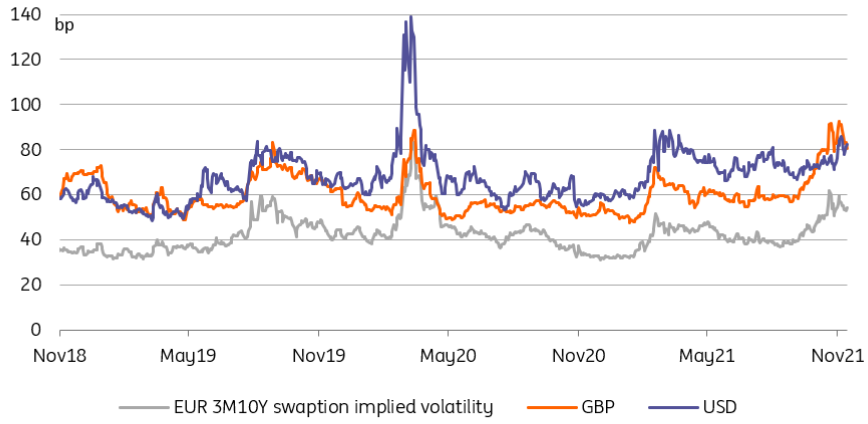
Rates Spark: Poking the bear

Central bankers continue to poke the bond market bear. They are right to highlight a wide range of outcomes but it is the hawkish message that resonates the most with markets. Things should accelerate after year-end, with fiscal policy adding to bond market concerns.

More central bank warnings

Central bank connoisseurs are having an exciting autumn. Yesterday's FOMC minutes highlighted the Fed's openness to accelerating the QE taper. The Thanksgiving holiday should reduce the Fed's output temporarily but the list of ECB and BoE officials (see last section) on the docket today will keep investors relatively busy. There is a case to be made for future central bank communication having less market-moving potential, however. After the recent flurry of speeches and interviews, it is indeed likely that officials have already shared all the nuggets of wisdom they intended to ahead of the mid-December 'triple witching' Fed/BoE/ECB meetings taking place on 15-16th December.

Higher rates volatility reflects the widening gap between economic scenarios



Source: Refinitiv, ING

If there is one trend emerging across major DM central banks, save perhaps for the BOJ, it is that officials are trying hard to prime investors for a wide range of economic outcomes. As we stressed yesterday, the gap between upside and downside scenarios is widening, and it is appropriate for financial market volatility to increase as markets are drip-fed information that alternatively corroborates one or the other thesis. As the bias in the past 20 months has undeniably been towards easing, it is only natural that the hawkish message proves the most market-moving.

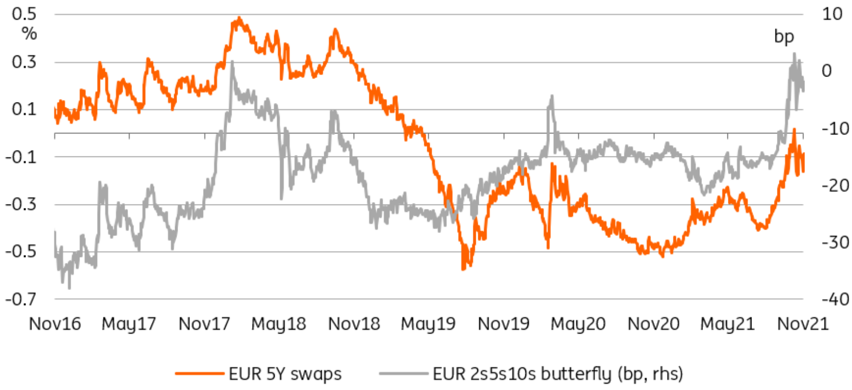
> *There is little question that central banks will hike, the main uncertainty is how soon and by how much*

In plain English, this means rates upside continues to dominate. There is little question that central banks will hike, the main uncertainty is how soon and by how much. In the case of the BoE, some communication back and forth on the urgency of policy tightening has kept investors guessing whether it will raise rates in December or not. We think it will, by 15bp, as recent data has eased fears of a post-furlough jump in unemployment. We think a lot of tightening is already priced in however, so the potential for further GBP rate rises is uncertain and momentum is likely to come from other currencies.

EUR: fiscal and monetary thrust

Speeches from the ECB, with no less than De Guidos, Holzmann, Panetta, and Weidmann speaking yesterday, are less urgent but the synchronised highlighting of inflation upside risk has not been lost on financial markets. In the grand scheme of things, market reaction has been muted. We think year-end distortions in EUR money markets have played a role in keeping a lid on EUR rates. The threat of near-term Covid-related economic restrictions is also on everyone's mind, with our economists increasingly concerned about the risk of a stagflationary outcome. If and when both drivers fade, EUR rates upside is significant.

5Y EUR swaps will bear the brunt of the repricing higher in the new year



Source: Refinitiv, ING

The German coalition parties' agreement is full of references to fiscal spending

Warm words from the (future) German fiscal authorities are also lighting a fire under EUR rates. The coalition parties' agreement is full of references to fiscal spending, for instance a front-loading of investment in 2022 before the debt brake applies again in 2023. A commitment to the fight against climate change also adds to the list of potential spending. At this stage, it is difficult to put a number on the plan, and our economists stress that coalition agreements generally don't have a long shelf life. In the context of central bankers warning on less monetary support going forward, we think it could still turn into another driver for higher bond yields.

Today's events and market view

The US Thanksgiving holiday will ensure focus is mostly on European developments, and that market liquidity is thinner than usual.

Central bank communication features prominently on today's calendar once again. From the ECB, no less than Villeroy, Elderson, Schnabel, and Lagarde will make appearances. This will be come on top of the October ECB meeting minutes. These are unlikely to contain much specific policy discussion but, judging from recent public comments, 'inflation, inflation, inflation' should be one of the main topics of discussion.

From the BoE, Haskel and Bailey complete today's central bank speakers list.

Italy will sell inflation-linked and 2Y nominal bonds.

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