

Rates Spark: Let's start talking louder about 4.5%

Let's talk louder about 4.5%! There has been a consolidation of the market discount for a soft landing. High yield has been an outperformer and the big talk has been of elevated re-financing risks as rates remain higher for longer. Given that and the latest data, there is still an upside for market rates to come, especially in longer tenors



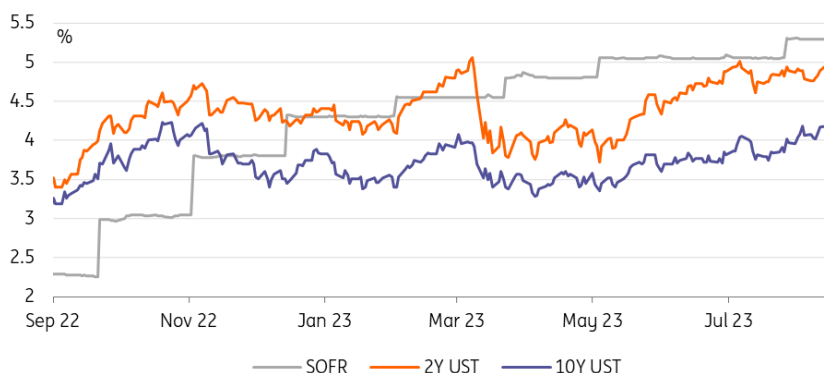
Enough from the data to tempt the US 10yr towards 4.5%

Key levels were hit on the US curve on Tuesday: 4.25% for the 10yr and 5% for the 2yr. Then there has been a brief consolidative theme, but only for more bond weakness to show overnight, with the 10yr hitting 4.3%. That is within spitting distance of last October's yield highs. Risk assets cannot quite decide whether to go risk-on or risk-off. It still feels biased to a risk-off tone in net terms. The issue here for risk assets is how to interpret the notion of a soft landing. On the one hand, it's good as it implies minimal default elevation. On the other, it also implies less room for rate cuts and, more damaging, the maintenance of elevated official rates for longer. This is a growing issue for players that need to get some re-financing done, as this is only going to be at more penal funding rates relative to what was obtained over the past 3-5 years (and further back too).

The bulk of this has to do with the robustness of the US economy. This is the main driver behind the paring back of future rate cuts as discounted by the strip. It's also showing up in a delay on the point at which the Fed is discounted to begin cutting rates. But then, on the very front end, there has been a pullback in the expectation for more rate hikes. Most of this has come from the significant fall in headline inflation and also in core inflation (albeit less dramatically so). That, in turn, has allowed the Fed to get less fussed over pushing the funds rate higher. Keeping it higher for longer is what squares the circle here in terms of the market discount. The rise in the 10yr Treasury yield reflects this, and it is a rationale for the 10yr Treasury yield to maintain an upward-looking profile, at least until this dynamic meaningfully changes.

Latest data pushes in the same direction. Industrial production came in at 1% on the month, and capacity utilisation rose, which typically does not happen to an economy facing into an imminent recession. Even the latest housing market data came in on the firm side. Basically, July has followed the June data so far as being very much 'glass half full' for the economy. Not even an economy that seems to be landing at all. Hence the logic for market yields to hold on up here for a period. The 10yr can hit 4.5% unless some dramatic tilt happens.

The 10y UST's October yield highs are close



Source: Refinitiv, ING

Today's events and market view

The [FOMC minutes](#) did not contain anything particularly surprising. The key passage was that "most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy". Limited summer trading is likely amplifying market reactions, but the bias for rates remains to the upside.

There are only a few data points of note on today's calendar. However, the initial jobless claims data has, in the past, been a source of knee-jerk reactions. With initial claims seen somewhat lower at 240k, the market seems to seek confirmation for the story of economic resilience. The other data point is the Conference Board's Leading Index, seen posting its 16th consecutive contraction. It has been crying wolf for some time now. The eurozone will release its trade balance for June.

French short- to medium-term bond and inflation-linked bond auctions make up today's government bond supply.

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