

## Rates: Pressure for higher rates and wider spreads

There is quite a contrast between the US and eurozone's rates narrative. The discount for a rate cut in the US has shifted to September, but in Europe, it's still June and/or July. That means upward pressure on market rates and wider spreads. And it also anticipates a steepening of the eurozone curve from both sides



Varying rate expectations: The ECB's Christine Lagarde and the Fed's Jay Powell

### US Treasury yields remain under upward pressure

In previous cycles, the 10yr yield typically managed to fall appreciably once the Fed has peaked. In the current cycle, the 10yr yield has, in fact, risen post the peak. What is clear is market rates have not fallen by anything near what would have been typically expected from a "Fed peak moment". See more [here](#).

Firm labour market data and pops in inflation data have muddied Fed rate cut ambitions. And the latest payrolls and consumer price inflation reports largely contain more of the same. Bottom line: the data since the Fed has peaked has not been consistent with an excuse to cut, which delays confirmation of July 2023 as the peak.

That, in turn, exposes an excuse for the 10-year yield to continue to retest higher for as long as the economy refuses to lie down. We've now hit 4.5%. The next big target is a potential re-visit of 5%. With another run of 0.3% or 0.4% month-on-month readings for March inflation, the pressure is building in that direction.

## Eurozone market rates can't ignore the US

In contrast, the eurozone is moving in the opposite direction as the discount for a June and/or July cut remains hard, while it has virtually disappeared for the Fed (a first cut from September is now discounted). This is quite an unusual circumstance but reflective of a US economy that remains more inflation-prone than the eurozone and, indeed, more vulnerable from a growth perspective. This is being echoed on the curve through a widening in the Treasury versus Bund spread, which has now shot above 200bp and is likely to continue to widen.

Progress towards lower longer tenor market rates for the eurozone is being frustrated by upward pressure on Treasury yields. The US 10yr Treasury yield, now at 4.5%, contrasts with a 10yr Euribor rate of c.2.7%. Should the US 10yr head towards 5%, the Euribor 10yr could be dragged towards 3%, even as the ECB prepares to cut. This would allow for steepening as 2yr Euribor moves from 3.2% down to sub-3%, finding it easier to shift clear of the US 2yr.

Bottom line, we see upward pressure on Treasury yields in the months ahead, and eurozone market rates are being dragged a touch higher by the directional impulse coming from the US. Hence, there's a continued widening of the spread from eurozone market rates to US ones. We should also see some steepening from the front end on the eurozone curve for as long as the ECB sticks to its pre-Fed rate cut ambitions.

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