

Rates Spark: Worries that more might be needed

The Bank of Canada has resumed hiking after a pause, highlighting concerns that elsewhere more might be needed to bring inflation down even as the Fed is mulling a pause of its own. Market rates have adjusted higher again and look vulnerable to more upside in the near term, especially in the US, with supply looming early next week



The Bank of Canada lends skip narratives globally more credibility

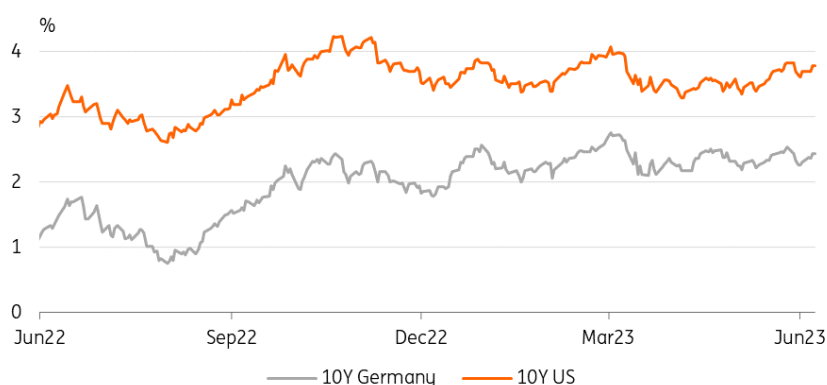
If they need any evidence that the current tightening cycle is not of the usual type, rates markets only have to look at the [Bank of Canada's 25bp hike yesterday](#). It was a move that surprised the majority of economists and came after the bank stood pat since last hiking 25bp in January.

The Bank of Canada has led Fed policy in many ways, when it came to starting quantitative tightening or reverting to larger hikes. Now it may well have jumped ahead with the “skip” narrative, just when FOMC members are mulling a pause of their own. While it was previously tempting for markets to read any pause already as the end of the tightening cycle, it shows that an adverse turn of the data can require central banks to tighten the policy screws further.

SOFR OIS forwards for year-end are back to their highest levels since March

With regards to the markets' pricing of the Fed, the implied probability of a hike next week increased moderately to 30%. The probability of a July hike briefly spiked above 90% before falling back to 80%, not far from where it sat before. Yet further out the SOFR OIS forwards for year-end are now back at their highest levels since March at just above 5%.

Inflation concerns and supply add near-term upside to yields



Source: Refinitiv, ING

Supply remains a near term factor for rates

However, it was longer rates in the 5- to 10-year area that underperformed, with 10Y USTs rising more than 12bp to close in on 3.8%. While the BoC's decision delivered the decisive push, the rise in yields already started earlier. That may also be owed to the prospect of faster paced Treasury issuance after the lift of the debt ceiling weighing on markets.

Markets will face 3Y, 10Y and 30Y Treasury auctions just ahead of the Fed

True, the rebuild of the Treasury's cash balance as indicated yesterday to US\$425bn by the end of June will mostly come from additional bills issuance, but early next week markets also will face 3Y and 10Y Treasury auctions on Monday and a 30Y auction on Tuesday. It means the bond sales will come around the crucial US CPI release and just ahead of the FOMC decision, volatility events that may warrant additional price concessions.

The US Treasury is about to rebuild its cash account



Source: Federal Reserve, ING

Upside inflation risks outweigh softer data, also at the ECB

In EUR rates markets as well, just ahead of the upcoming ECB meeting, worries about inflation continue to outweigh the impact of softer data. Market have been close to fully pricing a June hike for a while now and see at least one more hike until September. They see a 20% chance that we will have a third hike, reflecting the recent return of speculation that the ECB's deposit rate could reach the 4% handle.

Speculation that the ECB's deposit rate could reach the 4% handle returns

The ECB's Schnabel and the Dutch central bank's Knot were the latest to say more tightening was needed. Schnabel cautioned "given the high uncertainty about the persistence of inflation, the costs of doing too little continue to be greater than the costs of doing too much".

Our [own economists also think a hike next week looks like a done deal](#). More interesting is what the ECB will signal around the further path ahead. Given the current tightening bias evident in minutes of the last meeting and recent commentary as well as the still painfully slow decline in inflation the door should be left open to deliver more. A second hike in July looks likely. A third in September is possible, but not yet the base case.

Today's data and market view

The Bank of Canada's resumption of rate hikes also lends credibility to the skip narrative that Fed officials have increasingly been pushing last week. Despite all positive signs on the inflation front and weaker data, the concern clearly is that central banks may still need to do more.

Technical factors like the Treasury supply packed into early next week just ahead of the Fed decision can add a bearish tilt to the market until then, and at least to some added volatility.

Main highlight on the data front are the weekly US initial jobless claims. Consensus here is for little change which would indicate a still relatively tight job market. In the eurozone we will get the final first quarter GDP figures.

Supply certainly has been a theme in eurozone rates markets, too, especially with Spain printing a €13bn 10Y bond which added to the widening of periphery bond spreads. After recent busy primary markets, only Ireland is scheduled to be active - with two bond taps in the sovereign space today.

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