Rates Spark: More rates divergence

Markets are again spooked by rising energy prices. For central banks, inflation takes precedence and adressing the supply shock falls into the remit of fiscal policy, which may explain a more muted reaction by rates. The PMIs come as a reality check though and should at least play into the narrative of more divergence between US and European rates.

The main driver of the increase in inflation was energy prices

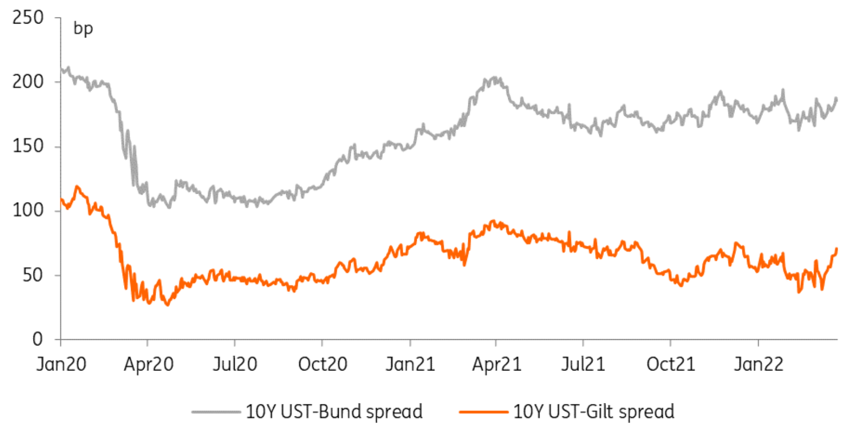
Energy prices spook markets again

Markets may have brushed off the ongoing conflict in Ukraine, but energy prices remain a weak spot of economies - that is judging by the reaction of risk assets to headlines that Russia would require gas exports to be paid in Rubles going forward. It again raises the spectre of a total energy embargo.

> *Visco: supply shock should be addressed by fiscal policy rather than central banks*

Yields have backed off their highs, with curves bull flattening yesterday. But the move is dampened to a degree, with the backdrop of central banks focusing on the inflation fight – even though with differing nuances of caution. The supply shock - as was expressed by ECB member Visco only yesterday - should be addressed by fiscal policy rather than central banks. In the Eurozone this has led to speculation surrounding a potential EU fund to support energy bills relief akin to the EU's proven SURE model. So far, nothing has been confirmed, but the topic will be discussed at the EU Council meeting that starts today.

The rates divergence narrative could regain more traction with today's PMIs



Source: Refinitiv, ING

Today's PMIs are a reality check on the robustness of economies

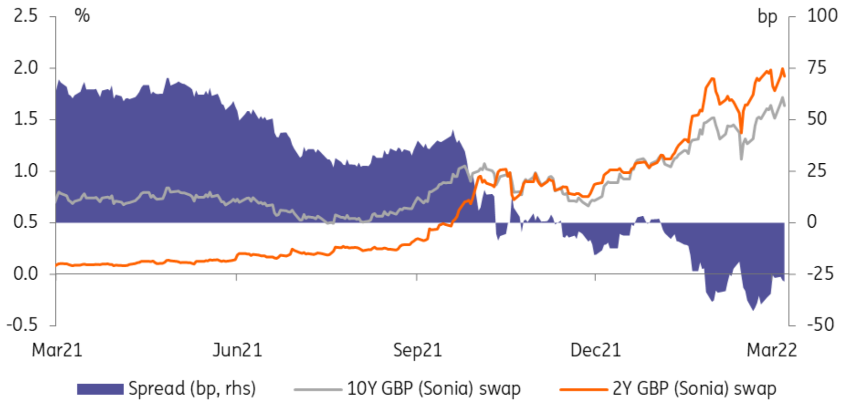
Europe is certainly more exposed to the supply shock. Buffering the impact of higher energy bills may indeed be more a task for individual countries and may eventually weigh on government funding plans. For now these plans have proven relatively robust. Germany's plans for substantially higher military spending are not impacting bond issuance plans this year – yesterday's published financing plan update for the second quarter was unchanged from December's.

The UK's "mini budget" yesterday even surprised markets with a lower than expected planned bond issuance for the next fiscal year. This will have supported the bull flattening of the Gilt curve which indeed outperformed Bunds. Notably, Gilts did not outperform versus swaps, suggesting that the macro backdrop remains the greater concern.

> *The PMIs should feed divergence narrative that has emerged with the onset of the war.*

Today's flash PMIs should provide first hints of how the Ukraine conflict and in particular the ensuing surge in energy prices affects economic sentiment. At least in Europe they are expected to mark larger declines compared to measures taken prior to the Ukraine invasion. The discrepancy with their US peers fits the divergence narrative that has emerged with the onset of the war.

More curve flattening after the UK's "mini budget"



Source: Refinitiv, ING

Today’s events and market view

The Nato and G7 meeting, as well as the EU summit starting today may create more headlines on the geopolitical front. The ECB speakers front is cooling, with Elderson speaking and Schnabel later in the evening today. For a change the focus could lie on macro data, with the flash PMIs gauged for the conflict’s impact on economic sentiment. The Eurozone manufacturing flash PMI is seen dropping from 58.2 to 56 in March, services from 55.5 to 54.3.

In the US the durable goods orders are dragged down by aircraft orders, but ex-transport likely to remain more robust. Fed speakers continue to feature highly on the agenda. After having heard from the Fed’s Mester that 50bp hike may be needed this year, we will hear from the Fed’s Kashkari, Waller, Evans, and Bostic today.

SSAs continue to fill the supply pipeline with KFW mandating a 15Y EUR benchmark and the EFSF sending out an RFP for an upcoming transaction. Nonetheless, having passed the main slate of sovereign supply including the syndicated deals from Austria and Italy could provide rates markets with additional relief. Given the diverging economic backdrop that should become more evident with today’s data, the spread widening narrative between US and European rates should gain more traction.

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