

Rates Spark: Super Thursday

The hike in the "Fed's dots" was in excess of the 75bp delivered up front, requiring a re-calibration of market rates higher in the weeks ahead. Today is a high-risk meeting for sterling assets. We expect the Bank of England to refrain from accelerating its hiking cycle. The Swiss National Bank could deliver a hawkish surprise



The Fed delivers a bigger hike in the dots than the 75bp up front

[A 75bp hike from the Federal Reserve](#) was as expected, but the median dot of 4.6% for 2023 and the 4.4% median dot for 2022 were higher than expected. These dots are above the pre-FOMC market discount, and mean that the rates market needs to re-calibrate. The dots are nothing more than a guesstimate, but they are from those that ultimately set the rates. In that sense, the entire curve needs to react to this.

Note also that the hike in the dots is in excess of the 75bp hike delivered up front. The 2022 hike in the dots is 100bp and the 2023 hike is 80bp, which helps explain the big move higher in the 2yr yield.

The big impact move was in the 2yr, which shot up to 4.1% post the hike, a full 10bp move. The elevated median dots for 2022 and 2023 were the dominant driver here, and especially the 2023 median dot which is now closer to 5% than to 4%. There is also a messaging there for the market that the Fed intends to maintain a tightening trajectory beyond the end of 2022 and into 2023, as

least as telegraphed from the dots themselves.

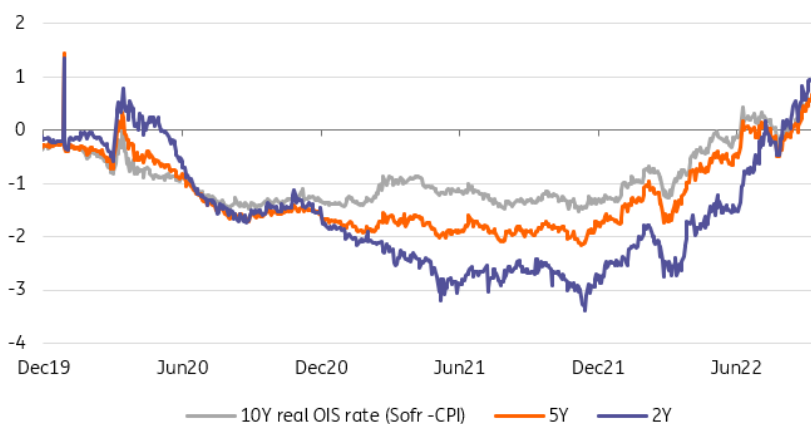
The 10yr yield now needs to consider a path towards 4%

The 10yr yield now needs to consider a path towards 4% in the coming couple of months. History shows that the 10yr rarely trades more than 50bp through the funds rate before the Fed has peaked. And note that 50bp through is the exception. A more normal discount would be to see the 10yr 25bp through the funds rate ahead of a confirmed peak from the Fed.

Real rates have come under rising pressure as inflation expectations managed to ease lower post the hike. This is good from the Fed's perspective. Higher real rates are required in order to tighten financial conditions, while an easing in inflation expectations tells us that the market ultimately expects the Fed to see inflation fall. The thing is, the case for big falls in inflation has yet to be proven.

The dot profile points to rising official rates in 2023, and muddies the waters for the prognosis of falling market rates into the turn of the year. But if we are right and the Fed does in fact peak by year end, then that fall in market rates anticipated through December/January is very much back on.

