

Rates Spark: The ECB remains in the passenger seat

The European Central Bank meeting caps the shortened week ahead of the Easter holidays. Whether it also caps the upward trend is another question. Rates have traded better supported, but much of that dynamic comes from the US. It does not look like we have seen the peaks there just yet



Christine Lagarde,
president of the
European Central Bank

ECB likely to keep its options open, but also no pushback against markets

For now, markets have clear expectations that the ECB will only turn more hawkish in the months to come. A year from now they see the overnight rate close to 1%, implying six 25bp hikes until then. Markets have picked up on the hawkish voices in the latest ECB minutes that have been calling for immediate normalisation steps, as well as on a string of hawkish comments in the days before that signalled the possibility of two rate hikes already this year.

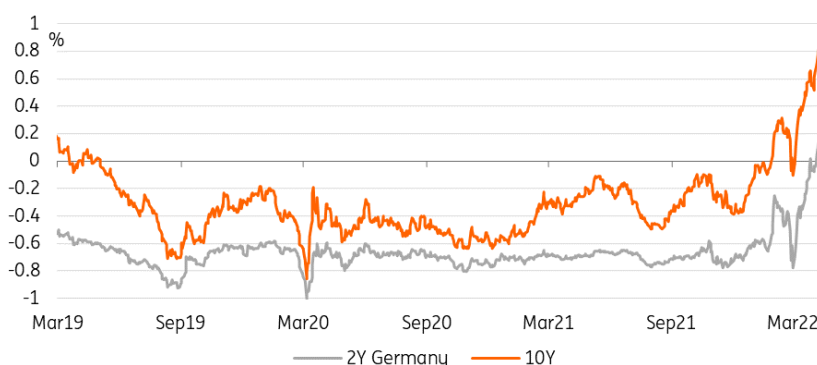
Guidance on net asset purchases and the timing of rate

hikes should stay unchanged from March

However, that may be a somewhat selective view that too easily fits the narrative of a central bank with a narrow inflation-fighting focus. It might be true for the Federal Reserve, more removed from the war raging in Europe and its fall-out, but we doubt that the ECB can materially change its tone already at today's press conference.

"Optionality" and "data dependence" were made a cornerstone of the more recent ECB strategy. Given there is not much data to go by since the last meeting, our economists do not expect more than qualifying remarks on what optionality might entail (or more importantly not entail). Guidance on net asset purchases (possible end in 3Q if data allows) and the timing of rate hikes ("some time" after the end of net buying) should thus stay unchanged from March. This may still be seen as a "wait-and-see" stance, falling short of aggressive market expectations.

Elevated Bund yields, premised on eight ECB hikes by end 2023



Source: Refinitiv, ING

The ECB should be content with the market doing part of the tightening job

Would the ECB actively push against aggressive market pricing? The futile attempts to do so have looked reserved in the past, and were given up on since the March meeting. Being aware of its own limited manoeuvring space, we think the ECB might actually be quite content with the market doing part of the tightening job.

The ECB not changing its tone too much just yet may look dovish compared to how far the market has evolved since the last meeting. This may extend the recent rally back lower in rates, but by itself is unlikely to break the general trend. The ECB meeting today, especially if it proves as uneventful as many expect, will fade amid global dynamics.

US markets are still the driving force

The main impulses for general market direction still come from the US. Here, markets rallying yesterday despite producer price inflation accelerating to 11% tells us that the recent rally in rates is less about traders identifying a lower-than-expected core month-on-month reading in the consumer price data the day before, than about the market attempting to put in a technical top in rates, again.

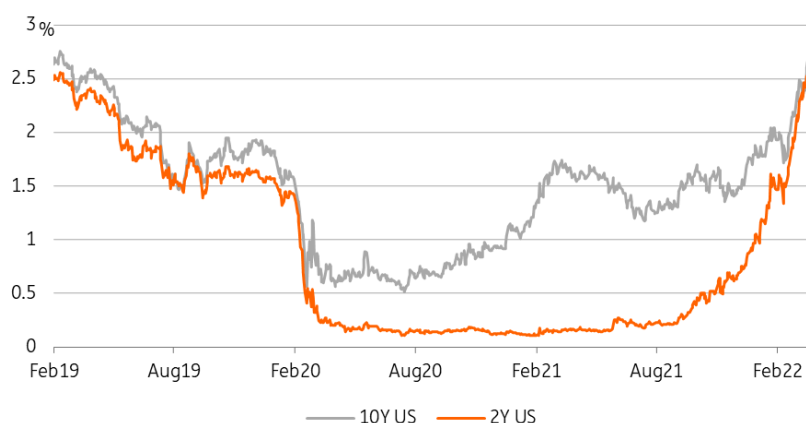
It tried this a couple of weeks back when the curve first inverted, as the 10Y attempted to mark 2.5% as the peak. That failed, and it looked off at the time as the 5Y was still pulling the curve higher. Now, the curve is actually re-steepening with the 2Y-10Y now at 35bp as market rates fall. That would be fine on the eve of a sequence of rate cuts. But here we're on the verge of the opposite; the Fed has only started its hiking process.

We likely have not seen the peak in rates just yet

It seems that the front end has hit a peak at 3% for the extent of rate hikes, and longer tenors are now having difficulty in getting to 3%, partly as the concern is if the Fed does go to 3%, then it'll just have to cut thereafter. However, if that were the real thought process, then the curve should be inverting from the back end. And it's not. It's steepening from the front end.

It just does not look or feel like a classic turning point in rates. We likely have not seen the peak in rates just yet. The conversation would look different if we had seen a dramatic flattening on the 2/5yr segment led by the 5yr.

Struggling close to the 3%, but still looking up



Source: Refinitiv, ING

Today's events and market view

With just not enough new data to go by, ECB President Christine Lagarde may struggle today to live up to the hawkish expectations that have built in markets for the months to come. But markets' focus may indeed have already turned to June, so that any rally on the back of the ECB meeting today is unlikely to break the general trend.

The main driving force remains the US which will see notable data releases today. Retail sales should look softer once the impact of surging gasoline prices is stripped out and the University of Michigan consumer confidence index should further suffer from the rising costs of living. Initial jobless claims, however, should signal ongoing job market tightness.

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