

Rates Spark: Nothing breaking means higher 10Y Bund yields

As the Federal Reserve has now finally kicked off its easing cycle, we see room for longer rates to move higher again, if nothing breaks. For 10Y Bund yields, the current 2.2% seems too low in comparison to the macro backdrop as painted by current data and forecasts. In the UK, the Bank of England's steady QT should continue to slowly build a term premium



Days with bear steepening of the Bund curve could become more common

With the [Fed](#) and now also the [Bank of England](#) behind us, EUR rates will be planning their next move. For 10Y Bund yields, we think the direction is higher, because the current 2.2% seems too low in comparison to the macro backdrop as painted by current data and forecasts. The economy is cooling, but this has always been expected given the tight monetary policy. This doesn't mean we're anywhere close to a full-blown recession, although we can imagine markets are still traumatised from the 2008 crisis and euro debt crisis.

The bear steepening of the UST curve is adding to the steepening pressure in Bunds, and we

shouldn't be surprised if more bear steepening were to materialise over the coming months. The front end already seems fairly priced in the eurozone and thus the scope for 2Y yields to go lower is limited. On the other hand, the 10Y yield could drift higher and we target 2.6% by the end of next year. As long as nothing breaks, this will be the path of least resistance. And don't forget that global financial conditions have already started easing, reducing systemic financial stability risks compared to earlier this year.

Bank of England sticks to QT path, term premium continues to slowly build

The Bank of England was not persuaded by the European Central Bank and Federal Reserve to cut again and decided to hold the policy rate at 5.0%, in line with market expectations. The Committee also kept the pace of quantitative easing steady at £100bn over the next 12 months. Of this amount, £87bn will be coming from maturing Gilts, and thus the active sales component is relatively small. There was some talk that this pace could be increased, but the Committee opted unanimously for a predictable path going forward.

The impact on rates will be minimal from the decision to keep the current pace, which was also the consensus view. Quantitative tightening will continue to play on the term risk premium, but we are likely talking in the range of about 10bp for the 10Y yield over the next year. In terms of liquidity conditions, QT will have less effect because the BoE's short term liquidity facility (STR) has shown significant uptake of late (£44bn now) which mitigates the risk of QT draining too many reserves from the system.

Friday's events and market views

Relatively little notable data on the agenda. From the eurozone we have consumer confidence data, where the index is expected to improve slightly, continuing the trend upwards. ECB President Christine Lagarde will be speaking in Washington. No issuance is scheduled.

Authors

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

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>.