

## Rates Spark: on the one hand...on the other hand...

The ECB delivered on its promise of a quiet meeting. Still, optimism is rising perceptibly. This is positive for peripheral spreads, and should allow EUR rates to continue their re-pricing towards positive territory.



ECB President Christine Lagarde

Source: Shutterstock

### ECB: avoiding the hawk trap

Despite facing a barrage of questions on the appropriate pace of PEPP purchases, president Christine Lagarde did a good job at keeping the ECB's options open. Through her answers, we gleaned that there is no pre-determined monthly amount and that purchases are instead data dependent. As our economics team has stressed, [that question will be a lot more pressing at the June 10th meeting](#). In fact, there seems to have been no major display of dissent according to Reuters, probably more a reflection of the fact that no decision was taken yesterday rather than due to a newfound unity on the governing council. Hawks' views are well known and we can expect them to grow louder in the run-up to June.

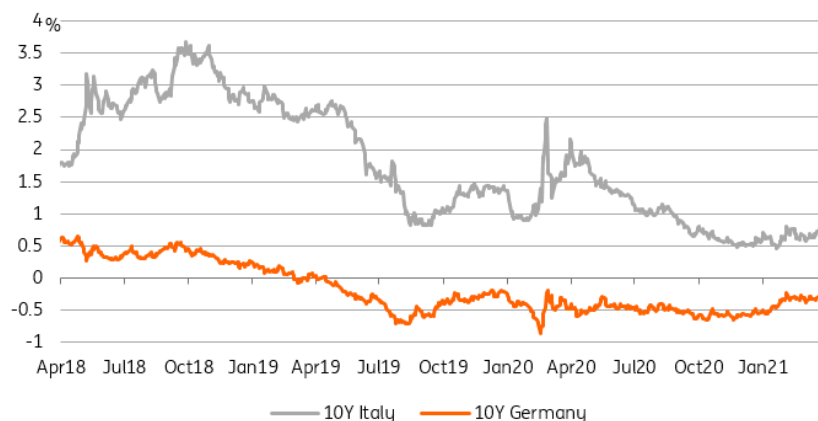
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*Hawks' views are well known*

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Those looking for signs of optimism were satisfied, but so were those looking for prudent communication. In Lagarde's own words, this proved a 'on the one hand...on the other hand' meeting. The ECB successfully walked that tightrope. The upshot for rates is twofold. The lack of communication accident and of policy signal leave the market free to gradually price the recovery, by converging to 0% in the case of 10Y Bund. We also think it clears the way for further tightening of peripheral spreads.

## More yield convergence is in the cards between Italy and Germany



Source: Refinitiv, ING

## Italy: riding the Draghi wave

In addition to a peaceful ECB meeting, this week has renewed our conviction that peripheral spreads are due for another leg of tightening. The German constitutional court has paved the way for the ratification of the EU recovery fund. This is not the last bump on the road for the embattled fiscal tool but it removes a tail risk that sat uncomfortably with our bullish Italian debt call. Draghi's government has also published its €220bn recovery plan which he intends to accompany with much discussed structural reforms to boost Italy's competitiveness. We do not expect S&P to modify Italy's rating tonight but its assessment on Draghi's plan could be a shot in the arm for Italian confidence.

This week has also shed light on a political development that, in time, might shrink the spread between Italian and German government bonds: the rise of the German Green party ahead of [September's federal election](#). As the EU recovery fund saga best illustrates, changes at the EU level tend to play out over long timeframes, but a staunchly pro-EU integration party as part of a governing coalition would greatly reduce the perceived risk of Eurozone breakup, one of the main reasons why 10Y Italian bonds trade 100bp above their German counterpart. We renew our call for this spread to sink to 75bp in the coming months.

75bp

10Y Italy-Germany spread

Our target this year, from around 100bp currently

## Today's events and market view

European April PMIs are expected to retreat from their March levels. While a resurgence of cases has definitely cast a shadow on the recovery, we are in the camp of those who see more upside than downside risks, and the same goes for EUR rates today.

New home sales is the only notable event on the US calendar. We have no doubt that next week's Fed meeting is already in everyone's mind. The main question is how much optimism will the Fed allow itself to express. If the US recovery is indeed chugging along, the policy implications are yet unclear. The Fed has said repeatedly that it will run the economy hot in order to maximise job market gains. The question is whether inflation allows it to.

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