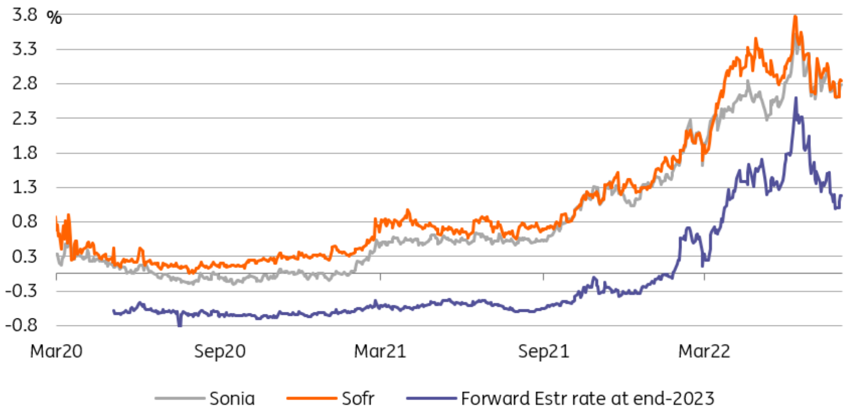
# Rates Spark: Pushing inflation into focus again

Today the Bank of England should burnish its inflation fighting credentials by delivering a 50bp hike – as it is largely priced. This will not allay recession fears which are keeping curves flatter. Eventually, the market should also realise that the window for further hikes is closing, opening more downside for Gilt yields

## Global central banks still have a hiking job to do

Central banks still have a hiking job to do. Markets have their doubts as to how much further that will take key rates as the attention turns from inflation to recession fears. Fed members continue to verbally push against any notion that the central bank will be deterred from its inflation fight. Better data recently lends those words more credibility which has allowed the US Treasury 10Y to keep a distance from the key 2.50% level. A crucial upcoming data point here of course remains tomorrow's US jobs statistics.

## Even after the Fed's hawkish salvo, markets doubt that many more hikes are coming




Source: Refinitiv, ING

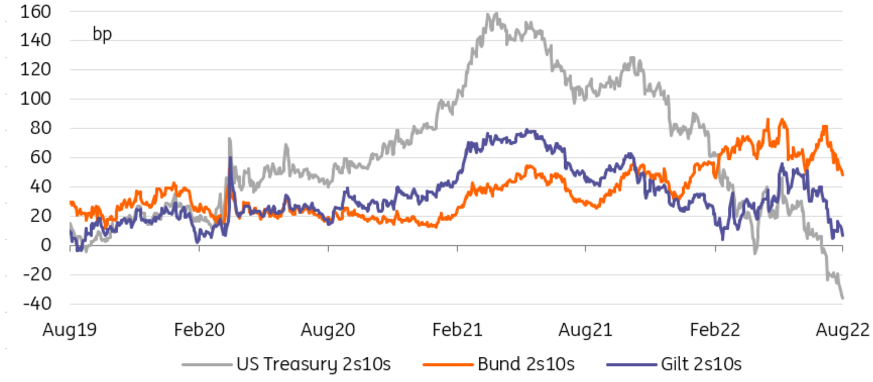
## The BoE will struggle to pull attention away from growth fears

After the European Central Bank and Federal Reserve, it is now the BoE's turn to burnish its inflation-fighting credentials. However, the shift of market worries has already led to an aggressive flattening of the sterling yield curve. Outright yields falling further from their June peak is the more recent and dramatic manifestation of where investors' worries lie. Despite rates rising again in the past few sessions, the 10Y Gilt yield has not managed to climb back above the symbolic 2% level.

*We still see more downside to yields*

We still see more downside to yields over the coming weeks and months. The aggressive tightening in money markets has further room to correct lower, with our economist James Smith seeing another 25bp hike in September, and at most another 25-50bp depending on persistent worker shortages, as well as potential tax cuts. Crucially however, global growth concerns are driving more money into the safety of government bonds. Taken together, 10Y gilts may well flirt with 1.5% over the summer months, a level not touched since March.

## A hawkish BoE today would add to the curve flattening trend



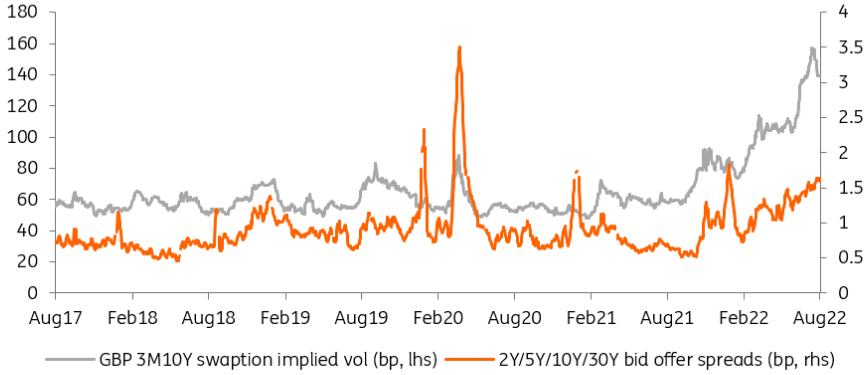

Source: Refinitiv, ING

## What to watch for in today's BoE meeting

- **Rate hike size**: The market is looking for a larger hike of 50bp, attaching an almost 90% probability to this outcome. The market is looking for further tightening with forwards seeing the key rate more than 170bp higher from the current 1.25% by late 1Q 2023. Our UK economist also thinks a 50bp hike now looks very likely given that Governor Andrew Bailey specifically put a hike of this size on the table. But we doubt much more than 25bp will follow.
- **Vote split**: In June, the committee voted 6-3 in favour of a 25bp hike. Our economist now expects one or two votes in favour of a smaller hike this time around.
- **Forward guidance/signals**: Other central banks have already abandoned forward guidance, and we'd be surprised if the BoE hinted at more than simply being prepared to act 'forcefully' where needed. Nevertheless, our economist points out that the bank's projections in May, based on market pricing showed unemployment rising and inflation below target in a couple of years' time. A similar pattern would be a hint that markets need to pare back their hike expectations further.
- **Quantitative tightening**: The Bank should offer more details on its plans to actively sell government bonds. The effect of quantitative tightening is a key risk to our view of still lower Gilt yields. Assuming £100bn of annual balance sheet reduction, the total increase of gilts in circulation in the next three fiscal years will reach record levels. Apart from the amount, we will watch for operational details and any dependence of plans on market conditions. Current stressed conditions may not be the best of time to kick off QT.

For more detail also refer to our dedicated BoE preview.

## Impaired trading conditions suggest it is too early to start BoE Gilt sales




Source: Refinitiv, ING

## Today's events and market view

The BoE will want to brandish its inflation-fighting credentials, but it should struggle to allay growth concerns that are reflected in the flattenig of the yield curve. Market reaction these days is less straightforward as the drop in yields in reaction to the larger ECB hike last month has shown.

BoE aside, the focus is on the US where we will see the release of the weekly initial jobless claims as well as trade data.

In primary markets, France will reopen 10Y and 12Y bonds for a 'summer-sized' €5-6bn. Spain auctions up to €5.75bn across 4y-, 7y- and 10y-lines as well as a 15y inflation-linked bond.

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