# Rates Spark: Central banks vs economic data

Next week sees the three major central banks' first policy meetings of 2023. Yet key data releases framing the meetings will mean an ongoing tug of war between the inflation and recession narratives in the market. Stretched valuations are at risk from more vocal central banks arguing that their jobs are not done

## Fed, ECB, BoE: High conviction on the hikes that will be delivered next week

First policy meetings of the year for the Fed, European Central Bank and Bank of England are all squeezed into the next week. Each of these central banks will tell us that their job is not done yet, though some are clearly seen closer to being done than others.

*Central banks will tell us that their job is not done yet*

Markets have a pretty high conviction as to what will be delivered next week in terms of rate hikes. It is expected the Fed will slow to a 25bp hike, coming closer to its cycle end. A total of 60bp tightening is priced until summer. The BoE should still raise rates by 50bp next week, but is seen slowing thereafter with an overall 95bp of tightening by late summer. The ECB is also seen to deliver 50bp next week, but officials have signalled further sizeable hikes may be necessary and the market is pricing 140bp of tightening in total by summer. If we set this against our economists forecast the market is in line with our own view, at least for the upcoming meetings next week.

## Markets are more concerned about what lies beyond

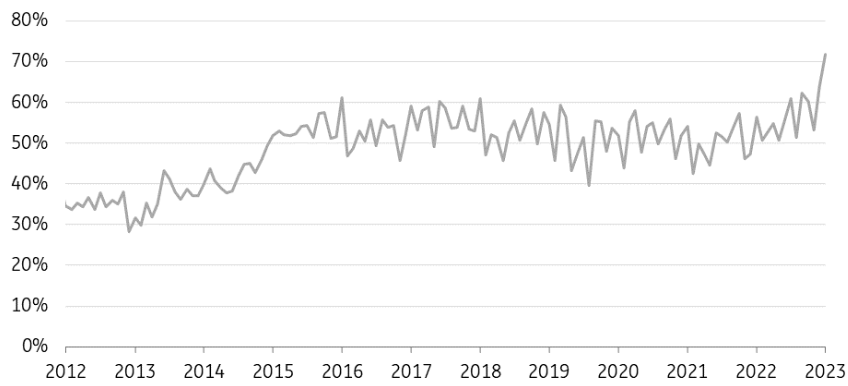
But merely looking at the pricing of the next couple of hikes belies the fact that markets are more concerned with what lies beyond. The central banks signalling will be more important. It is still a tug of war between the need to rein in elevated inflation and the fear over a deepening downturn – it is central banks versus data. And next week is also packed with key data releases.

> *Next week is also packed with key data releases*

The eurozone will see preliminary inflation data ahead of the ECB meeting, though the slight easing of the core inflation rate to 5.1% seen by the consensus is hardly going to change anyone's mind on what the ECB's next steps are. Fourth-quarter GDP is likely to see growth stalling, though avoiding outright shrinkage, which should also give the ECB more confidence to stay the course.

More importantly, also for long end EUR rates is that the US the macro data could still feed recession angst with the ISM releases framing the Fed meeting. Crucially, the jobs data in the wake of the Fed could blunt any hawkish message from the meeting – the current consensus is looking for the labour market to lose further momentum. However, the weekly initial jobless claim data yesterday showed again that there is no one way narrative in the macro data.

## High allocation to indirect bidders in UST auctions shows strong demand




Source: TreasuryDirect, ING

## We see the balance of risk from the meetings tilted towards higher rates

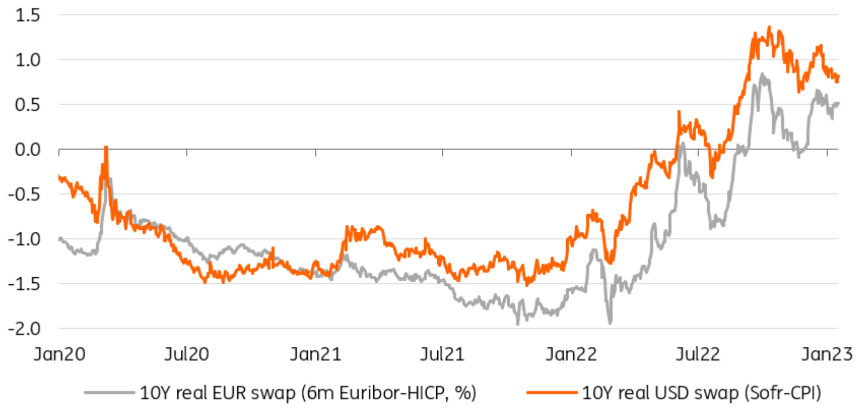
That said, US Treasury auctions so far this year signal ongoing demand right along the curve – yesterday's 7yr auction was no exception. The market appears primed for a Fed pivot and therein also lies the risk. If the Fed's communication surprises on the hawkish side, we see the possibility that stretched valuations, especially the still deeply inverted curve, can imply a stronger pull higher of longer dated rates as well.

Also keep in mind that ECB officials of late have pushed back hard against rate cut speculation that has crept into forward rates for late 2023 and 2024, spilling over from the recession angst in the US. President Lagarde may well attempt continue these efforts during the press conference.

*Real rates which define financial conditions have actually remained relatively stable in their positive range*

One consolation for the ECB is that despite market rates rallying back since the start of the year, real rates which define financial conditions have actually remained relatively stable in their positive range to which the ECB had elevated them with the December policy meeting. But the ECB has fought hard for this and will not want to risk diminishing these gains. And while tighter spreads in the periphery of the eurozone do signal easing conditions in some corners, that should give policymakers reassurance on their recent decision  to downsize the balance sheet.

## Real rates have remained higher despite markets rallying at the start of the year




Source: Refinitiv, ING

## Today's events and market view

We will get US data today covering personal income and spending as well as the Fed's favoured inflation indicator, the PCE deflator, but it is doubtful that these will move the needle regarding next week's decision.

With 10Y yields having rallied back to the levels seen around mid-December, we see the risk that of profit taking as we approach the policy meetings. In particular the ECB should have an incentive to signal that the job is far from done and more tightening is still needed. Also keep in mind that long end supply in EUR has come with more concessions as opposed to the spectacular auction results in the US. Next week will see a busier acution schedule again including longer maturity bond sales out of France.

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