

Rates: Tactical upside to yields

The brief banking panic is behind us – at least until we get the next one. In front of us is a Fed in a holding pattern, and a May cut is now being questioned. As the Fed strip nudges higher, so too does the US 10yr yield. The 4.25% to 4.5% area is one where it will dawn on the market that it's gone too far. But for now, there is little to object to having that test



Federal Reserve
headquarters in
Washington, D.C.

US remains pivotal, tactical upside to yields with Fed in holding pattern

The local high for 2024 for the 10yr Treasury yield was just short of 4.2%. It feels right to be back up here, threatening to take out that high and making a path to the 4.25% area. The area between 4.25% and 4.5% is one where it will begin to feel like things have gone a bit too far, and one big catalyst can see us crashing back below 4%. We are just not at that tipping point yet.

The New York Community Bank fall is behind us now, and the big falls in the Regional Bank Index have stalled. Until we get some clear sight of material follow-through angst in this space, we move to a point where we effectively ignore the risks, just like we ignore major geopolitical calamity risks (until they hit us, that is). It leaves us with two items ringing in the ears. First, the payrolls report

confirmed the maintenance of a strong labour market. Second, a Federal Reserve cut in March is now a no-go. These are factors forcing yields higher.

In fact, the next question is whether the Fed can cut in May – that's now a toss-up from the market's perspective. The unwind of the May rate cuts discount and the upward drift in the Fed funds strip correlates with the ratchet higher in the 10yr Treasury yield. That can continue at least until something happens to negate it.

Structural dis-inversion still on the cards, to be led by the front end

On the curve, we'd expect it to dis-invert before an actual cut. Once we are a couple of months ahead of an actual cut and it's been effectively endorsed by the market discount and minimal Fed objection, then the 2yr yield will have space to gap lower by 50-100bp. That should be more than the 10yr can do, wiping out the 30bp inversion on the 2/10yr segment. From there, the 2/10yr segment begins a journey toward 100bp. The biggest part of that move will come from the front end, to begin with.

Eurozone rates to echo the US, but are already quite rich versus future policy rates

Eurozone rates reflect a lot of the same pushes and pulls. The nuance is that eurozone rates are already quite low. For example, 5yr to 10yr Euribor rates are in the 2.6% area, and similar ESTER rates are in the 2.4% to 2.5% area. The interest rate strip curves that discount the future for key front-end rates don't push much below these levels, if at all in the coming few years. That suggests that eurozone rates can echo moves in US rates, and in net terms we should see a structural convergence of US to eurozone rates once we get beyond the current tactical upside test to yields in general.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central

Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.