Rates Spark: Mounting concerns

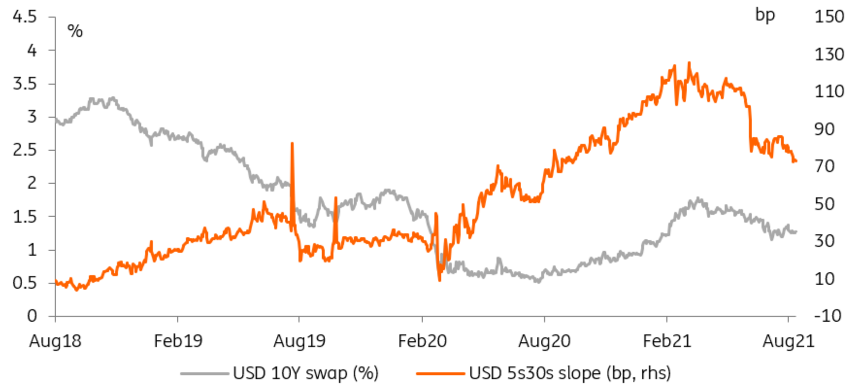
Weak PMIs mean expectations of strong taper warnings at Jackson Hole are being pared back. This could be a mistake, but pessimism means even a hawkish Fed would be greeted with a modest market reaction. In the meantime, supply skews rates moderately higher this week.

Source: Shutterstock

Macro concerns are rising, and so are expectations for a cautious Fed

The fall in UK and US PMI services in August added to worries about the strength of the recovery, and about the impact of a resurgent Covid-19. This isn't the first indictor to raise the alarm, cue the drop in University of Michigan consumer sentiment, but we think it will contribute to shifting market consensus ahead of the Jackson Hole symposium toward a more cautious tone from Powell. Truth be told, expectations of a tapering announcement this week were probably pretty low to begin with, with most calls concentrating on the September 22nd FOMC, or later.

Long-end rates are lingering near the bottom of their recent range



Source: Refinitiv, ING

The increase in term premia could be offset by a drop in the market's estimated terminal Fed Fund rate

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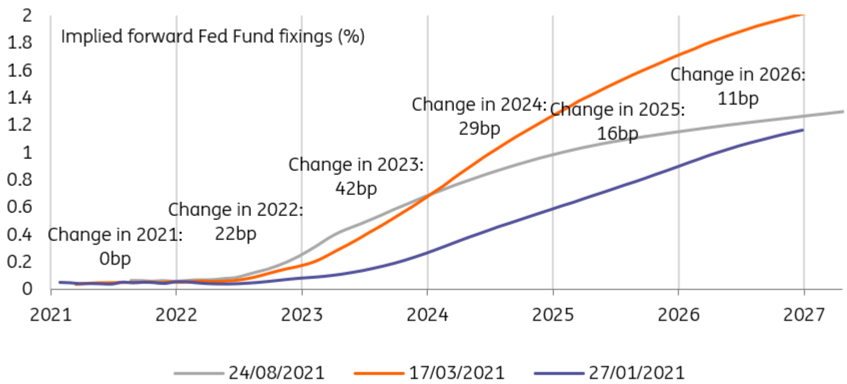
Whilst this is probably the sensible call to make, rates markets are vulnerable to a step-up in hawkish comments aimed at keeping the Fed's options open. With the focus squarely on employment gains, the prudent approach from the Fed would be to maximise its optionality and to keep the possibility of a tapering announcement next month on the table. How impactful this proves for markets is an open question. Macro sentiment is squarely in the driving seat of USD and EUR rates and the market could well greet stepped-up tapering rhetoric with a shrug. This is particularly true if the increase in term premia is offset by a drop in the market's estimated terminal Fed Fund rate.

A decline in the terminal rate would prevent the curve from re-steepening



Source: Refinitiv, ING

Greater conviction is required to move rates lower than higher in our opinion

The argument for higher rates in the run-up to Jackson Hole hinges on supply. Treasury auctions and debt sales from Finland, Germany, and Italy this week are manageable but should weigh on bond direction due to lower liquidity conditions, and to limited risk appetite ahead of the symposium. The fact that rates linger near the bottom of their recent range also means greater conviction is required to move rates lower than higher in our opinion. Fresh impetus will have to wait until Powell's speech on Friday.

Today's events and market view

Finland mandated banks for the sale of a €3bn 5Y bond via syndication. The duration of the sale is limited but it will come on top of a €3bn 7Y German auction scheduled for today.

The US Treasury will carry out the first of its 2Y/5Y/7Y auctions today.

The economics data calendar is mostly in the Richmond Fed manufacturing index, and in US new home sales.

We would venture that, ahead of the Jackson Hole event risk, appetite to enter new positions will be limited. This should prevent rates from breaking out of their recent range. With yields as low as they are, we think this will translate into a moderate upward bias, helped by supply.

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