Rates Spark: Bonds need better than 0.3% MoM for CPI

Although there are lots of signs of underlying angst, three factors are preventing yields from tumbling. First, the labour market is not laying down. Second, latest MoM inflation readings are a tad too hot for comfort. And third, supply pressure remains intense. Tuesday sees another supply test, but first a key inflation test. Passing both will be tough

Supply and inflation are the key drivers for Treasuries this week

The US 10yr yield has held above 4%, which makes sense given what we know. Friday saw it have a think about hitting 4%, but it never got there. One could pick holes in the payrolls report, but in the end it was far from a weak report, or at least not weak enough in parts to justify a crash below 4%. To validate the price action of THE previous week which saw the 10yr move persistently down from the 4.35% area, the report needed to be far weaker than what we got.

Tuesday sees another CPI report to think about. The core year-on-year rate is set to fall from 3.9% to 3.7%. But that's still closer to 4% than 3%. The headline rate is expected to hold at 3.1% YoY, which is better. And while that's in the 3% area, it really needs to be in the 2% area, or at least closer to that vicinity. Worse, the hold at 3.1% YoY assumes a 0.4% month-on-month outcome. And that's where the issue is right now – sticky high MoM outcomes through January and into

February. The expectation for core at 0.3% MoM is better, but that's still too high (just annualise it).

Really for the 10yr to have any shot at breaking below 4% at this juncture, it needs a 0.2% MoM outcome. Failing that, we'll hold off till the PPI report on Thursday to get another read on the February inflation pulse.

In the meantime, the 3yr auction went well on Monday, on strong pricing. But the first big duration test of the week comes from Tuesday's 10yr auction, and then we have the (often tail-prone) 30yr auction on Wednesday to get through. Not much discussion on the weight of supply this time around, but it remains a test every time there is an auction event. And that will remain the case right through 2024 and beyond.

Today's events and market view

The US CPI takes centre stage as a potentially market moving release. The consensus is looking for an unchanged 3.1% YoY headline CPI rate with core falling to 3.7%. But all eyes are on the momentum in the monthly readings. Headline could notch slightly up to 0.4%, and core slightly down to 0.3% MoM. In the eyes of the Fed, it is likely still too hot for comfort.

There is little in terms of data out of the eurozone leaving the focus on the UK, where the Bank of England will be closely monitoring today's wage growth figures. BoE's Mann will speak today, Governor Bailey participates in a panel organised by the Bank of Italy. Market expectations for a first BoE rate cut have been relatively firm on August, with a 50% probability of a cut already in June.

Primary markets we will see 2Y (€4.5bn) and 6Y (up to €2.5bn) bond auctions from Germany and the Netherlands, respectively. Outside the eurozone the UK will sell £3.75bn in 10Y bonds. After Monday's new 3Y note the US treasury will reopen the 10Y note for US$39bn on Tuesday.

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