Rates Spark: A 3 per cent inflation environment, and still on the rise

Thursday likely sees US PPI core inflation back up to 3%, while core CPI inflation was confirmed earlier this week at 3.1%. In all probability these inflation rates will be on the rise in the coming months, and can easily touch 4%. We see, for example, how proposed eSLR changes are good for Treasuries. But Treasuries can't fully ignore evolving inflation data

Even though the Federal Reserve kept rates on hold, we think US rates can still go higher with euro rates more contained

Core US PPI is anticipated in the 3% area for July, posing an issue for long dates to fret about

Earlier we sent out a short piece on the proposed recalibration of the enhanced Supplementary Leverage Ratio, which applies to Global Systemically Important Banks and their subsidiaries is open for public comment until 26 August 2025. The full pieces is here, with all its detail. But cutting to the chase, broker-dealers and depository subsidiaries could *potentially* add $3trn in Treasuries or reserves, about 9% of marketable debt - over time.

Is this impactful for Treasuries? For sure if up-front inflows dominate. But a more gradual application would be less impactful. Still, it's a positive impulse. Just as the backing of stablecoins with Treasury bills is a positive for bills demand into the medium term, which also has a potential multi-trillion dollar demand effect. Again, a positive. But only meaningfully impactful if accelerated, as supply is increasing significantly too.

Remember, the fiscal deficit of $2trn means adding that every year to the size of debt outstanding. That's some $10trn over five years, and will need appetite to grow with it.

Still, for the Treasury market bulls, this extra demand potential is a positive factor. One that can offset to an extent fiscal and supply concern. And it can even mute tariff-related inflation concern. That said, we continue to view the likely rise in US core inflation in the coming 3-6 months as a burdensome factor for longer-dated securities. And any cut in rates that appears to come from a Fed that is deemed to be politically motivated will also pose issues for longer dates. No simple bull story here per se for Treasuries.

Thursday is likely to see US PPI core inflation back up to 3% year-on-year (for July), and core CPI inflation was confirmed earlier this week at 3.1% YoY for the same month. In all probability these inflation rates will be on the rise in the coming 3-6 months, and can easily touch 4% before peaking. That remains a dominating factor for the long end to worry about, and rate cuts don't necessarily take long end pain away, in fact they can potentially exacerbate it.

Thursday's events and market views

When European markets open the UK will release second-quarter GDP. The monthly data so far has been weaker as the front-running of US tariffs skewed exports into the first quarter.

The eurozone will see releases of final French CPI data for July as well as the bloc's second reading of second-quarter GDP and industrial production data for June.

Following the morning UK data it is likely US data that will be more relevant for the market where the details of the PPI data will give expectations for the PCE, the Fed's preferred inflation measure. Markets will also be sensitive to jobless claims data where especially continuing claims had seen a surprising uptick last week.

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