

Rates Spark: Yields have reached a sticky spot

Euro rates' failure to make new lows shows that policy normalisation is far from forgotten, it also brings bad memories of deleveraging in 2020. Granted, real rates continue to drop and a lack of clarity from the ECB would probably allow dovish pricing to be maintained for a while. Medium term, yields will struggle to remain below 0% in our view.



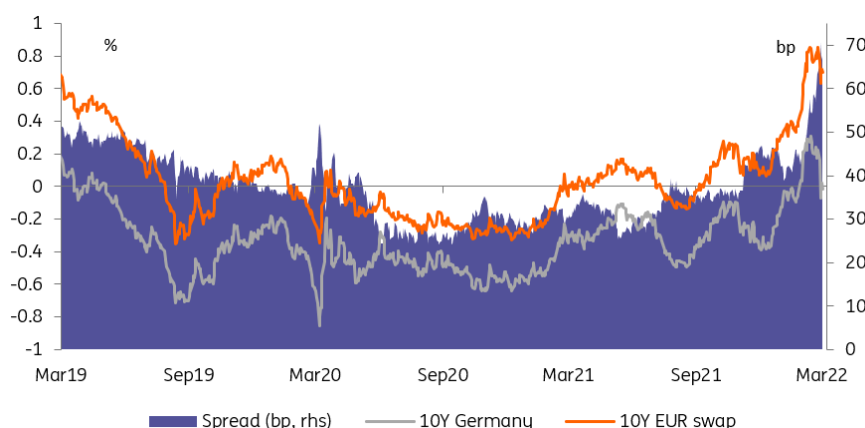
Dovish confirmation bias can continue for a while

Financial markets are dancing to the tune of Oil, which is in turn dancing to the tune of geopolitics. Overnight, Russia threatened to cut gas export if oil sanctions are implemented, while the EU is set to announce plans to reduce its dependence on Russian gas. For euro rates, the negative impact on growth far outweighs the positive effect on inflation. There are no questions that the bar is high to call off monetary policy normalisation, but it is probably lower at the ECB than for other central banks.

Markets are currently trading with a clear dovish bias

Markets are currently trading with a clear dovish bias, visible not only in low long end rates, but also in the pause in peripheral spreads widening, and in the curve pricing out near-term hikes. That dovish bias may well survive this week's ECB meeting, as a lack of clear signals typically allows confirmation bias to kick in. With a longer timeframe in mind however, a mere delay of the ECB's tightening would make negative yields hard to justify in our view.

Without flight to safety, Bund yields would be comfortably above 0%



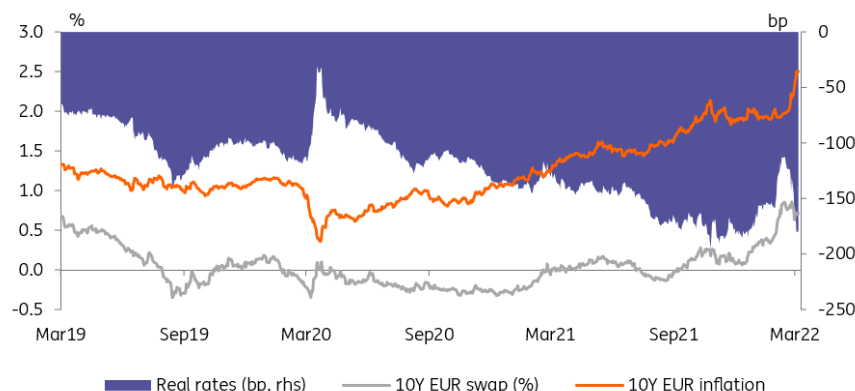
Source: Refinitiv, ING

For now, this is difficult to assess. Even the economic and financial repercussions of the existing sanctions are not well understood, let alone that of further escalation. This explains current Bund valuations. Even assuming no move in 10Y swap rates, a reversal of swap spreads to the levels prevailing in early February would put the 10Y Bund comfortably above 0%.

Flight to quality but deleveraging concerns mount

Rates appear to have reached a spot where further rallies (ie, drops in traded interest rates) becomes more difficult. This is testament to the resilience of the central bank normalisation narrative, but one should also point at real rates dipping to fresh lows thanks to the continued rise in inflation swaps. It is becoming abundantly clear that nominal and inflation swaps can decouple for long periods of time but the fall in real rates is another illustration of the dovish bias taken by euro markets.

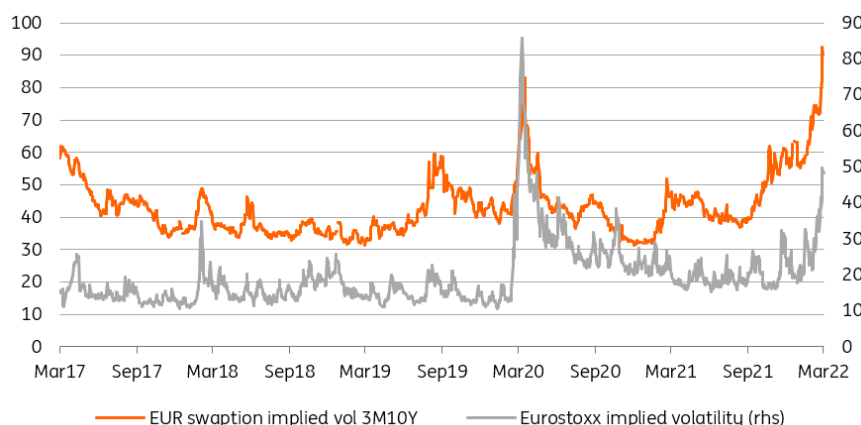
Lower real rates are another sign of investors' caution



Source: Refinitiv, ING

Another, more worrying, explanation for the reluctance of yields to make new lows even as risk assets continue their plunge, would be a worsening of market liquidity, even for assets supposedly easy to trade such as government bonds. As volatility rises across financial markets, the likelihood of widespread deleveraging increases. It is difficult to measure leverage across all financial markets but a key concern is a repeat of the indiscriminate selling that occurred at the onset of the Covid19 pandemic, and which forced central banks into massive government bonds buying.

The rise in volatility brings fears of March 2020-style deleveraging



Source: Refinitiv, ING

Fiscal authorities have taken the lead in responding to the current crisis

A focus on the many ramifications of the current crisis has masked a further weakening of Europe's fiscal orthodoxy. Accounting tricks aimed at side-stepping Germany's debt brake explain why the

figures floated to finance defence and [industrial transformation](#) do not translate into immediate financing needs. We're also waiting for a pan-European response to the cost-of-living crisis faced by customers. This should not divert attention from the fact that fiscal authorities have taken the lead in responding to the current crisis.

Today's events and market view

Today's Eurozone GDP print is its final release.

The Netherlands (7Y), Austria (3Y/10Y), and Germany (inflation-linked debt) make up today's supply slate. The UK will sell 30Y gilts.

The main releases out of the US include small business optimism, inventories, and trade. It might be too early for the full effect of higher energy prices on sentiment but this is clearly a key channel through which the current war in Ukraine feeds into lower growth.

Authors

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 <http://www.ing.com>.