

## Rates Spark: What's brewing in Japan should in the end push rates up

Developments in Japan look to be ultimately a higher rates narrative, as yen weakness exposes a dis-equilibrium that is unlikely to end well. We also think the short end of the euro rates curve can shift up as the probability for just two ECB rate cuts in 2024 should be more material. We await now the FOMC and US re-funding announcement on Wednesday.



### Refunding and FOMC focus, with the BoJ an ongoing higher rates issue (we think) in the background

The fall on global core rates post the apparent Bank of Japan intervention smacks of a temporary reaction. The underlying issue remains. Japanese rates are significantly below US ones, and if the Japanese yen can't appreciate versus the US dollar, then we don't have a steady state equilibrium. Facing that with FX intervention typically does not end well. The more obvious solution to this is for Japanese rates to rise. If they don't, something will have to give. And the bigger the hold-out, the bigger is the subsequent reaction. We continue to watch this space with a degree of concern. As a package, it suggests upward pressure on market rates generally, augmented to the extent that

the US economy does not slow by enough to allow the Fed to cut rates in a timely fashion.

The next key impulse comes from Chair Powell's tone from Wednesday's FOMC. A hawkish tint is likely, and this can in fact help to calm a back end that has been feeling very unprotected. But anything overly hawkish could cause the back end to get too worried on whatever risks the Fed sees. So Chair Powell has a tough balancing act to perform. We also get the second quarter re-funding announcement from the US Treasury. We have no reason to expect a deviation of any note from the provisional refunding indications, which sees auction sizes in the 2yr, 3yr, 5yr and 7yr held steady at \$69bn, \$58bn, \$70bn and \$44bn respectively (historically high levels though). 10yr, 20yr and 30yr lines are upped for May, but then carved lower for June and July. Whatever the narrative, supply pressure remains elevated.

## Markets interpret mixed messages as dovish

Spanish CPI numbers kicked off the week and they appeased markets by coming in just below expectations. But the message from German HICP was more blurred, slightly above expectations and 0.1% higher than prior reading. Given the early easter effect we hoped to see headline inflation a tad lower and thus, in our view, this data point should have pushed back against the observed easing of short end rates. Markets are set for a June cut, and so are we, but these inflation dynamics do not argue for a fast pace of easing thereafter.

Perhaps markets are more focused on the disappointing economic sentiment indicators from the European Commission and the softening of selling price expectations. But the latter is still above historical averages for most sectors. Current market pricing is for 72bp of cuts this year, but in our view this should be closer to 63bp, which would imply a 50-50 for two or three cuts.

The back end of the curve has less potential to shift up, as the inflation risk premium has already been dragged up quite a bit by US markets over the past two months. The 5y5y inflation swap forward is now at 2.36%, well above the ECB target of 2.0%. This should give a bit of a buffer in case inflation numbers later in the week contain some upside surprises. We therefore see a tendency for Bund curves to flatten in the coming days.

### Tuesday's events and market view

Another day with eurozone inflation numbers, this time from France, Italy and the eurozone as a whole. Core CPI for the eurozone is expected to fall to 2.6% from 2.9% last month. Alongside we have GDP estimates for major eurozone countries and the eurozone, all of which are expected to come in close to zero. From the US we have the conference board data, which includes consumer confidence and expectations.

Supply wise we have a Dutch 10y DSL auction of €2-2.5bn and Germany a 5y Green Obl for €3bn. The UK will auction GBP 4bn of 5y Gilts.

## Author

### **Padhraic Garvey, CFA**

Regional Head of Research, Americas

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

### **Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@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 [www.ing.com](http://www.ing.com).