Rates Spark: Inflation blinkers on

The FOMC minutes seem to be from a different time, pre the payrolls revisions; but can still embolden Powell on Friday. Gilt yields came down on the day of hotter CPI numbers suggesting a possible peak. Having said that, with Autumn Budget discussions kicking off, volatility is likely to remain. Meanwhile, the path for the 10y euro swap rate is still up

The minutes from the Fed meeting on 30 July do not indicate a rate cut is coming. We expect Fed Chair to be balanced-to-hawkish at his speech on Friday at the Jackson Hole Symposium

FOMC minutes and the 20yr US auction

The Fed minutes from the 30 July meeting don't in general sound like the type of minutes that are setting us up for a rate cut. There is acknowledgement of a slowing tendency in the economy, but also identification of resilience. And there is a clear message that tariffs will result in higher inflation. The minutes also point to strong equity markets, steady to tighter credit spreads and decent availability of credit.

Granted these minutes come after the infamous July employment report; the FOMC was looking at more robust employment numbers than we have now, as revised. Still, when Chair Powell speaks on Friday, he's likely to echo much of this prior sentiment. So, don't expect Powell to be outright dovish on Friday. He's more likely to be balanced-to-hawkish. Remember, he does not have to decide till 17 September on the rate decision. Nothing to lose by keeping his options open and his

prior biases alive until negated by events. We'll get another payrolls and inflation run ahead of the next FOMC. He'll stick to his guns till he sees those.

Market yields were up across the curve on the back of these minutes - makes sense. There is also a nod to bank reserves, which can fall as the Treasury rebuilds its cash balance. But the Fed notes the standing repo facility and ability to increase reserves as fixes should they be needed (we'd agree that this is the best way to look at this).

The 20yr auction was also safely away on Wednesday, but was not great. No tail, and in that sense tidy. But there was a cheapening into the auction, which helped avoid a tail, and even with that, it just came very slightly through secondary. The indirect bid was lower than last time and dealers had to take down more than last time. But at least the run of three tailed auctions has come to an end, and we move on.

Overall we remain stuck in the 4.3% area for the 10yr and 3.75% for the 2yr, and tending to edge above and below these levels. We could be doing this all the way through to Powell on Friday.

High gilt yields make for an attractive case if you can bear the bumps ahead

Gilts gaining on the day of a hotter CPI number suggest that maybe gilt yields are now at an attractive entry point for investors. Having said that, investors would need to have enough risk appetite to get through a volatile phase as we get closer to the Autumn Budget. Political appetite for further spending cuts is extremely limited, while the Treasury has continued to rule out lifting any of the major taxes. Meanwhile, we have a decision about the pace of quantitative tightening coming up and markets already expect quite a slowdown with potentially a shortening of the maturities for sale. Also here, the risk for disappointments is non-negligible. Looking further ahead though, the jobs market remains a major risk - and one that received little discussion at the Bank of England's August meeting. That suggests the BoE has more cuts to go than markets are expecting, which make for a dovish case in the medium term.

Perhaps the most attractive way of looking at 10Y gilts is relative to USTs, between which we now have a material spread of around 40bp. In our view the upside risk to UST yields is significantly higher as inflation is on the rise, the fiscal deficit is not being addressed and the central bank's independence is under fire, all exposing the back end of the curve. Unless we have US recession risks rising (for now unlikely), the spread between 10Y gilts and USTs should narrow in our view. Having said that, the correlation between the two remains strong and thus for 10y gilts to come down more meaningfully, US rates may have to lead the way.

No PMI surprise leaves path to higher EUR rates alive

The gradual drift higher over the past months of longer EUR rates has been underpinned by a more constructive macro outlook with trade agreements adding to the sense of stability. Markets are no longer fully pricing another rate cut by the European Central Bank, seeing it as a coin toss by the end of the year. Unless there is a bigger downside surprise in the PMIs on Thursday that picture of a stabilising outlook should hold up and the prospects of a large fiscal impulse out of Germany should argue for a continued drift higher in longer rates with the front end seeing little reason to budge.

Thursday's events and market view

The main data are the eurozone PMIs, which the market expects to be slightly softer. The bloc's services PMI is seen holding up just above the 50 threshold, while the manufacturing index remains just below.

The US also sees the release of the PMIs, but they usually grab less headlines than their ISM counterparts. It is likely that the weekly jobless claims data will be more influential if for instance there were to be a resumption of increasing continuing claims figures. Other data include existing home sales and the Philadelphia Fed business indicator.

France auctions short- to medium-term as well as inflation linked bonds for a total of up to €11.75bn.

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