

## Rates Spark: June hike angst and supply pressure yields higher

The odds of a June Federal Reserve hike clearly aren't zero, and the appetite to issue debt in this window of relative calm remains healthy. The drift higher in yields can continue into Wednesday's Federal Open Market Committee minutes



### All eyes on June Fed hike probabilities, as supply continues

Selling pressure on bonds seems unrelenting and more likely stemming, in the short term, from borrowers rushing to issue debt in the current window. Headlines regarding the ongoing debt ceiling negotiations are a distant second but, here, we think the signal-to-noise ratio of plentiful headlines is characteristically low. In the meantime, low volatility breeds more favourable primary market conditions, and if Monday is anything to go by, the appetite to issue debt remains healthy. Our base case is for this to continue, although near-term events risks, especially tomorrow's FOMC minutes, could at least pause the bonds sell-off.

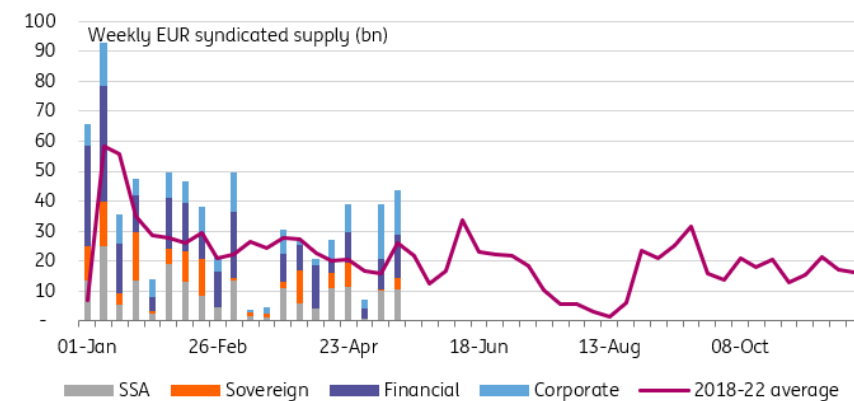
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*The market's fear is that the Fed may not be done with its hiking cycle*

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Interestingly, it appears that most selling pressure in the past several days occurred in US hours. This may tie in with the two explanations above for bond market weakness, but we feel there is an underlying current of fear running through investors. This fear is that the Fed may not be done with its hiking cycle and that a more resilient economy than expected will catch markets off guard once again. Recent Fed commentary, admittedly from noted hawks Neel Kashkari and James Bullard, supports the view that not all on the FOMC want the probability of a June hike to go to zero, which makes good risk management sense. So far, it has struggled to rise above 30%.

## Calm market conditions have created a window of opportunity for bond issuers



Source: Bond Radar, ING

## US-EU differentials widen as expected but eurozone spreads go from strength to strength

A decline in last week's Zew Economic Sentiment Index wasn't enough to stop the march higher in yields. A decline in the PMIs today would stand a greater chance of attracting investors' attention. That being said, with the EUR curve already pricing in two more 25bp European Central Bank (ECB) hikes in this cycle, there is less of a discrepancy between markets and central bank messaging than in the US. There, the curve still prices 40bp of cuts by year-end. This has led to a re-widening of US-EU rate differentials, as one would expect in periods of rising market rates. Note however that, as recently as a few weeks ago, market conviction in a growth-busting credit crunch was much higher in the US. Debt ceiling optimism notwithstanding, these fears may well resurface.

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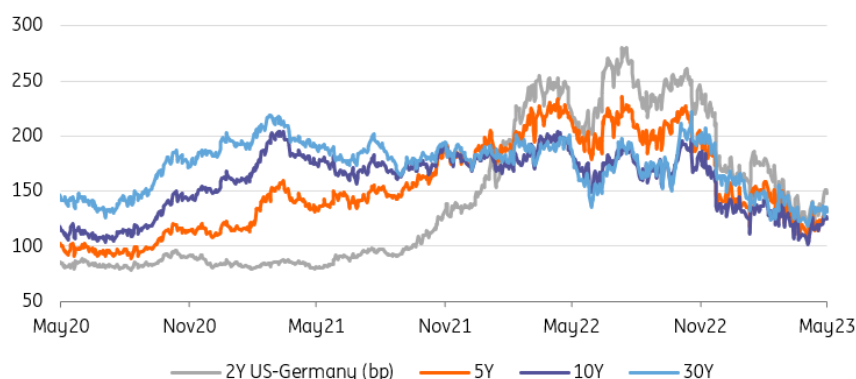
*Market conviction in a growth-busting credit crunch was much higher in the US*

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Another development one would expect amid rising market rates is a widening of European sovereign spreads, with the less financially resilient countries more likely to struggle due to higher borrowing costs. So far this year, there is little evidence of that. That Moody's left Italy's Baa3 (negative) rating untouched came as a relief to markets on Friday, compounding the good news of outlook and rating upgrades from Moody's on Portugal and S&P on Ireland, respectively. Despite a likely period of political uncertainty, the result of Greece's elections was greeted positively by

markets, capping an already impressive period of outperformance for Greek government bonds.

## Higher market yields have re-widened US-EU rate differentials



Source: Refinitiv, ING

### Today's events and market view

The main item on today's agenda is the release of May PMIs. Following the decline of other sentiment indicators, the consensus is for a slight drop, explained mostly by froth coming out of the service sector. Taking the eurozone composite index as a guide, this would be the first decline since October 2022.

Aside from PMIs, the main focus will be bond supply. The relatively calm market conditions have triggered a wave of deals. From the sovereign side, the Netherlands will sell 5Y debt, followed by the UK's and Italy's long-dated inflation-linked sales, and by Germany's 2Y auction.

US PMIs aren't as closely watched as their European counterparts but they complement a calendar that also includes new home sales and the Richmond Fed's manufacturing survey.

There are plenty of central bank speakers today, including from the ECB, but it is the odds of a June Fed hike that should keep investors on their toes.

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