

## Rates Spark: Another 0.2% and the rate cut story is intact

US PCE is the key for Friday. Once that's in, and okay, then it's Labor day weekend for the US. German and Spanish inflation showed a downside surprise, helping the front end of the Bund curve lower. Friday's eurozone inflation and unemployment numbers could shine light on whether market pricing for an October ECB cut is justified



### Get through the PCE price index intact, and the day should quickly drift into the weekend

The US 7yr auction was not so hot on a near 1bp tail, although the indirect bid at 75% was very respectable. The 7yr is a betwixt-and-between maturity, without the weight of the 10yr reference, nor the cross-over popularity of the 5yr. The lower size in part reflects this. And despite the tail, another \$49bn is safely away from the US Treasury perspective. There is little doubt that the rate cutting target ahead is masking any possible concern there could be on issuance sizes and fiscal pressure. It's helping lower yielding product to get done, as the prognosis into a number of rate cutting events is for yields to ease lower leaving, auction takedowns today in the money on a 3mth forward basis.

Barring a surprise on the PCE price index front, Friday is likely to be a quietish day as players will have one eye on the Labor day weekend. In fact many will be taking the Friday off to make it a proper long weekend. The baseline expectation is we continue with the 0.2% month-on-month (or lower) readings. That's all we need to keep the rate cut narrative alive and well, and reasonably aggressive to the downside. If we pop that into our back pockets, the rest of the day should then be a drift.

Apart from getting through the spikes being seen in SOFR as we get through another month end of window dressing by the banks, this has caused them to withdraw from repo. Barring the unexpected, that should be broadly back to a more normal footing by next week.

## **Inflation data improving but not there yet for consecutive ECB cuts**

The German and Spanish inflation numbers were welcomed by markets as both headline figures came in below consensus. The German headline CPI number even hit 2.0% year-on-year, right on the European Central Bank's inflation target. These figures should help with tomorrow's eurozone CPI data, of which the core component is expected to come in at 2.8%, just a notch below the prior reading of 2.9%.

The front end of the curve ended the day lower, with the 2Y Bund now well below 2.4%. But overall the impact was not that material, which makes sense given markets are already pricing 65bp of ECB cuts for 2024. For September a full 25bp cut is priced in, which seems fair, but market positioning also implies a 50% probability of an October cut immediately thereafter. Various ECB speakers have already warned that a September cut is not necessarily the start of a series of consecutive cuts and we think current pricing would need further improvements in inflation to justify.

If inflation remains sticky for longer, then a material deterioration of growth would be needed for consecutive ECB cuts, but for this more convincing data is needed. Eurozone unemployment numbers will also be released tomorrow, but even if the number ticks up from 6.5% to 6.6%, the level will still be at historic lows. Having said that, EUR rate markets may be more sensitive to US growth numbers as the upside surprise in US GDP growth today was enough to fully offset the morning's decline in 10Y yields.

### **Friday's events and market views**

Plenty of important data, including the US PCE index, and eurozone inflation and unemployment numbers. The core PCE deflator is expected to come in at 0.2% month-on-month, with not a single economist forecasting 0.3%. Other data from the US includes the Chicago PMI, Michigan indices and personal income and spending figures.

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