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

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

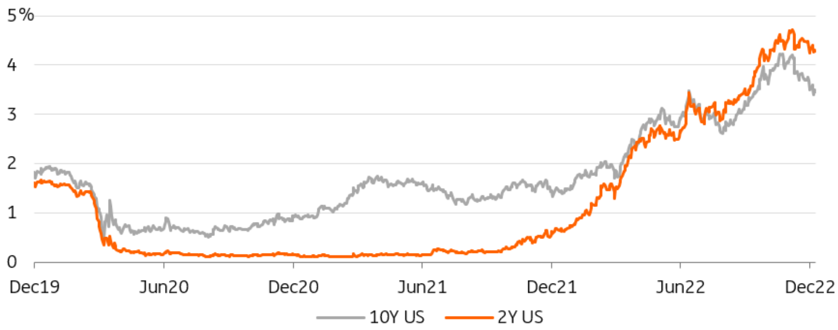
Just as we were starting to wonder whether the rally was ever going to stop, Treasuries put in a breather yesterday. The extent of the move and its contrast to the messaging from the Fed would have been reason enough already earlier on. But now the actual FOMC meeting next week is within grasp, including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

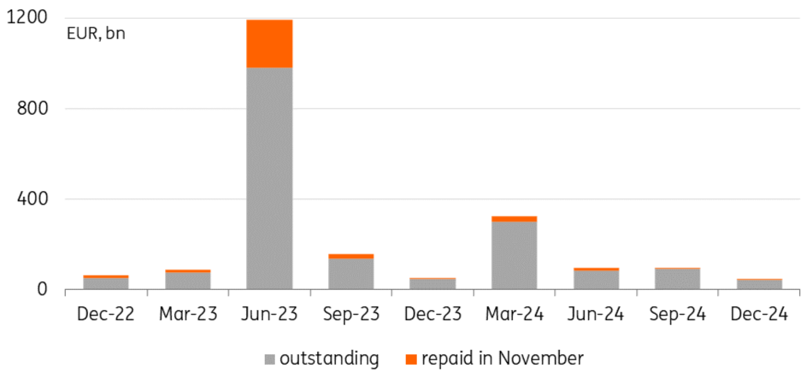
Today at 12.05 CET the ECB will announce the amount that banks will repay of their currently outstanding TLTROs ahead of year end. That amount will come on top of the €52bn TLTRO.III tranche that matures this month. We are looking for an early repayment of around €200bn, but admittedly it is not a high 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 wholsale prices. Probably more eyes will fall on the preliminary readings on surveyed consumer inflation expecations by the University of Michigan. Consensus is not seeing any change here, making it a bit of a wildcard. But there is a precendent 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 annoucement of banks' early repayments for December.

Author

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com