Article | 9 October 2020

Rates Spark: the trend, is it your friend?

With a fairly thin events calendar, we expect market participants will have the opportunity to reflect on recent trends in USD and EUR rates, and assess if a continuation make sense. By and large, we are inclined to answer in the affirmative.

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Overnight: US fiscal stimulus hopes refuse to go away

Supportive comments from house speaker Pelosi and a reported U-turn in the president's willingness to consider a larger deal left markets guessing as to what are the real odds of an agreement . By most accounts, the practicalities of passing a comprehensive bill by the end of the month are challenging and we would be wary of attributing market optimism to this factor only. This being said, the US reflation trade should in our opinion continue until much closer to the vote, with USD rates widening relative to EUR (see below).

More USD-EUR divergence, but a breather today

In USD, the most pressing question is whether markets can continue to price a Biden reflation trade with an even greater degree of confidence. With USD 10s30s at a 4-year high, it is tempting to say that a lot is priced already. Barring a reversal of fortune though, we see the proximity of the vote itself as likely to cause a wave of profit taking among curve steepeners. Without supply as a tailwind (this week saw US auctions in 10Y and 30Y), the move could take breather today and resume next week.

In EUR, the ECB minutes published yesterday cemented expectations of easing at the December meeting. As our economics team noted, the rising risk of deflation and of a double dip recession should keep the ECB up at night, and help hawks comes around to the idea. This, in our view, is a strong enough economic and policy divergence to justify a further widening of USD-EUR rate spreads.

It is possible that this assumption gets challenged next week as October surveys start pouring in. Conventional wisdom would dictate that Europe fares worse as more social distancing measures are implemented, and as the number of cases rises rapidly, so we think expectations will be quite low.

Planning ahead with EU's SURE about to kick off: Spain lowers its funding targets

As the EU funding activities for the SURE programme draw closer it also gives national debt agencies more visibility of their financing positions ahead.

Yesterday Spain reduced its 2020 net borrowing target by €15bn versus its plans in May. While it had hinted earlier that EU support would have an impact this year – Spain is slated to receive €21.3bn from SURE, €10bn of which already in 2020 – there is also a domestic driver behind the latest downward revision. The Spanish autonomous regions are finding cheaper funding away from the central state and plan to repay around €10bn of loans. Looking further ahead the Spanish debt agency also reckons that on top of the remaining €11bn coming from SURE, funds from the EU recovery funds should lower next year's financing needs by €25bn.

The market had speculated about a new 10Y bond from Spain this quarter, especially after the debt agency had actually revised the bond issuance target to €198bn in September. Now, alongside a reduction in in the bills financing target, the bond target stands at €188.5bn with around €22bn left to issue. Consequently the debt agency also communicated with the latest revision that no more syndications were planned for the year. In the market Spanish bonds outperformed their Italian peers noticeably yesterday.

Today's Events: French/Italian IP, BoE's Haldane

The calendar is very light for today. In data we get industrial production data from France and Italy. On the central bank front the Bank of Italy publishes its report on "Money and Banks". The BoE's Chief Economist Haldane speaks on 'New Tools and Techniques Emerging from Covid-19' at the OECD.

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