

## Rates: Sinister market discount

Things are discounted to remain bad, or even get considerably worse, for an extended number of years. A snapshot of current curves rings many alarm bells. The hold-out hope has been the US, but with the 30-year now below 2%, that hope is waning fast. We don't like it, but the path of least resistance is still for lower market rates.



Source: Shutterstock

While there has been a keen and sensible focus on global central banks in recent months, there have also been some remarkable moves seen at the other extremity of core curves. Not only is the German 30-year yield below zero, but the US 30-year yield has broken below 2% in the past few weeks. That takes the US 30-year yield to a new cycle low, taking out the financial crisis and subsequent angst-period lows. If we are to believe the market discount, then these are the worst of times. Plus, things are discounted to remain bad or even get considerably worse, for an extended number of years.

These remarkable valuations have been heavily influenced by two key questions that are very difficult to answer.

1. The first question centres on core central bank policy, and to what extent central banks have the capability to influence activity, and by extension inflation. Central banks may (and

indeed were) key in averting depression following the financial crisis, but their ability to influence has been severely impaired since. Japan has struggled, Europe is now struggling and while the US is in better shape, it is far from clear that the Fed has the control it once had.

2. The second issue revolves around politics and global policy disagreement. Here the immediate focus is on the future of Europe (and the eurozone) and by extension Brexit and trade relations. Overlaying that is the widening gap between the narratives coming out of the US and China with respect to the resolution of trade disagreement. Things on this front are getting worse, and likely to get even worse before a tone change is probable.

The preliminary answer to the first question, coming from the central market discount, is that central banks have lost considerable capacity to influence economies. And the second political issue is one that augments the answer to the first question, as political wrangling such as Brexit and trade wars makes it even more unlikely that central banks can have the impact that they could have. And in a way, central bank efforts to cushion economies in fact make more room for trades wars and allow the like to deepen.

Long end rates have long noses. Often the 30-year rate can behave differently from shorter tenors, as the 30-year will pick up on ultra-long trends. This can manifest in very steep 10/30-year spreads for example as the 10-year gets pulled lower by front end vagaries, but the 30-year maintains some degree of longer-term aloofness. This can be a comfort that all of the bad stuff being discounted today will go away eventually. There is an element of this in play on current core curves, where the 10/30yr is far steeper than the 2/10yr e.g. in the US the 2/10yr is flat while the 10/30yr is 50bp.

That said, there has also been a clear flattening tendency in play in recent months. And flatter curves imply a lower forward discount for higher rates in the future e.g. a completely flat curve implies no rise in rates, and an inverted one discounts cuts on fears for recession. A snapshot of current curves rings many alarm bells. The German 2/10yr curve is a mere 20bp, implying a minimal forward discount for higher rates, ever. The absolute 10yr yield at -65bp is even more sinister in terms of implied discount (imputes depression). The hold-out hope has been the US, but with the 30yr now below 2%, that hope is waning fast. We don't like it, but the path of least resistance is still for lower market rates, with most such room in long-tenor rates.

## 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>.