

## Central banks to the rescue

The Federal Reserve has led the way with a 50bp cut to combat coronavirus fallout, and we've pencilled in two more 25bp cuts for 2Q. Will the constrained ECB now follow suit? Australia and Malaysia have already slashed rates, and next up is the swift and decisive Bank of Canada. We think they won't disappoint either

### In this bundle



#### The Fed cuts rates in emergency move

The Fed cuts rates by 50 basis points. It signals it is prepared to do more should the coronavirus spread further. We expect a further 50bp of cuts by the...

By James Knightley



FX

#### US asset markets: What Fed cuts mean for US Treasuries and the dollar

G7 Finance Ministers and central bankers hold a conference call on the impact of the coronavirus this Tuesday. We think this could ultimately lead to the...

By James Knightley, Padhraic Garvey, CFA and Chris Turner



FX

#### Can the ECB deliver, and what are the implications for EUR markets?

The European Central Bank is at an impasse having nearly exhausted its easing options. We see more downside to core rates regardless of ECB action, but we...

By Carsten Brzeski and Chris Turner



## FX | Australia

### Australia's central bank cuts rates by a quarter point, says more possible

A 25 basis point rate cut takes the Reserve Bank of Australia's official cash rate to just 0.5%. One more quarter point cut would push the central...

By Robert Carnell and Francesco Pesole

---



### Bank of Canada: We expect a cut this week

We look for a 25bp cut by the BoC this week as coronavirus worries increasingly weigh on the economic outlook. This should translate into more Canadian...

By Francesco Pesole and James Knightley

---



### US market rates bracing for 1%

Equity markets have swapped their spectacles for bond market ones and are finally seeing some angst down the line. That has helped bond yields push...

By Padhraic Garvey, CFA

---



### Central banks talking a good game

Markets are taking heart from central bank comments, but nothing has actually been done yet, and the new case count for Covid-19 is accelerating. This...

By Robert Carnell

---

---

Snap | 3 March 2020

## The Fed cuts rates in emergency move

The Fed cuts rates by 50 basis points. It signals it is prepared to do more should the coronavirus spread further. We expect a further 50bp of cuts by the...



Source: Shutterstock

Friday's statement that the Federal Reserve is "closely monitoring" developments and stands ready to "use our tools and act as appropriate to support the economy" indicated that action was coming and the Fed has just delivered a 50bp rate cut. The decision follows a 7:00am ET call between the G7 Finance Ministers and central bank heads that initially underwhelmed with little sign that coordinated action was going to be forthcoming.

The brief accompanying statement acknowledges that while economic fundamentals "remain strong... the coronavirus poses evolving risks to economic activity". The FOMC is "closely monitoring developments and their implications for the economic outlook and will use its tools and act as appropriate to support the economy".

We doubt today's policy action will trigger a meaningful boost to aggregate demand, but implementing rate cuts may help to mitigate some potential strains in the financial system and give a lift to sentiment.

## Fed funds target rate vs 10Y treasury yield



Source: Macrobond, ING

The Coronavirus outbreak started out as a supply chain shock for the US due to disrupted supply chains as factories closed in China and other parts of Asia. However, over the past couple of weeks it escalated into a financial shock as markets recognised Covid-19 was going to have a much broader impact on the global economy. The concern now is that the fear factor surrounding Covid-19 will change corporate and consumer behaviour and lead to a demand shock as well. This is most likely through the service sector of the economy with travel, hotel accommodation, restaurants and leisure-related sectors looking vulnerable. Add in the prospect of significantly weaker export performance and a negative second quarter GDP print is looking a distinct possibility.

Given the uncertain outlook for the path of the virus most governments are advising the situation is likely to deteriorate before hopefully easing over the summer. With economic activity likely to be significantly impacted and inflation set to fall pretty sharply – energy prices are set to plunge on oil while core inflation will likely edge lower as weaker demand offsets the supply shock - we are pencilling in two further 25bp rates cuts for 2Q giving a total of 100bp of easing.

### Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## US asset markets: What Fed cuts mean for US Treasuries and the dollar

G7 Finance Ministers and central bankers hold a conference call on the impact of the coronavirus this Tuesday. We think this could ultimately lead to the...



