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Rates Spark: End-of-cycle vibes in rates markets

The European Central Bank probably has one more hike in the tank, but it looks like the end of the global developed markets tightening cycle is near. Curves responded in kind by bull-steepening. More is on the cards but not in a straight line, with US jobs and US CPI the next banana skins. Latest data on Fed help for banks also out overnight - we assess.

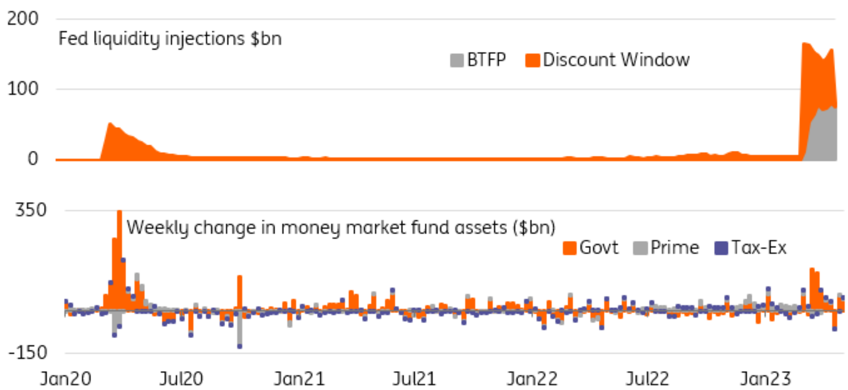
US money market fund inflow alongside easing lower in emergency help from the Fed

Despite the elevated pressure in the US small bank sector, there was no evidence of elevated angst in terms of takedown of emergency help from the Federal Reserve. The latest data through to the close on Wednesday in fact show an ease lower in overall Fed access of help to banks. In total Fed help fell to US$ 318bn, down from US$ 334bn. Moreover, there was a signifiact fall in use of the discount window, which fell from US$ 74bn to just US$ 5bn. Somewhat surprisingly, use of the bank term funding facility also fell, from US$ 81bn to US$ 76bn. This certainly suggests less need for such avenues of liquidity. It is also posible that such facilities are a tad tainted, even if their use in anonomised. What is holding up Fed help for banks is through the more opaque liquidity credit / FDIC route, and no doubt the end game for First Republic was a factor here.

We also expect ongoing outflows from bank deposits

There was also an inflow into money market funds registered. In the previous week there had in fact been an outflow, but that was reversed this week. Total liquidity in money market funds is now up to a record US$ 5.3trn. The deposit data lags by a couple of weeks, but it is quite possible that this could correlate with some deposit outflows over the same period. Overall inflows to government funds increased by US$ 37bn this week. It's big, but not a massive number in itself. We saw larger numbers immediately around the demise of Silicon Valley Banbk. But it becomes very large if annualised (US$ 1.8trn). That's the key here - whether it persists. We think it likely does. We also expect ongoing outflows from bank deposits, not because of small bank concern alone, but also the impact of ongoing quantitative tightening on large bank deposits; actually it's a natural consequence.

Recourse to the Fed's emergency facilities fell after the fall of First Republic but money market inflows continue



Source: Refinitiv, ING

The ECB downshifts to 25bp hikes, and markets contemplate the end of the hiking cycle

The ECB delivered the 25bp hike most expected yesterday but the accompanying statement initially led the market to believe that doves had gained the upper hand. Forward guidance for more tightening didn't make it back to the statement, and a new emphasis on 'forceful' transmission of past rate increases suggested the ECB was shifting to a wait-and-see mode. This was balanced by a decision to fully end APP reinvestments from July onwards, a probable concession to the hawks. Currently, portfolio reduction amounts to €15bn per month, and will accelerate to €27bn per month on average from July as reinvestments are discontinued.

