Rates Spark: Steadier, but big moves coming

A reasonable US 5yr auction further validates the Fed rate cut discount. Initiation of cuts will bring the 10yr rate down further. We identify more room for higher 10yr rates than lower on a one year horizon. In the eurozone, markets are pricing in a possibility of consecutive ECB cuts after September, but should also be careful not to get ahead of themselves

US rates steadish now, but some big moves anticipated ahead

Markets are pricing in a possibility of consecutive European Central Bank cuts after September, but should also be careful not to get ahead of themselves. German and Spanish CPIs tomorrow will prepare markets for the eurozone figures on Friday. An element of stability has broken out over the past few weeks in terms of the level of rates, although the 2/10yr spread has managed to stretch steeper (dis-inversion) on front end comfort with the Fed prognosis.

We sent out a note earlier on the direction of travel for longer rates against a reference where the Fed delivers on the current market discount for the funds rate. It's here. Essentially we are saying that the 10yr SOFR rate, now at 3.4%, is already overshooting to the downside. It can get as low as

3% as the rate cutting gets going. But there is little relative value sense to it breaking below 3%, as the Fed itself is not discounted to break below 3%.

If or when the 10yr gets to that type of level, we expect it to spark a journey back up to 4%. That journey should begin around the turn of the year, at the very latest.

Core inflation could constrain the European Central Bank

Little notable data coming in for the eurozone, but this was more than compensated with a heavy supply pipeline, including syndications from the EIB and Austria. Markets seemed to digest the issuance well, with yields ending the day lower across the curve.

Tomorrow Germany and Spain will publish CPI numbers for August, which will warm up markets for the eurozone figures on Friday. Headline figures are expected to come down to a consensus 2.2% for Germany and 2.5% for Spain, thereby looking good at face value. But in the end it will be the eurozone's core inflation that will decide about the ECB's room to cut and that number has resisted coming down.

As long as the eurozone's jobs market remains resilient and consequential wage growth strong, markets should be careful about extrapolating a cut in September to consecutive meetings. The front end of the curve can still go lower, but euro markets may need to be more patient than their USD counterparts. Having said that, a further steepening of the UST curve on the back of Fed cuts will pass through to the Bund curve.

Thursday's events and market view

Besides German and Spanish CPI numbers, we have confidence indices for the eurozone for August. The US will release the weekly initial jobless claims, which are expected to remain stable from the last reading.

Supply-wise we have Italy with a new 5Y BTP, 10Y BTP and 8Y CCTeu for a total of €9bn. The US will auction $44bn of new 7Y Notes.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.