

## Rates Spark: Hawkish blinkers

We are a bit surprised the market has not moved more on the Fed's firm preference for a holding pattern on rates. Bottom line we see pressure for yields to edge higher on a multi-week view. Not happening so far, but that's the view. From the BoE, our economist's base case is a 9-0 vote to hold after the 6-3 vote in December. Another holding pattern ongoing...



### Market rates should reverse and edge higher again, at least for the coming weeks

We are a bit surprised the market has not moved more on the Fed's firm preference for a holding pattern on rates. As far as the market discount is concerned, there's still near a 50% probability attached to a cut in March. This must change. We still think this should be in the 35% area, in terms of probability for a cut for March. And as it moves there, it can pressure the 10yr yield back above 4%, and it should stay above for a bit. The refunding story this morning has a bottom line narrative of heavy supply. There is too much talk there on silver linings. Bottom line it's heavy. And now we see the Fed is not cutting. At least not yet. As that gets factored in it's tough to see market rates ratcheting lower here. The NY Community Bancorp story also looks isolated, so far, and so not systemic. Bottom line we see pressure for yields to edge higher on a multi-week view. Not happening so far, but that's the view.

This was the FOMC meeting from which some big decisions on quantitative tightening (QT) tapering was thought to be indicated. We've been of the consistent opinion that the runway the Fed is on in terms of QT is perfectly fine. The Fed can continue to do the \$95bn per month for at least the coming 5 months, and after that it could either continue at this pace for another 6 months and then stop, or it could taper if it chooses to. Either way they have time, and that appears to be the way they have approached it at this meeting. It seems the market got too attached to commentary on telegraphing QT intentions from the previous FOMC minutes. This was no more than an early prudent discussion, and not a significant telegraphing event. This Fed is on a holding pattern here too, maintaining the QT at its current pace. We view that as perfectly fine at this juncture.

On the refunding numbers, even though the issuance projections for the second quarter are steady versus the first quarter, they are still projections at an exceptionally elevated level as set for today's release for the first quarter. Importantly there are no indications for a fall in net issuance ahead, and we should not expect one, as the US deficit remains far too high. Moreover, there is no plan in Congress to get it materially lower. Markets are parking the issuance pressure story here in favour of a focus on interest rate cuts as the big theme for 2024. But once the novelty of rate cuts wears off, markets will realise that the issuance pressure has not gone away. This ultimately will place upwards pressure on market rates. The interest rate fuelled bull market ahead should morph to a bear market for the back end should we indeed achieve a soft landing with lower front-end rates. But that's for later.

## Bank of England to drop its tightening bias

Nobody expects the Bank to change policy Thursday. Yet, when the [BoE changes its language](#) to drop any suggestion that policy rate could rise further it will be a dovish shift, even if it leaves references to policy needing to "stay sufficiently restrictive for sufficiently long" and staying "restrictive for an extended period" in place. The market may be far ahead, pricing already 115bp in cuts for this year starting as early as May and it may limit the further downside to rates, but the Bank's evolution of language is a move in the dovish direction.

Pushback could probably come more indirectly via the Bank's inflation forecasts. That would be the case if the two-year inflation forecast would still come in a little above 2% in the update, indicating that the rally in market rates since the November release is offsetting disinflationary effects on this horizon.

The final factor to watch is the voting split, which could be used by hawks to display their dissent by still voting for a hike – or on the dovish end a vote for a cut. Our economist's base case is a 9-0 vote to hold after the 6-3 vote in December.

### Friday's events and market view

Downside surprises in [French](#) and [German](#) inflation releases took the edge off the wider eurozone flash CPI release on Thursday. The consensus has it at 2.7% year-on-year in the headline and 3.2% in core. We will also get manufacturing PMIs for Spain and Italy alongside the final eurozone figure, as well as the eurozone unemployment rate.

Notable US data releases for Thursday are the initial jobless claims as well as the ISM manufacturing. The former are seen staying above 200k and the latter to stay softer in the headline, but with minor increases in employment new orders and prices paid sub

components.

Thursday's Eurozone govie supply slate is busy with French 10 to 30Y (up to €13bn) and Spanish 5 to 10Y plus linker auctions ( up to €7.25bn in total).

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