### A negative print for 2Q20 US GDP and a 100bp Fed easing cycle

The US economy appears to have started 2020 on a strong footing with consumer confidence close to record highs, business surveys bouncing back as trade tensions eased and residential investment a key source of strength. However, it is increasingly apparent that the US faces a significant economic drag relating to the coronavirus. There was already a (relatively modest) supply shock as supply chains faced disruption due to factory closures in China and other parts of Asia, but over the past couple of weeks this has increasingly turned into a financial shock as bond yields and equities plunge. The concern is that the fear factor surrounding Covid-19 will change corporate and consumer behaviour and lead to a demand shock as well. This is most likely through the service sector of the economy with travel, hotel accommodation, restaurants and leisure-related sectors looking vulnerable. A negative second quarter GDP print is a clear possibility.

Fed Chair Powell released a statement Friday afternoon saying the Federal Reserve is “closely monitoring” developments and stands ready to “use our tools and act as appropriate to support the economy”. This clearly hints that the Fed is poised to implement rate cuts at any point – the Fed knew full well that making such a statement would only fuel expectations of action – and we

now expect a 50bp rate cut imminently. The next scheduled meeting is 18 March, but given financial market volatility/tensions this could certainly happen much sooner. We doubt it will trigger a meaningful boost to aggregate demand, but implementing rate cuts should help to mitigate some of the strains in the financial system, particularly if it is accompanied by additional liquidity/credit measures. We are also pencilling in two further 25bp rates cuts for 2Q giving a total of 100bp of easing.

## US Treasury Yields: How low can they go?

The US yield curve had been flattening as the bond market front-ran the Fed. That has morphed into re-steepening as the market now discounts a more imminent move from the Fed. That discount is quite pronounced now, with the 2yr at c.75bp. At that level the front end is comfortably discounting 100bp in rate cuts. That said, part of this move on the front end is also the outcome of risk asset players parking some of their liquidated product on the front of the Treasury curve, and in bills. Typically this can see the 2yr overshoot to the downside during times like these.

The 10yr is now homing in on 1%, and in all probability will breach below that level in the coming weeks. There are two routes to consider. One is where the Fed holds off on cutting rates, and there is a flight into bonds which pushes the curve further down. The second is where the Fed gets in early with a cut, averting near-term damage. Here, the 10yr could well back up as equity markets briefly rally. But the subsequent reaction is still likely to be biased towards a re-test lower in equities, along with a push lower in the 10yr yield. We'd view a 50bp 2yr and a 75bp 10yr as entirely conceivable here.

The reaction function further out the credit curve is important too. Fed cuts would likely be accompanied by extra liquidity provision to the banking system, and the re-ignition of some QE would make imminent sense. Banks should be under far less pressure during this crisis than the last one. They have been building liquidity buckets, that have performed as rates have fallen. They are better capitalized. Still vulnerable to a wider slowdown, but not a massive point of concern for the Fed. A bigger concern is the functioning of the wider financial system.

The sell-off last week was as orderly as one could hope for given the size of the fall. That's good. But another week like that and price discovery could well become more opaque. That would not be good. High yield has been under particular pressure. The focus here is on a likely elevation in default risk. The good news is that investment grade corporates are long cash. They have not been over-investing and have been paying off debt in fact. An associated risk though is a closing of the primary market. Against that backdrop the Fed will be eager to ensure that there is easy access to liquidity for the wider economy.

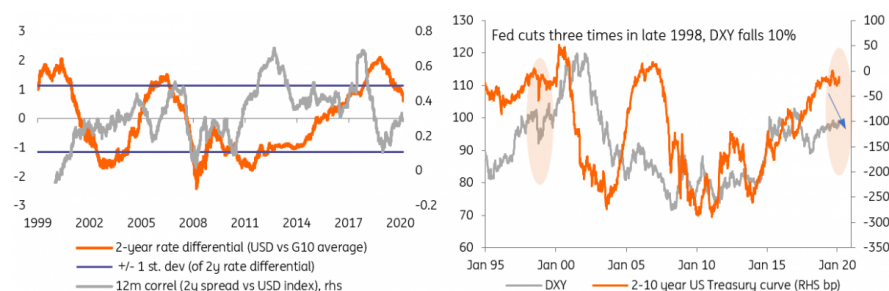
## US Dollar: A 5-10% correction

The US S&P 500 at one stage last week was off 15% from its mid-February highs. Typically, high beta/high yield currencies are hit most during episodes like this, whilst the dollar enjoys some safe-haven properties on the back of the liquidity and yield advantages. What has changed over the last week is that the market is now convinced – helped in part by the Fed statement late Friday – that the Fed is set to imminently embark on a series of emergency rate cuts.

