

Rates: All the 2s in 2020

The rates profile for 2020 has a particular focus on the 2s when it comes to the global benchmark (the US). Or more correctly, the sub 2s. That describes the growth, inflation and 10-year yield prognosis. It's L-shaped in the sub-2% area, but with a downside bias as a central risk. We could see breaches above 2, but the central tendency is resumption below



Source: Shutterstock

The logic for higher rates in 2020 is there. The US 10-year yield trades with a negative term premium of -90 basis points. That suggests the 10-year yield is far too low. Inflation expectations from the TIPS market pitch inflation in the next 10 years at 1.75%. That's a 25bp discount to current inflation in the 2% area; it should be a 25bp premium. That's a 50 basis point deviation from a "fairer value". Meanwhile, the US consumer is very confident and the labour market is firm. Our basic macro model pitches fair value for the 10-year at 2.25% to 2.5%.

But to get there will prove quite difficult in 2020 on account of a number of other competing drivers. There is still very strong demand for fixed income. This comes from pension funds looking to match liabilities which are discounted with something close to the risk free rate. Also from banks, which must fill liquidity buckets, and remain big buyers of core bonds globally. Central banks also hold a significant rump of core government bonds through quantitative

easing programmes, and these holdings will increase by \$1 trillion in 2020.

On top of that, uncertainty with respect to the rules of engagement remains. We are one tweet away from a pivot in policy, and a key election event awaits in November. The best barometer of how this is affecting sentiment is in manufacturing surveys, which are below 50 in the US and still well below that threshold in Europe. Then from a technical perspective we find that yield curves remain quite flat, implying a muted forward uplift. And curve structures remain bullish (5-year trading rich to the wings, both on the US and European curves).

Things have improved through. The Chinese PMI is back above 50 and European PMIs look to have troughed (albeit at uncomfortably low levels). Imminent recession risk in the US has also receded. Tensions in Iran have been tamed for now. Brexit is more certain. And trade tensions have diminished. That all being said, the risks here remain elevated, which is why the US 10-year has struggled to break back above 2%. It could do so now though, and has a window in the coming weeks, but it's unlikely to stay there. There are just too many balls being juggled, and it only takes one of them to fall. That would take the 10-year back below 2%, to that famed sub-2% zone.

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.