

## Rates Spark: Turning point watch

Retreating yields even amid hawkish central bank tones? Markets are on watch for a market turning point, also with 10Y US real yields having touched zero this week. Key to watch is the market's reaction to the three central bank heads' comments tonight

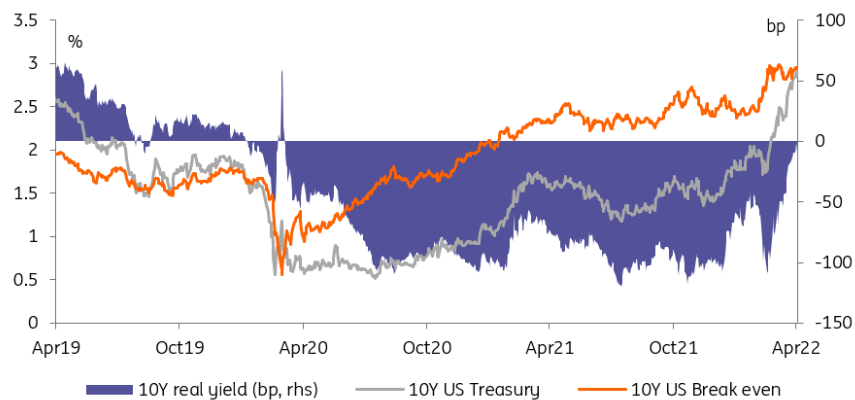


### Starting to tick the boxes for a turning point...

It appears that just shy of psychological key big figure levels, bond yields have turned the corner. The 10Y US Treasury yield brushed with 2.98% before turning lower to below 2.9%. Similarly, 10Y Bund yields further distanced themselves from the 0.95% mark touched on Tuesday.

The obvious question whether this is the turning point. The market is certainly on watch after US 10Y real yields had briefly turned positive earlier in the week. We also saw what we would usually want to see when a turning point occurs – the 2Y/5yr flattening from the 5Y (ie, the 5Y yield falling). But is it enough? No, as the 5yr is still far too cheap to the curve. Typically as the Fed gets into the rate hiking process, that's when the 5yr richens to the curve, or at least begins that process. The May 4th FOMC in a couple of weeks is a moment when (at least) a 50bp hike is widely expected to be delivered. The 5yr should really start a richening process from then, or by then. We're then getting closer to a proper cycle turning point.

## US real yields hit zero – maybe not a turning point, but an important waypoint



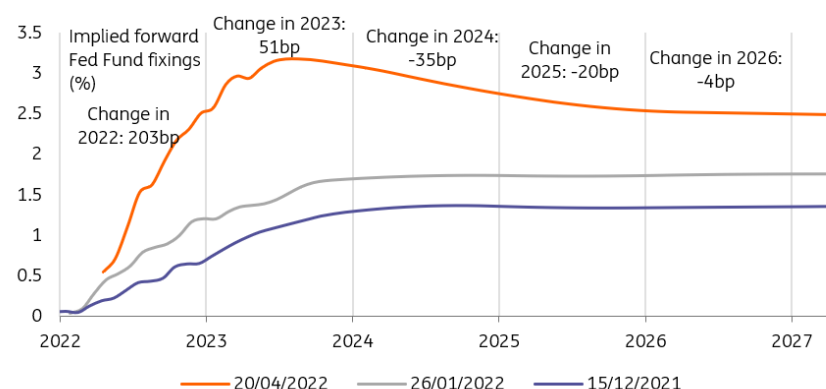
Source: Refinitiv, ING

But even then we need to watch how inflation expectations behave. From the Fed’s perspective, they need to come down. The 10Y inflation expectation remains too close to 3% for comfort. Therein lies the argument for a 75bp hike, where the Fed would effectively be saying “stand back, we’ve got this”. The counter is a good one – it’s not discounted, and could cause more consternation than comfort. That all being said, its during such times that overshoots can occur and turning points get netted out. So we’re on the watch for both...

