

Rates Spark: Still tactically long

The next ECB cut is virtually a done deal, but markets will be listening to upcoming speakers for guidance about the landing zone. Meanwhile, price action in US Treasuries remains biased in a positive direction, and we maintain a tactical long positioning



Price action in US Treasuries remains biased in a positive direction, and we maintain a tactical long positioning

There are lots of forces that can ultimately force the 10yr yield up to 5% in the weeks and months ahead, but for now the bias is in the other direction, for a few reasons. First, we've just had a material prior move higher in yields, and typically they are followed by a test back lower again. Second, mutual fund data flows show a re-setting of duration longs for the first couple of weeks of 2025, reversing the significant preference for duration shorts into the turn of the year. Third, despite the strong speech laced with executive action(s) from President Trump post Monday's inauguration, the market continues to await precise policy prescriptions with respect to fiscal policy, tariffs and tax policy. Fiscal and tax policies require congressional approval, and indeed a legislative process, which takes time.

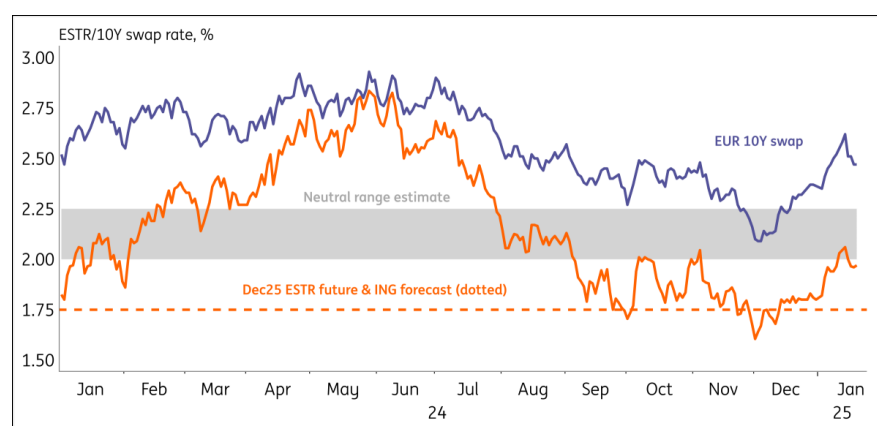
The time for discounting unclear outcomes is behind us; the market now moves into reacting to actual policy prescriptions. And arguably to more influence from actual data releases (and this week is quietish for those).

The uncertainty about the ECB terminal rate is a source of volatility

A European Central Bank rate cut next week is easy to call, bringing the policy rate down by 25bp to 2.75%, keeping it in slightly restrictive territory. But going forward the ECB's job is going to be more difficult, as the key question is where is the landing zone? With inflation numbers still too hot to call victory on that front, but growth numbers clearly weakening, the balancing act will be a source of rates volatility. As seen in the chart below, the pricing of the ECB's landing zone has been strongly tied with rates further out the curve. With plenty of ECB speakers on the agenda, markets will be listening for what to expect.

The uncertainty around the ECB's terminal rate means that US influences, including Trump's next policy moves, will remain a driving force on the short end of the EUR curve. For now markets seem to anchor the 2Y swap rate to a landing zone of 2%, which should hold well as long as US rates continue to see little room for Fed cuts. Should US markets start pricing in more Fed cuts (which we think will happen), then that 2% handle will come under pressure. Markets may very well start toying with the idea of a terminal rate closer to 1.5% again.

The 10Y swap rate is strongly linked to the ECB terminal rate pricing



Source: ING, Macrobond

Wednesday's events and market view

The main focus in EUR rates will be on the ECB speakers who are speaking at the Davos World Economic Forum. Villeroy will speak on "where are interest rates going". President Lagarde speaks at a panel on "unlocking Europe's potential", although she will also participate at a "global economic outlook" panel on Friday which seems more likely to generate relevant headlines.

The data calendar offers only second tier data with US mortgage applications and the Conference Board's leading index the only releases of note.

Primary markets remain busy. Spain mandated banks for a new 10Y benchmark (estimated around, while Finland mandated a new 20Y bond (€3bn). With regards to scheduled auctions Germany is tapping 15Y and 10Y Bunds (€2bn). The US Treasury will also sell

20Y bonds.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

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