

Rates Spark: More headwinds for euro bonds next week

The European Central Bank's pushback against market rates lower has had modest success so far, but we think more headwinds are brewing for EUR rates in particular. It is not just from the last dash of ECB communications ahead of the quiet period, but also from the direction of supply and data next week



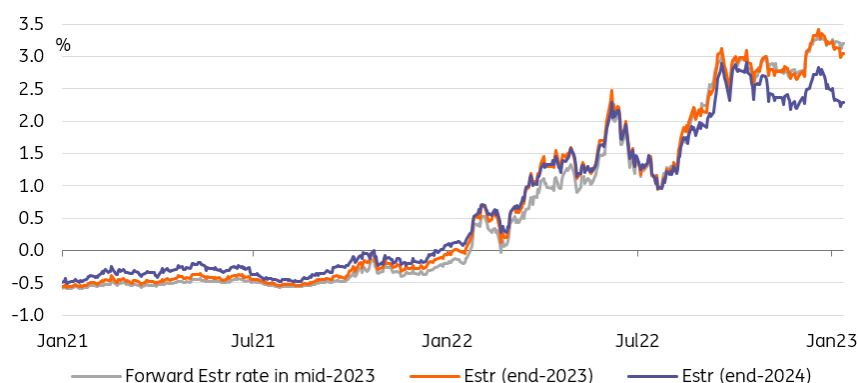
The ECB's pushback is becoming more explicit

US markets remain focussed on the looming recession, though data not being quite as bad yesterday allowed for a modest bounce back in rates. But it was a bigger bounce in Bund yields where we witnessed more pushback from the ECB against the notion that its rate hikes could be downsized to 25bp starting in March. Going into the session the ECB's Klaas Knot put it very bluntly, saying that the ECB was planning on hiking by 50bp 'multiple' times. President Lagarde, who had originally given out a series of 50bp hikes as a guidance at the last meeting, was less explicit in her remarks. She did make it clear, though, that inflation remained way too high and that the ECB would stay the course.

Knot: The ECB is planning on hiking by 50bp 'multiple' times

The [minutes of the December meeting](#) which were released yesterday gives us more reason to believe that we have not seen the last of the ECB's efforts to steer market expectations higher again. In December the central bank assessed that the "configuration of interest rates and expectations embodied in market pricing was not sufficiently restrictive". After the temporary push higher in market rates over the year-end, these rates are now close to where they were just ahead of the last meeting. While the ECB has officially moved to a meeting-by-meeting approach, it implicitly still sees it as crucial to its goals to guide longer term rates. One should expect more micro management of market expectations in coming days.

We expect the ECB to push back against the lower terminal rate and cuts in 2024 priced in by swaps



Source: Refinitiv, ING

More headwinds brewing next week, especially for EUR rates

The distance Bunds have put between themselves and the 2% mark is yet small when benchmarked against the overall volatility we have witnessed, but we think it should grow further. For one we would be surprised if ECB officials were not to make good use of their final opportunities to steer expectations before the quiet period ahead of the February policy meeting kicks in next Thursday. Already scheduled to speak early next week are again Lagarde and Knot, but also Holzmann, on the hawkish end of the spectrum, and Panetta, who occupies the dovish end.

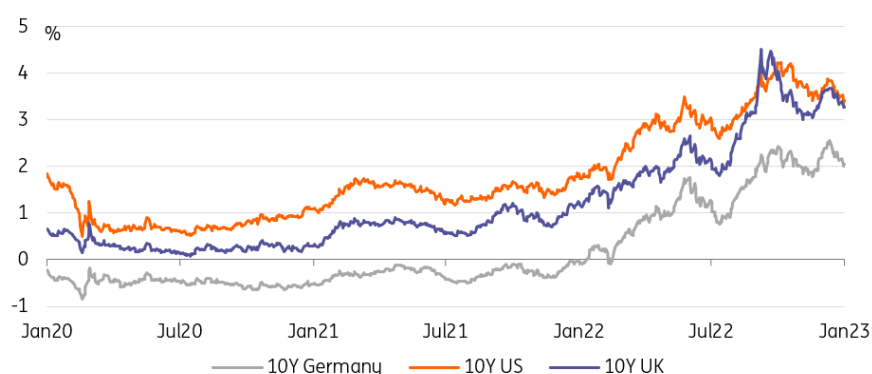
Data and long end supply are other factors to watch

On the data front we will get the flash PMI readings for which consensus is pencilling in a slight improvement. This would gel with the latest less downbeat data, but should also give the ECB additional room to tighten policies more aggressively than the market currently prices. Supply could provide a more technical headwind for rates markets with the EU slated to sell bonds via syndicated deals next week. The EU tends to be an issuer in longer tenors, although lately market expectations seem to have turned more towards a tap of an existing ultra-long bond as part of a

dual tranche deal rather than a new 30Y issue. Scheduled supply from the euro area sovereigns themselves is relatively muted, though markets are still waiting for new issue deals from Spain and France anytime now.

Of course one always has to take into account what happens on the other side of the Atlantic. The Fed will stay quiet next week ahead of its policy meeting, but we may still get some spill-over from market reaction to US data. Most prominently we will get the advance GDP reading for the final quarter of 2022, giving an indication of economic momentum late last year. We will also have the personal income and spending data, which will be scrutinized in the wake of the latest weak retail data readings. And crucially, the Fed's favoured inflation measure, the Personal Consumption Expenditures price index will also be released, where the consensus survey is pointing to a small uptick in the month-on-month core reading.

Supply and profit-taking are key risks to the January bull run



Source: Refinitiv, ING

Today's events and market view

Overall we have already suggested earlier that the current levels of market rates look stretched. The upcoming policy meetings may eventually put the rally to the test, but it is for EUR rates that we see the clearest signs of headwinds brewing already near term – not just from last dash ECB communications, but potentially also data and supply. We think the least we should see is an underperformance of EUR rates versus the US.

The Fed's Harker and Waller are the last scheduled speakers before the quiet period ahead of the Fed meeting sets in tomorrow. In Europe we will hear from Lagarde again today, and given the limited impact of communications over the past days she would have good reason to be more explicit.

Author

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@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.