

Rates Spark: Not enough yet for rates to fall

There are good reasons to get hopeful that US inflation will continue to drop in the months ahead. But there are also good reasons for market rates not to get too carried away with this single input. Nothing has broken yet, and it probably has to before market rates can meaningfully fall



US CPI was good, but we can't get too comfortable just yet

US CPI came in on track to a tad below expected. But we still have headline inflation above 3% and core inflation not significantly through 5%. The prognosis ahead is looking positive, but we need to see delivery. The jobless claims number was higher than expected, but still not at a level where we could conclude that something has broken.

Given that, there remains a net impulse for market rates to rise some more. While this seems at odds with the notion that the Fed has likely peaked and the European Central Bank is not far behind, there is also an ongoing nagging elevation in inflation expectations. So, while inflation rates have certainly eased lower, and will likely continue to do so, market expectations coming from 5yr/5yr forward rates have in fact been edging higher. This may or may not manifest in a re-acceleration in actual inflation down the line, but it in any case presents an issue for central banks

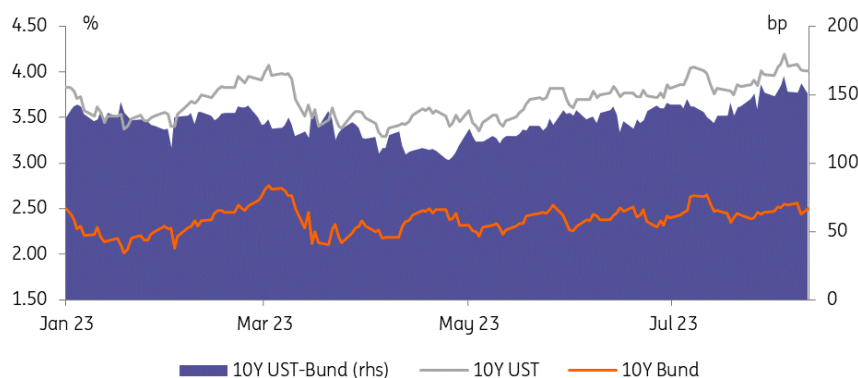
to keep an eye on.

The US 30yr auction tailed by 1.4bp. Not great, especially as a concession has been built into the curve ahead of time. Cover was not great either, but perfectly acceptable. A decent indirect bid though. Overall not the best auction, but safely away.

The 10yr US Treasury yield is managing to just about remain in the 4% area and the 10yr Bund yield is holding in the 2.5% area. Our central opinion here is for market rates to remain elevated, with a mild tendency to test higher. A lot of this is a reflection of US macro robustness and heavier US supply. While circumstances are weaker in the eurozone, the pull of Treasury yields should dominate, especially with the spread already at a wide enough 150bp between Bunds and Treasuries. We also note that this US macro robustness has acted to pare lower future rate cut expectations. This too is containing the degree to which longer tenor market rates can fall.

In due course, the US economy is liable to break as the various pressures hitting it will cumulate and hurt. And this will ultimately correlate with market rates falling by the time we get to the fourth quarter of this year. As a guide, expect the US 10yr to remain above 4% for now with a tendency to edge higher, but then to be targeting the 3.5% area by the turn of the year. Eurozone market rates should follow a similar trend.

Net impulse is for US rates to rise more and EUR rates to feel it too



Source: Refinitiv, ING

Today's events and market view

The [US CPI was broadly in line with expectations](#) which feeds expectations that the Fed will stay on hold in September. To corroborate the unfolding goldilocks scenario, markets will look to the PPI release and the University of Michigan consumer sentiment survey today. The PPI headline is seen somewhat higher though, also on a month-on-month basis. The Michigan survey's measured 1Y ahead inflation is seen a tad higher as well at 3.5%, while sentiment itself could ease lightly.

After this morning's UK GDP figures, the eurozone will see the release of final July CPI data for France and Spain.

At the end of the day, it was the 30Y auction that nudged the 10Y UST yield more decisively above 4%. Looking into next week, we are spared further auction supply in the US. In data,

markets are looking for a slightly firmer retail sales release and housing indicators. Markets will also parse the FOMC minutes against the background of the new data since the July meeting. Recent comments by the Fed's Bowman and yesterday by Daly bring back to mind that the Fed had indeed kept its bias to do more.

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