

Rates Spark: Close calls

EUR rates have drifted higher, contemplating the chances of further ECB tightening. Returning US markets today could extend the momentum of the late Friday sell-off while busy issuance could add to the upward pressure. Eventually data decides for how long 10Y UST yields can be supported in the 4 to 4.25% area, with eyes this week on tomorrow's ISM services



With the US out for Labor Day, EUR rates drifted higher at the start of the week with the usually more policy-sensitive belly of the curve in the lead. European rates' main focus remains the ECB, given the proximity of the next meeting and given that it's the final chance officials have to communicate their policy preferences ahead of the quiet period.

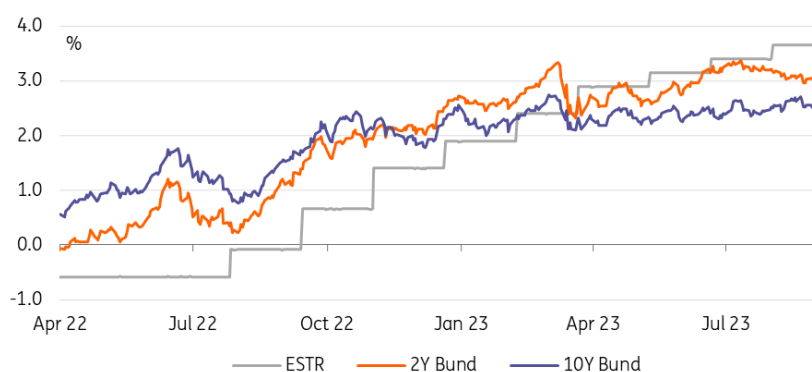
ECB President Lagarde's speech yesterday yielded little concrete information regarding the ECB's next steps – even though the speech centred around the importance of communication. She did remark that “action speaks louder than words”. While she was arguably talking more about what the ECB has already achieved, hiking rates by 425bp over a relatively short time span of 12 months, the comment surely resonates with the ECB's hawks' current thinking about the upcoming decision. Over the weekend the ECB's Wunsch already opined that “a bit more” tightening was necessary. Bundesbank's Nagel delved into more technical matters around the ECB's decision to end the remuneration of banks' minimum reserves. He argued that more should

be done on reserves – if via not rates, it seems some hawks are ready to consider other options for tightening financial conditions.

Important inputs to the upcoming decision are measures of expected inflation. Market based measures, such as the 5y5y forward inflation swap, have recently come off their peaks but remain mired in relatively elevated territory. The aforementioned 5y5y forward is still close to 2.6%. As ECB's Schnabel noted in last week's speech this is also a reflection of growing uncertainty surrounding the longer inflation outlook and could in turn reflect slowly eroding credibility of the ECB's commitment to get inflation to 2%.

Today the ECB will release its consumer survey which has seen 3y median inflation expectations already drop from 3% at their peak to 2.3% as of June. That is also ready close to 2%, but before the turmoil of 2022 median expectations were usually even closer to 2%. The June survey results also pointed to a more pronounced tail in the distribution, towards higher inflation outcomes.

The last ECB hike had little traction further out the curve



Source: Refinitiv, ING

Today's events and market view

Today the US markets return from their Labor Day holiday. Hopes of a possible goldilocks scenario - a cooling labour market bringing the Fed closer to target without necessitating any further hikes while, at the same time, growth remaining resilient enough to avoid recession - could keep long end yields elevated in the 4 to 4.25% range for now, with a busy primary market adding to the upward pressure. Such hopes remain sensitive to data, though with a particular focus this week on the ISM services tomorrow. Today we will get US factory orders.

Issuance is likely to keep some upside pressure on longer EUR rates, too, with also long-dated government bond auctions also slated for later this week. The key focus is the looming ECB meeting and the possibility of another rate hike. We think the decision is a closer call than the market's pricing of a 25% probability currently suggests. We will get more ECB comments and data to sharpen our views: The ECB consumer expectations survey is released today and we will also get Eurozone producer prices. Services PMIs from Spain and Italy will be released alongside the final European services and composite readings.

Government bond auctions from Austria (10Y and 30Y) are scheduled for today and Germany sells linkers. But it is worth also highlighting that Belgium lowered its long term

bond issuance target yesterday in light of the notable €22bn issued via a 1Y retail bond.

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