

## Rates Spark: Different causes, same effect

The US and European economic trajectories are diverging. Yields have followed, albeit more modestly. In both cases the result is ever flatter curves, helped by seasonal factors



### Yield differentials widen, but all curves flatten

It is hard to completely dismiss technical factors when finding an explanation for the continued flattening of yield curves heading into the summer market lull. Expectations of calmer market conditions in the summer don't always come true but worse liquidity make investors wary of keeping positions that carry negatively, for fear of being unable to exit them should markets move against them. We think this is an important factor adding a tailwind to the curve flattening. We think steepeners have been a popular trade in recent months as investors foresee the end of central banks' hiking cycles. The problem is, these are costly to hold. For instance, a euro swap 2s10s steepener costs over 6bp per quarter in carry. Its US dollar equivalent cost over 17bp.

---

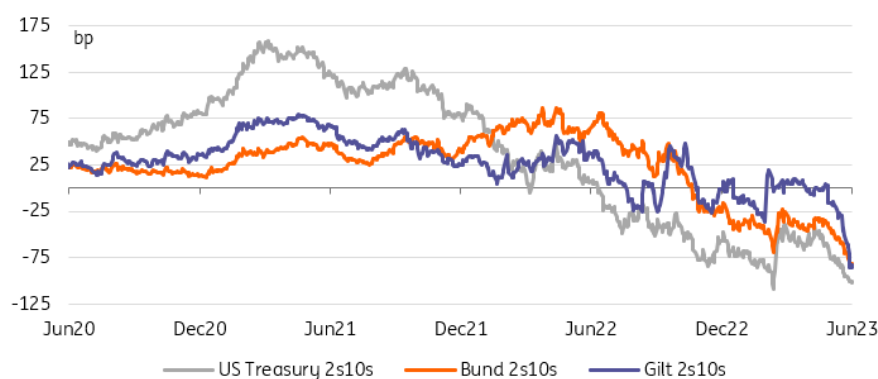
*A euro swap 2s10s steepener costs over 6bp per quarter in carry. Its US dollar equivalent cost over 17bp*

---

Of course, it helps that curve flattening is the rational reaction to a world where the economic outlook is worsening, look for instance at Europe or at the disappointing recovery in China. Add to that central banks adding another layer of hawkish paint at the European Central Bank's (ECB) Sintra conference which continues today, and you have the perfect recipe for a flatter curve. This thesis get an important reality check over the coming days in the eurozone, in the form of the June inflation data. Italy is the only country to publish its own today, but markets may well be tempted to extrapolate its finding to other countries until they publish their own.

One country that seems impervious to the overall gloom is the US. Perhaps due to its lower reliance on global demand for growth, or perhaps due to the resilience of its domestic job market. The result is the same. Markets increasingly believe the Fed will hike at least once more in this cycle. If US curve developments are highly correlated to its foreign peers, albeit for slightly more upbeat reasons, its curve has shifted upwards relative to its European peers. Despite arguably encouraging progress relative to Europe on the inflation front, euro-dollar yield differentials have widened. This yield divergence coincides with the divergence in economic surprise indices, albeit to a less spectacular extent.

## EU gloom and US glee both result in flatter curves, helped by carry



Source: Refinitiv, ING

### Today's events and market view

Italy is the first Eurozone member state to release its June inflation today. It will be followed by Germany and Spain tomorrow, and France and the eurozone on Friday. ECB monthly monetary aggregate data, including M3 growth, and Italian industrial production complete the list.

US data is relatively thin today, with only mortgage applications and inventories to look out for.

This will leave plenty of time for investors to scrutinise central banker comments with an all-star line-up comprising Fed, ECB, Bank of Japan and Bank of England governors.

TLTRO and eurozone financial system nerds will also look at the 3m LTRO allotment which settles tomorrow, a day after today's June TLTRO repayments. Yesterday, settling with the repayments, the central bank allotted €18bn at the weekly main refinancing operations facility, the most since 2017. Presumably, some lenders find its 4% interest rate

the most attractive option, or maybe the only available, to finance the repayment of TLTRO funds.

Italy accounts for today's euro sovereign bond supply with 2Y debt, followed in the afternoon by the US Treasury selling 2Y FRN and 7Y T-notes.

## Authors

### **Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

### **Benjamin Schroeder**

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@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>.