

Rates Spark: Migrating doves

Geopolitical headlines will have helped, but front-end rates have more reasons to ease back from extremes. In the US, the Fed mulling MBS sales offers an alternate tightening avenue and in the UK the BoE's pushback against aggressive pricing should find a more prominent platform next week. But it is ECB doves that are passing on opportunities to push back



Flight-to-safety US Treasury bonds

Bond flows show some de-risking and a front-end flight

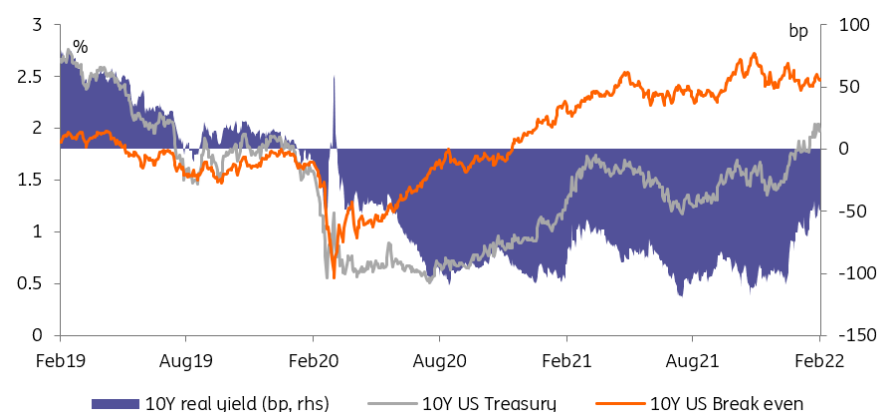
It's not been an easy market to read of late. Navigation of uncertain geopolitics and extreme macro circumstances has made it ultra tough.

What we can see from the latest weekly flows data (through to the close on Wednesday) is an inflow to government bonds, and especially into front end product. There is certainly more value on front ends with all this rate hike talk going on, but part of this also reflects some parking of cash and de-risking as the Russia-Ukraine stand-off continues

Flow reflect some parking of cash and de-risking as the Russia-Ukraine stand-off continues.

There is also evidence of re-risking in other asset classes, as there have been more outflows from investment grade corporates, and the bulk of these outflows are from longer duration product. High yield too has seen outflows, and the largest in proportional terms is out of EUR-denominated high yield. Emerging markets too have seen outflows, and this time including dedicated local currency outflows. Not an avalanche, but enough to be classed as a trickle that's persistent enough to worry about.

Demand for inflation hedges has turned, pushing real rates higher



Source: Refinitiv, ING

Some of the macro story can be gleaned from inflation-linked funds, which also saw more outflows. Assets under management in inflation-linked product are down some 3% in the past month, helping to ease real rates higher. The only reason that real rates are not higher than they currently are is the fear factor that is Russia - Ukraine, and the quality flight that could emerge should things turn sour.

USD and GBP front-ends coming off the boil

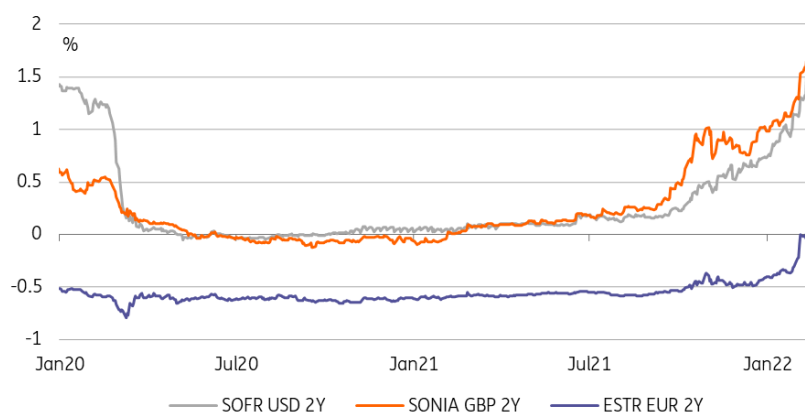
Actively selling MBS is an alternate and material Fed tightening channel

The Fed's Bullard only yesterday reiterated his view that rates needed to be 100bp higher by mid-year to curb inflation. He occupies the very hawkish end of the FOMC spectrum, but market forwards are not too far off. They have SOFR in July at around 0.96%, i.e. 90bp higher from current levels, and maybe that is already too steep, hawkish comments notwithstanding. If the idea of actively selling MBS from its portfolio gains further traction within the FOMC, then this is an alternate and material tightening channel that can further take the steam out of front end rates.

Although we have seen levels come off the boil already, the aggressive pricing of policy tightening across the developed market space should remain in focus in the coming week. In the UK the Treasury select committee will quiz the BoE on inflation, and it could offer the Bank's governor

another platform to push back against aggressive market pricing. So far reiterations that “modest” further tightening would be needed have not restrained hike speculation in any meaningful way.

Front-end pricing remains extreme, even after easing a little



Source: Refinitiv, ING

ECB doves pass on the opportunity for forceful pushback

Official pushback against the pricing of two hikes already this year has been timid

Eurozone front end rates may look equally stretched, though the difference here is that official pushback against the pricing of two hikes already this year has been timid. We find it noteworthy that the ECB’s Chief Economist and arch-dove Philip Lane passed on an opportunity to offer a more forceful verbal intervention yesterday, and instead retreated to a typical two-handed economist’s description of the policy options. Spain’s De Cos at least argued one should take the fragmentation of markets into consideration, a clearer acknowledgement of the rising sovereign bond spreads of late, and called for a gradual removal of accommodation.

Markets may get a better picture of the discussion behind the ECB’s hawkish turnaround at the last press conference when the minutes of said meeting are published next week. But we doubt this will make the policy path much clearer with many officials having indicated that even the March meeting may well provide only a monthly guidance.

The ECB’s desire to keep all its policy options open will still have the market looking to the data for more guidance. In that regard next week will offer the PMIs which could show some improvements as governments have eased restrictions, and perhaps more importantly first country inflation updates out of France at the end of the week.

Today’s events and market view

Geopolitics remain a wild card in the near term which continues to put a damper on risk

taking and supports safe havens. This has added to flattening pressure on curves but we see an avenue for curve resteeptening especially if front-end pricing eases. One factor that could help prolong the current situation though is the technical backdrop for Eurozone bonds. Next week will see limited supply from only Germany and Italy after Belgium cancelled its auctions following the 30Y syndicated deal.

Today's data calendars are a quiet affair with US existing home sales and EZ consumer confidence data. Focus should remain on central bank speakers. ECB's Panetta will speak in the evening - usually an outspoken dove, but the topic of central bank digital currencies makes comments on monetary policy less likely. In the US we will hear from the Fed's Evans, Williams and Brainard ahead of the president's day holiday on Monday.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@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 <http://www.ing.com>.