

Rates Spark: It's all about expectations

It's tempting to call the top in rates, but inflation expectations have to come off first. More hawkish central banks could help, as the Fed's experience has shown, or a global growth slowdown could do the trick.

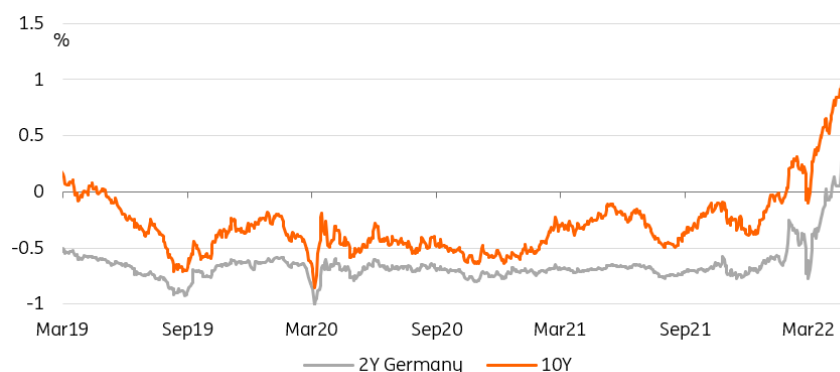


Source: Shutterstock

Growth concerns and hawkish central banks weigh on sentiment

Market sentiment seems to have turned a corner this week on growing Chinese slowdown risk, and with geopolitical tensions never too far from investors' minds. Mixed data has been a reality for some time in developed markets, but not enough to throw central banks off their policy tightening course, at least in the market's mind. Judging from the tone of public central bank comments, markets were generally right in anticipating a hawkish turn on higher energy prices.

German yields may have peaked just as the ECB turned more hawkish



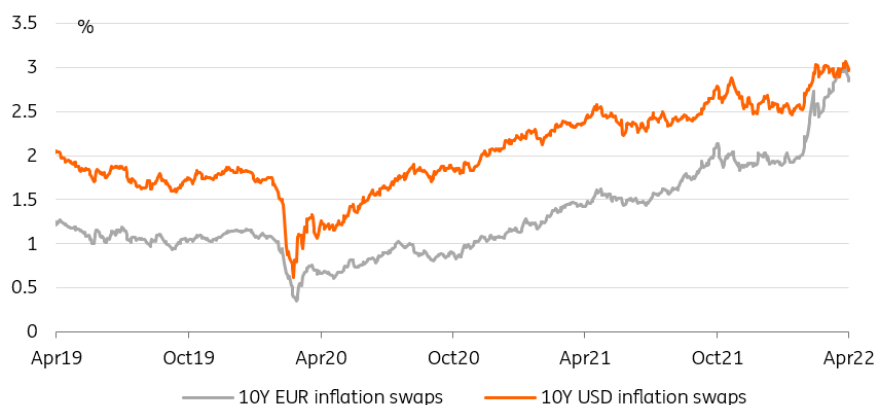
Source: Refinitiv, ING

This is nowhere more striking than in the Eurozone where hawkish talk has picked up a notch in April, and allowed EUR rates to catch up to their USD equivalents, in nominal term at least. This was far from a foregone conclusion despite the US's experience as, for now at least, the vast majority of the currency union's inflation is energy-related. It is also ironic that markets would decide to pay more attention to growth downside risk at precisely the same time as ECB speakers started to validate the policy path implied by the curve.

EUR inflation swaps have caught up with their US counterpart

Despite more reasons to be sanguine about Eurozone inflation, at least on the basis of what is known of local wages developments, long-term EUR inflation swaps have converged to their USD equivalent for the first time since the great financial crisis, both lingering below the psychologically important 3% level. It is tempting to attribute this to a divergence in policy stance between the ECB and the Fed. We continue to regard a turn lower in inflation expectations as a [necessary condition for nominal rates to also peak](#).

It is tempting to attribute higher EUR inflation swaps to the ECB's gradualism



Source: Refinitiv, ING

Concerns about global growth did more than what central bankers could conceivably achieve

The recent surge in hawk-talk at the ECB could be one factor that prevented EUR inflation swaps from crossing the 3% line but we suspect concerns about global growth did more than what any central banker could conceivably achieve. The result has been that EUR real rates failed to catch up to their USD peers despite the sharp repricing of ECB hike expectations, but we think one should also consider the difference in economic outlook with the energy shock still posing a threat to Eurozone growth. This is something our FX colleagues think will continue to cap EUR upside.

Today's events and market view

Madis Muller and Christine Lagarde make up today's list of ECB speakers. We've argued that with the barrage of hawkish comments of late, only doves have the power to move the market's rate expectations. President Lagarde in particular has adopted a more moderate tone than other GC members. Any departure from the 'gradualism' rhetoric could be impactful. If not, markets seems to be in a mood to pay more attention to growth downside risks, of which there are many, than inflation upside risks.

Greece has mandated banks for the sale of a 5Y bond via syndication that we expect to price today. This prompted a nearly 30bp widening of 5Y Greek bonds against Italy on the day of the announcement. Germany will auction 16Y debt and the US Treasury will sell 5Y notes.

It'll be all quiet on the data front, with only US inventories, trade, and pending home sales due for release.

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