Rates Spark: When it rains it pours

Rates are being pressured lower by growing recession angst. Against the backdrop of the banking stress markets appear to display an asymmetric reaction function to weaker data. That looks to hold for tomorrow's US jobs release, and likely also next week's key CPI data. EUR rates levels should remain more resilient, with banking stress less prevalent

Market reaction is increasingly sensitive to weaker data

Recession fears are taking over following a string of US data disappointments that extended yesterday with a low ADP payrolls estimate and more importantly an ISM services printing its lowest value since July 2020. The employment component of the index also dropped more than expected from 54 to 51.3, raising concerns ahead of the official jobs report due on tomorrow.

Markets are focussed on what lies beyond the peak of the current hiking cycle

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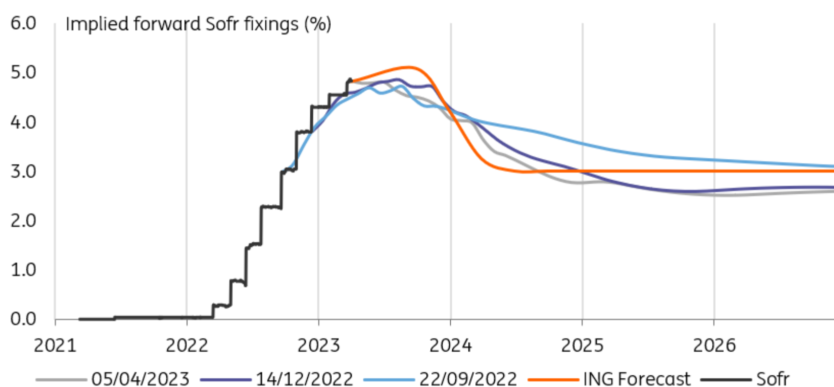
10Y UST yields have dipped below 3.3%. But the extent of the initial market reaction especially at the front end, peak-to-bottom a drop of 25bp in the 2Y US Treasury yield before some of the gains were later pared, highlights a market that is increasingly focussed on what lies beyond the peak of the current hiking cycle. At the moment the market is looking for the Fed to cut rates by at least 75bp from their peak before the year is out.

The banking turmoil has added a large downside risk to the economic outlook, crucially with lagged data impact. That in mind we suspect that upside surprises would not have seen a symmetric move in yields, and that presumption likely holds ahead of Friday's payrolls report. Anything above 200k in non-farm payrolls growth is likely to raise the chances for a final Fed hike in May, but markets will be cautious in extrapolating any data strength beyond that.

In the week after Easter the Fed will receive one more key data input: The month-on-month core CPI rate for March is seen decelerating to 0.4%, the year-on-year rate still inching up slightly to 5.6%. Both likely still too high for the taste of the Fed, but then the growing risks for a hard landing of the economy also raise the chance of inflation coming down more quickly going forward. The Federal Open Market Committee minutes of the 22 March meeting may give insight on the Fed's already shifting assessment of the economic backdrop as it came across more dovish at that meeting than expected.

Even if the Fed hikes once more in this cycle, the focus is firmly on future cuts



Source: Refinitiv, ING

Euro rates follow the US rally but not quite as fast, nor as furious

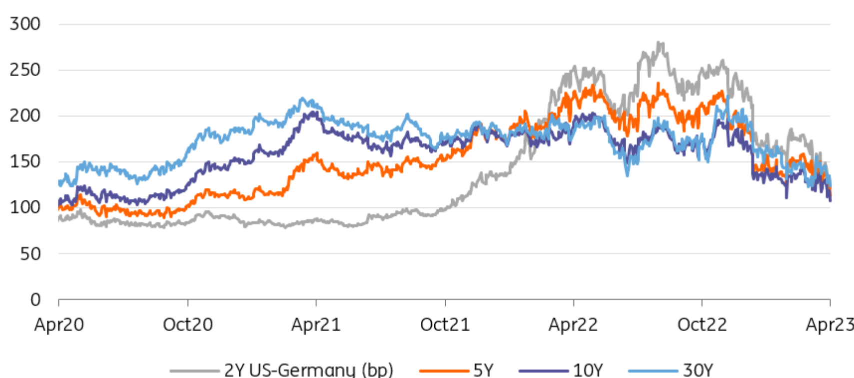
EUR rates are in the passenger seat of US dynamics. The narrative that the end of the cycle is near is catching on, leaving markets open to ponder what lies beyond here as well. Croatia's Vujcic was the latest European Central Bank member to highlight that the biggest part of the rate hiking cycle was now behind. As ECB chief economist Lane has laid out in a recent speech, the central bank sees itself on the right track with inflation dynamics to turn for the better soon. Pipeline inflation pressures are close to peaking and there are no signs of wage-price spiral – everything in the base case of course.

that the ECB is close to its peak, too, should not stand in the way for further convergence

However, the notion that the ECB is close to its peak should not stand in the way for further convergence of USD and EUR rates. Keep in in mind that the projections of the ECB are predicated on policy rates still moving a little higher and more importantly remaining there for a while. Banking system stresses, which have become a growing concern in the US and have pushed markets towards focussing on Fed rate cuts, are less prevalent in the eurozone.

EUR rates are still being dragged lower, but especially at the more policy sensitive front end, levels are holding up better. This has resulted in a further convergence of 2Y UST Bund spread, which briefly dipped to a low of 116bp yesterday, the lowest since late 2021.

US yields are quickly converging to their German equivalents as the US economy decelerates



Source: Refinitiv, ING

Today's events and market view

Ahead of Good Friday's US non-farm payrolls the market is looking at further job market indicators today – the Challenger job cuts as well as the initial jobless claims. It appears that the market is at a point where it can only get worse from here on – maybe in different shades and perhaps with some delays as the banking turmoil only slowly feeds through to the real economy – and that clearly points to lower rates ahead. The bull steepening reflexes are there – we saw a 10bp intraday swing of the US 2s10s yesterday – but may have to wait for the first actual Fed cut being imminent to fully unfold.

EUR rates will likely remain in the passenger seat of US markets for a while with little data on the euro area calendars to show for next to the US key CPI. That leaves the focus here more on communication from ECB officials of which we will hear more next week to drive the rates differential.

In other events today we will see the Fed's Bullard speaking on the economic outlook in the afternoon and later in the day the Fed will publish its regular update on the usage of its liquidity facilities – one gauge for ongoing banking stresses.

In primary markets France will launch a new 10Y benchmark today alongside 20Y and 30Y bond taps. Overall for €10-11bn.

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