That flip to bullish steepening from bullish flattening in the US 2-10 year yield curve has seen the dollar fall across the board – even against the low-yielding EUR and JPY. With the ECB and the BoJ far more constrained in what they can deliver in terms of rate cuts, the US yield advantage is

therefore narrowed sharply. Over the last couple of years yield differentials have not had much say in dollar pricing – but we have argued that those differentials have been too wide to make a difference. These differentials have now narrowed back inside historical norms (+/- one standard deviations) and should have a bigger say in dollar pricing going forward.

As James notes above, we see scope for the Fed to deliver as much as a 100bp easing cycle over coming months. That should temporarily hit the dollar – just as the 75bp Fed easing cycle interrupted the dollar bull trend in 1998. That cycle was worth a 10% correction in the DXY. So far we’ve seen a 2.5% correction in DXY from last month’s highs. With equities set to stay fragile over coming months, we certainly think DXY can fall another 3% (5% from the highs) from current levels. We therefore seeing EUR/\$ correcting to the 1.15 area in 2Q20, before dropping back to 1.10 towards year-end. Equally USD/JPY looks set to press strong support at 105 over coming quarters.



Source: Bloomberg, ING

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
EUR/USD	1.12	1.15	1.12	1.10	1.10	1.10	1.10	1.10
Prior*	1.10	1.11	1.12	1.13	1.14	1.15	1.18	1.20
USD/JPY	107.0	105.0	107.0	108.0	109.0	110.0	110.0	110.0
Prior*	108.0	108.0	108.0	108.0	107.0	106.0	105.0	100.0

Source: Source: ING, Prior: 'Monthly Economic Update: Feb 7th, 2020'

## Authors

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

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

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

# Can the ECB deliver, and what are the implications for EUR markets?

The European Central Bank is at an impasse having nearly exhausted its easing options. We see more downside to core rates regardless of ECB action, but we...



Source: Shutterstock

## ECB action: mostly words, for now

Last night, the ECB finally joined other major central banks' communication efforts to calm financial markets, stating that it stood ready to take "appropriate and targeted measures". The "targeted" in this statement could be key in predicting the ECB's next steps.

Under the leadership of ECB President Christine Lagarde, the bank looked less sensitive to financial market developments than it did under her predecessor Mario Draghi. Judging by recent statements, there has been a growing awareness of the adverse effects of the ECB's unconventional measures, lowering the likelihood of, or at least the willingness for, additional monetary policy easing. In our view, the ECB would still prefer to stick to its wait-and-see policy until next week's official policy meeting and then try to steer markets with words rather than action.



## Out of ammo and ineffective tools

The ECB is facing a challenging situation in which the staff projections, which are based on the no-policy-change assumption, and the still relatively benign macro data (cut-off date for the projections was last week), will be more optimistic than the gut feeling of many ECB officials about the possible economic impact of the coronavirus. This combination of fear and uncertainty, and the root problem originating clearly outside of the ECB's reach, once again illustrates the ECB's dilemma: it has run out of ammunition.

The coronavirus and its impact on the economy, in our view, call for fiscal rather than monetary policy. Think of state guarantees, bridge loans or temporary tax relief. There is very little the ECB can do, besides calming financial markets. To be blunt, at the current juncture a vaccine would definitely help more than another rate cut.

Still, coordinated action from central banks and governments would likely involve the ECB, if only for the sake of emphasising the so-called "mutual brotherhood of central banks" and to avoid an unwarranted appreciation of the euro. This could mean a 10 or 20 basis point rate cut, combined with some tweaking of the tiering facility and some new or tweaked Targeted Longer-Term Refinancing Operations.

