

Rates: Risk mood to tip the balance ahead

We called for the recent rise in market rates, and when they eventually popped it was in a flash. Thematically, inflation stickiness is a key theme, and heads have turned to 'we told you so' central banks. Logically, upward pressure for market rates remains, which is probable if risk assets perform. If not, duration buying should mute the upside risk



Front ends are getting priced higher on more hikes and fewer cuts being discounted

Front ends are hitting new extremes as the rate hike narrative from central banks has become more credible. The German 2yr has popped above 3% in the past week for the first time since the Great Financial Crisis. And the 10yr Euribor is also now back above 3%; comfortably in fact, at 3.2%. The marketplace is being bullied by inflation stickiness (see the latest [French](#) and [Spanish](#) readings) and the associated heightened European Central Bank rate hike risks.

The front end is being bullied by inflation stickiness

It's a similar story on the US curve. A June hike of 25bp is now fully priced (so we have 25bp priced for March, May and June). There is some talk of a 50bp move, although we view this as being quite unlikely, and indeed unnecessary. The Fed needs a degree of underlying stability, so upping the size of hikes here would be counter-productive.

The other big change on the US front end has been the downsizing of the probability attached to interest rate cuts in late 2023. This is the other reason for the US 2yr to hit a new cycle high in recent days. It's off the highs hit in the week but is still only a smidgen below 5%, a level that the 2yr yield collapsed from in 2007 as US banks began to feel a sense of impending doom as the housing market collapsed.

Long rates also rising, but still low versus the front end

The US 10yr has responded to heaping pressure to move higher in yield over the past few weeks but still remains a tad anomalous, as the 3.9% area is still some 150bp below the market's projected peak in the Fed funds rate. Most of the time the 10yr hits the same peak as the front end, only much sooner. Here, the 10yr peaked at around 4.25% back in October. That's a deep discount versus the terminal funds rate now discounted at 5.4%.

Long rates suggest that economies will creak ahead

One of the plausible reasons for the remarkable early and deep inversion of the US curve is longer maturities are a tad nervous about the future. Putin's war in Ukraine shows how uncertain geopolitics is, and how impacts from such events become global really quickly. And it's ongoing. The bigger question ahead is whether we can sensibly suggest that the US and eurozone economies are about to successfully weather the cumulative effect of rate hikes delivered. Remember these rate hikes have been quite aggressive, and quick, and they are not yet complete. At a certain point, economies will creak.

The data ahead will of course be pivotal. But we'll also take our cue from the appetite for risk. Stay risk-on, and market rates are pressured up in tandem with recent data. Come off, and they can calm down as future data is projected to take a dip. We think market rates should be calming here after their hectic ride higher, and should be dominated by duration buying and fixed rate receiving, ultimately pulling market rates back down. But the current mood is in fact to go the other way; risk-on, tempting rates to dare to go higher still first.

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>.