

Rates Spark: Drawing a line under EUR rates

Central bank comments have helped draw a line under euro market rates. We think 2% is a decent bottom for 10Y Bund yields. The rally is also at risk of higher gas prices, or if today's PMIs don't confirm the market's rosy price assumptions



Robust vs gradual, 50bp hikes have the edge at the ECB

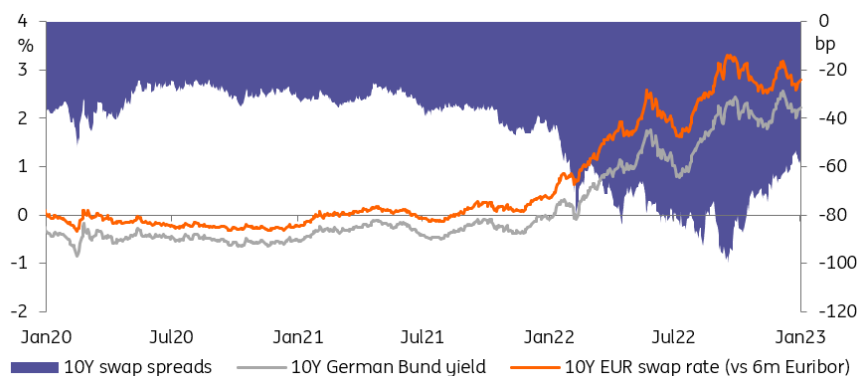
European Central Bank (ECB) officials are making full use of the last days before their pre-meeting quiet period starts this Thursday. There appear to be little appetite to deviate from the guidance given in December that the February meeting will see another 50bp hike. Whether the same holds for the March meeting is less certain, but only a couple of national central bank governors came out in favour of a more gradual pace of increases going forward, understood to mean 25bp increments.

We wouldn't overplay the importance of ECB guidance more than one meeting ahead

In a sense, we wouldn't overplay the importance of ECB guidance more than one meeting ahead. The March meeting will feature a new set of staff economic forecast which will go a long way

towards shaping policy decision. Our base case is that, out of consistency at least, President Christine Lagarde will repeat the March 50bp guidance at next week's meeting, but we think market direction is more likely to be dictated by economic releases, for instance today's PMIs, and especially the components related to inflation.

10Y Bund and swap rates have held the bottom of their ranges at 2% and 2.5% respectively



Source: Refinitiv, ING

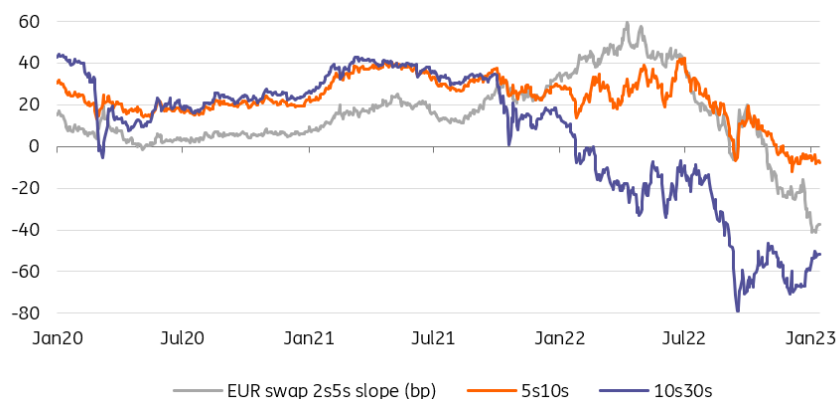
Hawkish skew helps draw a line under EUR rates

What happens after that is the object of less discussion but is of no less importance. The hawks are already positioning for hikes at the May and June meetings although few doubt that, by that point, more dovish members will have managed to push for a downshift to 25bp increments. Similarly, there has been comparatively fewer pot shots taken at market expectations of up to 100bp worth of rate cuts by end-2024. There is no doubt in our mind that pricing policy easing this far from the end of the tightening cycle is presumptuous, even if we assume that markets are right about the amount of Fed cuts to be delivered by that time.

We suspect that short-term longs are likely to take profit before next week's Fed and ECB meetings

All these considerations have acted as a barrier to 10Y Bund yields crossing below 2%, and for 10Y EUR swaps approaching 2.5%. We identified both levels as the likely bottom of the range for EUR rates this year and we think ECB policy will be instrumental in enforcing it, at least before the midway point of 2023 is reached. Meanwhile, we suspect that short-term longs are likely to take profit before next week's Fed and ECB meetings, and a rebound in natural gas prices has also pressured rates higher.

ECB rate cut expectations have inverted the swap curve, this will take time to reverse



Source: Refinitiv, ING

Today's events and market view

Today's economic highlight is a first glimpse of January PMIs in Europe. Following the improvement in economic surprise indices as well as market economic sentiment, consensus is for a rebound in both services and manufacturing PMIs. Any comment on respondents' price expectations will be particularly relevant in assessing the sustainability of the January bond market rally. We think it has run out of steam already.

The same indices will be released for the UK and US later in the day. UK data also feature CBI orders and prices, whilst two regional Fed surveys will be the highlight in the US, from the Philadelphia and Richmond Feds.

The Netherlands are scheduled to sell 30Y bonds for €2bn, and Germany to sell €1.5bn of a green bond maturing in just under three years' time. The EU also mandated banks for a syndicated tap of a 30Y bond.

Today's roster of ECB speakers include Klaas Knot, Boris Vujcic, and Christine Lagarde.

Authors

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

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