Rates Spark: Diverging ECB views increases uncertainty

ECB comments on the path beyond June are become more dispersed, with the hawks warning it is premature to discuss cuts beyond June, while some doves now flag more than 100bp of cuts as a possibility. To us this implies the outlook beyond June is less anchored overall, meaning it could be more prone to correct higher near-term if US rates push on upwards

Risk tilted towards higher pricing beyond June fixing

The European Central Bank seems to be heading towards a June cut, but with diverging views within the Governing Council, markets are fishing for the path thereafter. For instance, on the one hand we have the ever-hawkish Austrian Holzmann who still sees plenty of inflation risks and expressed concerns about deviating from the Fed by more than three of four cuts. Mario Centeno from the Portuguese central bank, on the other hand, downplayed worries about services inflation, stressed independence from the Fed, and continued that cuts could exceed 100bp this year.

The divergence of views also means that markets are less anchored beyond the June fixing and in our view the risk is tilted towards higher pricing beyond that, at least in the near term. For one, markets may interpret the divergence as a slowing factor in the pace of rate cuts simply because the ECB will only make moves with broad support. Secondly, US inflation data, including this week's PCE, remains hot and thus a drift of US yields up can drag eurozone rates along. Lastly, market positioning and consensus may underestimate the probability of just two cuts this year, with a recent Reuters survey showing only 7 out of 97 economists forecast 50bp of cuts (no one less).

Growth dynamics will also play a role in drawing the ECB's path beyond June and Tuesday's flash PMI figures will be a gauge of the ability for eurozone growth to recover during tight monetary policy. The composite eurozone PMI only just broke above 50, and with German manufacturing remaining a drag, the positive trend is still a fragile one. ECB council members expressed concerns about the poor growth in many eurozone countries and only a considerably higher PMI number would likely argue for a repricing of rates higher purely on the back of this data.

Tuesday's events and market views

PMIs for the eurozone, France, Germany, UK and US are the highlight in terms of data. From the US we also have new home sales and the Richmond manufacturing index. In addition, the ECB's Nagel and Panetta will be speaking.

For issuance we have an EU dual tranche syndication of a new 3y alongside a tap of an existing 20y bond which could come in around €7bn in total. Finland is set for a 10y syndication typically worth €3bn, Italy an auction of 2y BTPs and 5y/12y BTPei totalling €5bn, and Germany will auction €5bn 2y Schatz. The US will auction $69bn of new 2y Notes.

Authors

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com