

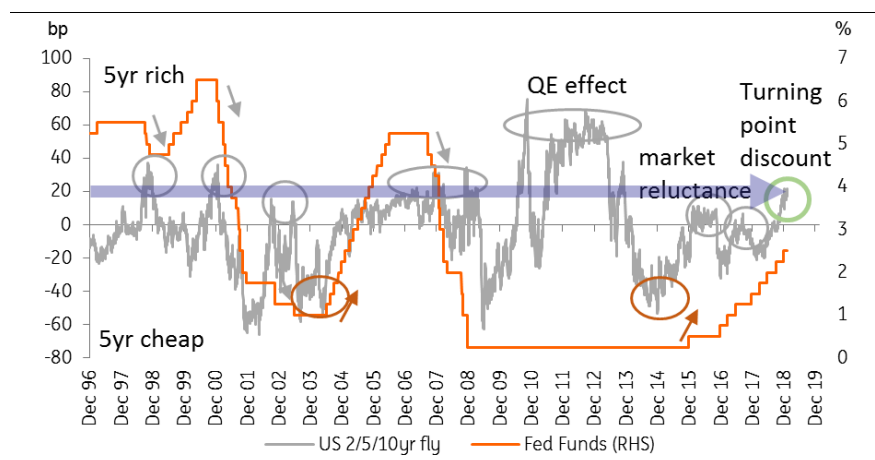
## Rates: Risk-on can't mean cuts

We have identified a change in rates market psychology; it shows that rates are peering down, but we'd prefer to bet against this as a tactical view. Structurally there will indeed be rate cuts at some point down the line



Take a look at the chart and large arrow below. It's an update of what we showed last month, but is worthy of a repeat as it illustrates that the market has steered towards valuations that are not out of sync with interest rate cuts. Why? Typically when the 5-year trades more than 20 basis points rich to the curve, the Fed is often cutting rates (or engaging in QE).

## The 5yr versus a combination of the 2yr and 10yr – Key barometer of sentiment



Source: Bloomberg, ING estimates

Does that mean that the next move in the Fed funds rate is down? Not necessarily. The jury is still out on the extent of slowdown risks. We don't anticipate an imminent recession (at least not in the next two years), and the re-steepening of the yield curve (especially on the 10/30yr) supports that notion.

Also, market yields are still above the Fed funds rate. These would typically trade below the funds rate ahead of actual delivery of interest rate cuts. The 2-year is sitting just above the funds ceiling at 2.5%. History shows that even the 10-year would trade through the funds rate if cuts were seriously being contemplated.

The market discount is finely balanced though. Market probabilities do not contain a conviction view for the coming year. But after that, the bias is more towards a cut than a hike. The medium-term discount sees the funds rate settling in the 2% to 2.25% range, an implied cut of 25 basis points from current levels.

We can agree with the medium-term discount, but the balance of risks still points to a residual rate hike risk later this year (see the US macro section). That is where we identify alpha versus the forwards, and we note that the ongoing rally in risk assets points in the same direction; the Fed can also hike to push against this.

We have identified a change in rates market psychology; it illustrates that rates are peering down. But we'd prefer to bet against this as a tactical view. Structurally there will indeed be cuts at some point down the line. But to accelerate towards this, a deeper deterioration in growth would need to materialise. It's noteworthy that the current risk-on mood is implicitly pushing against this too.

## 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).