

Rates: If the system's okay, rates should edge up

The pivot camp thinks market rates have peaked. They may indeed have, but that doesn't mean we can't get back up to that peak. We think it's too early for a precipitous fall, unless the system creaks loud(er). Recession risks are not enough – they may slow down hikes, but that doesn't make them go away. Market rates therefore remain under upward pressure



Key market rates are thinking about falling, but it's too soon. There's still upward pressure

The US 10yr Treasury yield has settled at around 4% and the Euribor 10yr at 3%. Breaks below these levels have been seen in the past week or so, and are generally premised on market talk of a slowdown in hikes. That has also helped buoy risk assets. Market participants are terming this a pivot, but we'd say it's an adjustment or a modification-type pivot at best, rather than a hard pivot where the direction is materially changed.

The fact remains that central banks are still hiking, and slower hikes can still result in elevated terminal rates. This is especially true given the stickiness of inflation, and we've seen examples of

this from both the US and the eurozone in the past week or so. So, the pressure remains on central banks to do something about inflation, and there is only one thing they can do – ensure financial conditions are tight and constraining on the economy.

Any material fall in market rates loosens financial conditions. Not ideal yet

A material fall in market rates and/or a precipitous narrowing in credit spreads is not what central banks want to see at this juncture, as it frustrates their purpose. Indeed, if there were to be a material fall in market rates ahead, it would most likely need to be countered by a stronger reaction from central banks. It might be verbal to begin with but will ultimately signal an ambition to target higher terminal rates where necessary.

We are therefore reluctant to join the bandwagon for lower market rates. We will get to that point eventually, but we think it's still too early. Upward yield pressure remains a call for the coming month.

There is a mild creaking in the system

There is one important caveat to this though, and that is a slow uptick in system pressure. One measure of this is where banks print (3-month) commercial paper, and in particular the spread over the risk-free rate. In USD that spread has crept out to the 30bp area, and European banks are printing in the 50-60bp range. That's not awfully wide, but it is much wider than it was.

System pressure presents a more credible risk for a hard pivot

This type of widening is a more credible reason for a “pivot” than mere recessionary fears. After all, tighter policies from central banks are designed to slow growth, and such policies accept the risk of consequent recession. But what central banks can't accept is any threat to the functioning of the system. There's no need to panic yet, but this is what we really need to be cognisant of.

Any material fall in market rates from here will only make sense if the system is really creaking. Here we've outlined the risks, and note that they are there. But we are not at a point yet where it can cause central banks to abort what they are up to. Therefore, the upward pressure on market rates remains.

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 <http://www.ing.com>.