Markets Directorate Interest Rate Flash

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K&H

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The ECB accelerated the rate hike cycle !

Source: Bloomberg			
Short term interest rates EUR (%)	5.10.22	29.7.22	difference
Estr	0,6520	-0,091	0,74
EURIBOR1m	0,7060	-0,071	0,78
EURIBOR3m	1,2000	0,232	0,97
EURIBOR6m	1,7310	0,653	1,08
IRS EUR (%), source: Bloomberg			
IRS 2Y	2,75	1,17	1,57
IRS 3Y	2,82	1,24	1,58
IRS 5Y	2,89	1,39	1,51
IRS 10Y	3,01	1,70	1,32
Zero cost (ZC) collar 3 month EURIBOR (%), calculation by K&H based on Bloomberg data		IRS+0% strike floor purchase on 3 month EURIBOR	
5.10.22		5.10.22	
collar 3Y	2.50-3.50	IRS+floor 3Y	2,85
collar 5Y	2.50-3.50	IRS+floor 5Y	2,96
collar 7Y	2.60-3.40	IRS+floor 7Y	3,06
collar 10Y	2.60-3.62	IRS+floor 10Y	3,20

Source: Bloomberg				
IRS euro Forward start (%)		5.10.22	29.7.22	difference
1Y Forward	IRS 2Y	3,02	1,37	1,65
	IRS 4Y	3,04	1,48	1,56
2Y Forward	IRS 3Y	3,02	1,53	1,49
	IRS 7Y	3,09	1,78	1,30
CAP 3month EURIBOR (%), source: Bloomberg			5.10.22	
3Y 4.00%				1,14
3Y 5.00%				0,76
5Y 4.00%				2,56
5Y 5.00%				1,79
Running premium paid quarterly on 0% strike floor purchase on 3 month EURIBOR (%) calculation by K&H based on Bloomberg data				
5.10.22				
floor 3Y	0,1			
floor 5Y	0,14			
floor 7Y	0,17			
floor 10Y	0,19			

Source: Bloomberg	
Base rate (%)	5.10.22
Eurozone	1,25
US	3,25
Great-Britain	2,25
Canada	3,25
New-Zealand	3,50
Japan	0,10
Poland	6,75
Czech Republic	7,00
Australia	2,60
Hungary	13,00
Turkey	12,00
Romania	6,25

Markets commentary and significant price evolutions

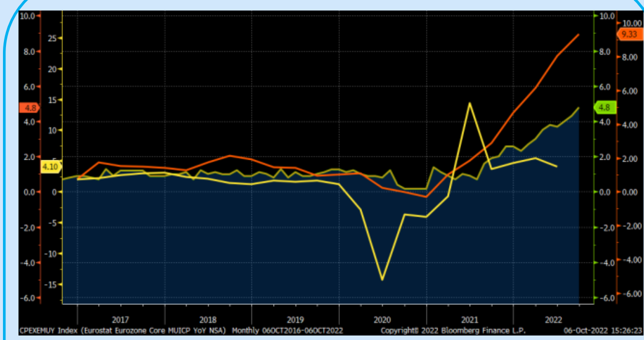
The European Central Bank continued its cycle of interest rate hikes, and accelerated its pace, as the 50 basis points hike in July was followed by a 75 basis points tightening, bringing the benchmark 1-week repo rate to 1.25%. At the same time, market expectations for the culmination of the rate hike cycle have also shifted upwards.

Rising energy prices, a tight labour market and high inflation requires the tightening monetary policy. The latest expectations suggest that inflation could peak at around 10 percent in the eurozone towards the end of the year and ease to around 3 percent by the end of next year. Moreover, average annual inflation could fall from 8 percent this year to only 5 percent, well above the ECB's inflation target.

While inflation risks clearly still dominate in the short term, the central bank is increasingly concerned that Europe's economy is heading to recession, which would justify maintaining looser monetary conditions. In our view, current conditions are still loose and far from the neutral level that is desirable in the long term. We expect the ECB to continue its rate hike cycle until the first quarter of 2023, with the base rate peaking at between 2.5% and 3%. Continued tightening is also needed to stem the rapidly weakening euro exchange rate and thus reduce imported inflation.

The temporary fall in the IRS curve seen in mid-summer was followed by a steep rise from early August, triggered by the ECB's relatively hawkish tone. The IRS yield curve has flattened almost completely, indicating that the market is anticipating a severe rate hike cycle, i.e. another 75 bps hike by end-October. In addition, the market does not expect a rate cut in 2023, which is why the 1-year IRS is around 2.5%. The main question is whether the economic slowdown/recession will bring a significant fall in inflation or whether we will be stuck in a stagflationary environment where the ECB will have to maintain higher than currently expected interest rates in the coming years. For the time being, it seems that the era of low interest rates will have to bid farewell to for the time being, and that in the short term, upward factors pointing to further rise in interest rates enviroment, so that IRS levels could move up by another 50-100 basis points in the coming weeks.

The 5-year EUR IRS (white).



EU YOY GDP at 4.10% (yellow), core inflation at 4.80% (green), inflation at 9.33% (orange)