Rates Spark: last-minute notice

Rates markets are exposed to opposing forces. On the one hand there is the spread of the delta variant that has brought back fears the recovery being thrown off track again. On the opposite end is the looming taper by the Fed and we could get more insight on the Fed's internal debate from the FOMC minutes later tonight.

Rates remain torn between souring risk sentiment ...

Yesterday, the risk-off mood kept yields under downward pressure initially, only to make way for a somewhat counterintuitive sell-off on the back of a disappointing retail sales release. This already took the 10Y yield briefly back above 1.25% during the day.

But it appears that the market whisper number extrapolated from real-time data sources had been even lower than the consensus. This could reconcile the market reaction with a market still primed for downside risks to the outlook. The impact of the virus resurgence is something to keep an eye on and last Friday's drop in consumer confidence indeed added to these worries.

But as our economists point out on the retail sales release, while disappointing it was not a calamity: This only makes up 40-45% of total consumer spending and is still up 17.2% on prepandemic levels. And speaking of yesterday's data it is notable that industrial production actually rebounded sharply. This came to confirm the upside in yields which saw some follow-through overnight and took 10Y UST over 1.27% as sentiment took a breather in Asia.

… and the prospect of nearing Fed tapering

The notion of a nearing tapering could gain more traction with the release of the 28th July FOMC minutes tonight. By definition the minutes will be a dated release, the meeting predating the strong labor market report and the CPI for July. Nonetheless, a more detailed discussion on the pace and composition of purchases of a taper at the July meeting could provide more hints that the Fed is moving closer to announcing QE taper. This would chime with various Fed officials' comments since the strong jobs report for July.

Our economists expect to hear more on this at the Jackson Hole symposium and are increasingly leaning toward a September announcement on slowing monthly asset purchases from the current $120bn per month rate, with an October start date. Importantly, it could also be a much swifter taper than seen last time with it possibly concluded by late 1Q or early 2Q 2022.

Chair Powell did not provide any further hints at his appearance yesterday, aside from the commonplace statement that it is too early to declare a win against the pandemic and that the impact of the delta variant is still unclear. Today will see the Fed's Bullard speaking on the economy before the minutes are published. He inhabits the hawkish spectrum of Fed speakers and has previously pointed out that inflation could be more persistent than most people expect.

Today's events and market view

With a hawkish Fed speaker on the agenda and the release of the July FOMC minutes later tonight, markets are facing some impulses for higher rates today. Add to that the US$27bn sale of a 20Y UST. However, with ongoing uncertainty surrounding the resurgent virus globally and its economic impact, that might not be enough yet to move rates out of their ranges.

Europe sees the release of final inflation data. Germany sells €1bn in 30Y Bunds. At below 45bp the 10s30s Bund curve is again exceptionally flat, but the ECB's continued buying amid lingering uncertainty is keeping rates pinned down. Note, though, that in September Germany will sell a new 30Y Bund via syndication.

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