Rates Spark: Dis-inversion in vogue

If the Fed has peaked, then long tenor market rates would typically be falling – but they aren't, and we continue to point to the reduction in the rate cut discount as the rationale. Medium-term supply pressure pushes in the same direction. And so too do other lower-yielding core rates as they get pulled higher by the made in America bond bear market

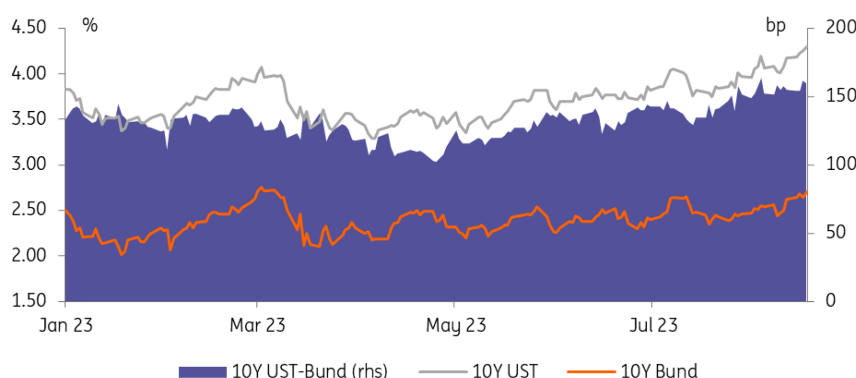
Dis-inversion set to continue as long tenors rates push on some more

The dis-inversion of curves is an interesting outcome from the market rates movements of late. Longer tenor rates have been rising while shorter tenor rates have not being doing a lot. This is unusual at this stage of the cycle. Typically if the market sniffs a peak in official rates, then longer tenors rate tend to drift lower in anticipation of future cuts in official rates. Here, it seems the market is fine with the peak in rates narrative, as there has been no material build in the risk for a Fed hike in September, and so far the market is erring on the side of no more hikes. But the big change has been the discount for less rate cuts. This discount has continued to build in terms of fewer and fewer future rate cuts, and that continues to correlate with upward pressure on longer tenor rates.

We continue to view this dampening of the rate cut discount as the dominant driving force to higher Treasury yields, ultimately reflecting US macro robustness.

The other ongoing feature is future supply of Treasuries. Bear in mind that the congressional budgetary office has the US debt/GDP ratio hitting 200% by 2050 on unchanged policies. That paints a picture of ongoing elevated fiscal deficits (currently in the 5% of GDP area or higher) and that typically would correlate with market rates being forced higher, all other things being equal. While that alone does not explain why the US 10yr snapped up to 4.3%, it is certainly a force that continues to push very much in the same direction.

USTs are leading the sell-off with spreads over Bunds widening



Source: Refinitiv, ING

It's also clear that the recent up-move in Treasury yields has been made in America. The Treasury – Bund spread has widened, illustrating that Treasuries are pulling Bund yields higher. The same holds true for the Treasury spread to Japanese Government Bonds (JGBs), supporting our view that the rise of the cap on 10yr JGBs was an ancillary development and not a driving force behind the up-move in Treasury yields – especially as spreads between Treasuries and JGBs have been re-widening of late.

Today's events and market view

We may see some interim consolidation given that today's calendar does not hold data prone to further feeding the main narrative currently driving the market. The only notable release following this morning's UK retail sales is the final eurozone inflation reading for July.

Looking into next week, however, the eurozone flash PMIs could further highlight the contrasting macro backdrops between the US and the eurozone. Only late next week will the focus shift back to Federal Reserve monetary policy, with the Jackson Hole conference starting on 24 August.

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