## Central bank speakers offer another test for peak hawkishness

In the past, markets already came up to points where it seemed unlikely that views could turn even more hawkish. But officials’ comments have evolved alongside markets ever more aggressive expectations. Case in point being the Fed, where we have now reached the point where 75bp hikes are no longer excluded.

## Pricing a series of 50bp hikes, but could the market stomach more without flattening the curve?



Source: Refinitiv, ING

At the ECB communication has largely focused on the lift-off and possible end of negative interest

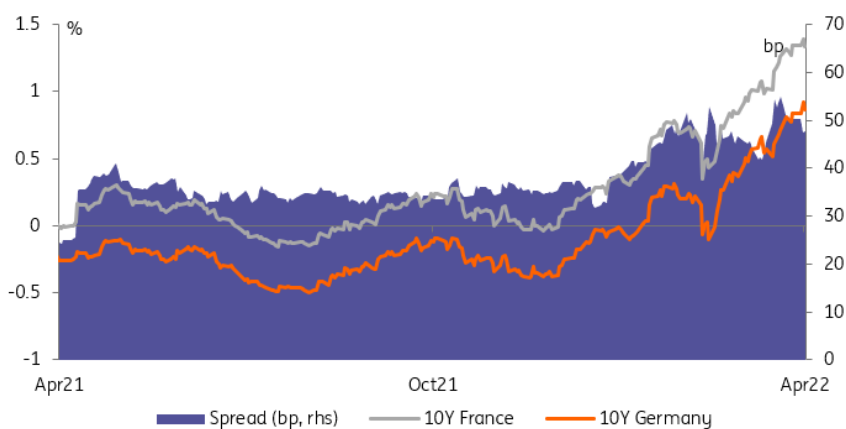
rates this year. We heard from two ECB speakers yesterday calling for a first rate hike in July, yet longer market rates headed lower nonetheless. Importantly what lies beyond 2022 – beyond "policy normalisation" – remains pretty much left in the open. But just like the ECB is unwilling to commit to a scenario, markets are also pondering the possible outcomes, though obviously still leaning heavily towards a hawkish one. And yet markets also leave room for more hawkishness judging from the curve shape (no inversion) and real yields (still very negative), as we pointed out yesterday.

Today's session could provide some insight into market sentiment as it will see the three central bank heads of the Fed, ECB and BoE speaking tonight. Of course it will be key whether they push back against aggressive market pricing or continue along their hawkish line. But perhaps more indicative for where markets are headed is how they react in each instance. Should longer rates continue to rally on hawkish tones it may vindicate those who see the top in yields as being reached.

## One market worry less for Eurozone bond spreads

Following the first round of the French presidential election market unease over a potential win of the right wing candidate Le Pen was alleviated by Macron widening his lead to 12 points going into last night's debate. The key spread of French government bonds over Bunds had continued to narrow towards 46bp, after peaking around 55bp ahead of the first round.

### French government bond spreads recover



Source: Refinitiv, ING

Macron is seen as having delivered the more convincing performance in yesterday's televised debate. This should further help French spreads in particular recover as the tail risk of a Le Pen win gets further priced out. However, for spreads across the broader Eurozone the overriding theme remains that of the ECB ending its net asset purchases soon. As such, the French election may not mark a turning point for spreads yet.

### Today's events and market view

Although scheduled for late in the day central bank speakers are key today. ECB president Lagarde and Fed Chair Powell will appear on an IMF panel discussing the global economy. Separately, BoE Governor Bailey will appear talk at an event organized by the Petersen

Institute. While he has already struck a more cautious tone recently, the others may be happy to let the market do part of the job for them by running well ahead of hikes. For those on the watch for the turning point, key is how markets will react if the hawkish line is reinforced.

Other data to watch are the US initial jobless claims and in the Eurozone the final CPI data as well as consumer confidence.

In Eurozone bond markets some attention will fall on the French auctions with the final round of the French presidential election coming Sunday. €10-11bn in below 10Y maturity bonds will be sold as well as inflation linked bonds. Spain is also active in the primary market selling €5-6bn in bonds.

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