Rates Spark: Front-end EUR curve detaching from US dynamics

Market reaction to the US CPI and jobless claims data showed that in the end, growth concerns outweigh inflation. ECB rate cut expectations remain sticky, and the long end may drive the EUR curve alongside global dynamics for now

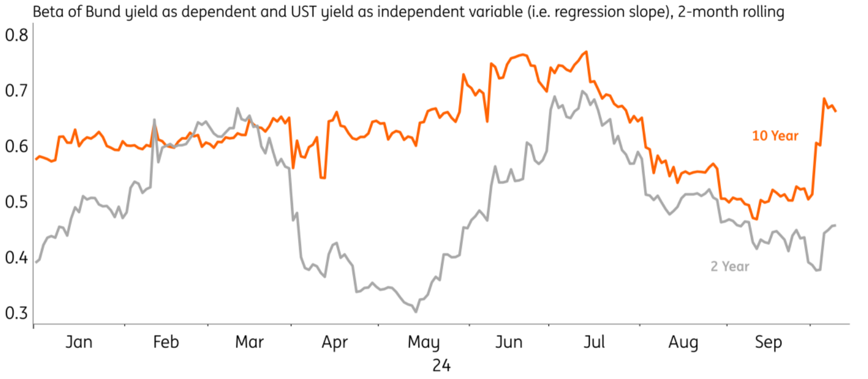
Sensitivity of 2Y Bund to UST yield has declined significantly

The US data releases set the tone for markets on Thursday and whilst risk assets clearly suffered from such numbers, the impact on rates was more ambiguous. Overall, the front end of both the USD and EUR curves nudged lower on the day, which really highlights the current environment where growth dynamics get more attention than inflation. Of course, a third hot CPI number could challenge that view, but for the time being markets have their eyes on labour dynamics.

Earlier this year, surprises in US data had a significant impact on the entire EUR curve. Now, however, those dynamics appear to be more detached. The rate cut expectations for the European Central Bank have remained in place, with two 25bp cuts still intact for this year. In the figure below one can see that the sensitivity of 2Y Bund yields to UST yields has fallen significantly compared to the summer period. In recent weeks, the front end of the EUR curve has settled on a gradual easing path from the ECB and we don't think US data can easily pull markets away from this view.

The back end of the EUR curve remains more sensitive to US and global dynamics and over the past two months returned to the sensitivity levels from earlier this year. Here, risk sentiment plays an important role. With US elections, Middle East tensions and Chinese growth concerns all looming, this will be unlikely to go away for the time being. In effect, this means that we could see more episodes of bull flattening on global risk-off events as the front end is already positioned for back-to-back rate cuts and has little room to go lower.

Front end of Bund curve less sensitive to UST curve



Source: ING, Macrobond

Today's events and market view

The US remains the main focus in terms of data flow. After the somewhat hotter CPI, Friday's PPI data will deliver more insight into the price components to nail down economists' forecast for the September PCE deflator. This will then be released at the end of the month. The University of Michigan consumer sentiment index will be closely followed for any hints that the consumer is already sensing a cooling jobs market. For now, the consensus is looking for a subtle improvement, but unlike the Conference Board's measure, today's index is somewhat more impacted by inflation dynamics.

There are no notable eurozone data releases over the day, but after markets close, all eyes are on Fitch which is scheduled to review its rating for France, currently at A-/Stable and last confirmed in April this year. Just yesterday the government presented its 2025 budget plan in more detail which will be discussed in parliament starting next week.

In primary markets, Italy will tap bonds from 3y out to 30y maturities for a total of up to €9.5bn.

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