

Rates Spark: Flatter Bund curve should ECB fail to deliver

ECB cuts for October and December are fully priced in, yet ECB speakers appear to be pushing back against such firm positioning. If the ECB holds next week's meeting against all expectations, we could see some flattening of the Bund curve as policy mistake risk increases. The FOMC meeting notes showed support a 25bp cut in September



The ECB building in Frankfurt

Markets holding firm position on October ECB cut

With the ECB blackout period starting, members of the Governing Council had one last chance to dissuade markets from a cut next week and push back against the 24bp priced in by markets. Kazimir was especially critical about the expectation of a done deal and Wunsch was not yet convinced of an October cut. But markets held their position and even for December another cut remains fully priced in. Whilst October and December cuts are the most likely outcome in our view, we do warrant against excluding a hold scenario entirely.

That begs the question of whether the ECB can deviate from market pricing and what such a bold move would mean for euro rates in general. Forwards are now expecting four back-to-back cuts of 25bp, and thus skipping the October cut could be a bit of a blow to that conviction. On the front end, that would translate to higher rates as the ECB turns out more hawkish than interpreted and

seemingly focused more on inflation. Interestingly we'll receive the minutes from September's meeting on Thursday which may shed some light on the balance between perceived inflation and growth risks.

In contrast, not cutting would probably lead to backend yields coming down as the risk of a policy error increases by being behind the curve. Growth concerns would mount and markets would return to the view that the ECB might have to cut below the neutral range of 2-2.25%. In effect, this could result in more rate cuts priced in, just moved further back in time and likely only reaching a low towards the end of 2025. Altogether the curve would flatten.

FOMC meeting notes showed support for 25bp cut in September

Wednesday's FOMC minutes pointed to a more divided Fed than the sole dissent to the 50bp cut decision had suggested. While in the end most supported the decision, some had preferred a smaller cut, which others said they would also have supported.

The market's pricing for the Fed's terminal rate, which should implicitly also provide a floor to rates further out, has in the meantime risen to 3.4%. The 2Y US Treasury yield has topped 4%, albeit just barely and we do not think it should move much higher from here. Rather the path should still be gradually lower as upcoming rate cuts draw closer. The 10Y still faces more persistent upside pressure in our view, having risen to 4.07%.

Thursday's events and market views

The key data release comes out of the US with the CPI data for September. The headline is expected to slow to 2.3% YoY and the core rate to stay at 3.2%. More relevant again is the monthly core rate that is seen reverting to 0.2%, which is needed to keep the annual rate tracking towards the 2% target. As such, the data should leave all options for the Fed on the table, even if the debate in the market seems to have shifted to whether even 25bp is necessary at all.

Unless there is a big (upside) surprise on the CPI data, the initial jobless claims data might be more market-moving in the wake of the payrolls data. It is a more contemporary indicator of job market health and the consensus sees the weekly figure ticking up only slightly.

The only noteworthy release out of the eurozone is the ECB minutes of the September meeting when the ECB cut a second time by 25bp.

Germany will be in the primary market auctioning two bonds in the 15Y maturity area for a combined €1.5bn. The US Treasury auctions are probably more closely followed after the weaker 3Y and 10Y sale earlier this week. Thursday the Treasury will sell 30Y bonds for US\$22bn.

Author

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@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.