

Rates Spark: Expectation management

The glass-half-full view some market segments are taking contrasts with rates' reluctance to price out hikes to the same degree. Caution concerning inflation remains warranted, and absent a notable rise in growth concerns, longer rates can still go higher



With oil prices still elevated, rates markets continue to remain concerned about inflation

Some risk assets have more than fully retraced, but rates are right to remain concerned about inflation

Markets continue to take the glass-half-full approach to the situation in the Middle East. One could easily argue that valuations start to look vulnerable here. After all, some market segments have already fully retraced the drawdowns caused by the turmoil. At the same time, the Strait of Hormuz remains effectively closed for now. As time passes and expectations are not met, real knock-on effects could start to be felt clearly – after all, economies are living off reserves. In the background are stories such as the IEA warning that European airlines have maybe six weeks before they run out of jet fuel, or the IMF again warning that the economic damage is being underestimated.

[The ECB minutes](#), meanwhile, confirmed the central bank's hawkish shift. Still, it was signalled again that there is unlikely to be enough data available at the upcoming meeting in two weeks' time to change the policy stance. Market pricing for the April meeting has continued to slide, with only 3bp of tightening now in the forward rate. With an implied probability of just over 10%, an April hike scenario has effectively been reduced to a tail risk.

Further out though, the market pricing did bounce off from a low of seeing just 50bp of tightening by year-end. For one, oil prices have moved a little higher towards US\$100/bbl again. But we also think the significance of the 50bp might rest on the 'one is none' narrative. While this is a fair assumption in the sense that you want a policy shift to be effective, our own revised base case scenario actually sees only one rate hike. Of course, this remains highly path-dependent on the energy situation, but we think it is a plausible scenario if one views the ECB's strategy through the lens of expectations management and the ECB's concerns around the credibility of its reaction function.

We think rates markets are right not to look through the inflation story as readily as some other market segments. Keep in mind that the containment of longer rates, absent a notable rise in growth concerns, is premised on the reaction function that the market is pricing on the front end. That is a delicate balance the ECB needs to manage, and also leaves the long end still prone to temporary rises.

Friday's events and market view

Despite the growing optimism in some corners of riskier asset markets, investors are still looking to the Middle East, especially ahead of the weekend.

In terms of data, the week will end on a quiet note, with the eurozone trade balance for February the only release of interest. Central bankers will still be speaking, with some focus this time on the Bank of England, with Sarah Breeden and Chief Economist Huw Pill speaking. From the Fed, Mary Daly, Thomas Barkin and Christopher Waller will be speaking. But overall, markets should already have a clearer picture of central banks' thinking after the busy communications over the past few days.

Primary markets are also quiet with no scheduled bond supply for the day. Rating agencies have pencilled in review dates for the Netherlands (S&P), Belgium and the EFSF (Moody's), as well as Italy, Slovakia and the EU (DBRS).

Author

Benjamin Schroeder

Senior Rates Strategist

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.