

## Rates Spark: Are we there yet?

The CPI surprise will not keep the Fed from hiking rates this month, but further hikes look less likely. Today's PPI may give markets another excuse to trade the easing inflation narrative, with front-end-led steepening sending end-of-cycle vibes. Today's ECB minutes will pit a hawkish stance against signs of easing inflation pressures



### US CPI surprise gives markets end-of-cycle vibes

There was something in the air in the past few trading days. Just when 4% on the 10yr was looking comfortable, there was a pivot of attention towards yesterday's CPI report. Consensus pointed to a low 3% headline number. But we got better. Bang on 3%, so close to a break into a 2% handle. And, the core rate gets back below 5% for the first time in a year and a half. A good look for inflation overall, and correlating with market rates heading decisively lower.

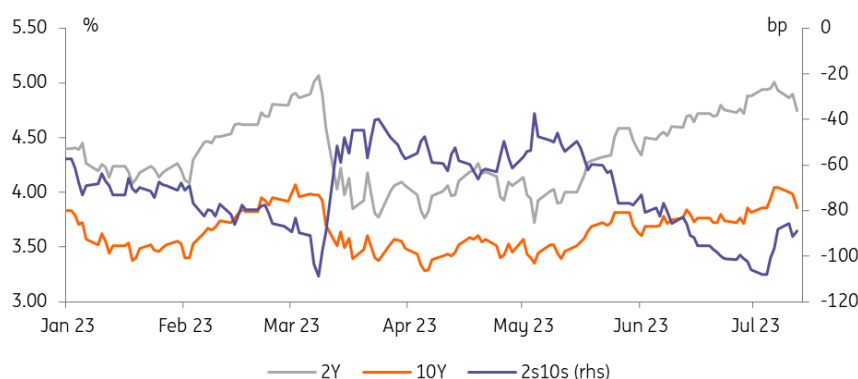
The 10Y US Treasury is now below 3.9% and the 2Y closer to 4.70%. The curve dis-inverted, this time in bull-steeping fashion as one would expect towards the end of a tightening cycle. Both real yields and inflation expectations ease lower. The 2Y breakeven rate has dipped back below 2%, a very comforting reading from the Fed's perspective.

The question now is whether the market continues to trade off the easing inflation narrative. There is an excuse to do so as today's PPI report is also expected to be friendly. It's quite a swing from the

strong wage data last week into an easing inflation narrative for this week. Both are in fact backward looking, but the core inflation reading in particular is the dominant driver for market rates. If the market begins to believe that easing pipeline pressures and the pull of lower headline rates can dominate, then the strong labour market backdrop can be downsized as an issue.

It is tough to make a conviction-directional view from here. We had been consistently looking for a break above 4% and to stay above that level for a while. But we are clearly back below, and with some reasonable justification.

## Front-end led steepening signals end-of-cycle vibes



Source: Refinitiv, ING

## June ECB minutes – gaps in the hawkish line?

The European Central Bank will release the minutes of the June policy meeting. Recall that the ECB hiked rates by 25bp and all but pre-announced another 25bp hike for this month. Markets have more than complied and are now more than fully discounting one more hike by the end of the year.

This contrasts with more signs that inflation pressure is actually starting to ease, not just in the US but also in the eurozone. But it also suggests markets are for now still fully embracing the ECB's focus on current inflation and it basing the policy stance on backward-looking data – a clear preference to err on the side of doing too much when it comes to inflation.

But there have also been important voices within the ECB's governing council which seem to take a more centrist view. The Bank of France's Francois Villeroy recently acknowledged that there was "first good news" on inflation and that policy rates would soon reach their terminal rate. ECB observers will scour today's minutes to see whether the hawkish consensus is starting to crack in light of the softer macro backdrop. After all, we also believe that the ECB's own growth forecasts on which the hawkish case is based look overly optimistic.

### Today's events and market view

The main event from a European perspective is the ECB minutes of the June meeting. The question is whether a softening macro backdrop will also heat up the debate between the ECB's relatively silent doves and the currently dominant hawks.

Over in the US, the focus will be on producer prices, which should suggest further easing

pipeline pressure for prices. The initial jobless claims give a more contemporaneous read on the job market after the underwhelming payrolls report last week. Consensus is not seeing a large change with 250k initial claims after 248k last week and stable continuing claims, but with more signs of inflation cooling, the resilience of the labour market may be less of a worry, at least in the eyes of the market.

Fed speakers will be watched more closely following the CPI release and given the fact that the pre-meeting black-out period will set in this weekend, a meeting at which the Fed could well deliver this cycle's last hike. First voices yesterday, such as Richmond's Thomas Barkin, already warned against backing off too soon. Scheduled for today is San Francisco's Mary Daly while Governor Christopher Waller is slated for tomorrow.

Supply will come from Italy and later in the day from the US, where a US\$8bn 30y bond auction awaits.

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