Rising real rates are helpful for the Fed to reach its target



Source: Refinitiv, ING

Bank of England: a catch(up) 22

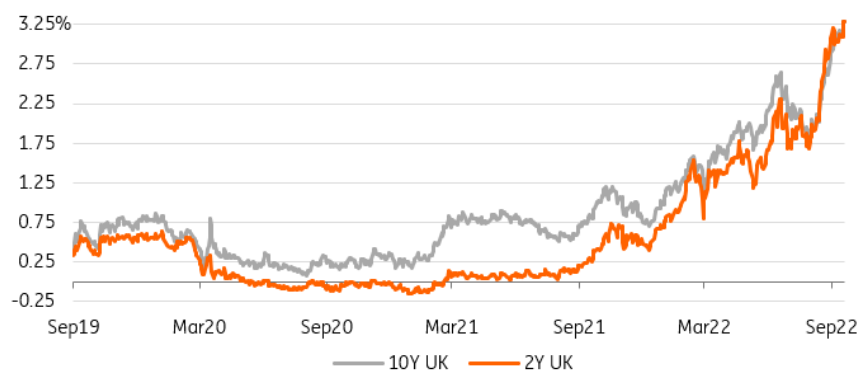
Consensus seems to have shifted from a 75bp to a 50bp hike at this Bank of England (BoE) meeting on the back of an already visible economic slowdown, and despite a very generous energy support package aimed at shielding consumers from higher prices. At first glance greater, probably debt-financed, government support should push the Bank into more aggressive tightening by shielding the economy from a more serious recession. This is a simplistic view however, given that the plan also entails a much lower inflation peak, and given that the UK economy looks set to enter a difficult phase economically regardless. This is without even considering the optics of working at cross purposes with fiscal policy.

The BoE also has to contend with markets quickly losing confidence in the UK's economic management

If the economic dilemma it faces wasn't daunting enough, the BoE also has to contend with markets quickly losing confidence in the UK's economic management. The promise of effectively open-ended fiscal support, a current account deficit, and a fast-approaching recession have foreign investors question their exposure to sterling-denominated assets. In theory, the BoE could help stem outflows by raising interest rates but it would do so at the risk of worsening two of the three problems mentioned above. Keep also in mind that the Bank is currently actively reducing its balance sheet size (aka Quantitative Tightening) and could start active gilt selling as early as this month, and you have a [credible rationale for not raising the hike increment from 50bp to 75bp](#).

If it finds the time, the BoE may also discuss remuneration of the bank reserves, running at £945bn, created in large part to finance QE. As the Bank Rate (BR) rises, markets are now pricing a terminal rate not far from 5%, the cost of remunerating these reserves will quickly climb, resulting in a loss for the BoE and a cost for the Treasury. One of the ideas floated repeatedly in the press would be for a fixed portion of Bank Reserves to earn 0%, and the rest to earn the BR. We have covered [the mechanism for the ECB in a recent article](#). The BoE doesn't have to worry about cross-border effects but the basic dilemma remains: the more it wants to save in interest bill to banks, the more it risks losing control of money market rates.

The rapid climb in gilt yields also reflects foreign investors losing confidence in sterling assets



Source: Refinitiv, ING

Today's events and market view

An already busy week on the central banking front culminates today with policy meetings at the Swiss National Bank (SNB), Norges Bank and Bank of England (BoE).

Consensus, and our, expectation is for a 75bp hike from the SNB. Back in June, it surprised markets with a 50bp hike and another hawkish 100bp surprise is not excluded at this meeting. We also suspect the same hawkish skew exists in the market's mind after [the Riksbank delivered a 100bp hike](#) on Tuesday against expectations of a 75bp move. Fixed income markets will also look closely for any comment on FX intervention as any selling of

its FX reserves are likely to come with sales of its large foreign bond holdings. [Our FX colleagues](#) think the SNB is satisfied with the CHF appreciation year-to-date however.

This BoE meeting (see above) doesn't come with a press conference nor with an update to its monetary policy report. Still, the vote split, discussions on the path for the economy, how fiscal support is affecting the Bank's thinking, and active gilt sales, will be ample information for markets to ponder.

Other economic releases will play second fiddle to central bank meetings but look out for eurozone consumer confidence, US jobless claims, current account, and Kansas City manufacturing index.

Isabel Schnabel will attempt to keep the European Central Bank in the headlines. Whilst Silvana Tenreyro, of the BoE, is scheduled to speak, she will do so at a climate-focused event so comments on monetary policy may not be forthcoming.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.