

Rates Spark: New hopes, but patience is wearing thin

Markets remain uneasy while ceasefire headlines offer hope. But oil near \$100 keeps inflation risks well alive, rate hikes are priced aggressively, and safe-haven demand has been rising. Also, ECB liquidity use is inching up. The tightening conditions threaten already fragile eurozone growth



Ceasefire headlines offer hope, but market patience is wearing thin

Recent signals that Iran may be open to negotiations, alongside talk of a one month ceasefire, offer some hope. That said, a series of false starts and premature declarations of victory argue for continued caution.

We're seeing euro rate markets getting increasingly impatient. Each day that oil trades close to \$100, inflation risks increase, as does the probability of rate hikes. On Tuesday, we saw that despite oil trading broadly sideways, the 2Y swap rate still managed to climb throughout the day. ECB officials are not pushing back either, and if anything, seem to take a hawkish stance. Market positions now imply a 70% chance of an April hike and are back to an aggressive three hikes priced

in for this year.

Besides inflation risk concerns, other parts of the markets are flashing warning signs. Bunds, for example, are beginning to outperform swaps more materially. The 2Y Bund yield now trades more than 25bp below the swap rate, which suggests safe-haven flows are picking up. Those levels are on par with 'Liberation Day', and the momentum from the past few days suggests we may not have seen the end yet.

The demand for safety and liquidity is also observed in the latest ECB refinancing operations. A total of €17bn of 7-day liquidity was allotted to banks this week, a sharp increase from the average this year of €11bn. This means banks are starting to rely more on relatively expensive funding from the central bank rather than market sources.

These signs clearly suggest that markets are being pushed out of their comfort zone. Only a significant decline in uncertainty and energy prices can alleviate the pressure. If not, financial conditions will deteriorate further and in turn weigh on the economic outlook. With the growth backdrop in the eurozone already fragile, we think the back end of the euro swap curve may, at some point, succumb to pessimism and be forced lower.

Wednesday's events and market view

Eyes will be on ECB President Christine Lagarde, who is kicking off the ECB watchers conference in Frankfurt. That means there will be a slew of speakers to follow, including Lane, Rehn and Kocher.

Data-wise, the February UK CPI release and the German Ifo index are the main data points. The US will later release the import/export prices for February.

In primary markets, Italy auctions 2y bonds as well as 5y and 10y inflation-linked bonds (up to €4bn). Germany taps 15y and 26y Bunds (€2bn) while the US sells a new 5y note (US\$70bn) and reopens 2y FRNs (US\$28bn).

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