EUR curve: The new - flatter - normal

Given the shallow rise in EUR interest rates we are forecasting for 2021, we expect curve dynamics to remain equally muted. EUR 2s10s will steepen more than 10s30s

30Y richness is structural, EUR 2s10s to steepen more than 10s30s

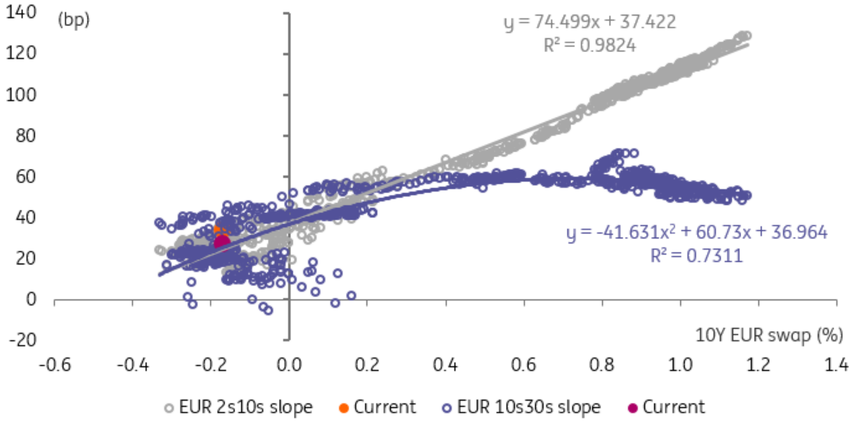
We've detailed in a previous section the fundamental reasons why we expect the hunt for yield to be a prevalent factor in keeping rates low. The question for the shape of the curve is where exactly this demand will be directed.

> *The richness of 30Y reflects a structural shift*

In recent years, in particular 2019, maturity extension demand has made the 30Y the most directional part of the curve. We do not expect that dynamic to go into reverse. To an extent, the richness of the 30Y reflects a structural shift in growth and inflation expectations and the fact that the main European Central Bank policy lever is to remove duration risk from the market to support the economy.

Absent any concrete hope of rate hikes over the coming years, we thus expect the 2s10s segment to be the most sensitive to direction. This should result in a faster steepening of EUR swap 2s10s, of around 17bp, than the 10s30s, of around 10bp, and so in a cheapening of the 10Y sector of the curve.

EUR 2s10s should steepen as rates rise (slowly), 10s30s not so much



Source: Bloomberg, ING

Terming out and ECB mandate change: muted risks

There are two risks to this view. The first one is if governments pursue an aggressive debt maturity extension policy beyond the 10Y point. This is a possibility, but we suspect such an increase would be mostly demand-led and so of little market impact.

Another risk is if the ECB's policy review opted for a Fed-style average inflation targeting (effectively aiming for an overshoot to the 2% inflation target). Not only is this unlikely, we think the credibility of such commitment would require radical, and sustained, fiscal support for the economy, something we are not prepared to assume.

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