

Rates Spark: Finally a breather

Whether it is the end of the rally or not, there are good reasons to take a breather. The Fed meeting next week is drawing closer, with a crucial CPI release just ahead of it. Resuming Treasury supply will add another technical headwind. But already today we see a consumer inflation survey that has swayed the Fed before. The ECB will announce the TLTRO repayment



Source: Shutterstock

Rates rally puts in a breather, but the Fed's patience is likely tested already

Just as we were starting to wonder whether the rally was ever going to stop, Treasuries put in a breather yesterday. The extent of the move and its contrast to the messaging from the Fed would have been reason enough already earlier on. But now the actual FOMC meeting next week is within grasp, including another crucial inflation report just ahead with Treasury supply to top it off.

Already today will see data that could give reason for pause

Already today will see data that could give reason for pause. While the PPI data is seen to confirm easing pipeline inflation pressure, the University of Michigan consumer survey could be a bit more of a wildcard. One is tempted not to place too much weight on the reading given the relatively small sample size, but we recall the FOMC having had an eye on that measure when they decided to hike 75bp in June, despite earlier guidance of a 50bp hike. Currently, market consensus looks for unchanged consumer inflation expectations.

The June meeting set a recent precedent about the Fed swerving way from prior guidance. We do not know what it would take to tip the Fed towards placing another sounding with the press in order to steer market expectations ahead of a meeting. But the way current money market and yield curves are plotting for the path of key rates, at least beyond the upcoming meeting, is not aligned with the narrative that the Fed is trying to instil in markets.

10Y Treasury yields have dropped through 3.5% into the December FOMC



Source: Refinitiv, ING

A TLTRO piece to the ECB's balance sheet puzzle

Today at 12.05 CET the ECB will announce the amount that banks will repay of their currently outstanding TLTROs ahead of year end. That amount will come on top of the €52bn TLTRO.III tranche that matures this month. We are looking for an early repayment of around €200bn, but admittedly it is not a high conviction call. Already ahead of November's repayment, polling pointed to a wide range of forecasts from €200bn to €1.5 trillion for total repayments this year. The close to €296bn that materialised last month was clearly at the lower end of expectations, and likely also a disappointment for the ECB itself.

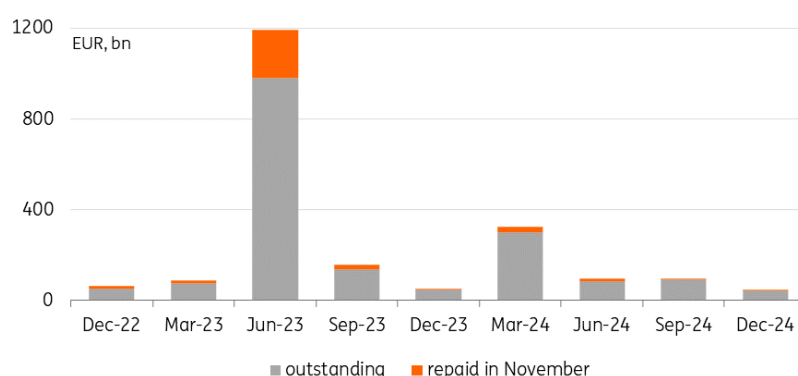
The TLTRO repayments were seen as an important first step in the ECB balance sheet reduction process

From the October ECB accounts we gathered that the TLTRO repayments were seen as an important first step in the balance sheet reduction process. The amounts repaid could also inform the decision on the reduction of the asset portfolios. According to the minutes the Council deemed the TLTRO recalibration "more efficient" than trying to achieve the same objective through an earlier start of (quantitative tightening) QT or more aggressive interest rate hikes. Taken at face

value, that would imply another disappointing repayment could prompt a more hawkish reaction from the Council to achieve the desired pace of policy tightening – be it via rates or faster QT. However, one should also be aware that year-end considerations can influence repayment decisions and one should not move to rash conclusions. In any case it could spice up the Governing Council deliberations, where our economists have been seeing [the risk of another 75bp rate hike on the rise again](#).

Our main take remains that there is an overarching desire by the ECB to withdraw the exceptional accommodation provided via its balance sheet. And we have repeatedly said that we think the ones that have benefitted the most now also most at risk for an adverse market reaction. Yet, especially sovereign bond spreads of the eurozone periphery have proven remarkably resilient so far. While there was some widening in the 10Y Italian-German spread of around 5bp, it still remains at a relatively tight 186bp overall.

The ECB has incentivized early TLTRO repayments, with modest results so far



Source: ECB, ING

Today's events and market view

The rates rally has finally put in a breather. A level of 10Y US Treasury yields below 3.5% still looks stretched and today's data could give first reason for pause. Less so the PPI data, where the consensus is looking for a clear decline in wholesale prices. Probably more eyes will fall on the preliminary readings on surveyed consumer inflation expectations by the University of Michigan. Consensus is not seeing any change here, making it a bit of a wildcard. But there is a precedent for the Fed putting some weight on this measure.

Away from the US the focus in the Eurozone is on the ECB's TLTROs and the announcement of banks' early repayments for December.

Author

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@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.