

## USD: That stretchy feeling for the curve

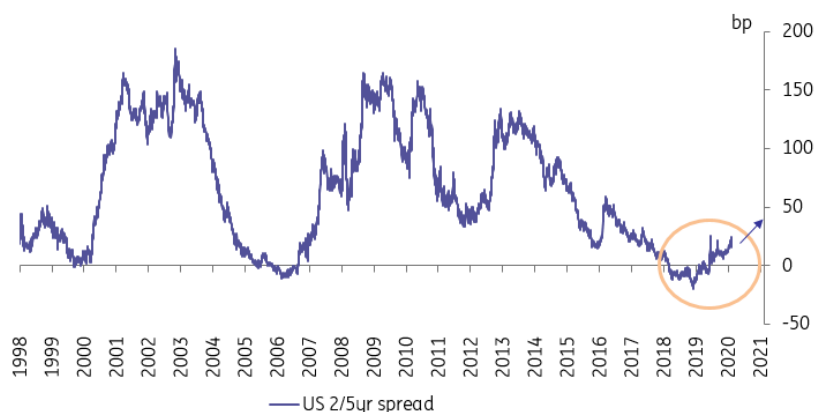
The shape of the curve is all about direction in 2021. By 2022 that will likely change as the debate on possible Fed hikes by 2023 will be live, unnerving the jumpy 2yr. But for now, even the vaccine moment did not radically impact the fed funds strip, and by extension the 2yr. Given that, watch the 2/10yr curve stretch to 100bp, driven by back end direction



### It's a directional curve for 2021 with the front end anchored

We'll see the reflation discount in the shape of the curve; it should steepen. Watch the US curve here more than the eurozone one, as the latter has a strange front end that can go as deeply negative as it likes it seems, bringing long end rates with it. The US curve is more anchored at zero. When it stretches steeper, it means something.

## US 2-5 yr spread



Source: Macrobond

### The 2/5yr anticipated a recession back in 2019, but now it is stretching steeper; a reflation story

As it does stretch steeper, it further moves clear of the inversion episode seen in mid-2019. Remarkably back then the curve was already discounting a recession. Well, we got one. And we'll likely get a Covid-induced a double-dip. Beyond that, a steepening bias should dominate as a theme for 2021. As the 10yr marks a 1-handle, we'd see the 2yr remaining in sub-25bp territory. Hence a 100bp 2/10yr curve targets the 10yr in the 1% to 1.25% range.

---

*The debate on the Fed hiking rates will be a live one by the time we get to 2022*

---

Even in the wake of the vaccine announcement, there was very little shift in the Fed funds strip. Implied rates in 2021 and 2022 did ease higher a tad, but not significantly so. This maintains a firm footing for the 2yr to remain anchored in 2021. That said, the debate on the Fed thinking about hiking rates will be a live one by the time we get to 2022 - any sense that the Fed could hike in 2023 would be reflected in the 2yr by 2022.

For 2021 though, there should be less discussion on Fed hikes as a live issue. In fact, this is one of the reasons underpinning the rich valuation attached to the 5yr on the curve. That is highly correlated with the money market curve and by extension rate expectations; these remain dampened down, and will likely remain so for the bulk of 2021.

#### Author

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto: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](http://www.ing.com).