

## How high will bond yields go?

How high will bond yields go? That depends on how soon and what sort of trade deal we are getting, if any.



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### Up, up and away!

Since their September intraday low of 1.4271%, 10Y US Treasury yields have moved erratically higher. But the recent move taking them to 1.94% sets a new high since that low. You have to wonder, how much more? The answer is relevant for us, since the fate of Asian currencies such as the KRW and CNY will rest on similar considerations. The next retracement level of note for yields from charts looks to be 2.12%, so a further 20bp or so increase in yields looks to be eminently plausible in short order. But is this also consistent with fundamentals?

Model-based approaches are one way of looking at this question, but then I don't think fundamentals were what took bond yields to their recent lows, so asking how high they might go "fundamentally", ignores what happens if the same factors return again. I refer of course to trade war fears.

And the news here remains messy, but perhaps in a different way than before. I checked my phone as usual this morning on the way into work for any tweets or clues as to which way this was going. But aside from one tweet from the US President, saying that talks were coming along "very nicely" but adding that China wanted a deal much more badly than he did, there wasn't much.

This tweet doesn't, in fact, tell us anything new. I think it is virtually a verbatim repeat of one from several months back, when bond yields were heading in the opposite direction.

So if there is nothing new here, are markets simply now talking themselves out of recession fears in the same way that they talked themselves into them previously?

## The outcome is looking increasingly binary

I confess that some sort of trade deal does look in the works, but the other news from the twittersphere is less comforting. The problem is that it is not at all clear who, on the US side is in charge of the negotiations. Robert Lighthizer is officially the lead negotiator. But ultimately, it seems as if the President alone can decide whether a deal will happen. His adviser, Peter Navarro, is taking a characteristically tough line, and as his comments reported on line suggest (he doesn't appear to tweet himself), talk of rollback of tariffs may simply be fake news. Still, even he seems to view some sort of "glide path to a phase one" deal as being a realistic assessment of the current state of play. If so, then how does this relate to the bond market and Asian currencies?

From our perspective, some rollback of tariffs would need to be delivered in order for China to sign up to any deal. Let's not forget that China also has needs and demands from this deal, it is not all about what the US wants. So if no rollback, it is hard to see even a phase one deal happening. And if not, and no deal ensues, then a rapid plunge to new bond yield lows would likely be on the cards.

But that then also suggests that any deal that *does* get done, *will* involve rollback, and *will* involve some concessions on Intellectual Property (a US red-line), and so could be regarded as somewhat substantive.

That could be enough to see bond yields pushing up against that 2.12% resistance. and maybe even through it.

What it does *not* look like we will now get, which was once a third option, was a deal which basically just acknowledged the Chinese efforts on increased agricultural purchases, and made some half-hearted commitments to looking again at tariffs based on some future contingencies. That sort of "Dino" deal (deal-in-name-only) would have been unlikely to support bond yields at today's levels, and so would likely have given way to a slide back down, though perhaps not as rapidly as with a clear no-deal outcome, complete with recriminations and escalation.

At least this helps clear the options a little. Our probability tree now looks to have one less node on it.

## Asia Day ahead

We have already had core machine orders for September from Japan today. That data is a proxy for current business investment in plant and machinery, so it helps form opinions about the strength of overall economic growth. 3Q19 Japanese GDP is due out on Thursday, so this is one of the last bits of hard data before that figure will be released. And it wasn't good. Despite rising 5.1%YoY, up from -14.5% in August, September orders fell 2.9%MoM. This is hardly the front-loading ahead of the October consumption tax hike that saw orders in March 2014 rising 13.7%MoM (admittedly falling sharply thereafter). So it now looks as if we are relying on what looks like it will have been about a 2.8% real consumer spending boost to deliver a stronger

outcome than the 0.9%QoQ (seasonally adjusted annualised rate) forecast.

(And From Prakash Sakpal): Bank Negara Malaysia's (BNM) move on Friday to ease via a 50 basis point reserve requirement cut comes amid deteriorating economic conditions. And we expect BNM to go further with overnight policy rate cuts. This week's data on September industrial production (due out today) and 3Q19 GDP (due on Friday) should underpin rising downside growth risks. We have recently revised our 3Q GDP forecast to 4.4% from 4.8%, taking down the full-year 2019 forecast to 4.5% from 4.7%, and expect at least 50bp BNM policy rate cuts in the first quarter of 2020.

