

Rates Spark: Keeping up the hawkish pressure

Market rates are pointing higher as central banks are under pressure to do more. This is exemplified by the latest upside surprise in the US CPI and, in the eurozone, by the ECB pushing the topic of quantitative tightening on all channels. In the UK it is fiscal policy putting pressure on the BoE, and that stand-off continues to be a major source of volatility



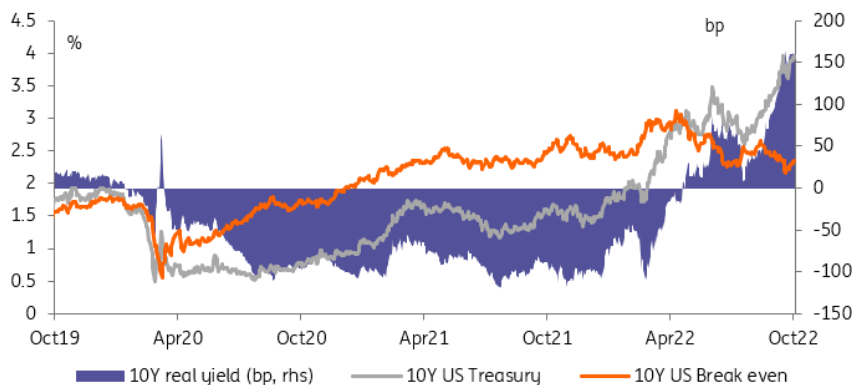
CPI data sends clear signal that the Fed needs to do more

The US CPI report came in higher than expected, with the core rate marking a new peak of 6.6% and surpassing the level seen at which the Fed began hiking interest rates in March. The data is a clear signal that the Fed has more to do. In the wake of the Federal Open Market Committee minutes which showed that the Fed sees the cost of doing too little on inflation outweighing those of doing too much, the market has started to attribute a small chance to an even larger 100bp hike in November, and 75bp now looks like the bare minimum. Looking into December markets now see a 50% chance of a further 75bp. Mind you, our economists still think it more likely that the Fed will slow its pace then.

Looking beyond the pricing of immediate Fed policy, the CPI report briefly pushed the [10Y Treasury yield above 4%](#) again, the third time within the past two weeks. Eventually a break above 4% for the 10Y now looks inevitable as the Fed is unlikely to signal any inclination to slow its pace near

term.

Bearish risk: 10Y Treasuries should rise above 4% and real yields push even higher



Source: Refinitiv, ING

Gilt markets remain a source of extreme volatility

The US CPI report saw 10Y US Treasuries spike with an intraday move of almost 24bp. But that move still pales next to the more than 40bp intraday swing in 10Y gilt yields over the course of yesterday's session. Speculation suggesting a potential U-turn of the government regarding its fiscal plans had been the main driver, leaving 10Y gilts to end the day some 25bp lower at close to 4.2%. The ill-fated long end of the curve saw 30Y gilt yields ending almost 30bp lower.

The BoE is still planning to end its gilt market intervention after today

While it may seem that the Bank of England could win this stand-off, it does not mean it is the end to the volatility in the market just yet. For now the reports of a potential U-turn are just speculation and officially the government is still sticking to its plans, according to later statements. With the BoE still planning to end its gilt market intervention after today and the government's medium-term fiscal strategy at the end of October, markets could be left on tenterhooks for longer.

Not out of the woods yet: gilts need BoE support and fiscal U-turn confirmation



Source: Refinitiv, ING

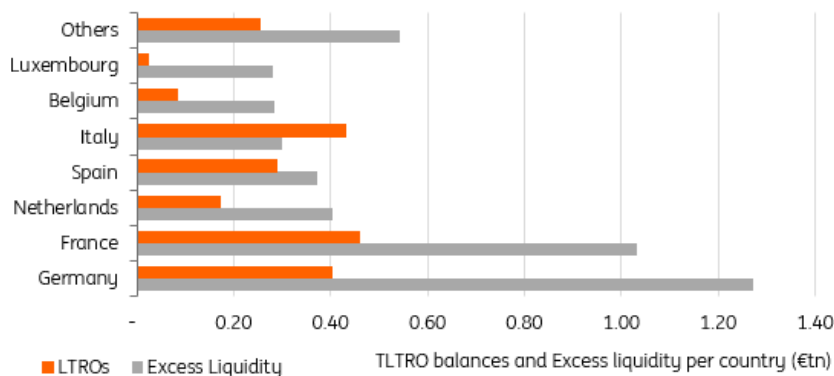
The October ECB meeting is shaping up to become a busy one

The wild gyrations in gilt markets have managed to pull 10Y and longer EUR rates lower, but the front-end rates have pushed higher with the European Central Bank showing resolve in pursuing more policy tightening. Hawks like Belgium's Wunsch not excluding key rates even above 3% keep up pressure on the front-end pricing of hikes as inflation data continues to surprise to the upside. For October the market is already discounting a more than 80% chance of a 75bp hike.

Euro front-end rates have pushed higher with the ECB showing resolve in pursuing more policy tightening

But it is the more concrete plans to whittle down the balance sheet that continue to grab the headlines. Reuters had already earlier reported that staff was working on three options to make it less profitable for banks to hold on to their targeted longer-term refinancing operations funds, one of them a likely [tiering of bank reserves](#). A decision in that regard could already be taken at this month's policy setting meeting. But that would only be the first step as we have learned over the past days. Also according to Reuters reporting, the ECB could already be laying the groundwork for the next step, which is quantitative tightening, by changing the wording of the reinvestment guidance already this month as well. This would then leave a decision to actually kick off [quantitative tightening](#) for the December or February meetings. The hawks on the ECB council are obviously the ones targeting an early 2023 start to letting the bond portfolios roll off Bloomberg reported.

Tiering risk: TLTRO balances and excess liquidity are unevenly distributed in the eurozone



Source: ECB, ING

Today's events and market view

Clearly the data and monetary policy backdrop suggests persistent upward pressure on rates. However, developments in the gilt market remain a wild card. Even more so as today will see the BoE last buying operation in support of long end gilts – unless it were to decide on an extension of the operations the gilt market would be even more exposed to headlines surrounding the government's rethink of its fiscal plans.

In data the focus remains on the US today. Retail sales for September should have received a lift as auto sales rebounded and gasoline should be less of a drag given a recent stabilisation in prices. More closely watched will probably be the University of Michigan consumer confidence survey and in particular the gauges of consumer price expectations. Consensus sees the 1Y inflation expectations receding, but perhaps more worryingly it sees the 5-10Y expected inflation measure inching up a tad to 2.8% from 2.7%.

Author

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@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.