Rates Spark: Inflation should matter, but

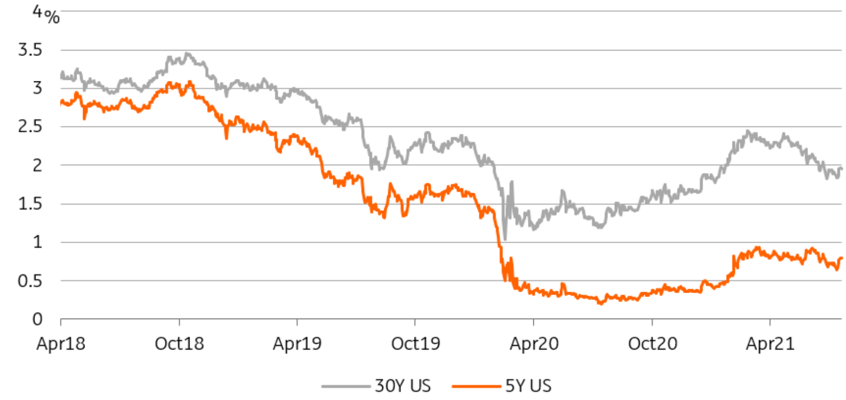
Global markets get another helping of US inflation data today. We think some of the rise in yields this week owes to supply, but the proximity of the Jackson Hole Fed symposium at the end of the month make a retracement too much lower unlikely

Source: Shutterstock

Credit where it’s due: supply helped rates higher

US CPI came and went without triggering much drama in global markets. In fact, the rally around the release’s slightly disappointing core inflation print may betray a skew in expectations that went above what the Bloomberg (and other) surveys were showing. Another, complementary, explanation is that near-term positioning going into yesterday’s 10Y auction was dominated by shorts. This wouldn’t be a surprise given the need for dealers to ‘make room’ in their book for the additional bonds. But it leaves open the question of whether the rise in bond yields so far in August was as a result of better economics data and hawkish Fed rhetoric, or just a reflection of the usual ebb and flow of supply and demand.

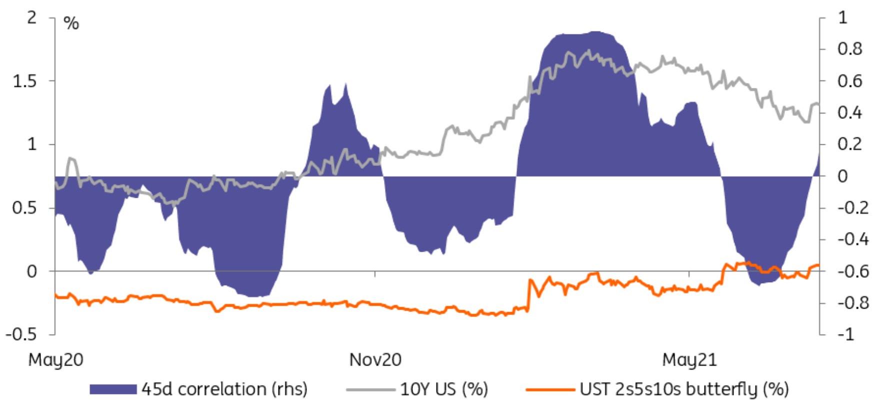
Demand for 30Y UST tends to weaken below 2%



Source: Refinitiv, ING

The exceptional aspect of yesterday's 10yr bond auction was the large size of the indirect bid. This is indicative of strong overseas interest, and includes central banks. The 30yr is up next later today. It flopped last time following good 3yr and 10yr auctions. And the 30yr auction will not have a bid from central banks in our view. The 30yr yield is broadly in the same area as it was at the last 30yr auction, when it objected to a sub-2% print. It's in a similar boat this time around.

Rising correlation between UST 2s5s10s and 10y suggests a macro rationale to the sell off



Source: Refinitiv, ING

> *This week stands out as a bit of an exception seeing both Treasury auctions and non-negligible primary market activity*

As we have written earlier in the summer, there remain a significant skew in favour of low rates based on central bank asset purchases and overall limited supply. This week stands out as a bit of an exception seeing both Treasury auctions and non-negligible primary market activity from corporate borrowers. The question is thus whether the same causes will produce the same effects once the borrowing spike is over. We think not. While the upcoming Fed Jackson Hole symposium at the end of August is a well flagged risk, it should nonetheless mean potential bond buyers will be more inclined to sit on their hands until after the event. At the very least, this makes a revisit of the August lows (some 15-20bp lower for 10Y US Treasuries) unlikely.

Today's events and market view

Today, most of the action will come from US releases. PPI (producer prices) will follow hot on the heels of the CPI (consumer prices) report yesterday. The headline figure is expected to decline on a MoM basis compared to June but the 'core' ex-food and energy is due to remain constant. Weekly Jobless Claims is the other item on the US data slate.

The US Treasury concludes this week's supply with the sale of US$27bn 30Y T-bonds. It is likely that US Treasuries benefit from a relief rally as the week's supply comes to a close but we think the trend higher in yields will resume shortly.

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