

## Rates Spark: Unstoppable

The bond rally continues and finds more confirmation in the Bank of Canada seeing itself close to the end of its hiking cycle. Against that backdrop the Fed's narrative becomes increasingly hard to sell, but it is especially the European Central Bank that finds itself in an uncomfortable position



### More competition to the Fed's narrative

10y USTs rallied further towards 3.40% with the 2s10s curve touching -85bp. Some have pointed to the third quarter US unit labor costs being revised to 2.4% from 3.5%, but our economist would downplay the significance of the data. It seems more that the market is not done squaring positions into year-end.

At the same time the market is increasingly adding to the rate cut expectations in the second half of 2023, further inverting this part of the money market curve. This goes directly against the messaging of the Fed, which has sought to convey the message that key interest rates will stay elevated for some time. And the northern neighbour is making it even more difficult to sell this narrative. Yesterday the [Bank of Canada hiked by 50bp](#), the second 50bp in a row after previously hiking by 100bp and 75bp. While still a larger hike than some had expected, it was the forward-looking message that proved more market moving.

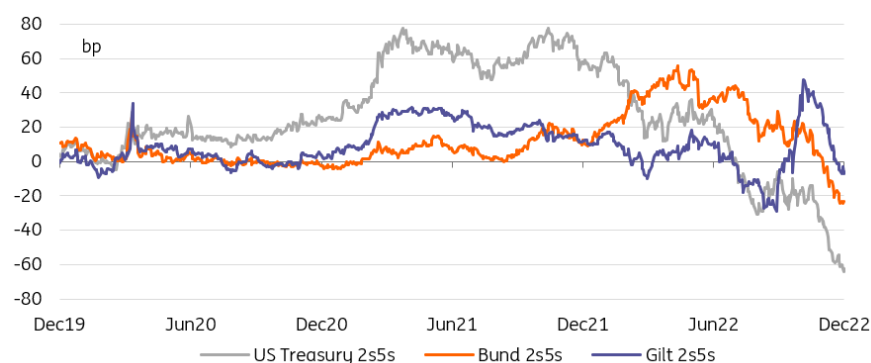
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*Bank of Canada is "considering whether the policy rate needs to rise further"*

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The Bank's accompanying statement pointed to "growing evidence that tighter monetary policy is restraining domestic demand", citing softer consumer spending growth and a weakening housing market. The expectation is that "growth will essentially stall through the end of this year and the first half of next year". And as for the key topic, which is inflation, it suggests "price pressures may be losing momentum". All this led the Canadian central bank to suggest that it is now very close to the end of the tightening cycle. The dovish shift was crystallized in the Bank now "considering whether the policy rate needs to rise further" whereas it had expected "that the policy interest rate will need to rise further" at the October meeting.

## The dovish mood in financial markets has mostly benefitted the 5Y part of the curve



Source: Refinitiv, ING

## ECB position becoming more uncomfortable

EUR rates are largely caught in the global current, pulling 10Y Bund yields below 1.80%. The 1y1y ESTR OIS swap is close to 2.5% again the lower end of its trading range since mid-September. For the ECB this premature loosening of financial conditions seems to become increasingly uncomfortable as well, especially given that it is less advanced into the hiking cycle than its peers.

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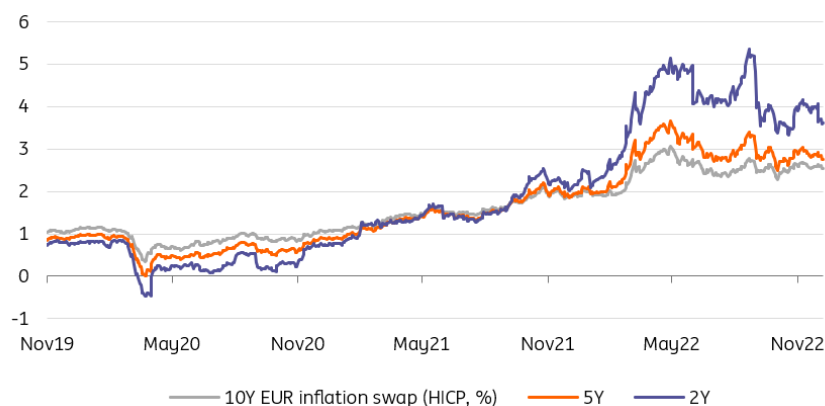
*The ECB consumer inflation expectations survey still pointed higher*

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Isabel Schnabel's speech from late November where she saw little room to slow down the pace of interest rate adjustments still reverberates. Only yesterday the ECB's consumer inflation expectations survey, one of the measures Schnabel also referenced, pointed to an increase of inflation expectations over the next 12 months. Median expectations for three years ahead were stable at an elevated 3%, though the mean still climbed higher.

Chief Economist Lane in his latest interview sounded less convinced about having seen the peak in inflation just yet, and only yesterday Slovakia's Kazimir – admittedly not the most influential ECB member – stated clearly that 10% inflation was no reason to slow hikes. Markets still think otherwise, having priced the December forward at around 52bp, which reflects only a minor chance for another 75bp hike next week.

## Measures of future inflation in the Eurozone are not quite back to the ECB's target



Source: Refinitiv, ING

### Today's events and market view

There is little data for markets to trade on today with only the US Initial jobless claims of note. Over in the eurozone some ECB officials are scheduled to speak, including Lagarde, but given that we have already entered the pre-meeting quiet period we do not expect to hear much on monetary policy.

No government bond supply is scheduled for today.

The lack of supply and event points to a continued drift lower in yields. So is the evident bias in market positioning since October. 10Y Treasury yields broke through the key 3.5% level to the downside yesterday although chance of profit-taking on short-term longs increases as next week's US CPI and policy meetings approach.

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