Rates Spark: Inflation unlikely to beat geopolitics

All eyes are on the US CPI data today and how it fits in with the Fed's recent change of tone regarding the need for further hikes and the change of mood in long-end rates. Geopolitical unease appears to persist even if the situation seems contained, meaning the front end could be more sensitive to hotter CPI data. A further reflattening would be the consequence

Inflation not a one-way road ECB consumer expectations survey shows

Inflation dynamics have been easing in the eurozone even if overall levels are still uncomfortably high. The latest flash estimate for September showed core CPI dropping to 4.5%.

But it is not necessarily a one-way road. Yesterday, both the one-year and three-year inflation expectations out of the European Central Bank's own Consumer Expectations Survey saw small increases. We have to keep in mind that this survey is for August, but it does cover the first leg of the rise in oil prices in the past months – and this may be showing some impact.

ECB officials like Vice President Luis de Guindos have confirmed that the ECB is keeping an eye on oil prices as they pose a risk to reaching the central bank's inflation target in a timely manner. That said, the risk premia in oil from the situation in Israel faded yesterday, though we still saw the EUR 2s10s curve twist flattening by 9bp with the front end up by 4bp, while the back end was still lower, reflecting more of what US rates are doing.

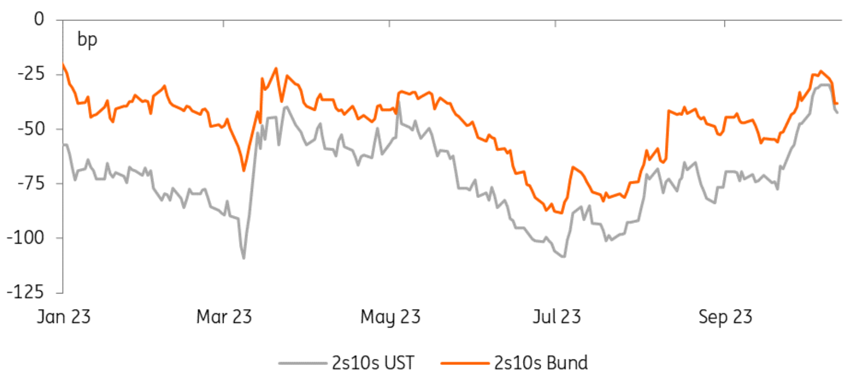
US long-end mood has changed, CPI may impact front end more

Even if the situation in the Middle East seems to be contained for now, the mood music for long-end rates seems to have changed and reflects ongoing unease. A 5% level for the 10-year seems to be off the table for now.

Of course, we have had the Fed signalling less inclination to hike further, which pushed in the same direction. The US CPI data will probably still have some more say today but the question is whether a slightly hotter CPI print can change the mood, also for the back end. It could lay the groundwork for yields testing higher eventually, but we saw that the reaction to the higher PPI yesterday, which also flagged some upside risk to today's CPI reading, was temporary. The more lasting effect was also confined to the front end. Two-year rates were a tad higher again, but 10-year US Treasurys held on to the gains of the previous overnight session with yields dipping back to 4.55%.

This is interesting as it means the long end is braving supply headwinds while the 10-year UST tap yesterday actually saw lacklustre demand. We also have a 30-year auction lined up for later today.

Curves re-flattened driven from both ends



Source: Refinitiv, ING

Today's events and market view

All eyes are on the US CPI data today and how this fits in with the Fed's recent change of tone regarding the need for further hikes. The consensus for the CPI is for 0.3% month-on-month, both for the headline and core rates, which should support a year-on-year decline in the headline to 3.6% and in the core to 4.1%. The PPI data yesterday flagged some upside risk to the release. Yet given the changed mood in long-end rates amid geopolitical tensions, the front end could be more impacted. The other data point to watch is the weekly jobless claims, which should again showcase the resilience of the labour market. In the past, markets had been more sensitive to these releases.

In the eurozone, the main focus will be on the busy slate of ECB speakers including François Villeroy, Klaas Knot and Robert Holzmann. The ECB will also release the minutes of the September meeting when the key rates were raised by 25bp.

On the supply side, we will see Italy coming to the market with 3-year, 7-year and 20-year bond taps, as well as a tap of its 12-year green bond – overall for up to €8bn. The US Treasury will tap its 30-year bond for US$20bn.

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