## EUR rates: lower... or lower?

Even with 10Y Bund yields trading around -0.60%, we continue to see downside to core EUR interest rates. Barring a sudden stop in the spread of the coronavirus, the reaction of EUR interest rates appears asymmetric to us: they are heading lower either on an easing package or on the ensuing disappointment. A risk to this view is if we see a strong fiscal policy response that boosts both the issuance of government bonds and growth expectations. We judge this unlikely. As a result, look for 10Y Bund yields to breach their all time low from September 2019, and rally to -0.75%.

Taking into account our expectation of an underwhelming ECB response, we think long-end interest rates are poised to outperform shorter ones. Even in a scenario where the ECB comes around to the idea of cutting rates, the limited space to lower the deposit rate further means the long-end would be more likely to reflect a deterioration in risk sentiment. Our curve flattening view might seem surprising in light of the strength of front-end EUR bonds of late but we attribute episodes of curve steepening to the steepening of the USD curve, [reflecting the possibility of 100 basis points of Federal Reserve rate cuts in the first half of the year](#).

## EUR risk assets: no support

EUR risk assets, in particular peripheral sovereign bonds, appear at risk of a further correction. Clearly, the ECB adopting a more reserved tone than its peers is not going to reflect well on risk appetite in EUR financial markets. While the threat to the monetary policy transmission mechanism is a concern, the central bank is ill-equipped to ease the blow to consumers and small businesses. If the situation deteriorates further, it is possible that financial markets will price in a probability of larger asset purchases, but this means that things need to get worse before they get better. More generous TLTROs aimed at SMEs are possible but there is already ample liquidity.

Due to the lack of specific response in EUR markets, the improvement in sentiment caused by Fed easing might be short-lived. Additional TLTRO liquidity injections might help short-end credit but

we doubt their effectiveness in suppressing spreads for longer tenors. The current level in Italian spreads, in particular, appears incongruous relative to the correction in other risk markets. The 10Y Italy-Germany spread [has reached our near-term target of 175bp](#). We see potential for a widening to 200bp in short order to reflect the risk of an economic slowdown affecting the eurozone's weakest member disproportionately.

## EUR/USD set to move higher

That the ECB has far less room than the Fed to lower the short-term policy rate is obvious. US short term rates therefore look to converge on those in Europe, which we think is [enough to briefly push EUR/USD to 1.15 in the second quarter](#).

Also important in the EUR space will be what happens to eurozone peripheral debt. A fresh spread widening stands to keep EUR/CHF under pressure at 1.06 and raises questions over the magnitude of the Swiss National Bank's FX intervention now that Switzerland is on the US Treasury's Monitoring List for currency manipulation. 1.05 beckons on EUR/CHF, while USD/CHF could trade down to 0.92.

### Authors

#### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

#### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

## Australia's central bank cuts rates by a quarter point, says more possible

A 25 basis point rate cut takes the Reserve Bank of Australia's official cash rate to just 0.5%. One more quarter point cut would push the central...



### A big change from last month

If we look back at last month's on hold decision by the RBA, we see lots of references to the phase one trade deal, positive global outlook, and only an occasional reference to the coronavirus. There are, in fact, far more references to the bushfires.

Admittedly, quite a lot has changed since then, but we're obliged to say that the case for a rate cut was clearly evident a month ago (we were making it then) and today's cut comes across as a little bit late. If that sounds a bit like sour grapes (we did not anticipate the RBA changing its view so abruptly), then it probably is.

We speculate that the groundswell of dovishness coming from other central banks, the Bank of Japan, Federal Reserve, and most recently, the European Central Bank, may have helped to galvanise support within the RBA for moving this month. Later today, the G7 finance ministers and central bank heads meeting will also likely deliver some words of encouragement (though little actual substance we imagine), and that might also have been a tough backdrop against which to leave rates on hold for a second month.

## More coming

The latest statement makes far more of the risks to growth and downplays the likelihood of any improvements in Australian wages or GDP, which for the first quarter, is expected to look "noticeably weaker". We would add that if this is the outlook for the first quarter of 2020, then the second quarter will probably look even weaker. Bear in mind that Australia has only 34 cases of Covid-19 so far, so were the disease to spread locally, then on top of supply chain disruptions and weak Chinese demand, we can also expect domestic demand to suffer as well.

