Rates Spark: The hawks are circling

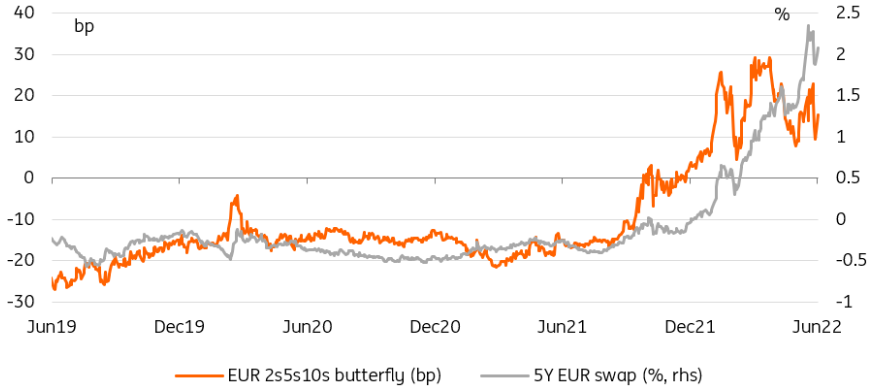
Central banks have proven their ability to move rates higher once again, trumping recession fears for now. We expect no let-up at the ECB's Sintra forum today, but any further rise in yields is subject to risk sentiment holding up. The EUR curve structure is at odds with the worsening macroeconomic backdrop

All eyes will be on the European Central Bank's forum in Sintra, Portugal

The ECB out-hawks the market

At the start of this week, one could reasonably have doubted central bankers' ability to push market pricing into an even more hawkish territory. After all, recession fears boiling over in the eurozone, and elsewhere, cast a long shadow on policy tightening forecasts. In addition, the European Central Bank's (ECB) Sintra forum promised to be a hawk-fest where officials try to regain control of the narrative, and inject some much needed confidence in the market.

ECB comments have rekindled EUR rates upside



Source: Refinitiv, ING

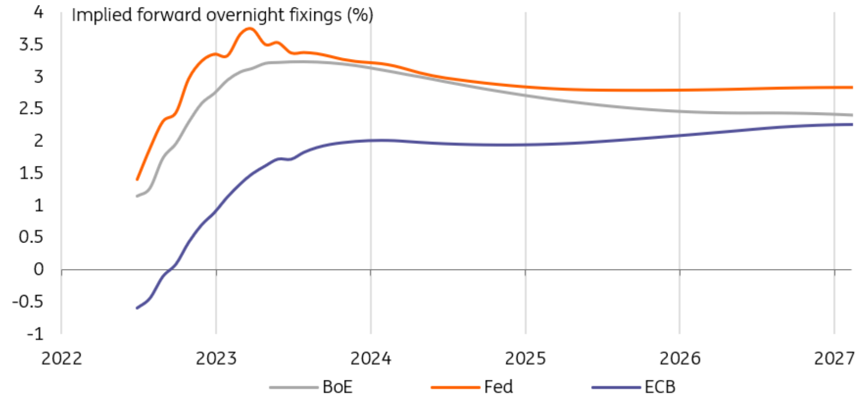
Today's line-up promises even more hawkish comments

The ECB has delivered on hawkish expectations, and then some. Martin Kazaks broke ranks with the 25bp July hike consensus, and President Christine Lagarde repeated ad nauseum that inflation-fighting remains the ECB's utmost priority. The latter was expected, and the former was a risk at least partially priced by the market going into the event. And yet, this was enough for the market to add to Monday's double-digit rise in EUR yields. It is difficult to extrapolate this into a third day of a bonds sell-off but, if anything, today's line-up (see events section) promises even more hawkish comments.

The EUR curve structure anomaly

Once again, the policy-sensitive part of the curve finds itself in the firing line. Traditionally, this has meant 5Y and maturities around it. As central banks scramble to catch up with high inflation, effectively front-loading hikes, shorter maturities have seen the most volatility. This week's underperformance of the 5Y point may be an accident, perhaps due to supply in the sector from Germany and KFW. If it isn't, it would signal a greater confidence into this tightening cycle being a more protracted affair than previously thought. In light of growing recession fears, we have our doubts and would expect the 5Y sector to come in on the curve, for instance with the 2s5s10s butterfly in EUR swaps converging towards zero.

The EUR forward OIS curve is the only one that isn't inverted



Source: Refinitiv, ING

We expect the 5Y sector to come in on the curve

Similarly, a more hawkish re-pricing should in our view come with an inversion of the near-dated forwards, effectively pricing the possibility of a subsequent cut. This has long since been the case in USD and GBP rates, but the EUR swaps term structure has so far remained flat. Should the terminal deposit rate climb above the 2% line, we expect inversion to occur… provided recession doesn't become the market's central scenario before then.

Today's events and market view

Spain and Germany kick off this round of June CPI releases today. A slight acceleration in the annual EU-harmonised measures would give weight to the barrage of hawkish ECB comments we're sure to get from and around the Sintra forum. This being said, regional Germany inflation indices available at the time of writing suggest further inflation acceleration is not a given in June.

Talking of which, no less than ECB President Christine Lagarde, Fed Chair Jerome Powell, BoE Governor Andrew Bailey are taking part of a policy panel early in the European afternoon. Recent comments suggest that central bankers will look to out-hawk each other to project an aura of confidence to markets roiled by inflation risk. They will be joined by Augustin Carstens of the Bank of International Settlements who, judging by his foreword to its annual report, will lean heavily in the hawkish direction.

US data consists of mortgage applications and the third read of the now dated 1Q GDP report.

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