Rates Spark: Don’t dismiss the remaining yield upside just yet

The US borrowing estimate and the BoJ were not the drivers of another leg higher in rates as many had feared. While it's unlikely to be the end of the supply story and we still await the quarterly refunding announcement, markets will also focus on the data and the Fed meeting again. After all, economic resilience was the other factor of higher rates

The long end took its cues from lower US borrowing and more cautious tweaks from the BoJ

Long-end rates took their cues for yesterday’s trading from the somewhat lower-than-expected US Treasury borrowing estimate as well as the Bank of Japan (BoJ) decision to only slightly adjust its yield curve control policy. In essence, two of the factors that many, including us, had seen as potential drivers of a renewed attempt at taking on the 5% threshold in 10Y UST yields proved to be duds. The UST curve kicked off with a bull flatteneing which also spilled over into other rates markets.

However, especially with a view on supply it is unlikely to be the end of the story. Markets are still awaiting the quarterly refunding announcement and the maturity split of the upcoming issuance today. Some had flagged the possibility of a more cautious approach focusing any increase on shorter-dated issues. But following the lower borrowing requirement, the US Treasury might feel less pressed on this topic. More importantly, the overarching concerns surrounding the medium- to long-term trajectory of the US deficit have not been addressed.

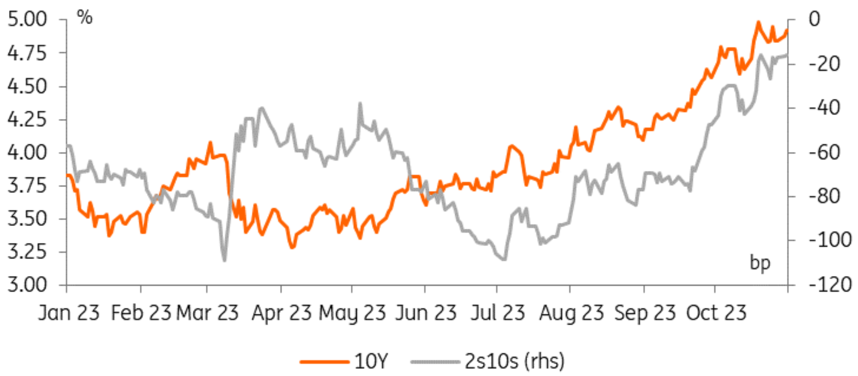
US economic resilience remains an important factor in keeping rates elevated as well

Yesterday's quarterly employment cost index rising to 1.1% should also remind us that the other important driver of higher long-end rates was the resilience of the economy and the job market in particular. It was in fact the faster wage growth figure managed to turn around the bullish dynamic yesterday and point yields higher again.

The Federal Reserve has guided markets to firmly expect a hold at tonight's FOMC meeting despite the more benign inflation backdrop, third-quarter GDP growth coming in hot, the jobs market remaining tight and inflation remaining well above the 2% target. But it has done so by pointing out that the higher long-end rates are now doing part of its job.

That said, European rates markets were confronted with a more dovish data set as the eurozone flash CPI slipped below 3% and 3Q GDP growth came in with a negative sign. Yesterday's bull flattening was probably still more inspired by the overall direction given US and Asian events rather than the domestic data. That said, European Central Bank (ECB) officials are still attempting to anchor front-end rates by emphasising the outlook of keeping rates high for longer.

The US yield increase is stalling, but curves remain steeper



Source: Refinitiv, ING

Today's events and market view

The BoJ and US borrowing announcements have proved more benign for rates than anticipated with the 10Y UST yield dropping towards 4.8% before moves were reversed in month-end flows. Especially on the supply side, it is unlikely to be the end of the story with the refunding announcement coming today. But economic resilience should also not be dismissed as a potential driver of another leg higher in rates.

To that end, we will get the ADP payrolls estimate today ahead of the key jobs data on Friday. Also on today's agenda are JOLTs jobs opening numbers as well as the ISM manufacturing. The key event for the day is the FOMC meeting tonight, although a hold has been well-flagged. The Fed is still likely to keep its bias for further tightening in place.

All Saints Day is observed in large parts of Europe.

In today's government bond primary markets, Germany will tap its 7Y bond for €3bn.

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