To cut a long story short, the outlook for the virus and Australia is more likely to worsen in the near term than improve. As a result, it is virtually impossible now to imagine that we will not see a further 25bps of easing from the RBA at the April meeting. Markets are already largely pricing this in.

What happens after that depends entirely on the spread of the virus, both globally, and in terms of Australia itself. While some are suggesting a positive scenario based on warming weather, remember, that only applies to the Northern Hemisphere. And as we move towards the middle of the year, parts of Australia will get noticeably cooler, and in all likelihood, wetter.

## What could unorthodox policy look like in Australia?

[In a piece we wrote about a month ago](#), we took a close look at what unorthodox policy might look like in Australia, without really being convinced that we might be staring at this in the face so quickly. There are a number of problems with trying to impose an ECB-style quantitative easing programme on Australia, not least of which is the relative absence of government debt securities. Likewise, the RBA seems to view negative interest rates as likely to do more harm to domestic demand than good - correctly in our view, for what that is worth.

That doesn't leave a lot of options, though some form of targeted lending, along the lines of the Bank of England's experiment with "funding for lending" (cheap money for banks, contingent on SME lending) might be a possible avenue, as would buying up bank paper to reduce their funding costs.

## What does this mean for the AUD?

The reaction of the Australian dollar (mildly higher) after the RBA cut shows how markets had already completely priced in the move by the time of the meeting, and some investors were possibly expecting a deeper cut.

In line with the global dovish repricing, futures on the RBA cash rate show markets broadly expecting another cut at the April meeting (around 75% implied probability). While this may suggest that further downside for AUD looks limited, there is a key caveat. As highlighted above, another cut would inevitably raise the question of unorthodox monetary policy. Unless the RBA clearly excludes this option, markets will likely be tempted to speculate around possible QE, which would inevitably pile pressure on the AUD.

Looking at the shorter-term, a round of global easing and a subdued US dollar may help avert another slump in the AUD/USD for now. However, we have noted above how the coronavirus has only marginally spread within Australian borders so far: this may change quite rapidly (as we learned from other countries), which further convinces us it is still early to call a bottom in AUD just

yet.

## Authors

### **Robert Carnell**

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

### **Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

---

Article | 2 March 2020

## Bank of Canada: We expect a cut this week

We look for a 25bp cut by the BoC this week as coronavirus worries increasingly weigh on the economic outlook. This should translate into more Canadian...



We have been pencilling in a 25bp BoC rate cut in early 2020 for some time now, but recent data had led to some doubts given robust job and wage figures while inflation was broadly in line with target. However, it is increasingly apparent that the coronavirus outbreak will be a major drag on both the global and Canadian economies in 2020. With G7 Finance ministers and Central Banks scheduled to hold a conference call to discuss their responses tomorrow, we confirm our view that the BoC will cut rates 25bp this week with a further 50bp of easing likely in subsequent months

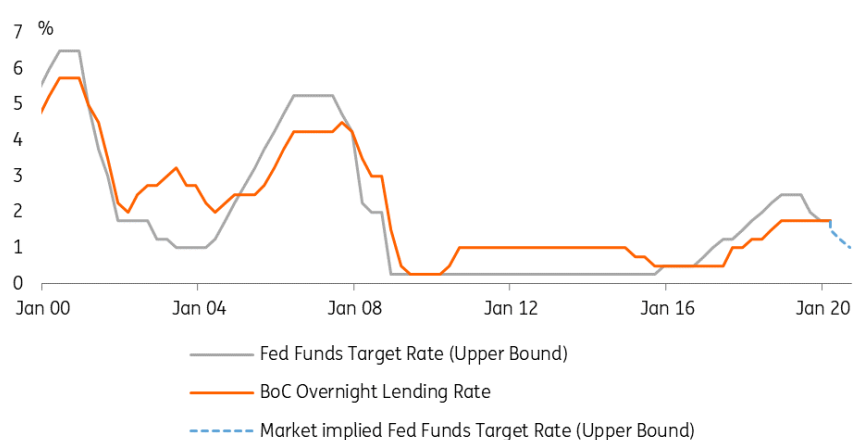
GDP growth had already slowed to just 0.3% annualised in 4Q19 and it seems probable that 1Q20 Canadian activity will be depressed by supply chain disruption because of factory closures in China and other parts of Asia. Exports will also be hurt by weaker demand from the region while protests trying to block the construction of the Coastal GasLink pipeline have had a disruptive effect on rail, road and sea transportation.

