

Rates Spark: Swap lines imply some pressure

We're in an uncomfortable place on the war. But clearly not uncomfortable enough for risk assets. Bonds are a tad more concerned, but not madly so. Talk of Gulf and Asian centres calling for dollars through swap lines points to potential issues, although not showing up so far in the dollar premium in the cross-currency market



Oil prices and bond yields continue to drift higher on a lack of a resolution to the US-Iran tensions

There are more pressures, but they are only mild

The market discount through to the end of March centred on the freezing of the Strait of Hormuz as critical. Fast-forward to this week, and equity markets impliedly think it's not that critical after all. The oil price, of course, has come under renewed upwards pressure, but only to the extent that it's the correct reaction to the ongoing closure of the Strait, and the threat from Iran not to negotiate until the US blockade is removed. And bond yields too have shown a tendency to edge higher, in tandem with a re-ratchet higher in front-end inflation expectations (albeit mild). We continue to find ourselves in an uncomfortable holding ground, as we await the US and Iran to come to some semblance of agreement. And an agreement of sorts remains the most likely outcome. If not, and things turn materially worse (not our base view), everything sells off (risk assets and bonds), apart from energy prices and volatility.

Our models continue to point to a dominant rate cut outcome in the quarters ahead, and that's not discounting front-end pricing. A worsening in the war narrative presents the biggest risk to this trade, as the higher inflation outcome would make rate cuts more difficult to deliver, at least in the immediate few months. We still think the war is in a wind-down phase, albeit uncomfortable. But even if the Iran war ended today and the Strait reopened instantaneously (still a stretch), we are left with significant price pressure that has yet to filter through. And it's not just the wider energy price complex, it's also the likes of fertiliser, which risk adding to food prices in subsequent months down the line.

Big picture, the US 2/10yr curve remains remarkably flat. Especially considering we are (eventually) nearing the tail end of a rate-cutting process. That aside, we identify room for short tenor rates to fall and for long tenor rates to remain under sticky upward pressure (at least in the coming month or so). If we are correct, and there is an eventual rebuild in the rate-cut narrative in the coming month, that typically coincides with a richening of the 5yr part of the curve (can trade further through an interpolated line between the 2yr and 10yr rates). We should see some relative flattening on the 2/5yr segment, but more relative steepening on the 5/10yr (while the overall 2/10yr curve comes under steepening pressure).

The dashboard of pain has eased considerably



Source: Macrobond, ING Estimates

Swap lines could be opened all the same

In the background, most of the pressure that we identified in previous weeks has ratcheted lower (chart above). That includes the USD cross currency basis premium, which typically would be a signal of funding pressures. Despite this, Treasury Secretary Bessent has confirmed that some Gulf and Asian centres have shown an interest in getting access to dollars through a swap line. This indicates that there is at the very least a need for dollars, and it's likely a preventative measure, rather than reflecting a front-and-centre problem. It shows that access to dollars remains an ongoing thing for the global system, no doubt amplified by higher energy prices (denominated in dollars). Basically, these operate like a cross-currency swap, on a fixed exchange rate and an agreed interest rate. And the US *will* provide these were needed, to avoid dollar funding issues.

Thursday's events and market views

From a data perspective, PMIs will be the highlight, with consensus seeing the eurozone composite index dip from 50.7 to 50.1, so just about in growth territory. The UK composite

index is expected to nudge below 50, however, to 49.8. From the US, we have weekly jobless claims numbers, which are seen to move slightly higher.

In terms of supply, we have the US auction 5Y TIPS for a total of \$26bn.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

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