Rates Spark: Markets are positioned for disappointment

Data still determines direction. But markets seem positioned for disappointments that, on balance, are not there yet. With next week's payrolls data looming large, we don't expect larger moves just yet. Today's key data is the core PCE deflator, which should confirm that inflation is no longer standing in the way of Fed cuts

US Treasury curve dives into cuts and risks being caught by upside surprises

While markets are prepared for more US data disappointments, the durable goods orders and jobless claims both performed better than consensus. The outperformance wasn't much, but nevertheless moved the 2Y UST yield higher by some 5bp and shaved off 4bp of cuts for 2024. Such a reaction really underlines the pessimistic positioning of markets and the expectation of an economy grinding to a halt.

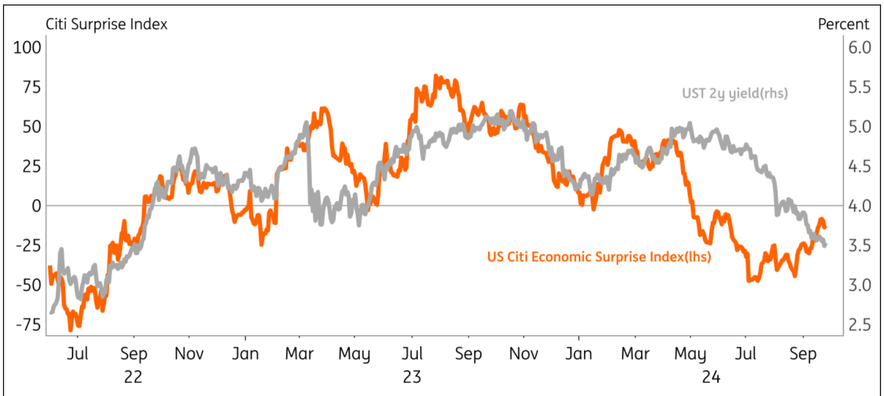
In a broader sense, recent economic surprises have improved recently, yet the front end of the US Treasury curve continues to dive deeper into cuts. Of course, positive economic surprises are also more likely when consensus turns more pessimistic, but even then the latest data points are far from recessionary territory. A slowdown is still our baseline, but the sentiment in rates markets may see some recovery if the data doesn't deteriorate as promptly as feared, potentially helping the back end of the curve retrace higher.

Next move in EUR curve likely to be driven by US

EUR markets remain sensitive to the idea of an October European Central Bank cut and news headlines about Governing Council members supporting an October cut have added fuel to the fire. At the same time, EUR rates are very sensitive to the US economic outlook, which based on Thursday's data is showing pockets of resilience. Netting these two out meant little change in the EUR rates curves.

Overall we expect EUR rates to trade sideways for the time being. And although we don't think an October cut will happen, we also don't think there will be enough data until then to conclude that with more certainty. The next move for the EUR curve could therefore come from the US, where a recovery in sentiment could provide some upward pressure on the back end of global curves.

US economic surprises making a recovery



Source: ING, Macrobond

Today's events and market view

Friday's data highlight is the personal income and spending report, with the core personal consumer expenditure deflator the key number within it. Core CPI came in at a relatively "hot" 0.3% month-on-month, but the core PCE should come in at 0.2% given the lower weighting for housing. As such, this should confirm that inflation is not a barrier to further Fed cuts. We will also get the final University of Michigan consumer sentiment index which could be followed more closely after the Conference Board's disappointing report earlier this week. There will also be a busier slate of Fed speakers to watch including Susan Collins, Adriana Kugler and Michelle Bowman.

In the eurozone, the main events are ECB related, with speeches from Olli Rehn, Joachim Nagel and Philip Lane. On the data side, only the ECB's results of the consumer inflation expectations survey are of note.

Italy will be auctioning 5Y and 10Y bonds as well as floating rate notes for a total of up to €8.75bn.

Author

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com