see detailed easing options discussed, since most don't expect new steps to be announced before December. Our economics team thinks an increase and extension of QE would be the most likely response.

EU provides more detail on upcoming SURE financing

Funding for the EU's SURE programme is expected to kick off in the second half of this month. Yesterday the EU published the [SURE social bond framework](#) under which all SURE related EU funding will take place. Of the €100bn programme envelope some €87.4bn in loans have been approved so far and it is anticipated that all funding will be completed by the end of 2021 at the latest. This implies that the current outstanding volume of €-denominated social bonds of €64bn (€39bn of which issued this year alone) could almost be tripled by the EU in just over a year.

In the accompanying [investor call](#) the EU provided more detail of what markets can expect. To fund SURE the EU will conduct syndicated issues, launching new bonds in benchmark size of up to €5bn, depending on the maturity within the targeted 3y to 30y issue range. Building on the existing EU bond curve, issuance will be initially focused on the benchmark maturities. Bonds can be tapped, up to a size of €10bn, which is also the stated limit for the total outstanding in a given maturity year. That limit does not apply to other EU loan programmes, though.

Importantly, the foreseen issuance modes to finance SURE also do not preclude any other means to finance the NGEU. Here, [Reuters recently reported](#) that also auctions in addition to syndications were being considered. SURE related issuance will serve as a first test run, as the bulk of the new EU issuance is still to come over the next few years, in total around €800bn in 2021 to 2026.

Made in America - the ongoing rise in market rates

The rise in market rates and steeper curves is a good thing, as it signals some unwinding of pain. And it has been made in America so far; the widening in the spread between USD and EUR market rates confirms this. Before Covid, the US 10yr Treasury yield typically traded in excess of 200bp over Germany. Covid took that spread down to 100bp, partly as most of the rate cutting came from the Federal Reserve. It is now back up to 130bp. It is still closer to crisis levels than to more normal levels, but the path that the spread is on is an auspicious one. What we want to see here is a classic US recovery that helps to lift the likes of Europe in the same direction. The bond market is in the early phase of pricing in that exact likelihood.

But we still have some way to go. Macro angst remains elevated in absolute terms. That is dominating the supply risk coming from stimulus packages, on both sides of the Atlantic. Risks remain elevated. Default probabilities are likely underestimated by current high yield spreads,

masked by a myriad of government schemes to keep things afloat. The US election outcome still has the potential to stoke considerable volatility and uncertainty. And Covid itself has clearly not gone away. A still relatively elevated VIX index is a good barometer of many of these unknowns, warning market participants to be on their guard.

Today's Events: ECB minutes and IRISH auctions, US initial jobless claims

The highlight of a day is the release of the ECB minutes, although a couple of ECB speakers including VP De Guindos will also have appearances. In the US, only the initial jobless claims are of note on the calendar.

In the primary market Ireland will be active reopening 7Y, 10Y and 15Y bonds for €1-1.5bn in total.

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