Rates Spark: Determining how much is in the price

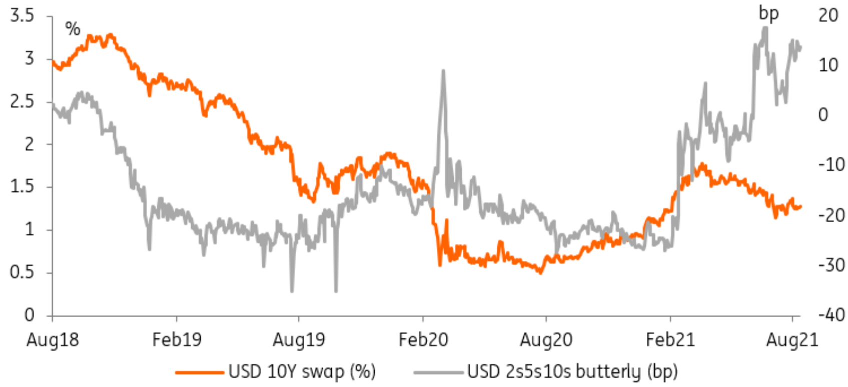
A softening of sentiment indicators comes as rates already sit close to the bottom of their recent range. Positioning might push them lower still but EUR rates, in particular, are already consistent with more central bank support next year. The belly of the US curve trades cheap, and it feels like it wants to at least have a nudge higher in the days ahead

Source: Shutterstock

Sniffing some upside potential for market rates

It's not been easy in recent months to point to macro releases and use them to position for higher market rates. But at the same time, it feels like the momentum for falls in market rates has abated somewhat. The narrative of Delta-impacted data is out there but beyond that, there is the realisation that within the next few months the vast majority of populations in developed markets (especially the US and Europe) will either have been vaccinated or will have contracted Delta. Either way, we will approach herd immunity.

5Y cheapness relative to the wings suggests residual momentum for higher rates



Source: Refinitiv, ING

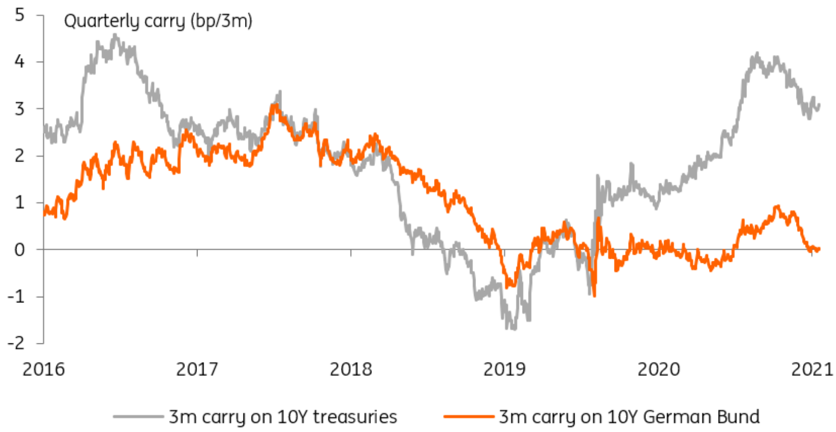
> *There is risk-on tone out there, and taper talk is in the air*

How the bond market treats this will be interesting. There is a risk-on tone out there, and taper talk is in the air. There is enough there, together with more balanced positioning, for market rates to start testing higher levels. It may be tentative, but it looks like the latest path of path resistance. The 5yr is cheap on the US curve, which also provides a moderate bearish signal. We are still easing into a big weekend, and we'll know far more by Monday, but that's the direction unless 'events' intervene.

More downbeat news but rates have already reacted

The Richmond Fed activity index was the latest soft economics indicator to suggest that the drop in rates over the summer months has more of a fundamental basis than thought at the time. A turn for the worse in economic indicators, not yet visible in hard data It should be noted, begs the question of how much is already in the price? We’ve argued at length that stop losses on reflation trades were in large part to blame for the drop in rates this summer. This should leave positioning more balanced but perhaps not yet consistent with what investors would prefer should growth deteriorate.

Bund yield downside is limited by its already paltry carry



Source: Refinitiv, ING

Voaluations are already consistent with a slower economics path

---

EUR rates have been bouncing off the bottom of their range, roughly around -0.5% for 10Y Bund, the level below which carry for leveraged longs turns negative. Here too, one can reasonably ask how low can rates drop if valuations are already consistent with a slower economic path and with continued asset purchases at a faster speed than at the start of 202? We judge that investors are increasingly coming around to our view that 2022 will see a rebalancing between the ECB's two QE portfolios rather than a sharp reduction in purchases. This is important. What a more downbeat outlook would achieve in our view is cap the upside from EUR rates from here but not necessarily extend downside.

Today's events and market views

Germany's IFO and the all-important expectations component are the highlights of today's session. After the drop in the German PMI manufacturing on Monday, we think market expectations are for a drop in the IFO which is understated by the Bloomberg consensus. This means a lower propensity for rates to fall on a disappointing print. More broadly, a drop in the index would validate market fears of a spillover from supply chain disruptions into European economies.

ECB VP Luis De Guindos is due to speak. The expectations management period ahead of the September 9th meeting lasts realistically until next Wednesday so comments will be closely watched. This being said, we expect policy signals to be given by the likes of Isabel Schnabel and Philip Lane.

Durable goods orders are the main US economics release of the day.

The US Treasury carries out its second auction today, focusing on the 5Y sector.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com