The plunge in equities and bond yields means the economy is also facing a financial shock that could lead to economically disruptive strains in lending markets. Then there is the threat of an aggregate demand shock as a sense of fear leads to consumers and businesses changing their

behaviour. This would most likely be felt in the services sector with travel, leisure and personal services sectors looking vulnerable to a sharp drop in demand. Add in the plunge in commodity prices, most notably oil, and business investment will likely weaken. As such an outright contraction in economic activity is a distinct possibility for 2Q20.

## Swift and decisive

The Bank of Canada has a reputation of being prepared to move early and deliver occasional surprise moves and we expect it to cut rates 25bp on Wednesday. In any case, the BoC has more room than most central banks to provide support to the economy and financial markets (the Overnight Lending Rate is at 1.75%). Given what has happened elsewhere, the domestic newsflow surrounding Covid-19 is likely to get worse before it gets better and we therefore expect the BoC to deliver a further 50bp of rate cuts in coming months.



Source: Bloomberg, ING

## CAD: More short-term woes

Looking at the market implications, it must be noted that markets have already priced in a significant amount of easing by the BoC for the next months. Despite the easing expectations being less aggressive than those for the Fed, two BoC cuts are already factored into the Canadian OIS curve for the next two quarters.

Despite hardly coming as a shock, markets may well not be entirely positioned for a cut at this week's meeting, so we expect a short-term negative impact on the loonie if our call proves right. The OPEC+ meeting will be another key challenge for CAD this week given markets high expectations in terms of production cuts. Jobs data will also be watched on Friday, with the bar set quite high after the very strong January numbers.

All this suggests that the headaches for the loonie in the short-term are far from over, although USD/CAD may fail to rally significantly more thanks to an underperforming USD as Fed easing expectations rise. In turn, most of the additional downside for CAD should be mostly channelled through low yielders, in particular JPY.

## Authors

**Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)



---

Article | 25 February 2020

## US market rates bracing for 1%

Equity markets have swapped their spectacles for bond market ones and are finally seeing some angst down the line. That has helped bond yields push...



### The Coronavirus effect

Covid-19 is the type of catalyst that both risk assets and core bond markets had been watching for, but from very different perspectives.

1. Bond markets were already trading as if there was trouble ahead (flat curve, rich 5yr valuation and rate cut discount).
2. Equity markets and risk assets generally were motoring ahead, but eyeing the blind spot for a pull-back risk.

The early reaction to Covid-19 had been a tad perverse. The US 10yr fell from 1.8% to 1.6% for starters. But equity markets saw the glass as half full - lower bond yields meant a heightened chance for a rate cut. That, plus a still benign inflation backdrop classically presents a positive underpinning for risk assets.

Fast forward, and there has clearly been a tipping point where vulnerability has been extrapolated. Risk assets have begun to look through bond market spectacles, and are now eyeing risks that are not immediately solvable through simple rate cuts. In turn we expect to see bond yields continue to significantly front run any Fed rate-cut response.

---

*"Interest rate cuts will neither cure anyone's flu, nor avert close-down risks for areas that have or will become Covid-19 impacted."*

---

The only logical rationale for an imminent interest rate cut is for the interests of financial market stability e.g. a case where the equity market sell-off turned into an uncontrollable rout. Beyond that, interest rate cuts will neither cure anyone's flu, nor avert close-down risks for areas that have or will become Covid-19 impacted.

Market rates, in consequence, have and will likely continue to lead any official response from the Federal Reserve. The Fed will be comforted in the fact that policy has already been eased by 75bp (in 2019), and as we turned the year into 2020 the Fed was in the process of balance sheet re-building / liquidity injecting. So no need to panic here, yet.

## **Excess demand is a central driver**

Before going into predictions for yields, there is one important (non-Covid-19) factor to consider – the excess of demand over supply for fixed income as a theme. Despite heavier USD bond supply, the demand for fixed income has been overwhelming; hence the persistent fall in yields.

