# Rates Spark: More peaking, less pivoting

Today's data should further underpin the notion that US inflation (expectation) has peaked. But this alone will not be enough to swing the FOMC around just yet. We may see more steepening near term, but we do not think that we have seen the last of the late-cycle flattening dynamic as the Fed is still set on ratcheting up the key rate


## More data to underpin the notion of the inflation peak having passed

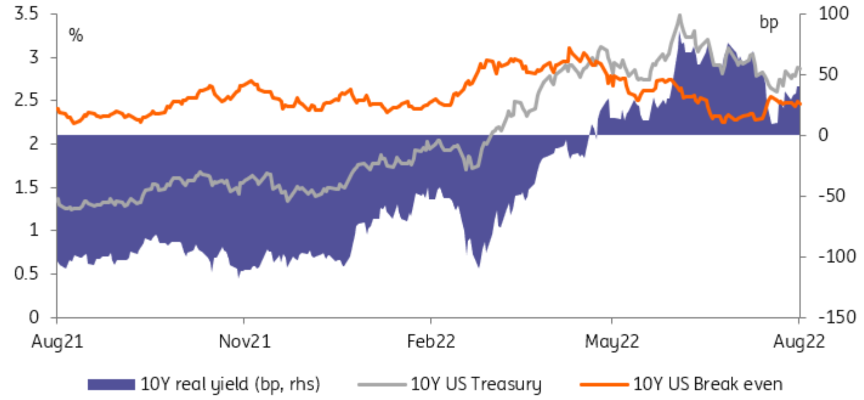
With today’s University of Michigan consumer sentiment release and the accompanying consumer inflation expectations, markets are set to get another piece of data that should underpin the notion that the peak in inflation has now been seen.

Already yesterday, producer prices posted an even bigger undershoot versus expectations than the CPI the day before. Headline prices fell month over month with the drop in fuel prices clearly of help. Overall the reports have helped turn around market expectations towards a 50bp hike in September and respective pricing is now only implying a 40% perceived chance of a larger 75bp hike.

*One soft CPI reading is probably not enough to swing around the FOMC*

However, one soft CPI reading is probably not enough to swing around the FOMC. We will likely not have heard the last from the Fed in terms of hawkishness. Officials continue to reiterate that the Fed's job is not done yet. Looking ahead into the next weeks we have the FOMC minutes and the Jackson Hole symposium, which could drive that message home again. And not to forget, there is still one more CPI and one more jobs report to come before the September FOMC meeting. The steepening we are now seeing may look a bit premature with a Fed set on a path to deliver more hikes, taking the Fed funds rate eventually to 3.50-3.75% before the year is out.

## The Fed's hawkish tone and lower inflation have put real yields up




Source: Refinitiv, ING

For now the US curve still stands notably steeper, with the initial post CPI bull steepening having morphing into a bear steepening, where even the front end pared some of the first move lower. The later dynamic may in part be owed to the long-end Treasury supply with yesterday's 30Y auction trailing despite the concession going into the event. Perhaps it is a sign of the Fed further losing grip of the long end. Now seen a tad less aggressive it may have allowed inflation expectations creep back into the long end – the 10Y inflation swap has entirely retraced the post CPI move lower. But less aggressive tightening may also help allay recession fears. It was actually real yields that have risen again, especially yesterday with the 10Y now at 0.15% again after having flirted with the zero line early in the week.

## Markets on summer tour with US events

With many of the upcoming events still revolving around the Fed outlook the US market will likely remain in the driving seat. But it should turn more quiet in the next week with perhaps finally some sense of summer pause setting in – especially as much of Europe is observing a public holiday on Monday.

*The evolving energy crisis will remian the underlying theme in Europe*

Data calendars are looking more quiet as well. While we have the FOMC minutes and also housing data to consider in the US and over in Europe a ZEW reading – one dares ask whether it can get any worse than it already is – the underlying theme in Europe will remain that of the evolving energy crisis. The summer drought is seeing dramatically falling levels on one of Europe's most important waterways, aggravating the energy crunch. A key level for navigability is expected to be undershot these days.

## Today's events and market view

Data leaves the US in the driving seat with all eyes on the University of Michigan sentiment index. As our economists recount, it has plunged as the cost-of-living crisis and falling equity markets sapped spending power and confidence. However, the drop in gasoline prices should now provide some relief and support. Consequently, they expect the index to bounce far more than the consensus is looking for while inflation expectations may also drop back a little.

Thus more to underpin the notion of the inflation peak having passed – and for now the market may see some more steepening. Eventually we think we have not seen the last of the late-cycle flattening dynamic yet.

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