Markets Directorate Interest Rate Flash

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The ECB is about to start its interest rate hike cycle!

Source: Bloomberg			
Short term interest rates EUR (%)	7.7.22	1.3.22	difference
Estr	-0,5790	-0,577	0,00
EURIBOR1m	-0,4640	-0,553	0,09
EURIBOR3m	-0,1410	-0,534	0,39
EURIBOR6m	0,2380	-0,496	0,73
IRS EUR (%), source: Bloomberg	7.7.22	01.03.22	
IRS 2Y	1,36	- 0,03	1,40
IRS 3Y	1,53	0,14	1,39
IRS 5Y	1,77	0,37	1,40
IRS 10Y	2,17	0,70	1,46
Zero cost (ZC) collar 3 month EURIBOR (%), calculation by K&H based on Bloomberg data		IRS+0% strike floor purchase on 3 month EURIBOR	
7.7.22		7.7.22	
collar 3Y	1.20-1.70	IRS+floor 3Y	1,71
collar 5Y	1.30-2.10	IRS+floor 5Y	2,21
collar 7Y	1.45-2.20	IRS+floor 7Y	2,76
collar 10Y	1.60-2.50	IRS+floor 10Y	3,55

Source: Bloomberg				
IRS euro Forward start (%)		7.7.22	1.3.22	difference
1Y Forward	IRS 2Y	1,84	0,40	1,43
	IRS 4Y	2,02	0,55	1,48
2Y Forward	IRS 3Y	2,09	0,64	1,45
	IRS 7Y	2,34	0,84	1,50
CAP 3month EURIBOR (%), source: Bloomberg			7.7.22	
3Y 2.50%				1,11
3Y 3.00%				0,88
5Y 2.50%				2,60
5Y 3.00%				2,10
Running premium paid quarterly on 0% strike floor purchase on 3 month EURIBOR (%) calculation by K&H based on Bloomberg data				
7.7.22				
floor 3Y	0,35			
floor 5Y	0,68			
floor 7Y	0,99			
floor 10Y	1,38			

Source: Bloomberg	
Base rate (%)	7.7.22
Eurozone	0,00
US	1,75
Great-Britain	1,25
Canada	1,50
New-Zealand	2,00
Japan	0,10
Poland	6,50
Czech Republic	7,00
Australia	1,35
Hungary	9,75
Turkey	14,00
Romania	4,75

Markets commentary and significant price evolutions

The European Central Bank confirmed at its June meeting what the market has been expecting for some time: the first policy rate hike (+25 basis points) in more than 10 years in July. In its statements, the ECB has hinted a further 50 basis point rate hike in September, which would put an end to the policy of negative interest rates. The European interest rate markets expect a policy rate of 1% by the end of the year.

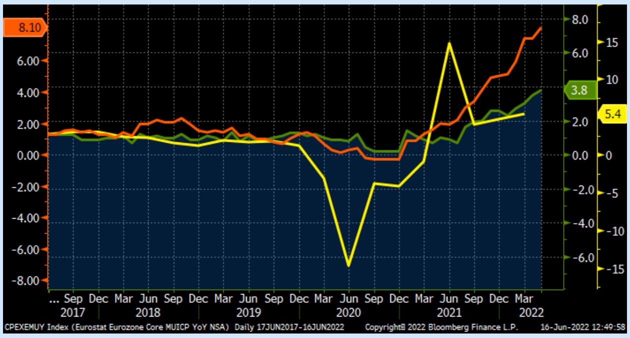
There is a strong consensus within the central bank on the right direction of policy. The aim is to normalise policy in order to bring down the skyrocketing inflation (8.1% yoy) and to avoid high inflation expectations becoming embedded in business thinking. It is consuming household budgets and delaying companies' investment intentions. However, the short-term economic losses are offset by the long-term benefits of inflation around the 2% target (expectations).

In contrast, the 2023 scenario is much more uncertain. The main problem is that by continuing the monetary tightening cycle, we are depriving the economy of its chance to grow. However, we believe that inflation will rise and remain high for too long to avoid policy normalisation.

The interest rate market is in a more moderate position for 2023. Nevertheless, the dilemma of growth or inflation will not end in the coming weeks. The real decision on the length and pace of the tightening cycle will likely to be made after September ECB meetings.

From this perspective, consolidation/correction in the interest rate market in the short term may provide an opportunity to protect against a continuation of an upward trend in interest rates in the medium term. The European 5-year swap rate peaked around 2.5% in the middle of last month. Technically, corrections could extend to 1.81% and in extreme cases to 1.61%, but a break of lower levels will signal that the markets are no longer expecting a strategy of interest rate policy normalisation.

The 5-year EUR IRS (white).



EU YOY GDP at 5.4% (yellow), core inflation at 3.80% (green), inflation at 8.1% (orange)