## Author

### **Amrita Naik Nimbalkar**

Junior Economist, Global Macro

[amrita.naik.nimbalkar@ing.com](mailto:amrita.naik.nimbalkar@ing.com)

### **Mateusz Sutowicz**

Senior Economist, Poland

[mateusz.sutowicz@ing.pl](mailto:mateusz.sutowicz@ing.pl)

### **Alissa Lefebre**

Economist

[alissa.lefebvre@ing.com](mailto:alissa.lefebvre@ing.com)

### **Deepali Bhargava**

Regional Head of Research, Asia-Pacific

[Deepali.Bhargava@ing.com](mailto:Deepali.Bhargava@ing.com)

### **Ruben Dewitte**

Economist

+32495364780

[ruben.dewitte@ing.com](mailto:ruben.dewitte@ing.com)

### **Kinga Havasi**

Economic research trainee

[kinga.havasi@ing.com](mailto:kinga.havasi@ing.com)

### **Marten van Garderen**

Consumer Economist, Netherlands

[marten.van.garderen@ing.com](mailto:marten.van.garderen@ing.com)

### **David Havrlant**

Chief Economist, Czech Republic

420 770 321 486

[david.havrlant@ing.com](mailto:david.havrlant@ing.com)

### **Sander Burgers**

Senior Economist, Dutch Housing

[sander.burgers@ing.com](mailto:sander.burgers@ing.com)

**Lynn Song**

Chief Economist, Greater China

[lynn.song@asia.ing.com](mailto:lynn.song@asia.ing.com)

**Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

**Michal Rubaszek**

Senior Economist, Poland

[michal.rubaszek@ing.pl](mailto:michal.rubaszek@ing.pl)

**This is a test author**

**Stefan Posea**

Economist, Romania

[tiberiu-stefan.posea@ing.com](mailto:tiberiu-stefan.posea@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Jesse Norcross**

Senior Sector Strategist, Real Estate

[jesse.norcross@ing.com](mailto:jesse.norcross@ing.com)

**Teise Stellema**

Research Assistant, Energy Transition

[teise.stellema@ing.com](mailto:teise.stellema@ing.com)

**Diederik Stadig**

Sector Economist, TMT & Healthcare

[diederik.stadig@ing.com](mailto:diederik.stadig@ing.com)

**Diogo Gouveia**

Sector Economist

[diogo.duarte.vieira.de.gouveia@ing.com](mailto:diogo.duarte.vieira.de.gouveia@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Ewa Manthey**

Commodities Strategist

[ewa.manthey@ing.com](mailto:ewa.manthey@ing.com)

## ING Analysts

### James Wilson

EM Sovereign Strategist

[James.wilson@ing.com](mailto:James.wilson@ing.com)

### Sophie Smith

Digital Editor

[sophie.smith@ing.com](mailto:sophie.smith@ing.com)

### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

### Adam Antoniak

Senior Economist, Poland

[adam.antoniak@ing.pl](mailto:adam.antoniak@ing.pl)

### Min Joo Kang

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

### Coco Zhang

ESG Research

[coco.zhang@ing.com](mailto:coco.zhang@ing.com)

### Jan Frederik Slijkerman

Senior Sector Strategist, TMT

[jan.frederik.slijkerman@ing.com](mailto:jan.frederik.slijkerman@ing.com)

### Katinka Jongkind

Senior Economist, Services and Leisure

[Katinka.Jongkind@ing.com](mailto:Katinka.Jongkind@ing.com)

### Marina Le Blanc

Sector Strategist, Financials

[Marina.Le.Blanc@ing.com](mailto:Marina.Le.Blanc@ing.com)

### Samuel Abettan

Junior Economist

[samuel.abettan@ing.com](mailto:samuel.abettan@ing.com)

### Franziska Biehl

Senior Economist, Germany

[Franziska.Marie.Biehl@ing.de](mailto:Franziska.Marie.Biehl@ing.de)

### Rebecca Byrne

Senior Editor and Supervisory Analyst

[rebecca.byrne@ing.com](mailto:rebecca.byrne@ing.com)

**Mirjam Bani**

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

[mirjam.bani@ing.com](mailto:mirjam.bani@ing.com)

**Timothy Rahill**

Credit Strategist

[timothy.rahill@ing.com](mailto:timothy.rahill@ing.com)

**Leszek Kasek**

Senior Economist, Poland

[leszek.kasek@ing.pl](mailto:leszek.kasek@ing.pl)

**Oleksiy Soroka, CFA**

Senior High Yield Credit Strategist

[oleksiy.soroka@ing.com](mailto:oleksiy.soroka@ing.com)

**Antoine Bouvet**

Head of European Rates Strategy

[antoine.bouvet@ing.com](mailto:antoine.bouvet@ing.com)

**Jeroen van den Broek**

Global Head of Sector Research

[jeroen.van.den.broek@ing.com](mailto:jeroen.van.den.broek@ing.com)

**Edse Dantuma**

Senior Sector Economist, Industry and Healthcare

[edse.dantuma@ing.com](mailto:edse.dantuma@ing.com)

**Francesco Pesole**

FX Strategist

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

**Rico Luman**

Senior Sector Economist, Transport and Logistics

[Rico.Luman@ing.com](mailto:Rico.Luman@ing.com)

**Jurjen Witteveen**

Sector Economist

[jurjen.witteveen@ing.com](mailto:jurjen.witteveen@ing.com)

**Dmitry Dolgin**

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

**Nicholas Mapa**

Senior Economist, Philippines  
[nicholas.antonio.mapa@asia.ing.com](mailto:nicholas.antonio.mapa@asia.ing.com)

