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# Rates Spark: CPI Wednesday a test for longs

US rates are running a tad scared ahead of Wednesday's CPI report. And it's a week of high duration supply to boot. We're still eyeing lower yields, but this week is pushing against that. Implied volatility of EUR rate markets suggests that near-term risks have fallen. Having said that, going into 2025 we see plenty of risks that can trigger strong rate moves



## US core CPI is a significant obstacle to negotiate on Wednesday

We remain minded to trade the market from the long side into the turn of the year. But we're also cognisant of two bearish factors. First, latest flows data from last week showed a material duration reduction and absolute selling of long dated securities by mutual funds. We suspect part of this is closing out ahead of year-end. It's actually been a decent year for total returns, in Govies and in Risk, and many players will move back to benchmark and/or into cash in the coming weeks.

Second, and front and centre, is Wednesday's US CPI inflation release. The thorn in the side of the

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inflation bulls has been the ongoing readings from core CPI – it's been running at 0.3% month-on-month and 3.3% year-on-year for the past few months, and the market expectation is for a repeat in the November reading. If this is confirmed, it's hard to get overly bullish on Treasuries, and in fact there is a material factor suggesting we've perhaps gone far enough to the downside for yields.

In any case, we continue to place a hard floor to the downside at 4% for both the 2yr and 10yr yields, and especially for the 10yr. Long dated supply this week (10's and 30's) is an additional hurdle to overcome.

# Near-term EUR rates volatility muted, but plenty of uncertainty further ahead

A 25bp cut by the European Central Bank on Thursday seems the likely outcome, followed by consecutive cuts going into 2025, with potentially a 50bp cut somewhere in the first quarter. And markets seem to agree with our view, pricing in 27bp of cuts for the upcoming meeting and another 30bp for the one thereafter. Implied volatility measures suggest that markets are also quite certain about this outlook in the near term. The MOVE index, which captures the priced in volatility over the coming months, has returned close to this year's lows.

The uncertainty on rates in the very near term has indeed fallen since last month, as growth data is gradually worsening, as expected, whilst inflation is progressively grinding lower. As such the ECB can continue easing at a steady pace for now. And since the US elections the uncertainty on US rates has come down significantly, as civil unrest was avoided and markets took a more wait-and-see approach regarding Trump's policies. These factors together have reduced the chance of large rate moves during the end of 2024 and the very beginning of 2025.

Instead, we think the uncertainty has moved more outwards in terms of timing. For one, the landing point of the ECB is still up for debate and markets are already pricing in a terminal rate below the estimated 2% neutral rate. Since the ending point is also a key driver of the back-end currently, this will add to volatility further out on the curve. Secondly, a lot of the (geo)political risks currently have not materialised into something tangible for markets to price in, but this could well change. Lastly, Trump's impact will take time to ramp up and it may take until the second half of 2025 before US rates really start moving upwards towards our projected 5-5.5% range, thereby pulling up the back-end of the EUR curve too.

## Tuesday's events and market view

A relatively quiet day in terms of events, with industrial production from Italy the highlight in the eurozone. From the US we have a small business survey, productivity and unit labour costs numbers. But all are considered second tier and are unlikely to move markets.

In terms of issuance we have Austria auctioning 9y and 29y RAGBs for a total of €1.15bn. The UK will issue a 9y Gilt linker for £1.5bn. Lastly, the US has scheduled a new 3y Note for \$58bn.

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