

## Rates spark: fast, faster, too fast

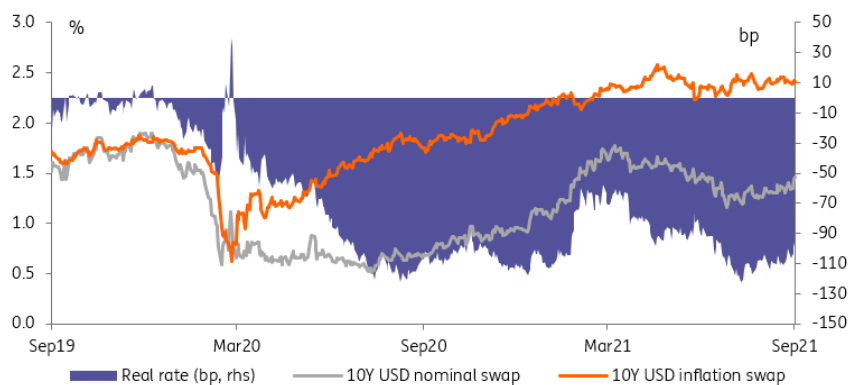
The Fed and BoE, having tilted more hawkish this week, have finally seen an overdue follow through in higher yields. The ECB still follows a dovish playbook which should put some more distance again between US and UK rates on the one side and EUR on the other. But the US is on a drive higher, led by the belly, and culminating in higher long end rates.



### The US 10yr break above 1.4%; it had been coming ...

The move in US rates is coming from the belly of the curve; its been becoming cheaper and that's a classic bearish construction. It's what you would expect to see happen as a curve begins to position for a future rate hike, but not an imminent one. The 5yr area has been cheapening over the past couple of weeks in fact, quietly but surely. It snapped cheaper again after the FOMC yesterday. Not immediately after, but by the end of the US trading day.

## Real rates led the way higher in yesterday's sell-off



Source: Refinitiv, ING

The move is being driven by a nudge higher in real rates, which is good to see. There has been some de-risking in evidence from flows in the past couple of weeks. Evergrande masked some of this on Monday, and saw market rates come down, back below 1.3%. But the tendency in the past few weeks has always been to test higher. We've now practically hit 1.4%. Big move. If we hold here, and even break above in the coming days, then 1.5% is the logical next level. And we'll then see from there.

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*We need to watch system risk here*

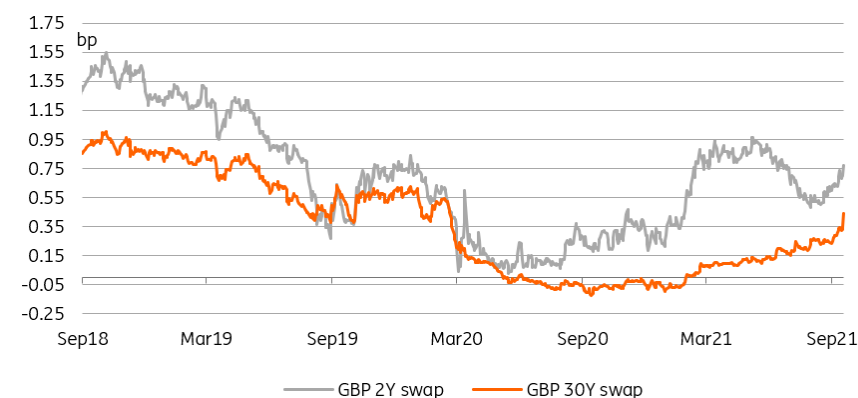
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We need to watch system risk here tough. USD Libor is a reasonable measure of this. It's been edging higher since Evergrande really broke as a global story on Monday. Any material correlation from this story would add further to system risk, putting a bid back into Treasuries. That apart, the test higher in yield makes a degree of sense. It was coming ...; its been becoming cheaper

### Bank of England: Bringing it forward

The BoE added fuel to the bond fire yesterday. One could even argue that the buck would have stopped in the European morning had it failed to stoke hawkish fears in its minutes. In the event, it didn't. The change of language was subtle but was apparently enough to send GBP rates into a tailspin. Interestingly, the curve already priced a 15bp hike in 1Q 2022 ahead of the meeting. It now implies that the threshold to start balance sheet reduction, the Bank Rate at 0.5%, will be reached before the end of next year.