**Egor Fedorov**  
Senior Credit Analyst  
[egor.fedorov@ing.com](mailto:egor.fedorov@ing.com)

**Sebastian Franke**  
Consumer Economist  
[sebastian.franke@ing.de](mailto:sebastian.franke@ing.de)

**Gerben Hieminga**  
Senior Sector Economist, Energy  
[gerben.hieminga@ing.com](mailto:gerben.hieminga@ing.com)

**Nadège Tillier**  
Head of Corporates Sector Strategy  
[nadege.tillier@ing.com](mailto:nadege.tillier@ing.com)

**Charlotte de Montpellier**  
Senior Economist, France and Switzerland  
[charlotte.de.montpellier@ing.com](mailto:charlotte.de.montpellier@ing.com)

**Laura Straeter**  
Behavioural Scientist  
+31(0)611172684  
[laura.Straeter@ing.com](mailto:laura.Straeter@ing.com)

**Valentin Tataru**  
Chief Economist, Romania  
[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

**James Smith**  
Developed Markets Economist, UK  
[james.smith@ing.com](mailto:james.smith@ing.com)

**Suvi Platerink Kosonen**  
Senior Sector Strategist, Financials  
[suvi.platerink-kosonen@ing.com](mailto:suvi.platerink-kosonen@ing.com)

**Thijs Geijer**  
Senior Sector Economist, Food & Agri  
[thijs.geijer@ing.com](mailto:thijs.geijer@ing.com)

**Maurice van Sante**  
Senior Economist Construction & Team Lead Sectors  
[maurice.van.sante@ing.com](mailto:maurice.van.sante@ing.com)

**Marcel Klok**

Senior Economist, Netherlands

[marcel.klok@ing.com](mailto:marcel.klok@ing.com)

**Piotr Poplawski**

Senior Economist, Poland

[piotr.poplawski@ing.pl](mailto:piotr.poplawski@ing.pl)

**Paolo Pizzoli**

Senior Economist, Italy, Greece

[paolo.pizzoli@ing.com](mailto:paolo.pizzoli@ing.com)

**Marieke Blom**

Chief Economist and Global Head of Research

[marieke.blom@ing.com](mailto:marieke.blom@ing.com)

**Raoul Leering**

Senior Macro Economist

[raoul.leering@ing.com](mailto:raoul.leering@ing.com)

**Maarten Leen**

Head of Global IFRS9 ME Scenarios

[maarten.leen@ing.com](mailto:maarten.leen@ing.com)

**Maureen Schuller**

Head of Financials Sector Strategy

[Maureen.Schuller@ing.com](mailto:Maureen.Schuller@ing.com)

**Warren Patterson**

Head of Commodities Strategy

[Warren.Patterson@asia.ing.com](mailto:Warren.Patterson@asia.ing.com)

**Rafal Benecki**

Chief Economist, Poland

[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

**Philippe Ledent**

Senior Economist, Belgium, Luxembourg

[philippe.ledent@ing.com](mailto:philippe.ledent@ing.com)

**Peter Virovacz**

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

**Inga Fechner**

Senior Economist, Germany, Global Trade

[inga.fechner@ing.de](mailto:inga.fechner@ing.de)



**Dimitry Fleming**

Senior Data Analyst, Netherlands

[Dimitry.Fleming@ing.com](mailto:Dimitry.Fleming@ing.com)

**Ciprian Dascalu**

Chief Economist, Romania

+40 31 406 8990

[ciprian.dascalu@ing.com](mailto:ciprian.dascalu@ing.com)

**Muhammet Mercan**

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

**Iris Pang**

Chief Economist, Greater China

[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

**Sophie Freeman**

Writer, Group Research

+44 20 7767 6209

[Sophie.Freeman@uk.ing.com](mailto:Sophie.Freeman@uk.ing.com)

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

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

**James Knightley**

Chief International Economist, US

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

**Tim Condon**

Asia Chief Economist

+65 6232-6020

**Martin van Vliet**

Senior Interest Rate Strategist

+31 20 563 8801

[martin.van.vliet@ing.com](mailto:martin.van.vliet@ing.com)

**Karol Pogorzelski**

Senior Economist, Poland

[Karol.Pogorzelski@ing.pl](mailto:Karol.Pogorzelski@ing.pl)

**Carsten Brzeski**

Global Head of Macro

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

**Viraj Patel**

Foreign Exchange Strategist

+44 20 7767 6405

[viraj.patel@ing.com](mailto:viraj.patel@ing.com)

**Owen Thomas**

Global Head of Editorial Content

+44 (0) 207 767 5331

[owen.thomas@ing.com](mailto:owen.thomas@ing.com)

**Bert Colijn**

Chief Economist, Netherlands

[bert.colijn@ing.com](mailto:bert.colijn@ing.com)

**Peter Vanden Houte**

Chief Economist, Belgium, Luxembourg, Eurozone

[peter.vandenhoute@ing.com](mailto:peter.vandenhoute@ing.com)

**Benjamin Schroeder**

Senior Rates Strategist

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

**Gustavo Rangel**

Chief Economist, LATAM

+1 646 424 6464

[gustavo.rangel@ing.com](mailto:gustavo.rangel@ing.com)

**Carlo Cocuzzo**

Economist, Digital Finance

+44 20 7767 5306

[carlo.cocuzzo@ing.com](mailto:carlo.cocuzzo@ing.com)