

## 3 calls for rates as the US tops out but the ECB has barely budged

It looks like the top for US market rates is in. The coming months may see some retrace higher, but the dominant impulse now is for rates to test lower. The fact that the ECB is only starting to hike as market rates peak is a sign of vulnerability. The tightening in financial conditions is all coming from market variables. Eventually, that also pulls rates lower



Fed Chair, Jerome Powell, faced US lawmakers last month to discuss the state of America's economy

### 1 US rates have likely seen a peak at 3.5%, look at the 5yr

A couple of weeks back, we made a call that [the US 10yr yield](#) had peaked after hitting the 3.5% area. The de-compression seen in the influential 5yr area of the curve drove that view, and since then there has been an outright richening in the 5yr area, as it effectively pulls yields lower. We expect this process to continue, likely inverting the 2/5yr segment of the curve.

A noted easing in inflation expectations has also been in play, a process that in fact began back in early May, but the move in the 5yr area has been the bigger signal that the top in US market rates is likely in. Data in the coming weeks and months could possibly push us back up towards the peak, but that is looking less likely, especially if the 5yr actually starts to trade rich to the curve (it

is still moderately cheap).

Against that backdrop, the dominant theme for the US curve should be the 5yr continuing to outperform, with the curve shape now becoming quite nuanced (as a potential peak in the Fed funds rate in the fourth quarter would mean a dramatic re-steepening of the curve).

## 2 Amazingly, a peak in US rates and yet the ECB has hardly budged

The tightening in financial conditions in the eurozone has come primarily from market pressure, basically driven by rises in market yields, widening in sovereign spreads and a notable widening in corporate credit spreads. In the background, the European Central Bank, remarkably, has done very little in the way of tightening, apart from ending its quantitative easing programme (and even here the de-fragmentation threat has seen the ECB suggest that it could buy again as needed).

The eurozone 10yr swap rate peaked out at 2.65% in mid-June (as the US 10yr Treasury rate approached 3.5%), and coincided with the German 10yr yield hitting the 1.8% area. All of these are now lower by some 60bp. While the ECB will belatedly hike this month, it will be quite late to a party that has seen a global response to the threat of runaway inflation.

It feels to us that there remains some residual upward pressure on eurozone market rates, and even if frustrated by the direction of US rates, spreads between US and eurozone rates should narrow.

## 3 Further opportunities will appear

Many will have been caught off guard by the remarkable move lower in market rates in the past few weeks. Big swings in market rates typically correlate with heightened volatility, which can also mean that market rates could easily swing back up again. That suggests that there will be opportunities to get back into the bond market at better yield levels.

One thing is for sure though - the performance of bonds in 2022 has been the worst in modern times, and as such, it was always liable to come to an end at some point. We had anticipated that this would come in the third quarter, with a marked fall in market yields in the fourth quarter, but the starting phase has been accelerated to the end of the second quarter (June).

If 3.5% for US Treasuries does prove to be the turning point, there is a lot of room to move lower from the current level of 2.9%. The 2.5% area will be a logical target. For players that have missed the first lurch lower in yields, we anticipate there will be further opportunities (as yields can still re-trace towards prior highs on data releases), as is typical when volatility spikes. Being long the market and long carry is perhaps one way to fade through the remainder of 2022

### Author

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

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