Rates Spark: Mounting concerns keep up the steepening

Disappointing data keeps markets pricing for quicker central bank responses. That reaction function keeps the steepening dynamic in play, buffeting longer rates with hopes that central banks can still save a soft landing

Data disappoints, but 10y SOFR is still up after the Fed's 50bp cut

Uncertainty surrounding the macro scenario remains high and markets are seeking more insight from data as it comes in. The risks are clearly tilted to the downside, and markets are seeing faster cuts than the Fed's projections. Cuts of 75bp by year-end are now fully priced in after Tuesday's disappointing consumer confidence data. Worryingly, the data indicated that consumers were increasingly noticing the cooling jobs market.

Long-end rates also dropped on Tuesday, but the 10Y SOFR rate is still up compared to just after the recent Fed meeting. Curves are grinding steeper and should continue to do so in the base case as long as the Fed is not seen falling behind the curve and endangering the longer macro outlook. It could still happen if key data were to dramatically disappoint and the Fed was not quick enough to close the gap to the neutral level.

Mounting macro concerns also keep the EUR steepening dynamic in place

In the eurozone, some of the main macro concerns centre around Germany. Disappointing data over the past two days; Monday's PMIs and Tuesday's Ifo, have pushed markets to expect a cut in October as the base case now – close to 16bp was priced as of Tuesday reflecting a greater than 60% implied probability of a cut. This has also been helped by ECB speakers who have not taken a cut off the table for that meeting.

We still see a lower chance of a cut for the 17 October meeting since it effectively holds little new data on top of what the European Central Bank will have known in September. We doubt the ECB will decide based on some weaker PMI and Ifo numbers. Until the meeting we only have September CPI numbers (1 October), the unemployment rate (2 October) and the bank lending survey (15 October). Inflation numbers are likely to remain sticky, whilst the unemployment rate may tick up, but would still be close to record lows. Bank lending showed some recovery earlier, so this may well continue.

The point is, EUR rates may be getting too far ahead of themselves and are being dragged down excessively by US markets. The eurozone economy may be slowing, but we probably won't see enough of that for an October cut. That doesn't mean we oppose the narrative of frontloaded ECB cuts (e.g. back to neutral by June 2025), it just means we would need to have some patience, with December offering the next opportunity. More importantly, in the grander scheme of things, the mounting concerns keep the overall steepening dynamic in place – the 2s10s Bund curve steepened another 4bp on Tuesday.

Today's events and market view

Markets remain focused on data. But Wednesday's calendars do not hold much to trade on. US mortgage applications and new home sales are the only releases of note. Central bank speakers scheduled for the day are the Fed's Kugler on the economic outlook.

In primary markets, Germany and Italy will be active in the eurozone. Next to Germany's 5y bond sale (€3bn), Italy sells a shorter dated BTP and linkers (up to €5.25bn in total). The UK sells 7y Gilts (£3.75bn) and in the US the Treasury sells 2Y FRNs (US$28bn) and new 5y notes (US$70bn).

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