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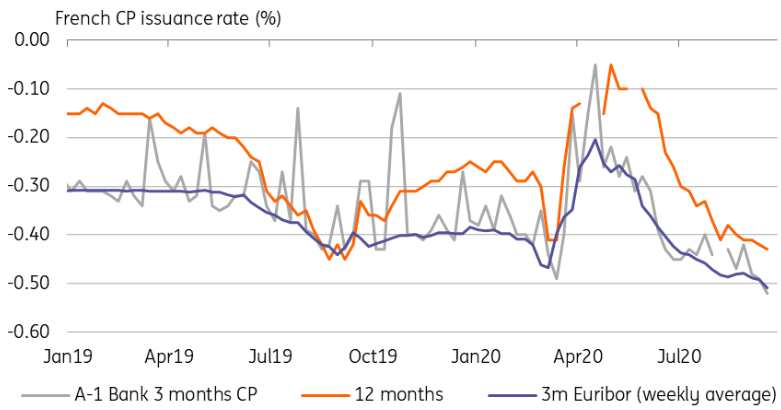
Rates Spark: Throwing more liquidity at it ...

We expect EUR curve fattening dynamics to reassert themselves today, notwithstanding the risk of a decent IFO report. The TLTRO III announcement should add to already plentiful liqudity, but won't change EUR money market dynamics dramatically..



Source: Banque de France, EMMI, ING

Back to flatteing for the EUR curve

EUR rates should breathe a sigh of relief today now that this week's significant long-end supply slate has been completed, and as the main macro risk of a rise in PMIs has been averted. Today's IFO could prove a last minute banana skin but we suspect the beat in German manufacturing PMI yesterday has taken the surprise out of any rise in the IFO figure. In a nutshell, we expect the long-end to outperform into month-end.

Whilst the debate between cutting rates, extending PEPP, extending the APP, or doing nothing rages on at the ECB, the implication for the EUR curve is fairly straightforward. Unlike in other currency zones (ie the UK) where there can be reasonable doubts about where the effective lower bound lies, it would be difficult for EUR rates to extrapolate and consider that any deposit rate reduction is the beginning of a string of cuts.

18bp

This is where we expect EUR 10s30s to flatten to

on a combination of greater demand for duration now that ECB easing is in play

What's more, despite a more proactive fiscal policy mix than last year, we still think the EUR curve would will find it difficult to price a change in inflation dynamic as a result of ECB easing. In short, the odds of a steepening on ECB easing are small in our view. In numbers, we see scope for a flattening of EUR 10s30s to 18bp on a combination of greater demand for duration now that ECB easing is once again in play, and on more risk-adverse investors' minds.

Today's TLTRO.III is unlikely to change the dynamics of front end rates

The ECB will publish the allotment of the latest TLTRO.III targeted liquidity operation. Bloomberg reported estimates as high as €200bn, which is still well below the €1.3tn that were allotted at the previous tender in June. This time around banks have chosen to repay just shy of €11bn out of older tenders ahead of today's allotment. This low amount already ensures that the net impact on excess liquidity in the banking system will be largely neutral at worst.

€10bn-200bn

Range of estimates for today's TLTRO III allotment

We expect allotment to be at the lower end of that range

Eventually though excess liquidity will continue to grow. The ECB's pandemic emergency programme still has some €800bn to spend and the regular asset purchase programme also continues to plod along. That means there is little let up in the downward pressure on money market rates and Euribor fixings, even after the 3m tenor fixed 1bp higher back above the ECB deposit facility rate yesterday. Approaching the €STR rate of -0.55%, which we think in the absence of any term or credit premia should be the most likely floor to Euribors, one could anticipate the dynamic to slow. That said, the 1 week and 1 month Euribor tenors fixed lower again yesterday.

Already after the June TLTRO.III the activities in some corners of the money market have slowed to a trickle. While the Banque de France's data on commercial paper (CP) issued by banks shows a recovery in activity over the latest week to over €10bn, this was largely concentrated in the one day tenor. At the same time the average rate for 3m bank CP fell to -0.52% last week. Euribor rates now based in transactions (where possible) tend to follow these dynamics.

Today's events: IFO, Fed and BoE speakers, Italian auctions

In data the focus is on the German IFO index following yesterday's disappointing PMIs.Germany's manufacturing was a bright spot however.

The calendar also remains packed with central bank speakers. ECB's Lane participates in a Twitter Q&A in the US Powell's appearances at congress continue and in the UK BoE's Bailey speaks after having only recently placed negative policy rates firmly in the Bank's tool box.

In primary markets Italy will reopen a 10Y inflation linked bond and sell a new 2Y zero coupon CTZ.

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