Rates Spark: Just listen to what I say

The FOMC statement was balanced and measured, with a nod of acknowlegment toward recent market angst. The verbals from Chair Powell looked yonder to March and translated into the requirement for a catch-up. Market rates have read this only one way, and that's up. In the Eurozone, Italian bonds are under pressure amid the ongoing presidential election.

The Fed outcome was all about listening to the man himself

Not sure why the Fed bothered with the statement at all. It contained nothing. Or at least the statement said there's nothing to see here, versus subsequent verbals that effectively said that every meeting from here is a live one. The juice was all in the commentary from Chair Powell. In consequence, the front end has been hit, and the entire curve has shifted higher. The breakout shows real rates up, and inflation expectations down. The 10yr is back close to prior highs, a remarkable turnaround following a couple of weeks that saw a severe tech sell-off and brewing concern on Russian ambitions with respect to Ukraine.

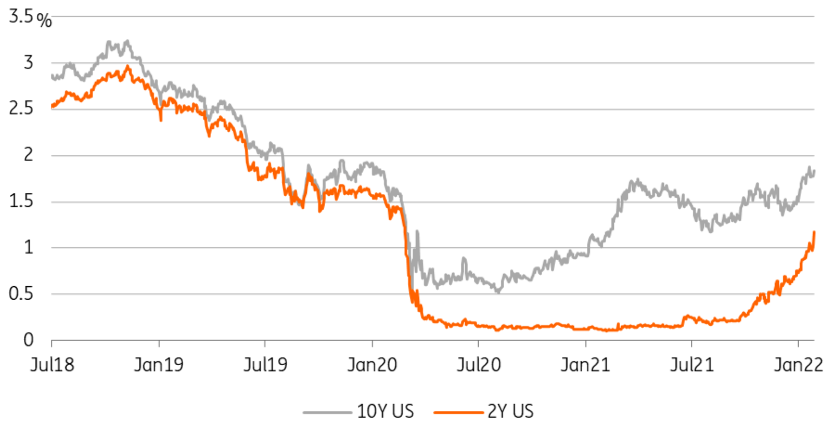
Every meeting from here is a live one

Risk assets don't like this, but it would take a sharp equity sell-off to cause market rates to come back down in a material fashion from here. Then again, remember that equity markets traditionally rally through the first couple of quarters of most rate hiking cycles, as the Fed is typically hiking as the economy is strong and needs quietening. We remain of the opinion that market rates can rise in a net fashion even if risk is deemed to be off.

> *Market rates can rise in a net fashion even if risk is deemed to be off*

How much can the Fed do based off the curve and market levels? The 2yr is discounting 100bp of hikes to begin with, and the curve is worth another 70bp. That's approximately 7 hikes before the curve inverts based off where we trade today. The 10yr can head higher by c.50bp to move the real yield from -55bp to zero. That's another 2 hikes. Those two will be the toughest to pull off, but the preceding 7 are entirely doable simply based off where the curve trades right now. Divide those between 2022 and 2023, with a weight in 2022, as Chair Powell is certainly looking to front load it seems. That's where the market discount is now.

Seven Fed hikes looks entirely doable, simply based off where the curve trades right now



Source: Refinitiv, ING

European bond spreads get to feel Italian politics

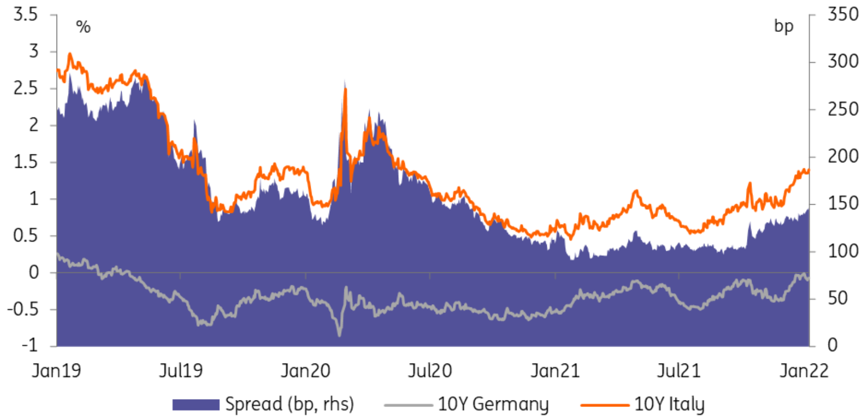
The Fed loomed large over markets but risk sentiment did see a tentative bounce back yesterday, that is at least ahead of the event. Notably in the eurozone this positive tone was not shared by intra-government bond spreads. In particular Italian bond spreads over German Bunds were subject to widening, as markets watch the ongoing presidential election. A widening of 3.5bp on the day may not seem dramatic by itself, but together with the widening over the past days this has now taken the 10Y benchmark spread to over 140bp for the first time since 2020.

The presidential election in Italy is without result after the third day. Starting today, however, an absolute majority will suffice to win the vote (see here for our detailed take on the process and possible outcomes). The main takeaway so far is that looking at the parliamentry landscape we are witnessing a more cohesive political right during the process, which at least in the eyes of the market does not bode well for the general elections in 2023 – that is, should the current government make it that far.

Italian bond spreads may stay elevated, feeling also the pinch from the prospect of waning ECB buying support.

The other takeaway is, that thus far there has not been any indication of an agreement on how a post-Draghi government could look like. That should be a precondition towards putting Draghi up for the role of President. With a lack of such agreement, one could even question the commitment to the current government more generally, raising the spectre of early elections. The political uncertainty in Italy can still increase near term, leaving question marks behind Italy's recovery plans and accompanying reforms. Italian bond spreads may stay elevated, feeling also the pinch from the prospect of waning ECB buying support.

Italian bonds feel the pinch from politics and slowing ECB purchases



Source: Refinitiv, ING

Today's events and market view

The Fed's undeterred hawkishness points the general direction for rates, though headlines surrounding the Russia/Ukraine tensions should be back in the driving seat of market sentiment.

In data the main focus today is on the US where we get the release of 4Q GDP data. Expectations have been pared back in recent weeks on the back of the softer December activity figures with the consensus now looking for 5.3% annualized quarterly growth. Durable goods orders for December are seen dipping -0.6%, while on the more current front initial jobless claims are see easing to 265k. None of the data looks set to change the general course of the Fed, though.

Italian bond spreads in mind, the presidential election process enters a critical phase where now an absolute majority is enough to win the vote.

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