---

*"Despite heavier USD bond supply, the demand for fixed income has been overwhelming; hence the persistent fall in yields"*

---

The demand side includes some key captive players. These include central banks (QE), private banks (regulatory liquidity buckets) and pension funds (ALM through "near-AAA" discount functions). On top of that players, like insurance companies, that have been forced out the credit curve for yield, have barbelled into core rates too.

And bigger picture impulses are in play too. European (negative) yields remain a drag for US ones, as do the likes of Japanese and Northern European ones generally. The persistent flow of funds into USD has been a coincident outcome from this, which has become a circular process, pushing yields down and USD product up.

These were all in play well before Covid-19 hit.

## **Covid-19 and final thoughts**

The Coronavirus backdrop has provided an open door for core bond markets to push through. The 5yr part of the curve has taken the lead, now at 1.15% as we head for the US close; a full 40bp through the effective Fed funds rate. The 30yr at sub-1.8% is just a smidgen above the Fed funds rate ceiling.

As nominal rates have fallen, there has also been a compression versus TIPS yields, resulting in a

big falls in implied breakeven inflation - the 10yr B/E is now only a tad above 1.5%. This is a remarkably low market discount for US inflation over the next 10 years, in turn providing fuel for calls for the Fed to step in with some rate cuts.

*"Calling the Covid-19 spread is a mugs game. But the fear factor that comes from any / every material geographical breakout is now predictable"*

Calling the Covid-19 spread is a mugs game. But the fear factor that comes from any / every material geographical breakout is now predictable, which points to material slowdown, both direct and indirect. Against this backdrop, there is likely room for yields to test lower from here, even if ultimately morphing into an overshoot to the downside.

The 1% level is a natural target, and we can envisage a scenario where the curve begins to pepper that level in the coming weeks and months, at least along the 2yr to 10yr segment. The 5yr would likely make the break below first, as the 2/5yr segment continues to invert. And the 10yr would not be too far behind as the overall curve maintains a flattening tendency (until the point where the Fed feels the need to cut).

## 1 And now for the technical bit

The US 10yr yield, now at an all-time low, does not trade through the Fed funds rate very often. When it has, it has typically been followed by significant Fed funds rate cuts.

### The 10yr breaks below the cycle low and well through fed funds

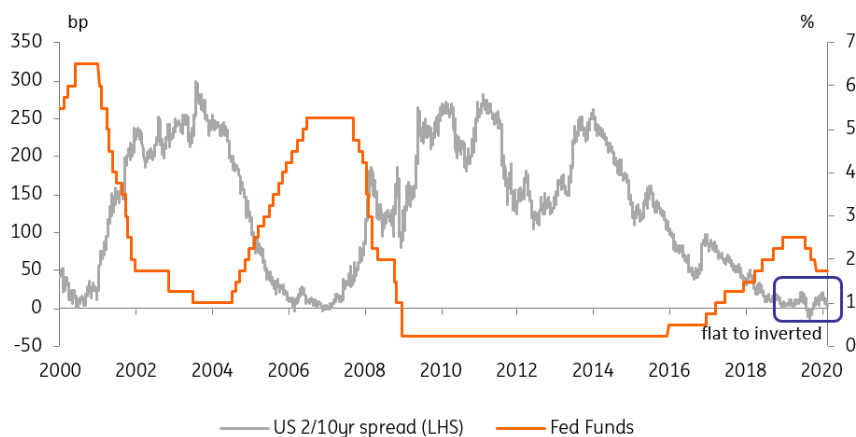


Source: Bloomberg

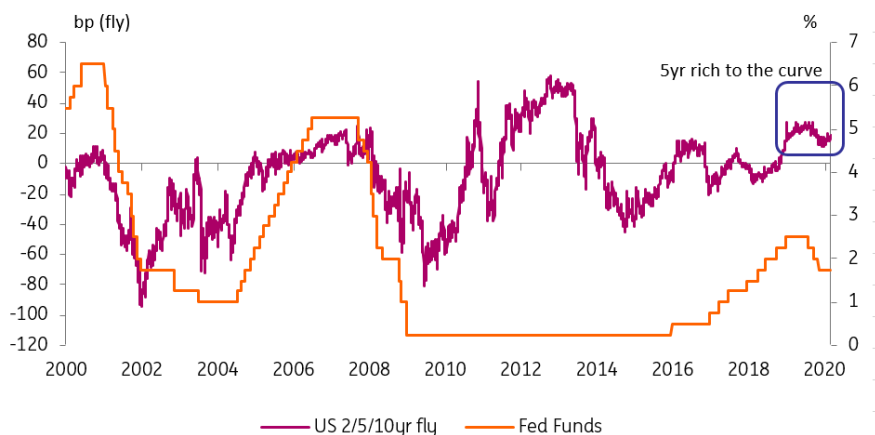
The US 2yr has been some 100bp lower than current levels, back when the funds rate was at zero-25bp. At 1.2% it is discounting at least two 25bp cuts.



