

## Rates Spark: Toppish yields, but central banks are not done

The surge higher in rates after the US CPI was brief only, but clearly central banks still need to deliver on promises as inflation is set to grind lower only slowly. The European Central Bank is locking in on a July hike and possibly positive rates by year end, converging with markets, though still more cautious on what lies beyond policy normalisation



### Psychologically important levels rejected, for now

The initial reaction to the US CPI was higher rates, but in the end markets took comfort in the details showing a few components being responsible for the upward surprise – this was capped off by a decent 10Y US Treasury auction and in the end the 10Y yields dipped below pre-CPI levels. In short, the revisit of plus-3% levels was only very brief.

---

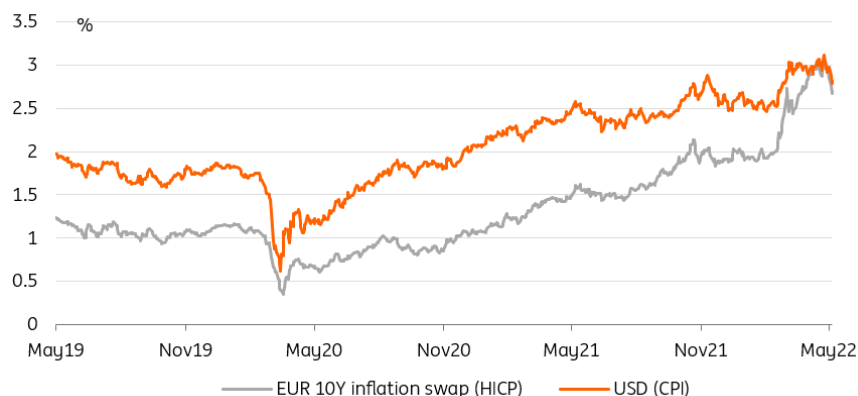
*The discussion around possible 75bp hikes may not entirely be put to rest just yet*

---

Nonetheless, the curve did flatten as the data also made clear that it will be a slow grind lower for inflation. This means the Fed is still under pressure to deliver a series of rate hikes, with our economist looking for a 50bp hike at each of the upcoming three meetings. For markets, the discussion around possible 75bp hikes may not entirely be put to rest just yet, even though the Fed's arch-hawk Bullard suggested the 50bp hikes were a good benchmark "for now".

Even if inflation expectations inched up slightly yesterday, we think that the overall decline since late April is in part a reward for the Fed's more aggressive approach.

## Starting to reap the rewards of more aggressive action



Source: Refinitiv, ING

## ECB wants to end negative interest rate policy quickly, but is wary of what comes after

Even if late to the game, the ECB has also started to reap that reward of pushing more aggressively towards the exit from extraordinary monetary policies. Lagarde, true to her form of not taking explicit positions, restated in connection with the timing of the ECB's first rate hike after the end of net asset purchases that "some time" can be as short as several weeks. With purchases seen ending with the end of 2Q, this has been taken as a further cue that indeed the ECB Council has now locked on July as the central bank's rate lift-off date.

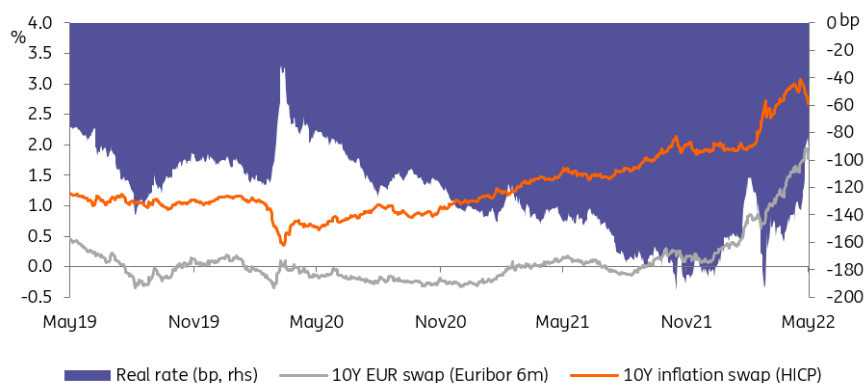
---

*The ECB has now locked on July as lift-off date*

---

ECB Schnabel's speech yesterday was another call for swift normalisation. But she also cautioned that achieving the ECB's mandate does not necessarily require the central bank suppressing domestic demand. The impact of the war and tightening global financial conditions were already dampening demand. In the US the 10Y real rate is back into positive territory after a remarkable rise, clearly signaling an end to easy financial conditions. In Europe this rate remains deeply negative despite its recent 50bp increase, a point that Schnabel has also highlighted in her call to action. If that were the benchmark, there is more upside in yields.

## Financial conditions are already tightening, but from very easy levels



Source: Refinitiv, ING

Bloomberg cited unnamed sources that the Council was also gathering around the view that ECB rates may return to positive territory before the end of the year. Some ECB members had voiced this view already, but it appears three hikes before the year is out is also becoming ECB consensus. To be clear, the market has eyed the possibility of positive overnight rates by December at least since the start April.

---

*The reiterated calls for gradual adjustments reflect a sense of caution*

---

The ECB has a stated desire to normalise before the window of opportunity closes, but the reiterated calls for gradual and data dependent adjustments also reflect a clear sense of caution. The macro outlook is starting to loud over also as the Ukraine conflict drags on and Covid disruptions in China look to become more protracted. Market pricing, though, remains aggressive beyond normalisation, seeing overnight rates above 1.25% by the end of 2023, an additional four 25bp hikes next year beyond the return to positive interest rates.

### Today's events and market view

Despite the upside surprise in the US CPI data the psychologically important levels of 3% in US Treasuries and 1% in 10Y Bunds have been rejected. However, we remain wary about calling a top in rates just yet as markets will still have to digest a series of 50bp hikes from the Fed and importantly the first rate hike from the ECB.

With ECB's De Cos and Makhlof scheduled to speak today we should hear from the dovish end of the Council, though the desire to normalise seems to be shared now across the spectrum.

After this morning's UK GDP data only the US initial jobless claims are of note among an otherwise quiet data calendar.

In supply the focus is on Italy selling up to €6.75bn in 3Y, 7Y (new) and 30Y bonds after spreads have started to retreat from their recent highs. Ireland sells up to €1.25bn in 10Y and 23Y bonds. The US Treasury will sell 30Y bonds.

## Author

### Antoine Bouvet

Head of European Rates Strategy

[antoine.bouvet@ing.com](mailto:antoine.bouvet@ing.com)

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@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 [www.ing.com](http://www.ing.com).