

Rates Spark: Buying time rather than bonds

While the BoE is buying bonds – and time – for the government to clarify its fiscal plans, the ECB remains undeterred from its tightening plans. The upcoming quantitative tightening discussion is met by rising funding needs from governments. But some of the latter seem to have taken note of the financial market stability implications of their doing



European Central Bank, Frankfurt, Germany

Source: Shutterstock

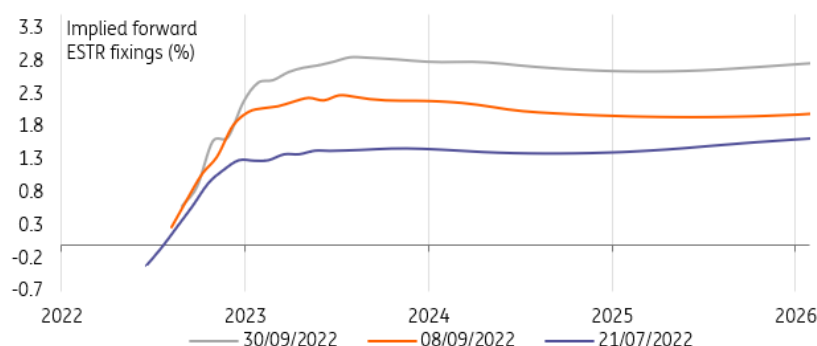
ECB remains undeterred from its tightening plans

[German inflation came in at 10%](#), and eurozone inflation today is expected in close vicinity. European Central Bank officials have all the reason to continue stepping up the hawkish rhetoric. Scanning recent ECB comments suggests that the Council is indeed homing in on a 75bp hike in October, and it is unlikely to stop there. Spain's de Cos pitched the terminal rate at 2.25-2.5% yesterday. If that is the target then an overall increase of at least another 150bp is on the cards over the next 'several' meetings. This is also what our economists are now seeing as a likely outcome given the ECB's new reaction function.

The ECB views Italy's latest widening not disorderly or unwarranted

The UK experience does not appear to deter the ECB from their chosen path. Not even when it comes to the topic of quantitative tightening. The main focus in the eurozone obviously remains Italy, but Reuters reported yesterday that the ECB does not view the recent widening of the 10Y Italy Germany yield spread towards 250bp as a concern. It was not disorderly and not unwarranted given that Italy currently faces a period of uncertainty as the new government is being evaluated. In their view, there is no reason to activate the Transmission Protection Mechanism.

ECB hike expectations are also pushed up by government fiscal packages



Source: Refinitiv, ING

Ramped up funding plans likely to face quantitative tightening headwinds

However, there is no denying that market conditions are far from normal. With the ECB signalling sped up plans to pull away from the bond market, and hawkish officials like Holzman even mulling active sales, markets are right to be concerned when at the same time fiscal policies point to government funding plans with likely considerable upward revisions.

Germany is at pains to distinguish its latest package from the UK-like fiscal plans

Germany has just announced plans for an energy price cap with an attached price tag of up to €200bn. Now Germany is one of the core issuers where markets would have few qualms of digesting the additional supply. But under current market circumstances it speaks volumes when the Finance Minister in a press conference takes pains to put some distance between his plans and the controversial UK government budget plan: In his own words, the German package is not

expansive fiscal policy, but targeted to the current emergency and with no inflationary impact. To the contrary it should dampen inflation, and by 2023 the plan is to fall back to the debt brake. We'd say it is still a lot of potential issuance coming in the direction of markets. And they have seen implied volatilities ratched up and yields already increase dramatically over the past weeks.

Core rates curve dynamics are in flux after the gilt long-end debacle this week



Source: Refinitiv, ING

Rates still under upward pressure

Eurozone curves have seen their flattening trend being stopped in their tracks, even reversed. Despite the upped hawkish rhetoric front-end rates actually declined. It could also be growing concerns over how far the ECB will actually be able to push the envelope on policy tightening, but maybe some of the UK spillover that had also dragged the front end higher still needed to be priced out.

The picture for curves is murkier than the directional outlook for rates

The longer end may feel the pressure from the fiscal front and current quantitative tightening chatter. One could also argue that the German package may help soften the blow of the upcoming recession, even if it cannot prevent it, but then the pressure on risk assets seems to tell another story. The upshot is that the picture for curves appears murkier than the outlook for general direction of rates, which we think should still be higher.

Today's events and market view

The highlight will be the release of the eurozone flash CPI. Consensus is looking for a 9.7% year-on-year reading. The acceleration of German inflation into double digits yesterday points to some upside risk. In any case it should ensure further hawkishness from the ECB where the central bank's current key figure Isabel Schnabel joins a discussion panel aptly named "Fight against Inflation" today.

The US will also see another busy slate of Fed speakers: Barkin, Brainard, Bowman and Williams. Much of the economy still looks frothy, which should keep Fed official focussed on the inflation fight. Next to the Fed's favoured inflation gauge, the PCE deflator, we will also see the release of personal income and spending data.

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