

## Rates Spark: Pushed higher by hawkish shifts

Front-end rates continue to push higher after a surprisingly hawkish BoE and reports that some at the ECB are already prepared to act in April. In EUR, longer rates are starting to struggle to keep up with front-end rates. But it does not look like a tipping point yet



The European Central Bank and Bank of England were seen as hawkish with yesterday's rate decisions, while acknowledging higher inflation expectations

### Aggressive front-end pricing might overstate how quickly the European Central Bank can act

The impression that yesterday's European Central Bank meeting left – given the magnitude of events – was a relatively balanced one amid this environment of high uncertainty. Unsurprisingly, there was an acknowledgement of the increased upside inflation risks, but also of the downside risks to growth. Importantly, without really passing judgement as to what will hold more weight at this juncture.

There is a clear readiness to act, however, which itself is a hawkish shift in the ECB's stance. And President Christine Lagarde highlighted that the ECB will monitor everything from supply bottlenecks and firms' price-setting intentions to wage developments to determine the pass-through of the shock. Lagarde stood by a data-dependent and meeting-by-meeting approach to

assess the ECB's appropriate policy stance.

While the ECB did not seem to signal imminent action at its meeting, subsequent press reports suggested that some officials were ready to raise rates as soon as April. The market is now fully discounting two hikes and the possibility of more this year. The upcoming April meeting has an implied probability of a 25bp hike of over 60%. But at the same time, markets do not set prices in a vacuum, and we saw, for instance, that just prior to the ECB meeting, markets digested a surprisingly hawkish Bank of England that also dragged up EUR rates – highlighting again that there is some element of positioning in play as well, and that market pricing should not be taken entirely at face value.

For now, oil prices and geopolitical developments will remain in the driving seat. That is until we reach a tipping point where adverse risk sentiment takes over. What we did observe was that the long end has had a greater struggle to keep pace with the rise in short-end rates. While the 2y swap rate has settled 15bp higher on the day, the 10y swap rate only got past the 3% mark briefly. 30y rates are outright lower on rising front-end rates for the past two sessions, accelerating the common flattening dynamic seen when front-end rates rise.

## The Bank of England sees the strongest hawkish shift

Markets see the Bank of England as the hawkish one, adding a full 25bp hike this year in reaction to Thursday's meeting. That brings the total pricing for hikes to more than 60bp for 2026. We also saw strong moves in the 1y rate in 2y forwards, reflecting the idea that the BoE may keep policy tight for a more prolonged period. Even a dovish interpretation of the ECB meeting immediately thereafter did relatively little to bring the 2y GBP swap rate down again.

The interesting takeaway from this is that markets are happy to price in different reaction functions per central bank. One could say that central banks face a similar supply shock while the demand backdrop is relatively weak, which in a simplified world would argue for similar monetary policy actions.

But if we look at the UK in particular, the inflation backdrop does add complexity. The ECB has already demonstrated the willingness and ability to bring back inflation to a 2% target while the BoE still faces CPI figures closer to 3%. The risk of seeing unanchored inflation expectations could therefore be higher in the UK. We don't see this so far, however. The long-term GBP inflation swaps remain very well-behaved and are less than 10bp above February's numbers.

### Friday's events and market view

We have a relatively light calendar in terms of data for Friday, which means we could have more focus on comments from central bankers after this week's meetings. Isabel Schnabel, for one, is scheduled to speak in the evening about the German economy, but we can expect more ad-hoc comments from others.

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