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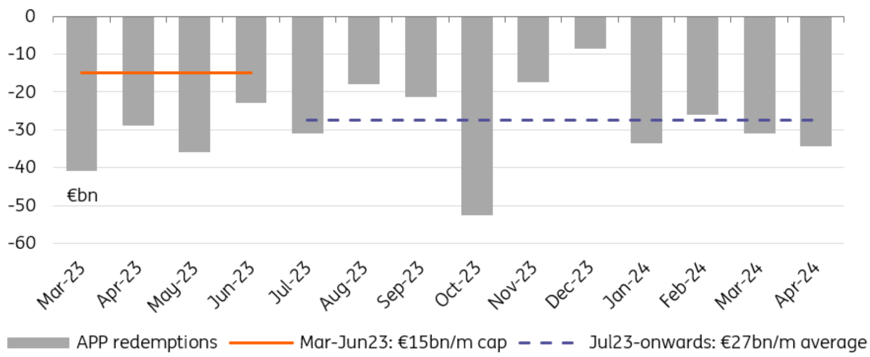
The market reaction was to power-steepen, with the front-end pricing a more dovish path for ECB policy rates in the coming quarters, and with the long-end coming under selling pressure with lower central bank protection against inflation. It is notable however that the uptick in inflation swaps was relatively muted, and that swaption-implied volatility actually fell throughout the day. The latter can easily be explained by the growing conviction across markets that this central bank tightening cycle is coming to an end. As a result, EUR 2s10s ended 8bp steeper and 10s30s 4bp steeper.

In July, ECB quantitative tightening will go from €15bn/month to €27bn/month on average



Source: Refinitiv, ING

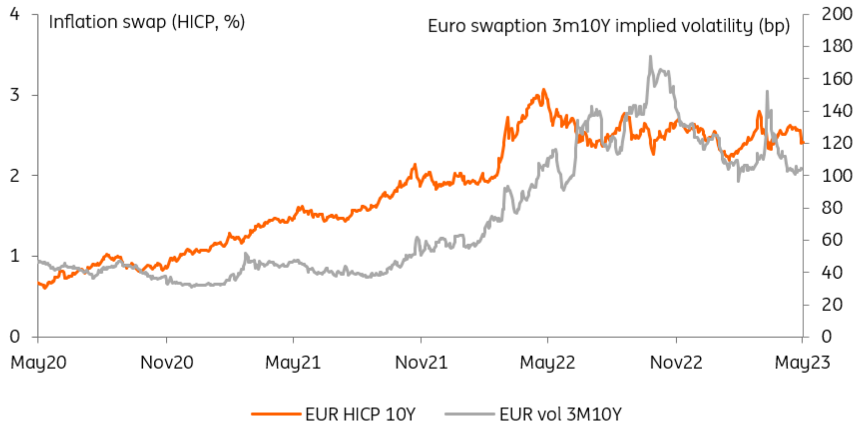
Rate cut conviction increases but a lot of potential banana skins in the coming days

Of course ECB President Lagarde was careful to set the record straight. If the statement contained no indication about future rate hikes, her press conference was dotted with hints that more tightening is in the cards, subject to incoming data. This is not enough in our view for markets to draw a clear distinction between Fed and ECB policy, something Lagarde tried, unconvincingly, to do at the end of the Q&A. A less hawkish-than-expected ECB message prevented further inversion of EUR forwards but as the consensus for Fed cuts strengthens, helped by regional banking troubles, we think European rates market will soon jump to the same conclusion.

Attitude towards US regional banks has been a greater driver of rates volatility than central banks themselves

This should limit the upside risk to rates in Europe as in the US but the path towards lower rates is likely to remain choppy. Today brings the US job report, a notoriously noisy indicator, and which may well wrong-foot markets intently looking for signs of a cooling labour market. The same goes with the April CPI report due to be published next Wednesday. This is saying nothing of the market's attitude towards US regional banks, which has been a greater driver of rates volatility than central banks themselves. It is unlikely that the Senior Loan Officers' Survey will brighten the mood on Monday. Expect more volatility but, the longer this goes on, the greater our conviction that the end of the developed markets tightening cycle is near.

Curve steepening supported by neither higher inflation swaps nor implied volatility



Source: Refinitiv, ING

Today's events and market view

Industrial production from Spain and France kicks off today's economic calendar. This will be followed by Italian and eurozone retail sales and by German and UK construction PMIs.

The ECB will also publish the survey of professional forecasters, a release it regularly refers to for indications of inflation expectations.

The fireworks will have to wait until the afternoon, however. The US employment report will cap a week rich in event risks, and will cast some light on market hopes that the May Fed hike was the last in this cycle. A steady decline in job growth is expected, but we would argue that moderation in wage growth is what the market is really looking for.

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