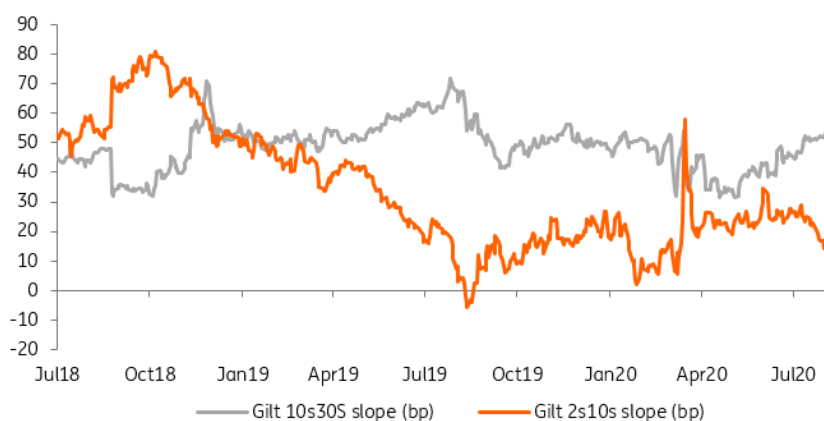


## Rates Spark: Upside building

Bank of England in line. US Treasuries bears are in the driving seat after markets ignored the weak employment data yesterday, ECB balance sheet data show TLTRO demand was also significant in core and semi-core countries



Source: Bloomberg, ING

### The Bank of England decides against negative rates

The Bank of England left its policy rate and target QE unchanged at today's meeting.

Unsurprisingly, the vote was unanimous. Besides forecasting that the fall in output from 4Q19 will not be erased until the end of 2021, and that by that point some slack might still remain in the economy, the meeting provided little by way of policy signals.

The monetary policy report included a lengthy discussion on the pros and cons of negative interest rates policy (NIRP), although no conclusion seems to have been reached on its net benefit. The bank's effective lower bound (ELB), currently considered to be above zero remains under review, for a probable conclusion we expect later this year.

The MPC continues to flag the possibility of an increase in QE if necessary. Taken together with the above NIRP discussion, we think it is too early to conclude that the central bank has fallen out of love with QE and that negative rates are the most likely easing tool going forward. This should limit the belly of the GBP curve's ability to richen further in our view, as was the case in the run-up to the meeting with 2s10s and 10s30s diverging strongly.

## Rates markets shrug off US job numbers, bears in control

In spite of our fear that weak US job data constitute a risk to our tactical bearish UST view, rates markets largely shrugged off both a [dismal ADP and a soft ISM services employment index](#). Some of the lack of reaction with the former may have to do with its questionable track record in predicting official payroll numbers, whilst the latter was accompanied by an improvement in headline and order components.

It remains that the downside risk to Friday's non-farm payroll report is daunting and might cause a temporary upset to our view. However, yesterday's releases should have skewed expectations lower, and so it should make the market better able to deal with disappointment. An additional argument was highlighted by our US economist: weak payroll numbers would act as an additional incentive for both sides of Congress to reach an agreement to support an ailing recovery. Friday's deadline is uncertain, however, with McConnell leaving open the possibility of reducing the senate summer break to allow negotiations to extend into next week.

In this context, we stick to our call for higher USD rates. This may only manifest itself if economic data improves, or if we witness more signs of a flattening of the Covid-19 curve in the US, but the [US Treasury quarterly refinancing announcement](#) brought another argument for US bond bears. It was largely expected that the Treasury would increase note and bond issuance to substitute some of the earlier bill supply. In nominal terms, the 7Y T-note will see the largest increase to its auction size but in duration-weighted terms, the long-end should see the most pressure. We do not regard this as a driver on its own but it has the potential to magnify a bear-steepening of the curve should optimism return on financial markets.

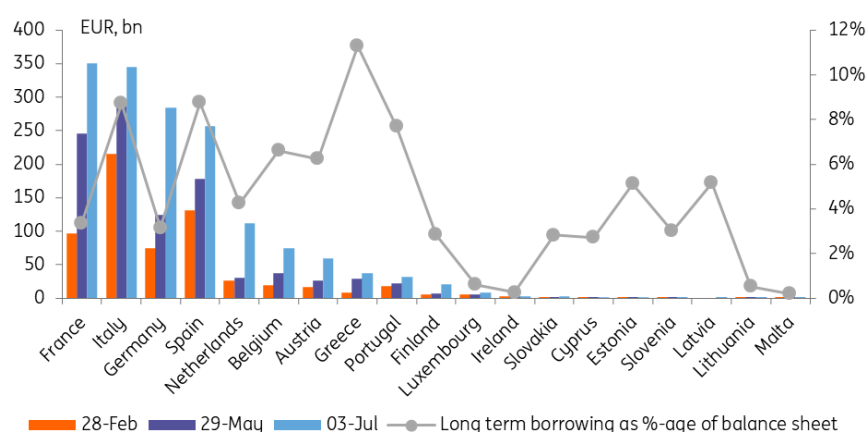
## French and Italian banks are the largest long term borrowers from the ECB

In June, the ECB allotted €1.3tn in a targeted longer-term refinancing operation (TLTRO). This had been one element to our favourable outlook for carry position also in periphery debt over the summer weeks.

Details on banks' long-term borrowing from the ECB released earlier this week now provides a country breakdown and points to larger take-ups of the ECB's June TLTRO III tranche, not only in the periphery but also in core and semi-core countries. Here the net increases over June actually topped those of the periphery. However, this masks the fact that Italian banks, for instance, had larger TLTRO II stock to start with which should now be largely replaced with TLTRO III funding, and that Italian banks also participated to a larger degree in the weekly LTRO operations already in the run-up to the June TLTRO – insofar as the increase over the latest month alone renders a somewhat incomplete picture. That said, the Bank of Italy should publish exact participation in the June TLTRO III by its domestic banks next week.

In absolute terms, French and Italian banks are currently the largest users of the ECB longer-term refinancing operations, tailed by German and Spanish names. Relative to their respective banking system's balance sheets, however, peripheral countries maintain a clear lead.

## Banks' long term borrowing from ECB boosted by TLTRO III



Source: ECB, ING

## Today's events: French and Spanish auctions, US initial jobless claims data

After the Bank of England decision, the focus turns to US initial jobless claims data amid an otherwise quiet data calendar.

In supply France will sell up to €9bn in 10Y to 30Y bonds, Spain will sell up to €4.5bn in 3Y to 10Y bonds and €0.75bn in an inflation linked bond tap.

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