Yields Move Higher as ECB Signals More Aggressive Unwind

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

This morning, the European Central Bank (ECB) formally announced it would raise the overnight deposit rate by 25 bps at the July meeting, dragging the key target rate up from -0.50% to -0.25%. The long-delayed and much-anticipated rate increase is expected to be followed by a second hike in September. Although the ECB granted itself latitude on the size of the next increase depending on how inflation evolves, it's almost certain that the days of negative interest rate policy will be ending in Europe. After the September meeting, ECB officials expect *gradual but sustained increases will be appropriate.*

The term *flexibility* was interwoven throughout the policy shift, but the overall tone was more hawkish than expected. The ECB also adjusted its GDP and inflation forecasts. Growth forecasts were revised downward from +3.7% to +2.8% in 2022 and from +2.8% to +2.1% in 2023, while the annual inflation outlook was boosted upward from +5.1% to +6.8% in 2022 and from +2.1% to +3.5% in 2023. By 2024, the ECB expects inflation to have receded all the way to +2.1%.

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Europe's inflation problem has been amplified by the war in Ukraine at the same time growth has abruptly slowed. Last week, Eurostat announced the rate of inflation for the 19-member eurozone had climbed from +7.4% to +8.1% in May. Energy prices (as expected) were the main driver, rising at a +39.2% annual rate. This was before EU leaders agreed in late May to ban 90% of Russian oil by yearend.

U.S. yields took another step higher this morning, with the 3-year Treasury note rising above 3.0% for the first time since a brief three-day period in November 2018; *before that, it had been more than 14 years.*

In other news, U.S. initial jobless claims rose to their highest level in five months, hinting that labor market tightness may have peaked, while mortgage applications fell for the fourth straight week and are now at their lowest volume level in 22 years. Overall applications are down-53.6% year-over-year, new purchase apps are down -20.5% and refi apps down more than -75%.

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Tomorrow, the May CPI report is expected to show an acceleration in prices for the month, along with a slight decline in the year-over-year rate.

Market Indications as of 12:09 P.M. Central Time

DOW	Down -37 to 32,874 (HIGH: 36,800)
NASDAQ	Down -43 to 12,043 (HIGH: 16,057)
S&P 500	Down -16 to 4,100 (HIGH: 4,797)
1-Yr T-bill	current yield 2.28%; opening yield 2.22%
2-Yr T-note	current yield 2.82%; opening yield 2.78%
3-Yr T-note	current yield 3.01%; opening yield 2.97%
5-Yr T-note	current yield 3.07%; opening yield 3.04%
10-Yr T-note	current yield 3.04%; opening yield 3.03%
30-Yr T-bond	current yield 3.18%; opening yield 3.18%