

Rates Spark: Rates volatility goldilocks continues

Eurozone consumer inflation expectations will be the main data point to look out for today. Markets have become numb to central banks' hawkish comments. Low rates volatility looks set to continue, benefitting risk appetite in other markets



Range-bound trading will be difficult to break from unless the data shows a considerable turn

Range trades are a near-term catalyst to our USD-EUR rates tightening view

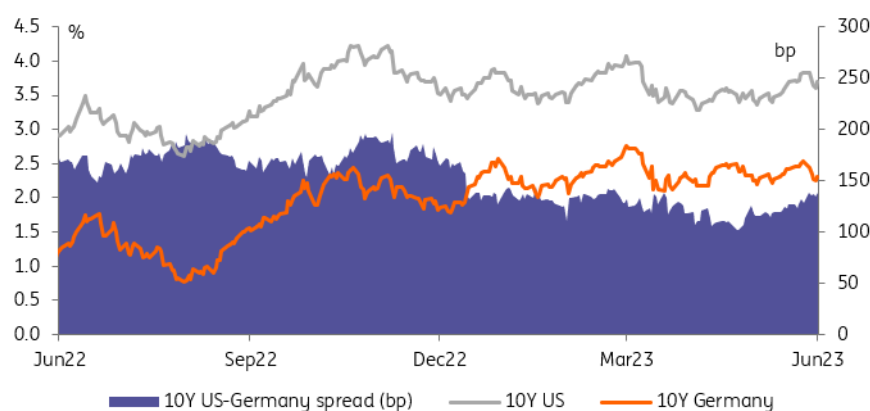
The Saudi oil production cut and calm market conditions paving the way to another flurry of debt issuance are the two most salient bearish risks for core government bonds this week. That said, the Fed went into its pre-meeting quiet period with the probability of a 25bp hike on 14 June well below 50%, and we think there is little the European Central Bank (ECB) can say to really cause a hawkish rethink of its rates trajectory. We take as evidence the lack of market reaction to various officials – including Christine Lagarde and Joachim Nagel – stating that inflation remains too high. The main reasons, we think, are that markets are already pricing two 25bp ECB hikes by the end of the summer and that central banks have been explicit that economic data will determine the path for monetary policy.

Markets are already pricing two 25bp ECB hikes by the end of the summer

We see this as a recipe for rates to remain within their range. Core bonds erased their early sell-off in the US session yesterday thanks to signs of a cooling service sector displayed [in the ISM services reading](#). Is this enough to change the prevailing narrative? It isn't, but Treasuries went into the release very close to the top of their recent range in yields which we suspect made short-term investors all the more enthusiastic about buying the morning dip. The same cannot be said of Bund yields, which started the week close to the bottom of their range, making them less appealing to range traders.

This state of play, high dollar and low euro rates, happens to contradict our expectation of narrowing rates differentials and we expect this dynamic to reverse. In the short term because the lack of market direction should limit further US Treasury sell-off and further Bund rallies, and later because tangible signs of a decline in core inflation occurring in the US are so far lacking in Europe. This should allow a fall in USD rates later this year, even as their EUR peers remain elevated for a while longer.

Yields close to the bottom of their range will make Bund less attractive than Treasuries to range traders



Source: Refinitiv, ING

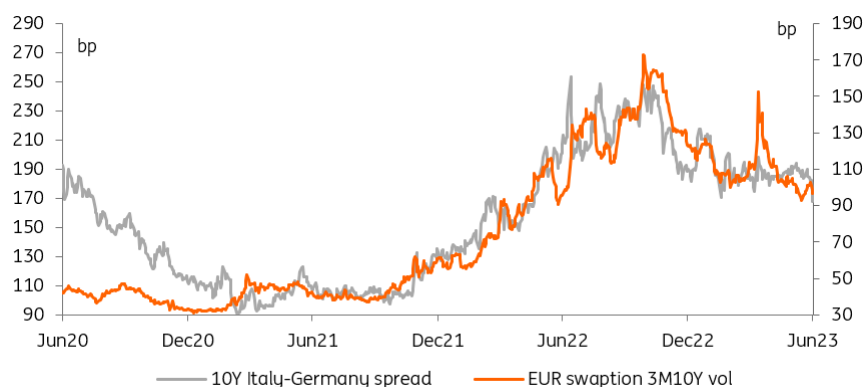
High but stable rates volatility is a boon for risk appetite

The implication for markets outside of rates is positive. After a year of being tormented by the relentless rise in borrowing costs in 2022, few investors are sorry to see yields lacking in direction. Realised and implied volatility remain high compared to their 2021 levels, but well below their late 2022 peak. Until rates make a decisive break lower on a dovish pivot by central banks, current levels of volatility can be thought of as the new normal. This stabilisation has been enough to boost risk appetite in other markets. Whether lower rates volatility is the cause or another symptom of lower macro uncertainty, it has come with valuations in some risk assets that belie recession calls.

Sovereign spreads, much like some measures of swaption implied volatility, are approaching their lowest levels in a year

This is visible in many corners of financial markets. Eurozone sovereign spreads, much like some measures of swaption implied volatility, are approaching their lowest levels in a year. Similarly, although the factors may also include money market dynamics, swap spreads are shedding their risk premium acquired during the latest bout of US regional banking stress. At the front-end of the curve, the credit premium received by investors is painting an upbeat picture. We will stop short of extrapolating this to other markets, but a continuation of the current rates volatility status quo seems to suit most markets.

Sovereign spreads and implied volatility are falling to their lowest levels in a year



Source: Refinitiv, ING

Today's events and market view

The release most likely to move euro markets today is the ECB's consumer expectations survey and more specifically the questions on their inflation outlook. Eurozone retail sales are expected to edge modestly up after their slump in March. There will also be construction PMIs to look out for from Germany and the UK.

Bond supply takes the form of a 30Y gilt sale from the UK, to which Germany and Austria will add respectively 10Y/23Y linker and 10Y/13Y bond auctions. The EU has also mandated banks for the sale of 7Y and 19Y debt via syndication.

Klass Knot, Mario Centeno, and Boris Vujcic are on the list of ECB speakers for today.

Weak factory orders in Germany released this morning add to the sense of anemic growth. We think this is more likely to result in an even more inverted yield curve in the near term rather than significantly lower rates overall as the ECB is laser-focused on its inflation fight.

Author

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@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.