

Rates Spark: One CPI does not make a pivot

Primed for pivot, the market has rallied on the US CPI surprise. Fed officials have started to push back against the premature easing of financial conditions, but timing is especially inconvenient for the European Central Bank, which is still seeing greater risk of deanchoring inflation expectations



We have published our [Rates Outlook 2023: Belt up, we are going down](#): After a horrific 2022, bond markets can look forward to improving returns helped by a higher starting running yield, and subsequent falls in market rates. Brace for a reduction in central bank liquidity, more bonds supply and lingering systemic concerns as key themes, too.

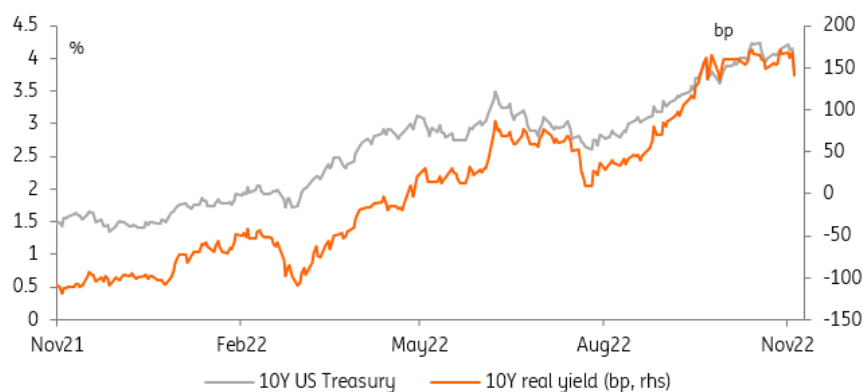
Market runs with the CPI and is tailed by the Fed's hawks

For once the [US CPI](#) release broke with the bad habit of surprising to the upside. And the market was quick to jump on the 'pivot'-bandwagon, with a larger Fed hike of 75bp for December now seen off the table, and if anything it now seems that the market is shifting to discussing whether it could be 25bp rather than 50bp next month. The terminal rate that the Fed is seen reaching has slipped to 4.87%. Just after the last Fed meeting this had stood as high as 5.15%. Risk assets rallied on the prospect of slowing inflation and the Fed turning less aggressive.

At first Fed officials were quick to push back against the markets optimism

The first Fed officials were quick to push back against the markets optimism. The data was better than expected, yet it is but one reading and the month-on-month core rate of 0.3% is still signaling inflation running well above the Fed's desired level. While encouraged by the data the Fed's Mester still saw greater risk in tightening too little than too much, Logan and George reiterated that the Fed had more work to do. While the Fed may well move on to a slower pace of tightening also to better assess the impact of previous rapid rate increases, it may not want to signal that it is doing less overall. In fact, rallying equity markets and lower market yields easing financial conditions is probably not what it wants to see at this stage already without having more clarity where inflation is actually headed.

The lower CPI print was greeted by lower nominal and real yields



Source: Refinitiv, ING

Spill-over of easing financial conditions comes at an inconvenient time for the ECB

The read across from US markets saw the 10Y Bund yield falling to 2%, coincidentally the lowest level since just after the October ECB meeting. Terminal rate pricing for the ECB also slipped to 2.87% from above 3% previously. The ECB, however, does not even have the comfort of having at least one set of encouraging data with regards to inflation that could justify easing financial

conditions, which may explain why we have had the ECB hawks becoming more vocal yesterday.

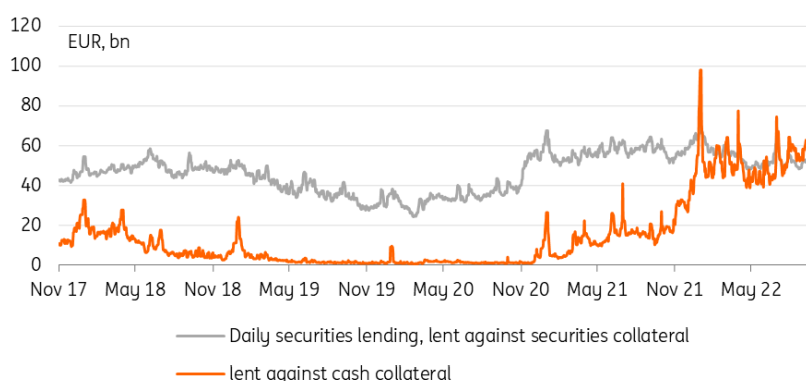
We had highlighted the ECB's consumer survey pointing to elevated if not slightly higher inflation expectations. The ECB's Schnabel picked up on the higher persistence of inflation in her talk yesterday, while pointing out that the risk of inflation expectations deanchoring remains. There is no time for complacency and rates will likely have to move into restrictive territory to rein in inflation. Neutral won't cut it, even as the probability of a recession in the euro area increases.

More signs that collateral scarcity is also on the ECB's mind

On a more technical matter concerning collateral scarcity, the ECB announced yesterday that it was raising its limit of lending against cash collateral from €150bn to €250bn. Schnabel commented in a tweet that this was a precautionary measure ahead of year-end.

Indeed when looking at the daily data through September, daily lending against cash never exceeded €100bn, which should be testament to the rather expensive conditions of this facility. But markets are also going into the upcoming year-end from an already much more strained starting point, so this increased backstop should be taken as a positive signal and further acknowledgement that the ECB is heeding market concerns.

Daily ECB securities lending has not run into its cap



Source: ECB, ING

Today's events and market views

The post CPI gains in bond markets may persist for a while despite some pushback from Fed officials. The US holidays might induce some calm into overall markets allowing also risk assets to bask in the sentiment lift from improving inflation for a little while. Alongside positive news out of China that could limit the further downside in rates.

This is not without risks, though. Today will still see the University of Michigan consumer confidence including its measure of surveyed inflation expectations. Longer run expectations are seen stable, while shorter run 1Y inflation expectations are seen ticking up a tad.

In the eurozone we will see another busy slate of ECB speakers, though this time around with representatives from both ends of the dove-hawk spectrum. Among others look out for Holzmann, Lane, Panetta and de Guindos. Also keep an eye on the release of the European

Commission economic forecasts.

In primary markets Italy will be active auctioning a new 7Y bonds and tapping a 3Y bond as well as a 12Y green bond, in total for up to €8.75bn.

Author

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

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