Rates Spark: Flying blind

US markets turned slightly bullish into quarter-end – and the government shutdown. As a result, key directional cues from official data around jobs and prices will be delayed. Eurozone preliminary inflation data is unlikely to provide markets with more clarity on the direction of travel

The US shutdown means that the usual directional cues from official data will be delayed

EUR rates will watch the preliminary inflation data on Wednesday. Much of the available country data has pointed in the direction of slightly hotter inflation, especially in Germany, where our economist pointed out that the inflation data should not distract from other indicators highlighting the economic challenges ahead.

For now, EUR rates have not shown any intention of changing their European Central Bank rate outlook, which reflects a moderate probability of one more rate cut. Longer rates, such as the 10y Bund, seem to be more caught up in the slowly shifting sentiment spilling over from the US over the past days. The 10y Bund yield was dragged modestly lower towards 2.70%, while the 10y UST yield traced back from a recent peak close to 4.2% down to as low as 4.12% as we headed into the end of the month and quarter – and of course, a US government shutdown.

Usually, the economic impact of a shutdown is largely a temporary one, and we have historically tended to see a catch-up in activity once the government reopens. The severity of the impact will depend on the length of the shutdown, and to be fair, the political landscape this time around hints at a somewhat longer one. A shutdown now also falls into an economically more sensitive backdrop, and is aggravated by threats of more permanent layoffs to the government workforce.

For now, the market moves do not indicate a sea-change, but the prospect of flying blind when the government shutdown delays key data releases, especially around the jobs market this week and next week around prices, can instil some caution into the market. Markets will have to take their direction from private sector data, such as the ADP private payrolls data. On the bright side, we are spared the notorious volatility of the official payrolls data, where data quality has come into question lately. The Fed itself will continue to do its work, but will also have to rely more on its own sources for insights, such as its Beige Book.

In all, our economist thinks we have enough reason to continue cutting rates in October and December this year. The latest set of data over the past few days – the JOLTs job opening numbers and consumer confidence – came with a dovish tinge.

Wednesday's events and market view

The key event for EUR rates is the release of the preliminary inflation readings for September. Consensus expects the headline rate to inch higher to 2.2% year-on-year, while the core rate remains unchanged at 2.3%. There will also be several ECB speakers, including Kazimir, Kocher, Simkus, de Guindos and Nagel.

In the US, the market will be looking out for the ISM manufacturing and the ADP payrolls numbers. For the former, markets are envisaging a small improvement within the sub-50 territory. The private payrolls number is expected to come in at 51k versus 54k last month. The ISM's employment components and the ADP may well be the only job market indicators to work with for a while. The Fed's Logan and Barkin are scheduled to speak.

In primary markets, Germany is auctioning €5bn in 10y Bunds while the UK sells £1.6bn in 10y gilt linkers.

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