

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

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.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@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.