

Rates Spark: Kicking off with new highs

The week has started with new yield highs for the cycle, with 10Y USTs having topped 4.34%. The bearish set-up with a waning Fed cut discount prevails, and with the 20Y Treasury sale and the Jackson Hole symposium looming large later this week, the appetite to take the other side is small



The Federal Reserve's Jackson Hole symposium later this week looms large for markets

The bearish set-up for rates persist

The week has kicked off with rates selling off again. The 10Y UST yield has in fact hit a new cycle high of 4.35%, surpassing the previous peak seen last October. One now has to look back to November 2007 to find yields at similar levels.

It is not clear where the impulse came from this time around. There were no data releases of note, although risk assets had stabilised somewhat. There is of course the anticipation of the Jackson Hole symposium, which may be the reason for market participants' reluctance to take the opposite side of the trade. The general consensus appears to be for a slightly hawkish leaning tone from the Fed Chair, not necessarily with regards to where the terminal rate should be, but with a pushback against the discount of rate cuts further out.

We have cautioned for some time now that the waning discount of Fed cuts with the Fed funds strip pricing a trough not materially below 4% would even support 10Y UST yields at 4.5%

accounting for a term premium.

Looking to Europe, we note that Bunds also sold off, but the 10Y Bund yield has not managed to rise beyond last week's highs, holding around 2.7%. The expectations of weaker flash PMIs tomorrow may provide some tailwind to Bunds. However, we did see the 30Y push to new cycle highs at 2.8%.

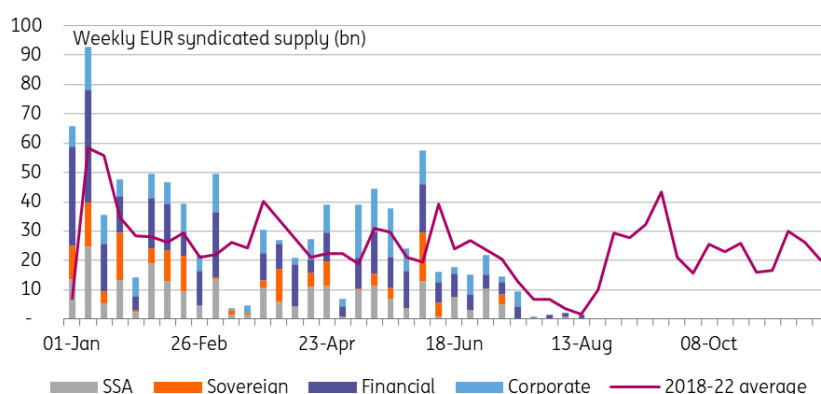
With the macro outlook bleak, the eurozone narrative for higher rates is still more centred around inflation risks. Energy, and in particular gas prices, remain volatile. And more generally the German Bundesbank yesterday warned in its monthly bulletin that inflation could stay above target for longer. The Bundesbank presented a survey that showed the European Central Bank's 2% target has gradually lost relevance in wage negotiations, and highlighted the risk of higher inflation expectations becoming entrenched.

Supply is coming to the fore again

Usually, the impact of individual primary market actions on valuations is fleeting. At least if they are not accompanied by expectations shifting towards materially higher issuance volumes in general. The latter seems to have played a part in the US Treasury sell-off where in particular the last 30Y auction has left a bitter aftertaste. This week the US Treasury will sell a new 20Y bond tomorrow and tap a 30Y inflation-linked bond on Thursday.

In the eurozone, weekly government bond auction volumes are likely to see their trough this week. In the wider market, the trough may even be behind us already, at least judging by issuance patterns of the past years and the new bond deals that are already lining up. In government bonds, it is Finland that usually ends the summer issuance lull with the launch of a new bond in the final week of August. This time it has flagged a new 5Y bond. In the supranational, sub-sovereign and agency sector, the German KfW and Dutch BNG mandated deals yesterday, and the EFSF sent out an RFP for an upcoming transaction last week.

Supply activities should have seen their summer trough by now



Source: Bond Radar, ING

Today's events and market view

It may feel like summer still with large daily market moves on seeming little outside impulses. But primary markets may have now seen their trough in the eurozone. In current conditions, the impact of supply could be more noticeable, especially on days when other

drivers are absent. This week though US Treasury supply remains in the spotlight with the upcoming 20Y sale tomorrow.

As for today, not many market-moving data points are on the calendar. Of note are the existing home sales data out of the US. With a view to the Jackson Hole symposium at the end of the week, the scheduled Fed speakers today – Barkin, Goolsbee and Bowman – may get a little more attention than usual.

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