History also shows that extreme curve flatness (and/or inversion) typically precedes a rate cutting process.



The inversion on the 2/5yr segment has coincided with the 5yr trading rich to the curve. A rich 5yr flags a tendency for lower rates.



Note the maintenance of richness on the 5yr segment even after the Fed had delivered 3\*25bp in rate cuts in 2019. This is unusual. Once the Fed has started a rate cutting cycle, the 5yr would typically revert to a cheaper valuation. Instead sustained 5yr richness pointed to an unfinished lower rates process, and that was before Covid-19 hit.

## Author

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

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

---

Opinion | 3 March 2020

## Central banks talking a good game

Markets are taking heart from central bank comments, but nothing has actually been done yet, and the new case count for Covid-19 is accelerating. This...



Source: Shutterstock

### Talking the virus down

The chorus of central banks saying that they “are monitoring the situation closely and stand ready to...” blah, blah, blah...is growing. After Jerome Powell came out last Friday and then was joined by the BoJ’s Kuroda on Monday, the ECB’s Christine Lagarde has now joined the fray.

Markets seem to be enjoying the rhetoric, with equity markets in the US rallying, and Asian equity futures up this morning.

It is worth pointing out that none of the central banks has done anything more than just say some words yet. And in the background, the number of new Covid-19 cases is rising faster each day. Cases in the US are also growing, with some doctors saying they don’t have the kits for testing, which if true indicates that the true count there may be much higher, or be on the cusp of rising further.

I remain sceptical that cuts, even 50bp from the Fed at their March 18 meeting, will do much to alleviate the macroeconomic consequences of a broader outbreak. As I wrote yesterday, the impact for firms is largely a cash flow crisis, not a debt service problem, and rate cuts won’t make much difference if your firm can’t produce due to supply chain problems, or staffing levels, or

logistical breakdowns associated with virus disruption, lockdown or quarantines.

## RBA - a tough call

The RBA is up on the blocks for possible rate action today. We didn't forecast any change when we put our week-ahead forecasts out, though the situation is fast-moving, and we certainly don't rule it out. Plenty of other economists are now changing their minds.

If they don't cut, we anticipate a strong hint of imminent possible future action. But Australia, although hit hard by the China slowdown, has only 33 Covid-19 cases itself, and the China situation itself seems to be resolving.

Also, the RBA also doesn't have an infinite arsenal of ammunition, so might want to wait to use rate cuts for more than just a two-day equity rally. This isn't about "keeping your powder dry", which is a ridiculous concept, it is about making sure you don't waste your last remaining bullets, which might be the case.

It also seems as if the government might be more disposed to finding some money to throw at this crisis, which, in our view, is likely to do more good than any rate cuts. Still, we won't have to wait long to find out, and this decision is becoming far more finely balanced.

## SE Asian central banks act where they can

Elsewhere in the region, Bank Negara Malaysia meets to decide rate policy today, and we are expecting a cut from them, more likely now given the political disruptions which means that fiscal stimulus packages that were stitched up and ready to go may now be delayed. [Here is a link to the recent note by Prakash Sakpal on Malaysia's political upheaval.](#)

Yesterday, Indonesia's central bank Governor, Perry Warjiyo, cut the foreign exchange reserve rate requirement for banks from 8% to 4%, which should release about \$3.2bn to the economy. He also promised to intensify intervention to stabilise the bond and foreign exchange markets following recent volatility. While the IDR remains weak, the RRR route remains Warjiyo's most likely source of stimulus rather than rate cuts.

### Author

#### Robert Carnell

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.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>.