

Rates Spark: Tight yield correlations are inconsistent with soft-landing narrative

The correlation between UST and Bund yields is significantly elevated, which usually points to a hard-landing narrative, as seen during the SVB crisis. The pricing in of rate cuts, however, points to a soft-landing scenario and is inconsistent with these high correlations. We expect the correlation between US and eurozone rates to weaken.



UST-Bund correlations are as high as during the SVB crisis

Ahead of the US markets reopening later after a holiday, we've seen some movement in euro rates after a flat day yesterday. The ECB wage indicator showed a small nudge down from 4.7% to 4.5%, leaving markets unimpressed and leading to little change in the immediate trading after that. But by the end of the day, both US and eurozone rates declined, with the UST 2y point leading the decline by around -7bp. This steering of euro rates by the US has been a recurring theme, and when we plot the rolling correlations between UST and Bund yields, we indeed see a correlation of over 0.5 for both the short end and long end of the curve.

Usually, global asset price correlations are driven by risk premia, but the strong correlation at the shorter end of the curve suggests that the anticipation of rate cuts is a more likely driver. In the case of a US hard landing, such as a severe recession or something "breaking", the ECB would also be inclined to react with short notice, leading to a synchronised policy reaction. This effect is

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

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