Markets Directorate Interest Rate Flash

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08.02.2024

Tight labour market, easing expectations of interest rate cuts!

Source: Bloomberg			
Short term interest rates EUR (%)	6.2.24	27.12.23	difference
Estr	3,9080	3,900	0,01
EURIBOR1m	3,8930	3,843	0,05
EURIBOR3m	3,9320	3,925	0,01
EURIBOR6m	3,9220	3,885	0,04
IRS EUR (%), source: Bloomberg			
IRS 2Y	3,08	2,85	0,23
IRS 3Y	2,85	2,58	0,27
IRS 5Y	2,70	2,41	0,30
IRS 10Y	2,72	2,43	0,29
Zero cost (ZC) collar 3 month EURIBOR (%), calculation by K&H based on Bloomberg data		IRS+0% strike floor purchase on 3 month EURIBOR	
6.2.24		6.2.24	
collar 3Y	2.20-3.10	IRS+floor 3Y	3,17
collar 5Y	2.10-3.00	IRS+floor 5Y	2,82
collar 7Y	2.15-3.00	IRS+floor 7Y	2,84
collar 10Y	2.10-3.20	IRS+floor 10Y	2,88

Source: Bloomberg				
IRS euro Forward start (%)		6.2.24	27.12.23	difference
1Y Forward	IRS 2Y	2,43	2,09	0,34
	IRS 4Y	2,46	2,13	0,34
2Y Forward	IRS 3Y	2,44	2,11	0,33
	IRS 7Y	2,59	2,28	0,31
CAP on 3month EURIBOR (%), source: Bloomberg			6.2.24	
3Y 3.00% strike	Premium (%)		1,20	
3Y 4.00% strike			0,37	
5Y 3.00% strike			2,18	
5Y 4.00% strike			0,91	
Running premium paid quarterly on 0% strike floor purchase on 3 month EURIBOR (%) calculation by K&H based on Bloomberg data				
6.2.24				
floor 3Y	0,09			
floor 5Y	0,12			
floor 7Y	0,14			
floor 10Y	0,16			

Source: Bloomberg	
Base rate (%)	6.2.24
Eurozone	4,50
US	5,50
Great-Britain	5,25
Canada	5,00
New-Zealand	5,50
Japan	0,10
Poland	5,75
Czech Republic	6,75
Australia	4,35
Hungary	10,00
Turkey	45,00
Romania	7,00

Market commentary and significant price evolutions

The Central Bank rate decisions and statements gave the markets a harsh reality check regarding their expectations about possible future rate cuts. The ECB and the Fed both aim to avoid an early easing cycle because they see multiple risk factors in economic indicators that could still cause another inflationary wave.

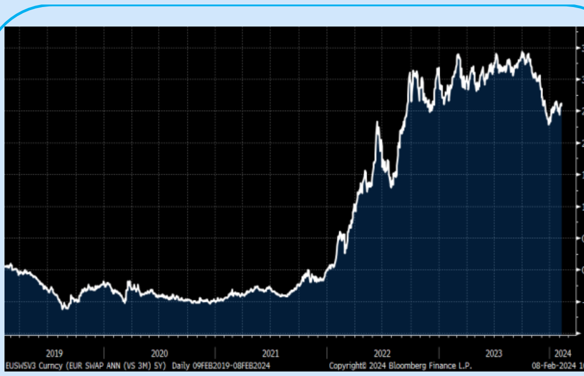
The pace of inflation has seen a massive drop towards the end of last year, however the deinflation process seems to have slowed down since then and the inflation targets of most Central Banks are not expected to be met until 2025. In addition, the geopolitical tensions (for example on the Red Sea) lead to an increase of expenses, which can also be visible on the prices of various goods.

The most important factors, however are the movements of the labour market. Unemployment is very low in both the EU and the USA and the increase in wages exceed the volume of inflation significantly. Real wage growth can be accompanied by the increase in household spendings and the return of inflationary pressure. With that being said, one big difference is that the US economy is expanding much faster than that of the EU, where certain member states are still experiencing a recession.

Central Banks are still data-driven and the main topic of the debate is not whether there should be rate-cuts this year but rather their size and timing. Also, the equilibrium interest-rate level at which price stability can still be maintained, is being discussed.

As of right now, the market is pricing in a probability of around 10% for a Fed rate cut in march and for april this number is still only abot 50%. On the other hand, it is interesting that the market sees the possibility of a 50 base point easing for the month of June. Thanks to this, until the end of this year, a total cut of 150 bp is being priced in by the markets.

The EUR interest rate curve has moved up by 15-20 basis points since the beginning of the year. The 6-year segment remains the lowest point on the curve, but overall we are talking about a very flat yield curve in the 3-10 year segment. In particular, a deeper recession and a surge in unemployment could push interest rates substantially lower, which is outside the baseline scenarios for the time being. The current outlook suggests that the ECB is unlikely to cut the base rate below 2% in the next one to two years, but in this context, current IRS levels could be close to their lows.



The historical evolution of the 5-year EUR IRS (white).

EU YOY GDP at 0.1% (yellow), inflation at 3.3% (orange)