

Rates Spark: The yield race to the top continues

US yields are rising across the curve but T-bills are at the intersection of a better economic outlook and a debt ceiling. Sterling rates are now offering a pick-up to dollar equivalents. This makes sense at the front-end but less so at longer maturities



US T-bills at the intersection of the debt ceiling-recovery Venn diagram

US T-bills find themselves at the intersection of two uncomfortable developments. First, the longer time passes without any dramatic fall in economic data, the more the fear of a credit crunch fades in investors' minds. Bank results so far this reporting season have failed to produce a recovery in the KBW US regional banks stock index but the broader bank stock gauge has shown clearer signs of a rebound. This is probably too early to sound the all clear but it is also fair to say that bank fears are no longer an impediment to higher front-end rates, and 2Y yields are still around 90bp below their each March peak.

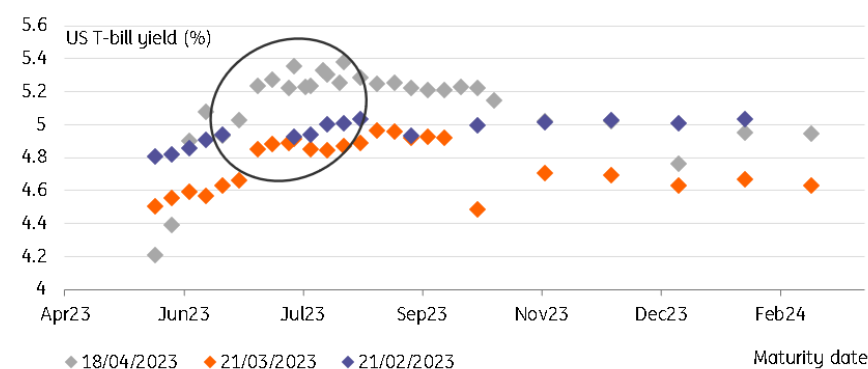
Markets face upwards of \$400bn in T-bill issuance, and a

commensurate drain of liquidity

The second development is the approaching debt ceiling showdown. There is a clear hump in the T-bill curve around the July-August maturity dates, when default risk is deemed most elevated. Information on tax receipts this week may help refine that estimate and so drive relative moves between securities. The fact is that 'X-date' is still roughly three months away, and so providing a precise estimate at this stage is challenging. The other driver is of course political developments but widespread expectation is for any solution to be found much closer to the deadline this summer.

Once a compromise is found, and it is our expectation that one will be found, T-bills face another challenge: the Treasury ramping up issuance to re-build a cash buffer in the Treasury General Account (TGA). As of last week, its balance was \$109bn, but it is likely to go up this week thanks to tax receipts, before going down into the X-date. Assuming the Treasury aims to build its balance back to \$500-600bn after the debt ceiling is solved, markets face upwards of \$400bn in T-bill issuance, and a commensurate drain of liquidity.

The default probability 'hump' in US T-bill yields is moving forward to June



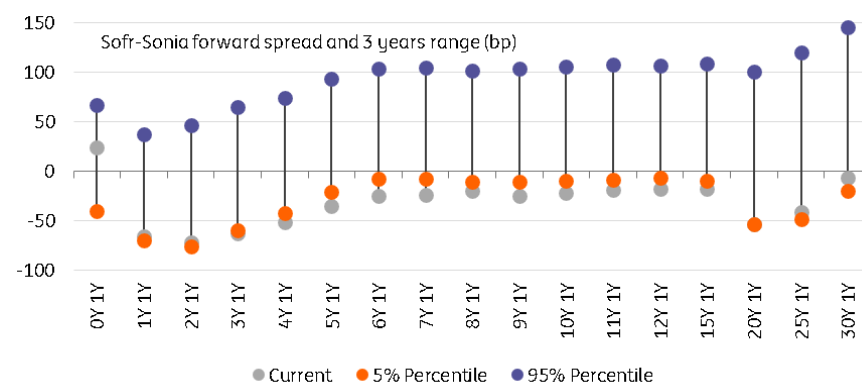
Gilts pick-up to Treasuries widens

The re-pricing higher in US yields has been impressive these past two weeks and has widened the spread with euro rates, a development we think will prove short-lived once Fed cuts come into view. The sell-off in sterling bonds however has outpaced that of Treasuries, and that move accelerated with [higher than expected wage growth in February](#). Clearly, the release, combined with core CPI failing to slow in March, increase the odds of a May hike at the Bank of England but market expectations have gone further than that. The Sonia swap curve now prices two more hikes in this cycle, more than what is priced by the dollar curve.

5Y GBP rate in 5Y is higher than its USD equivalent, by almost 30bp

This has taken 10Y gilt yields at a higher than 20bp pick-up to the Treasury curve. Understandably, the pick-up offered by GBP rates is higher at the front-end of the curve. 5Y Sonia swaps are almost 50bp higher than their Sofr equivalent which we justify by the market's greater conviction that the Fed is about to cut rates later this year. We agree that European policy rates, sterling rates included, will take longer to be cut. We find it harder to justify that longer-dated forward, for instance the 5Y GBP rate in 5Y is higher than its USD equivalent, by almost 30bp.

GBP forward swaps are higher than their USD equivalent at all but one maturities



Source: Refinitiv, ING

Today's events and market view

European data mostly consist of current account and construction output.

Bond supply will be from Germany (10Y) and the UK (5Y).

ECB comments will hit the wires throughout the day with speeches from Philip Lane, Klaas Knot, Pablo Hernandez De Cos, and Isabel Schnabel. Given the mood the market is in, with a re-pricing higher in Fed odds and hotter UK CPI than expected, markets will be more sensitive to hawkish comments. Look for the bear-flattening to continue for the time being.

Author

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@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 www.ing.com.