Rates Spark: A job nearly done

Undeterred by bank stress, central banks are still hiking, but they are now coming closer to the end. The Bank of England could deliver its final 25bp today. The European Central Bank still has the biggest job ahead, even if tightening financial conditions take on (a yet unkown) part of it

The Fed lets its facilities do their work, betting for resumed status quo, and system stability

The Fed hiked 25bp yesterday. The effect has been lower market rates, in particular on the front end as the market takes on board that the Fed seems to be almost done. One theme that we think continues is the dis-inversion of the curve, and we've seen another material move in that direction as a response to the Fed's decision.

> *Market rates can still re-nudge higher, at least until the disinflation story has become more compelling*

Market rates had been edging higher as we headed into the Federal Open Market Committee meeting, which no doubt helped to embolden the Fed to deliver the 25bp hike that the market had (practically) discounted. The market will also be comforted by the fact that the Fed decided to go ahead and hike, when the alternative could have been to hold and nod towards bank angst as the rationale. There is enough in that combination for market rates to re-nudge higher in the weeks ahead, at least till we get to a point where the disinflation story has become more compelling, notwithstanding the impact effect towards lower market rates.

Market technicals are in an interesting place right now. The Fed's balance sheet increased by US$40bn last week as a consequence of support being provided to some banks, including Silicon Valley Bank, Signature Bank and First Republic Bank. And indeed the regional Fed breakout of support confirms that the bulk of additional liquidity went through the New York Fed and the San Francisco Fed.

The consequence of this from a balance sheet perspective is to push against the quantitative tightening policy where US$95bn is being allowed to roll off from the Fed's bond holdings on a monthly basis. This, the Fed argues, is the various mechanisms doing their work. The same logic obtains for the reverse facility, which continued to act to mop up excess liquidity, and has popped higher in the past week, in part a reflection of that. No new angle on this from the Fed today.

It may well be the Bank of England's final 25bp today

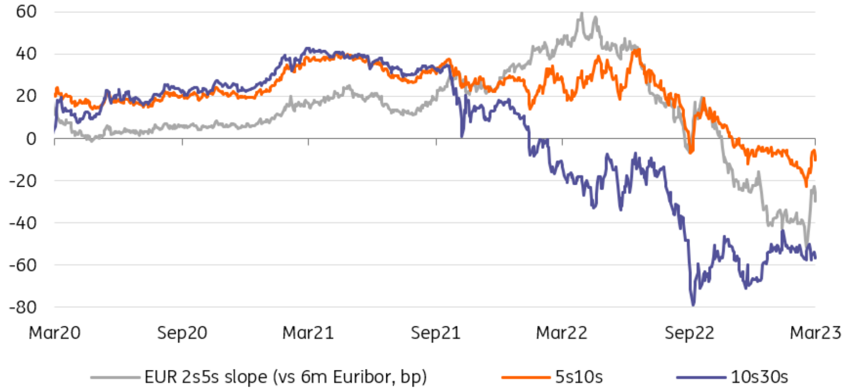
The upside surprise in yesterday's inflation reading for February was a reminder for the Bank of England that its inflation problem is not fully tackled yet. Given the easing fears of systemic stress, markets are now leaning heavily towards expecting a 25bp hike today – and they do see at least one more 25bp hike by summer.

> *Today's BoE decision is probably not as clear cut as the market believes*

Our economist does not think today's decision is as clear cut as the market believes, however. And he also expects that this will become evident in a monetary policy committee remaining heavily divided. Here we could see a vote for a 50bp hike on the one end and votes for no change and perhaps even a cut on the dovish end. The BoE is not focusing on any single inflation indicator, but is focused more on a broader definition of "inflation persistence" and price-setting behaviour where the data has been generally more encouraging over the past month or so. If that continues, our economist still suspects the committee will be comfortable with pausing the tightening cycle in May.

Today's expected hike, and a generally improving market backdrop could still help markets to retrace more of the recent drop in yields. Overall, though, the recent crisis reinforces our view that 10Y gilt yields are then headed to 3% by late 2023/early 2024.

The EUR curve could see more re-flattening as hikes are baked back into the front end



Source: Refinitiv, ING

The ECB's job could still be more protracted

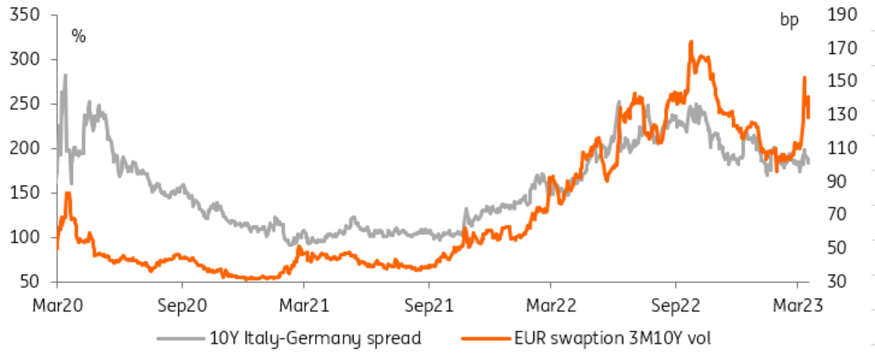
Rates have been tentatively moving higher, in the process bear flattening the curves as markets are baking policy tightening back into their outlooks. The big question remains just by how much should policy expectations retrace. From a low of close to 3% the pricing of the terminal rate has moved close to 3.5% again. At its high just before the turmoil it stood just above 4%.

> *Amid calmer markets ECB members are re-focussing on the need to raise policy rates further*

Amid calmer markets ECB members are now re-focusing on the need to raise policy rates further. Naturally these days, always under the condition that the baseline scenario holds. Even the dovish end of the governing council acknowledges that more tightening would be needed then, if only that the uncertainty warrants taking the decisions meeting by meeting.

One might think that Belgium’s Wunsch has turned dove cautioning that a tightening of financial conditions “could be doing part of the job, and [the ECB] might have to do less". However, his remarks should probably be benchmarked against his prior comments from early March, when he said “looking at rates of 4% would not be excluded”.

Well-behaved sovereign spreads encourage calls for further tightening



Source: Refinitiv, ING

Today's events and market view

Central banks are not distracted from their inflation fight, but there is some acknowledgement that the banking shock and the ensuing financial tightening will do some of the job, the uncertainty being just how much. And clearly some central banks are closer to the end of they hiking cycles, as for instance the BoE which we think may deliver its final hike today. Farthest behind is the ECB, and a stretch of calmer markets could further embolden officials to push the message that more hikes are needed. Although there may be spill over from the late-cycle dynamics beginning to unfold elsewhere, we think the EUR curve stands the greater chances of re-flattening, and underperforming versus its peers.

Next to the Bank of England, today's main focus will be on the ECB policymakers' comments given another busy slate of speakers. We should hear, among others, from Austria's Holzmann, Estonia's Muller and again from chief economist Lane himself. In data we will get a preliminary eurozone consumer confidence reading for March as well as the weekly initial jobless claims out of the US.

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