Rates Spark: Nothing new on the dovish front

Of the three factors pushing yields up, only the lack of clearly dovish data is a significant one in our view. Powell and Lagarde could aggravate the bond sell-off today but next week's sentiment indicators may paint a less rosy picture

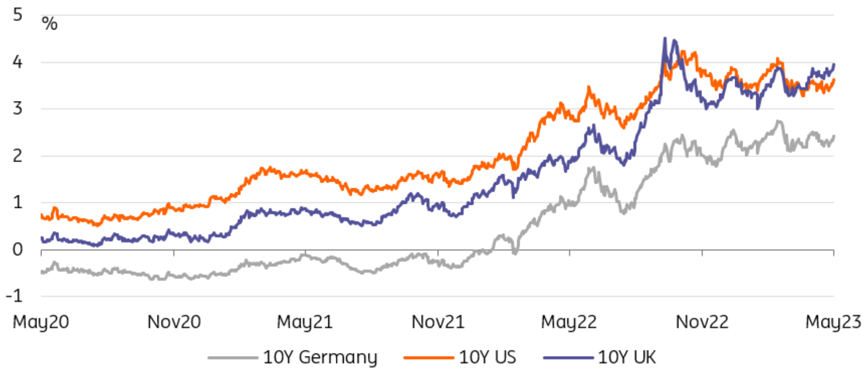
Three factors pushing yields up, but only one really matters

Bonds continue to trade on their back foot on a combination of factors, which we will divide into three groups. First, flow. A week of relative calm has proved a cue for borrowers to come to primary markets, saturating demand in some places and pushing yields up. Second, sentiment towards a number of tail risks, mostly US regional banks and the debt ceiling, seems to have improved. Third, a slowdown in economic data that would justify the rate cuts priced by yield curves, especially in the US, still elude the market.

> *We're still in the period after a lot of monetary tightening has been implemented, but before it actually bites*

We tend to dismiss the first as a mostly temporary factor, not least because the supply window may not remain open very long, and because a supply indigestion might deter opportunistic issuers. Tail risks are more complicated because they are – by their very nature as low probability but high impact events – eminently difficult for markets to price correctly. The third factor is more significant in our view. In our assessment, we're still very much in the misleadingly calm period after a lot of monetary tightening has been implemented, but before it actually bites.

10Y yields are pushing higher as data fails to validate dovish expectations



Source: Refinitiv, ING

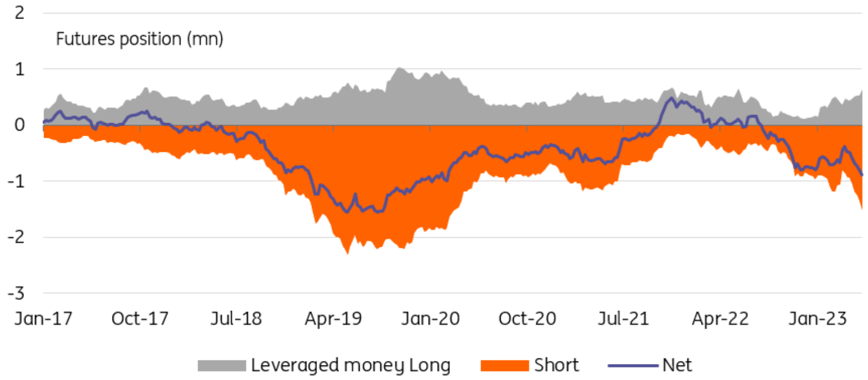
Drift higher could continue but the reversal may be violent

10Y Treasuries just crossed the top of range in place since mid-March. This is something 10Y gilts did a long time ago, while 10Y Bund yields are still off their April highs. Supply calming down should provide a relief to markets but today's central bank speakers (chiefly Christine Lagarde and Jerome Powell) stand a better chance of moving the market when they keep the option to hike open. At face value, the USD curve is more vulnerable to Powell's 'higher for longer' message as it still prices 46bp of cuts this year. The EUR curve on the other hand, with 50bp more hikes priced by September is more in line with the European Central Bank's message that more tightening is required.

> *The USD curve is more vulnerable to Powell's 'higher for longer' message*

The few positioning data available to us still suggest a decent short-base among leveraged investors, the category most liable to cover in a hurry if data or tail risks send yields lower. Our view is thus that the drift higher in rates continues in the near term, but we're fully aware that any reversion lower could be a violent one. The catalyst for this could be economic data. This week's Zew survey suggests a deterioration in sentiment in May, and it is entirely possible the same happens to PMIs and Ifo next week. We're more doubtful that the May Federal Open Market Committee (FOMC) minutes, due to be released next Wednesday, will contain much hint of a pause, but the prospect could at least pause the bond sell-off early next week.

Leveraged shorts in 2Y Treasury futures suggest any drop in yields will be violent



Source: Refinitiv, CFTC, ING

Today's events and market view

Overnight inflation data in Japan showed another acceleration again to 3.5% year-on-year in April, prompting thoughts of policy adjustment from the Bank of Japan. Another increase in the headline could be in store in June on the back of rising power bills. Our economists think inflation will probably come down only gradually, and more slowly than BoJ is expecting.

There isn't much on today's calendar, but markets have been primed for a hawkish re-pricing of late, so central bankers on today's schedule stand a better chance to move the market. Christine Lagarde and Isabel Schnabel of the European Central Bank are due to speak, while Jerome Powell of the Federal Reserve is also going to make a public appearance.

The lack of economic publications today will allow macro-minded investors to turn their focus to next week's busy slate, including a look at European PMIs and Ifo, the May FOMC minutes, and April UK CPI.

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