## 2Y GBP are catching up to long-end rates



Source: Refinitiv, ING

*We think doubts will grow in the market's mind*

We have misgivings about the path implied by the curve. For one thing, our economics team stresses that the UK will likely go through a rough patch over the winter months. This would make policy tightening incongruous. More importantly, the questionable case for imminent tightening hinges on an acceleration in wage gains. Nothing is less certain. It is not easy to move 2Y gilt yields by 10bp in one day. We think doubts will grow in the market's mind and cause a retracement over the coming weeks. This is all the more true if the rise in yields starts causing jitters in risk assets.

### While the BoE and Fed tilt more hawkish...

A week of central bank action has shown us that policymakers are ready to move towards reining in on loose monetary policies introduced during the pandemic. In particular front end rates have ratcheted up at first, although the follow through in the US today has seen the move higher propagate further out the curve.

Despite the hawkish shifts from both central banks, there is also a decent amount of skepticism in the market with fears that central banks are too ambitious in their plans to dial back stimulus in the face of uncertainty surrounding the outlook. This is playing out in the very back end of yield curves which have seen a considerable flattening in the wake of both meetings, especially as first reactions, when the front ends priced in faster policy tightening. As there is no single event to resolve this sense of caution, but rather the flow of data over the coming months that will determine the outcome, that dynamic is more likely to stick around for now.

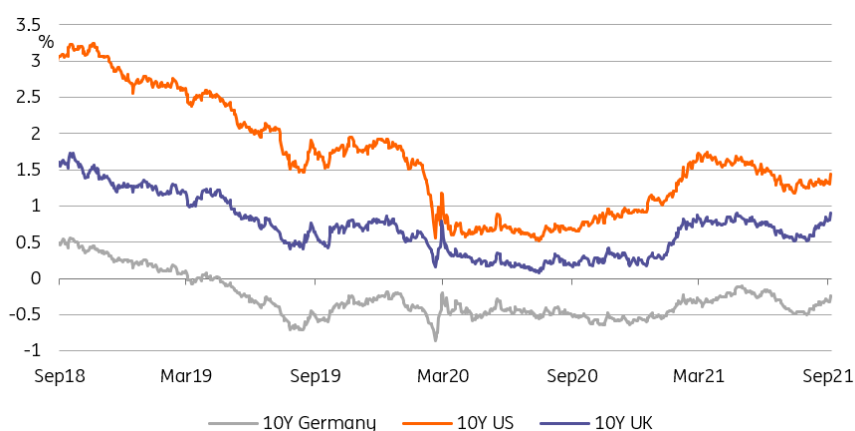
### ... the ECB is not there yet

EUR rates, coming from a very low absolute yield level, may still follow a different pattern. The central bank is also still following a very dovish playbook, even if hawkish surprises might still emerge as the discussions going into the all important December meeting gain momentum. Opportunities abound as the ECB's central banking forum with its busy slate of prominent speakers

will be opened by President Lagarde next week. That the inflation estimate for September is likely to show increasing price pressures might seem like a viable flashpoint next week, though we have assurances of ECB officials of being "vigilant, but not worried."

EUR rates will see themselves confronted with a pick-up in supply activities, overall some €20bn in European government bonds as well as the EU's first tap auction. But longer duration bonds do not feature prominently, and with a view to Italy in particular, last week's announcement that an anticipated ultra-long bond syndication for Autumn would be skipped should outweigh. In short, still muted supply in Europe alongside month-end flows next week should help to cap the upside in yields, especially relative to USD and GBP rates.

## The chasm between EUR rates and their GBP and USD peers is set to widen further



Source: Refinitiv, ING

### Today's events and market view

Following on the heels of yesterday's PMIs we will get the German Ifo today. European bond markets will also consider that it is the last trading day ahead of this weekend's general election in Germany. Here the latest polls still see the SPD in the lead, though the CDU/CSU has gained ground of late. Not that all will be known after the weekend; all indications are that government formation talks are likely to take a long time.

Fed speakers should shift into focus in the afternoon given Wednesday night's surprisingly hawkish FOMC meeting. Today's busy schedule including an appearance by Chairman Powell at a "Fed Listens" event offers the opportunity to further clarify positions.

In today's supply Italy will offer a 2Y BTP short and a 10Y linker for a total of up to €3.5bn.

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