Rates Spark: Lower yield test, but there are limits

When we look at the market discount, we see US rate cuts anticipated. But we don't see a US recession discounted. For as long as the latter remains true, there is a minimal path for the US 10yr yield to get below 4%. That said, 2 April will see reciprocal tariffs coming from the US, and we'll need to see where the chips fall after that

Treasuries up and down, but in the end unchanged. Some big weeks ahead

US Treasuries may have gone through quite a day on Thursday – down and back up in yield – but they've ended back where they started. We maintain our view that the FOMC outcome was effectively a one-day move, with minimal legacy in terms of immediate direction. That said, we also view the FOMC outcome as a whole as nodding towards dovishness, but with numerous caveats. When we look ahead, we do so nervously. 2 April will see reciprocal tariffs coming from the US, and we'll need to see where the chips fall after that. The macro data seems biased to be weak in the coming weeks too, but the PCE inflation data will likely show some stubbornness, remaining a tad elevated in nature.

When we look at the market discount, we see rate cuts anticipated. But we don't see a recession discounted. For as long as the latter remains true, there is a minimal path for the US 10yr yield to get below 4%. We say that as 1mth SOFR "floors" in the area of 3.5% ahead (forwards). Add to that a 40-50bp swap spread, and that churns out a base in the 4% area to reference the 10yr Treasury yield against. The 10yr yield could of course conceivably dip below briefly. But if no change in where the 1mth SOFR rate is expected to floor, then the 10yr yield would look very rich at 4%. That's the dynamic in play in the coming few weeks.

Not now, but in the medium-term (still 2025), a path to 5% subsequently has not gone away. We still have too much Treasury issuance, sticky inflation and an ongoing (potential) threat to "America Inc". Risk assets are currently tending to take the heat, with Treasuries as a safe haven. But that safety play is not that obvious should the aforementioned issues persist.

Growing concerns around tariffs outweigh the prospects of a German spending splurge

EUR rates ended Thursday slightly lower but this was largely reflective of the lower opening as the prior night's Fed was digested. Even as the Bank of England surprised markets with a more hawkish hold than anticipated, the bear flattening of the UK curve did not spill over into the EUR rates.

The latter saw little reason to rise as European Central Bank President Lagarde also touched upon one of the main looming concerns for European investors – that of the looming tariffs. Although the EU is trying to allow for more talks by delaying the proposed counter tariffs, the ECB president highlighted what is at stake, citing the bank's own impact analysis. The US imposing 25% of tariffs on EU imports would lower the Eurozone's GDP growth by 0.3 percentage points in the first year, and by 0.5 in the case of EU retaliatory measures. Markets are starting to lean again in favour of an April ECB rate cut with close to 15bp priced in OSI forwards – an implied probability of almost 60%.

In Germany, the amendments to the constitution that pave the way to a fiscal spending splurge should pass their final hurdle in the upper house. But it becomes also clear that a lot of the impact will hinge on the coalition agreement and then on the actual implementation. That already puts the plans on a timeline unlikely to offset the more immediate tariff effects. Perhaps reflective of a more sober and realistic take on the timelines around the German spending plans, the valuations of 10y Bunds versus swaps have gradually reclaimed further ground over the past days, now back to yielding around 11bp over swaps.

Friday's events and market view

In Germany the upper house representing the states will provide the final vote on the defence- and fiscal-spending plans. It is widely expected to pass, with courts in Germany also having dismissed last ditch injunctions against a vote by the states.

There is little other data of note on the calendar apart from the preliminary eurozone consumer confidence reading. The ECB's Escriva is scheduled to speak on AI in finance and from the Fed we will hear from Goolsbee and Williams.

Author

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

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@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.