Rates Spark: Flat bear

The beat in US CPI puts curves back into a bear-flattening regime. It is tempting to call for peak hawkishness but next week could see a more upbeat Fed. Euro bonds face a lot of supply, and eye the Commission's energy plans nervously

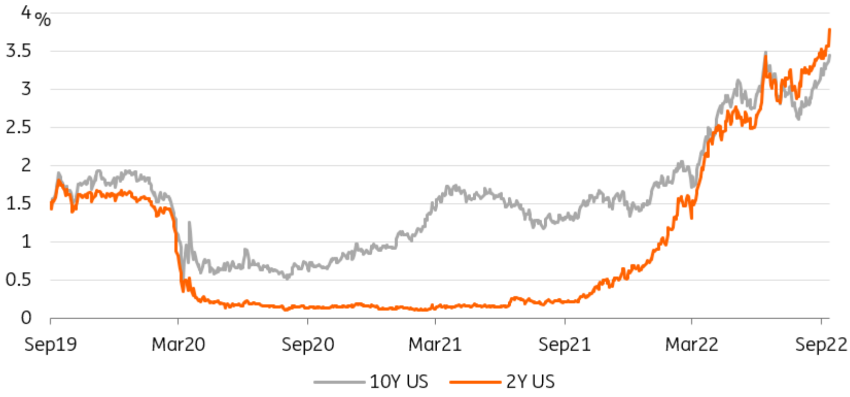
Peak hawkishness in the US? Not quite

US inflation is not coming down in a hurry and, despite some encouraging signs elsewhere, it has given hawkish price action in rates globally another lease of life. This means flatter curves, and higher yields. 10Y Treasuries are now within touching distance of their 3.47% June peak and we do not see much that would stop it from beating that level. In fact we've laid out a path towards 3.75%, while still seeing a peak in the 3.5% to 3.75% range. Given the magnitude of the CPI surprise, we think markets would only react to a re-acceleration in PPI (consensus is for a deceleration) today, and ignore an outcome with less hawkish implications.

> *The recent strong run of US economic data could result in upgraded Fed forecasts*

The next event is next week's Fed meeting. Barring a well-informed press leak ahead of the meeting saying the opposite, a 75bp hike will remain our, and the market's, favoured outcome. Of course, with now a 20% chance of a 100bp hike at the September meeting now priced in, it is tempting to call this peak hawkishness and to favour curve steepeners. There are still hawkish risks at next week's meeting however, even if one discounts a 100bp hike. For instance, the recent strong run of US economic data could result in upgraded Fed forecasts, and lend additional weight to the Fed's hawkish tone.

Bye bye flatteners, US CPI has inverted the US curve further



Source: Refinitiv, ING

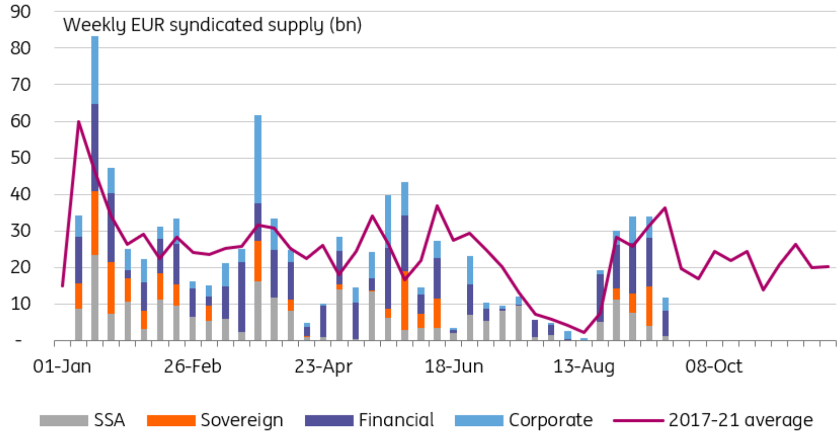
A difficult backdrop for EUR bonds, but look to the Commission for support

Of course this resonates with other markets. EUR bonds are still licking their wounds after the European Central Bank (ECB) signalled a new hawkish reaction function, and GBP bonds are looking nervously to a Bank of England (BoE) meeting next week where a 75bp hike is also quickly becoming the market's preferred outcome. All this is not an environment particularly conducive of bond performance, especially with primary market deals coming thick and fast. Despite difficult market conditions, the past four weeks have seen greater primary market activity than the average of the previous five years.

> *This is not an environment particularly conducive of bond performance*

The main event of the day is the European Commission unveiling its energy support plan. Gas futures jumped yesterday afternoon but are still down significantly this month. For bond markets, the outline of the plan that appeared over the past few days could be the perfect combination of demand destruction (mandated consumption cuts), not aggressive enough action that it could materially change Europe's economic trajectory (for instance via redistribution towards energy consumers), or that it would in itself cause a further cut in supplies by setting an import price cap, and reform of energy markets to avoid short squeezes.

Despite difficult market conditions, EUR syndicated supply is above its 5Y average in August/September



Source: Bond Radar, ING

Today's events and market view

Eurozone industrial product is the main item of note in this morning's economic calendar.

The European Commission will unveil its energy support plan this morning. Energy priced bounced yesterday afternoon but are still significantly down on the month. A continued fall would cap EUR rates upside although momentum is currently in favour of bond sellers.

Debt sales will be from Germany (in the long-end) and Portugal (5Y and 10Y). Belgium also mandated banks for the launch of a new 17Y green bond which we expect to price today. In illiquid market conditions we find that the greenium has been shrinking for sovereign bonds.

Hot on the heels of yesterday's US CPI report, the most salient piece of economic data to be released today is PPI. After the CPI beat, we doubt that a drop in PPI would be cheered as a dovish signal. The other less exciting release is MBA mortgage application.

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