Rates Spark: High expectations for consensus US CPI reading

A consensus 0.2% month-on-month US core CPI today would support a Federal Reserve rate cut in September and help restore market sentiment further. Should the number turn out higher be prepared for another risk-off episode, although this time bonds may not provide a safe haven

Upside US CPI surprise would be bad for risk sentiment

Markets are hoping today's US core CPI number for July will come in at 0.2%, which would strengthen the confidence that the Fed can move forward with a first rate cut in September. The past two CPI readings were jittery and thus some predictability will be welcomed by markets. If economists are right, then the chance of a 0.2% reading is very high, as Bloomberg shows only very few predicting 0.1% or 0.3%.

Having said that, a 0.2% MoM core CPI number won't change much to the pricing of the near-term rate cuts that we currently see. A total of 102bp is now priced in for the remainder of 2024, and a consensus reading would be nicely consistent with that amount of cuts, in our view. An upward surprise would be the most worrisome outcome, as this would put the Fed in a very awkward position. Hot inflation with a slowing economy could trigger another risk-off event and a flight to safety. In this case, however, bonds are not likely to be on the winning end.

Steeper curves on restoring risk sentiment

For the US Treasury curve, we continue to see lower overall rates if the 0.2% MoM core CPI materialises. A restoration of market sentiment after the turmoil earlier may offset some of the decline on the backend of the curve and thus the steepening would be led by the front end. A steepener can also be expected for the Bund curve, which still has lower long-end yields on the back given a risk premium. Relatively heavy issuance from France and Germany today will weigh on the back end too.

The core PCE deflator for July is still two weeks out, but yesterday's PPI numbers were reassuring that another 0.2% MoM reading is in reach. This means that the stars are aligning for the Fed to start cutting rates. As growth is starting to show signs of weakness, also in the eurozone as marked by disappointing ZEW survey data yesterday, the case for Fed cuts is clear. Looking further ahead we still think the curve can steepen more from the front end as the first cuts start materialising.

Today's events and market views

Besides US CPI numbers, we have the second estimate of eurozone GDP growth for the second quarter and industrial production figures. From the US, we also have MBA mortgage applications. UK inflation numbers this morning should be welcomed by Gilts, as the sticky services component surprised to the downside at 5.2% year-on-year versus the consensus of 5.5%.

In terms of issuance, we have France with a total of €9bn OATs (3Y, 5Y, 6Y and 7Y) in addition to €2bn of OATeis (5Y, 12Y, 29Y). Germany has 26Y and 30Y Bunds lined up for €2bn.

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