Rates Spark: Coping with more reactive central banks

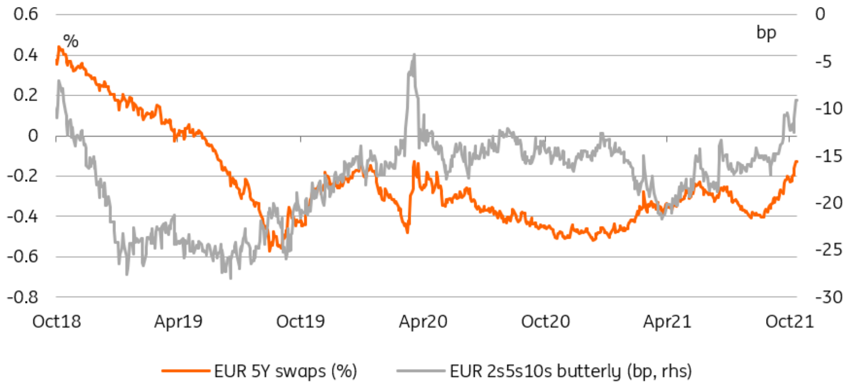
Rates markets yesterday broke with the patterns of recent days. Technical factors blur the picture, as the EU deal will have played a part in the EUR sell-off, and the US curve pivot may just be a squeeze ahead of 30Y supply. But we saw Fed speakers dispel any doubts of a November taper raised by the weaker jobs data while CPI will highlight inflation concerns.

Record-setting EU green deal weighs

The EUR rates complex sold off countering the moves of its US and UK counterparts. Fingers are easily pointed at the €12bn EU 15Y green bond deal, but it is at odds with the record demand that deal attracted with an order book north of €135bn.

That the sell-off was led by the belly of the curve may also hint at origins more related to central banks. The Eurozone saw the ECB's Villeroy bieng somewaht less dovish than usual, pointing out the likely end of PEPP after March next year. His view that some of the programme's flexibility should be maintained within the ECB's "virtual" toolbox appears to confirm earlier press reports that the ECB is mulling a new programme to replace the PEPP, but which would only be activated in emergencies and not actively buying by default. The upshot would be to allow for lower purchase volumes also by the APP that is still to exist for some time.

5Y is leading the rise in EUR rates

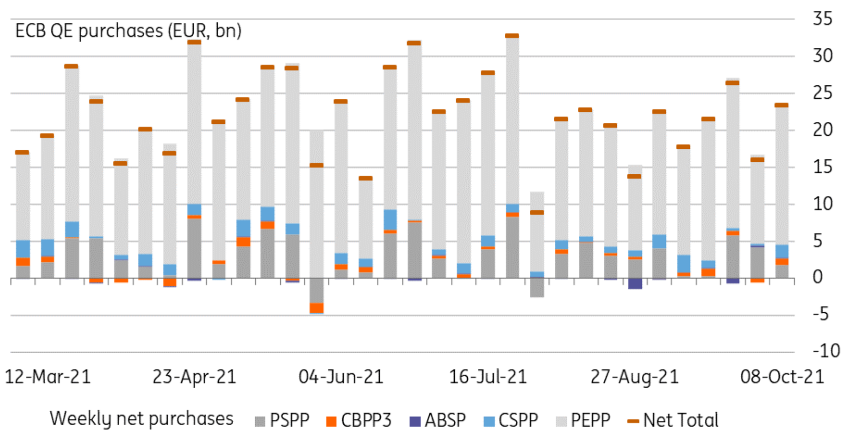


Source: Refinitiv, ING

The ECB continues to buy assets at a relatively high clip.

For now the ECB continues to buy assets at a relatively high clip. Last week's purchases of €23.7bn, €18.8bn net of redemptions were relatively high value for a single week. And it brings the average for the weeks since the ECB decided to moderately slow purchases in line with a monthly value of still above €70bn. Perhaps for the market perception it is more important what this value has not been able to achieve, that is prevent yield levels from rising significantly. We would point to a 10Y BTP/Bund spread still close to 100bp as the main prize, though the ECB may struggle to hold onto it eventually if it becomes clearer that the ECB's focus shifts away from asset purchases.

Last week's ECB buying was relatively high



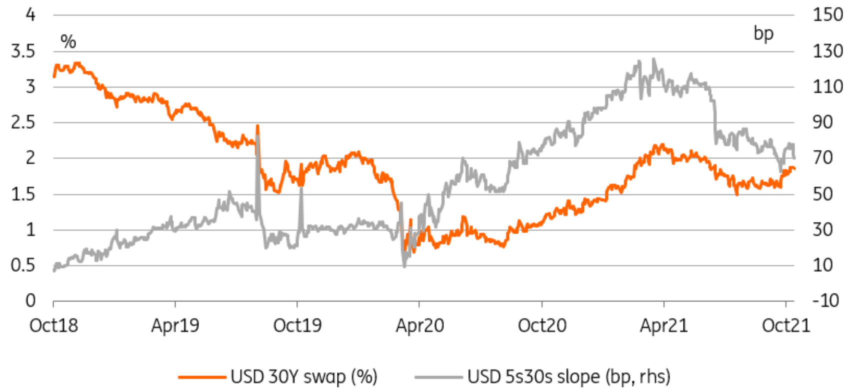
Source: ECB, ING

Unease or technicals?

US rates saw an agressive flattening pivot of the curve. While front end rates moved 2bp higher, the back end saw the 30Y rallying 7bp lower. On the eve of a 30Y auction that might hint at more technical factors at play like a market squeeze. Yesterday's 10Y auction saw strong demand.

What we also saw was a flurry of speakers signalling increasing determination despite last Friday's weaker labour data and all but confirming that the November taper announcement is a done deal. After today's CPI, which is seen to stay elevated and thus highlight the ongoing inflation concerns, there is admittedly very little that could possibly change minds bar any catastrophic turn of events.

The US curve is still figuring out which way it wants to go



Source: Refinitiv, ING

The November taper announcement is a done deal

The Fed's Clarida admitted there was a "flavour of stagflation" but this was unlikely to become a trend as inflation should still be largely transitory. Still, beginning tapering was soon warranted, but he also stressed that there was no automatism between taper and the timing of a first rate hike.The Fed's Bostic, though, labelled transitory a "dirty word" as inflationary effects turn out more lasting. He did not see the latest weaker job report derailing the taper from being announced next month.

Such comments may stir fears surrounding the economic outlook amid an overzealous Fed. However, if yesterday's aggressive flattening was a sudden sign of market concern, then this did find any adequate reflection in other (risk) markets.

Today’s events and market views

The key report today is the US September CPI. Our economists see a slight chance of at least the core inching higher. With market sentiment shifting clearly towards a more aggressive Fed and a taper announcement in November seen all but a done deal, we could at best see a small reaction in increasing front-end pricing of hikes.

Sentiment could be further vindicated by the FOMC minutes this evening, and one can hope to glean more hints around the shape of the taper. Also in the focus of US markets is the Treasury's sale of US$24bn in 30Y bonds.

The Eurozone sees 3Y, 7Y and 30Y taps from Italy as well as a 30Y tap from Germany. In data the focus is on August industrial production. Here shortages continue to bite and expectations are for another decline.

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