

Rates Spark: Another hot US CPI expected

Markets continue to price in fewer Fed cuts and a hot CPI figure could continue in this direction. Euro rates show an opposite trend as weaker data keeps showing up and could thus diverge more from the US. More clarity on the German elections can help stabilise the Bund ASW spread



Markets are continuing to pare back their Fed rate easing expectations. Pictured: Fed Chair Jay Powell

Markets turning more hawkish on the Fed

US rates are moving higher, and this might be the path of least resistance in the coming days, given Trump's victory and the potentially hotter CPI and PPI figures on Wednesday and Thursday.

Markets are continuing to pare back their Fed rate easing expectations. A cut in December is just about a 50/50 probability event in the eyes of the market. The SOFR futures strip bottoms out just above 3.80% and only around late-2026 to mid-2027. The broader Treasury curve, ie, 2s10s has resteepped somewhat, also driven by resuming issuance activities of the wider market.

Overall we are still in a bit of limbo in terms of the timing and impact of Trump's policies. This state where we move from pricing promises to looking at actual policies might last for some months, and in the meantime we think there is still a chance that data will sour and trigger a (temporary) leg lower in rates. But we need to see that cue from the data first.

Euro rates continue to diverge from the US

Looking at the eurozone, we see an ongoing divergence compared to the US. Following the disappointing ZEW reading, front-end rates pushed lower, including pricing for a potentially even larger 50bp cut by the European Central Bank in December.

The 2y ESTR OIS rate tested the downside and is now slightly below last week's level, while the US 2y SOFR rates increased by 9bp after the Monday holiday. The EUR back end couldn't fully escape the global trend of rising rates on Tuesday when the US markets reopened. The 10y ESTR OIS rate is now up by 1bp following Tuesday's late rise, but the spread to SOFR has widened by 9bp to over 170bp – the widest since late 2019.

Where things start to get a little clearer is the timing of elections in Germany after the recent government turmoil – a confidence vote is now slated for 16 December with new elections expected to take place on 23 February. The 10Y Bund has already stabilised over the past few days at around 1-2bp above the 6m Euribor-based swap rate. While the above swaps levels are a first for Bunds, we have made the point before that when comparing to OIS – a largely risk-free rate expectations measure – the currently observed levels “merely” represent a return to the pre-QE situation of 2014.

Wednesday's events and market view

The US CPI numbers will draw the most attention, with the core CPI expected to come in at a relatively hot 0.3% month-on-month. US CPI numbers triggered sharp global rate reactions over the summer, but more recently the focus has shifted to growth concerns. Later in the day, we have several Fed speakers, including Musalem from the St Louis Fed who will speak about the economy and monetary policy.

In terms of issuance, Italy will auction 3Y, 6Y, 8Y and 15Y BTPs for a total of €8.25bn. Germany has scheduled a 10Y Bund for €4bn, and Portugal a 10Y and 20Y OTs totalling €1.25bn. The UK will be auctioning £4bn of new 3Y Gilts.

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