

## Rates Spark: Europe bracing to spend on defence

Support for more defence spending is growing in Europe as the US takes a step back. Joint EU borrowing could be a way forward and the latest on German politics will therefore be watched closely, with long end Bund yields already nudging higher. Dutch pension funds might face complex choices if the final version of the legal proposal finds political support



French President Emmanuel Macron and UK Prime Minister Keir Starmer in Paris, France

### Spending needs clear as EU security landscape rapidly evolves

The US pushing ahead and engaging with Russia over a deal in Ukraine has instilled a sense of urgency among European leaders. Events are evolving fast with US and Russian officials meeting in Saudi Arabia today to discuss ending the war in Ukraine – with neither Europe nor Ukraine having a seat at the table.

At least at the start of the week, the rates market's focus appeared to be on the supply implications of Europe's drastically changing security landscape, as EU officials signalled the need for an immediate ramping up of military spending and an easing of fiscal rules to accommodate the added funding need.

The prospect of joint borrowing to fund the EU's defence needs had also received more tailwinds as the frontrunner of the upcoming German elections indicated some openness to the idea. It may still take months, with Friedrich Merz of the German CDU pointing to upcoming discussions at the NATO summit in the Hague in June. The outcome of the German elections on 23 February are [part of the puzzle](#). The composition of parliament will determine how easy it will be for Germany to reform its debt brake, which needs a 2/3 majority.

Long end Bund yields rose by up to 6bp, also partially unwinding the outperformance versus swaps that was witnessed at the end of last week. The 30Y Bund yields at 2.74% is still some 10bp off from January's peaks when European Central Bank (ECB) pricing was at its most hawkish point. For now, the front end reaction has been more muted, with the terminal rate pricing for the ECB still anchored at around 2% to slightly lower.

## Final proposal for change in Dutch pension reforms has been published

The New Social Contract (NSC) coalition party in the Netherlands published a final version of its legal proposal last week, which could [potentially disrupt](#) the ongoing [Dutch pension fund reforms](#). The latest adjustments to the proposal would allow pension funds to avoid a vote of approval by offering an opt-out to each participant instead. Those that object would only see their new contributions move to the reformed defined contributions system; existing assets would remain under the defined benefits scheme. For pension funds, the downside of choosing the opt-out path would be the need to run two pension pots in parallel, while a successful vote would allow a complete transition of assets to the new system. Parliament will discuss the proposed amendment in early March.

The potential impact from this additional feature remains difficult to assess, as the outcome would rely on the choices made by both pension funds and their participants. Assuming the legal amendment makes it through both parliament and the senate (which still seems unlikely), then pension funds would have to decide which path to take. Surveys suggest that finding a majority to vote in favour of the new defined contributions system will prove difficult. If for that reason many funds decide to offer an opt-out option, then we could see a more fragmented pool of assets. Given the uncertainty, we can imagine that pension funds will take a more passive approach to [rebalancing their interest rate hedges](#) for the moment. As such, any steepening pressure due to changes in longer-dated fixed receiver demand may ease for now.

### Tuesday's events and market view

US markets will be back from their holiday yesterday. With German politics in the spotlight, the outcome from the ZEW survey expectations will be closely watched. Consensus sees the expectations component improving moderately from 10 to 20. From the US, we have the empire manufacturing index and TIC data. Overall, we expect news headlines to grab more attention than data releases.

Supply-wise, Germany is auctioning a 2Y Schatz for €4.5bn and Finland 5Y & 10Y RFGBs for a total of €1.5bn. In Italy books are opened for the second day for the 8Y BTP Valore retail bond – subscriptions on the Monday reached €5.6bn. The UK will auction a 39Y Gilt for £1.75bn.

## Author

### Michiel Tukker

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).