

## Rates Spark: Yields back up as sentiment improves

A stumble in risk did seem increasingly probable last week, but Monday always seemed like an overreaction. Risk sentiment is now making a recovery, pushing equities and bond yields higher. Comforting ECB words and stabilising JGB yields helped reduce global volatility. US jobless claims will be watched closely for further signs of job market weakness



### A return to a more measured reaction to what in the end was not a whole lot

The 2-year yield is in effect an average for the funds rate over the coming two years, during which time the Federal Reserve is expected to have chopped the funds rate quite considerably. Assuming we continue on the build for a rate cut from the September meeting, and indeed for a sequence of cuts thereafter, the 2/10-year curve should swing into a positive slope. The risk-off tone on Monday accelerated some of that process – but history shows that material steepening of the curve is typically reserved for the period when the Fed is actually cutting rates, and that's all ahead of us.

Ultimately, expect to see the 2/10-year curve heading to at least 100bp, and at some point that

should limit the capacity for the 10-year yield to fall. For example, should the Fed cut to 3.5%, that would place fair value on the 10-year yield at 4.5% (or higher). The Fed would have to cut to 3% to give a 4% 10-year yield a chance to be viewed as fair value. In consequence, any material break under 4% for the 10-year yield should be viewed as an overshoot to the downside that will be unwound, and we suspect quite quickly.

At some point, likely by the end of 2024, the novelty of rate cuts will wear off, even as the Fed continues to cut, and attention at some point must shift to worries about financing the fiscal deficit.

The recent rally we saw to the 3.8% area for the 10-year yield is reminiscent of the rally to similar levels seen at the beginning of the year on quite an extreme rate cut expectation at the time. This time around there's been a wobble on equity markets, but not anything catastrophic. Moreover, the system is functioning fine. Talk of an inter-meeting cut neither made nor makes sense against that backdrop.

## Calmness returning to markets

Risk sentiment recovered further, helping equity markets and bond yields back up. The global unrest over the JPY carry unwind seems to be settling and Japanese Government Bond yields traded mostly flat on the day. From the European Central Bank, we had comforting words from Governing Council member Olli Rehn, who voiced that he sees the recent volatility as an overreaction and still deems the US economy relatively strong. So far, we have had little data of interest for the US and eurozone, and today's US jobless claims will therefore be focused on gauging whether a sigh of relief is justified.

As a result of calming sentiment, the Bund curve bear steepened quite sharply and there is potential for more of this if sentiment improves further. The 10-year yield moved some 6bp higher on the day whilst the front end stayed relatively anchored. Forwards pricing suggests a terminal ECB policy rate of around 2.3% in five years, around 20bp lower than a month ago. We still see a soft landing as a more likely scenario and the pricing of the terminal rate could return to previous levels, thereby steepening the curve further from the back end.

### Today's events and market view

Besides US jobless claims no notable data releases are scheduled. In terms of issuance, the US has scheduled a new 30Y Bond for \$25bn.

## Authors

### **Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

### **Benjamin Schroeder**

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### **Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@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 <http://www.ing.com>.