Rates Spark: A gift from Pakistan

We're not sure what will happen at 8pm this evening. But a window has just been presented by a call for a two-week ceasefire. There has been no reaction to this as of yet from the US. But it does present an opportunity to take us away from the brink. The alternative is concerning

As we approach another deadline, there are calls for a two-week ceasefire via Pakistan

On the brink of a delta, and it has the more potential to be positive rather than negative

In the past few weeks, we've monitored the ups and downs in the Iran war. A few weeks back it seemed that President Trump had declared victory and was preparing to wind things down (here). That proved a false dawn. Then things moved in a sinister fashion, and we highlighted the deterioration (here and here), with specifics based off elevated break-even inflation rates, rises in Treasury yields and a downsizing in rate cut expectations. The backstory saw Iran take control of the Strait of Hormuz, shifting the initiative from the US. And we roll on to Tuesday where an 8pm deadline looms, beyond which a severe threat has been laid before Iran.

In many ways, this is much worse than tariffs, as you just pay these and move on. Here, a global energy crisis is a whole different dimension, and it comes with both a price and demand shock risk, the outcome of which is actually not in the hands of the US. It's in the hands of Iran. In the past hour, there has been a call for a two-week ceasefire, via Pakistan, as part of the negotiations. This presents an opportunity for President Trump to seize the initiative, and take us away from the brink.

> *In actuality, this war must end in the next couple of weeks, else we are on the precipice of a pandemic-style shutdown in many regions of the world, with a global recession risk to boot*

The immediate issue, and the clearest transmission mechanism to bonds and Treasuries, is through inflation, with front-end break-evens in the 3-5% zone, and the prognosis for Treasuries is the curve keeps edging higher. This whole scenario is outright bad for President Trump. Opinion polls suggest no chance for Republican success in the mid-terms. A good chunk of his base voted for him on the theory that there would be no more wars like this one, and at the moment, the Republicans are at risk of losing both houses.

End the war quickly and declare victory presents and out for the President. If we have not ended this war in the next few weeks, we risk a significant sell-off in risk, and in bonds. In that world, yields will get to levels where they represent value as we begin to worry more about global recession than inflation, and then yields really flop lower, substantially. It's a roller-coaster that would not be comfortable for the President. So, best to avoid getting on to it.

Wednesday's events and market views

Markets will primarily be watching headlines for any developments related to the Iran conflict. In terms of data, we start with German factory orders and eurozone PPI data later, but since both are from February, these figures won't be moving the needle. From the US, we first have weekly mortgage applications data, but the more interesting thing to watch should be the FOMC meeting minutes from 18 March. Markets are still in debate as to what the next move from the Fed will look like.

In terms of issuance, Germany will auction 10Y Bunds for €5bn and Portugal 10Y and 14Y OTs totalling €1.5bn. From the US we have a 10Y Note for $39bn on the agenda.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com