

Rates Spark: Markets stick to frontloaded ECB cuts

Markets are anticipating more aggressive European Central Bank rate cuts, with a 40% probability of a 50bp cut in December, supported by little resistance from IMF speeches. The spread between USTs and Bunds keeps widening and this may continue until we have more clarity on the US election outcome



IMF speakers give little pushback against frontloaded ECB cuts

Markets are seeing more frontloading of ECB cuts and the central bankers at the IMF annual meeting seem to be giving little pushback. We now have a 2Y EUR swap rate of 2.1%, some 20bp below the peak earlier this month. The known hawk Holzmann commented that some Governing Council members may push for a big cut in December, suggesting a 50bp cut may not be too far-fetched. Markets now price in a 40% probability of a 50bp cut, which seems high but without pushback could build further.

PMIs may strengthen markets' positioning for faster ECB cuts as the composite eurozone index is expected to remain below 50. The eurozone services component is still in expansionary territory, but with a German manufacturing index of 40.8, there are clear weaknesses in the economy. An upside surprise in the PMI numbers is of course still possible, but the question is whether this would

dissuade rates much given the perceived ECB's keenness to return to neutral.

The spread between USTs and Bunds can keep widening

In the US, the Treasuries sell-off seems to continue and bearish sentiment is also reflected in the poor take-up of last night's 20Y Treasury auction. The 10Y UST is now well above 4.2%, the highest since July. This means that the gap between USD and EUR swaps keeps widening, whereby the 5Y SOFR-ESTR spread is around 160bp and approaching the peaks of April. Until we gain more clarity on the US election outcome, this divergence in rates may continue. From the US, the lack of disappointing data means the upward momentum in UST yields won't find any resistance, whilst a potential Trump victory caps the upward potential for Bund yields.

The Fed's Beige Book has once again painted a picture of a weaker economy than that portrayed in official data. It states: "On balance, economic activity was little changed in nearly all districts since early September, though two districts (out of 12) reported modest growth." The focus of course is on the jobs market, where "on balance, employment increased slightly during this reporting period". But demand for workers eased somewhat and hiring is focused on replacement rather than growth. Overall, the report contained nothing to dissuade the Fed from cutting rates in November but also did not signal any urgency to go beyond the 25bp that the market is currently still anticipating.

Thursday's events and market views

Data should take over as a driver with the next set of flash PMIs up for release and given how influential they were in the ECB's latest dovish shift. French and German PMIs are released first and the consensus is looking for a marginal improvement. This is also reflected in the eurozone PMI expectations, with the composite expected to inch up to 49.7 from 49.6. It will get quieter on the speaker front with the ECB's Lane and Kazaks scheduled to appear.

US data will also get more interesting with the initial jobless claims and the S&P PMIs up for release. Anything jobs-related always catches the eye, but weather effects might be behind the wider distribution in individual expectations, which is also skewed towards higher jobless claims.

In government bond primary markets we only have Finland with a small reverse inquiry operation and the UST selling new 5y TIPS.

Authors

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.