Rates Spark: Rates having a peek to the downside

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US Treasuries continue to find excuses to at least test how lower yields feel

The market remains in a mood to test the downside for yields (10yr now at sub-4.6%), sparked by the run of lower-than-expected core PPI and CPI data, and sustained in a sense by weaker-than-expected retail sales this morning. The latter though is very much second-tier data, and the market decided to conveniently ignore the firm-ish claims data, the pop in the Philly Fed, the higher-than-expected trade prices and the rise in the NAHB housing index (albeit all second tier too).

Commentary by the Fed's Waller that the Fed could cut rates in 2025 has also been given outsized influence. Such comments should not really be a surprise, as it's what the dots say and they are hot off the 18 December press (just a few weeks old).

We are going through a short period of testing how it feels on slightly lower yields. Mutual funds data are also showing buying of duration in the past couple of weeks, reversing the big duration squaring (and indeed outright shorts) over the final months of 2024. And there is a holiday on Monday that usually sees guys squaring up and placing funds in safe places (like bonds and bills) while markets are closed.

We're still structurally bearish for 2025, but as noted post the CPI release, this market wants to have a bit of a dip lower in yield to see how the water feels there, and will keep dipping until it feels wrong. Beyond that, we've still got a call for 5%+ on the 10yr, but on hold for as long as this phase lasts…

EUR rates join in with more moderate declines

10y Bund yields were marginally lower on the day, thus not fully reflecting the bearish dynamic in the US and resulting in a narrowing of the 10y UST/Bund gap towards 205bp – down from a peak of 225bp in December. This speaks to some of the homemade factors that had driven yields higher intially. But it was also telling that the front-end, which outperformed today, did so on the back of the Waller comments rather than a dovish interpretation of the December ECB meeting minutes.

They underscored that more easing is still in store as the disinflation process was seen "well on track". At the same time more concerns about growth were voiced, and with the depo rate at 3% still being restrictive, the arguments for cutting rates further at the upcoming meeting(s) are still very valid. However, the comments about gradually approaching the vague area of neutrality around 2.5% to 2% could leave markets leaning to a slower or at least slowing trajectory as long as near-term inflation still feels elevated and energy price pressures persist. But overall we think the upside to the front-end should remain limited and agree with the market putting more emphasis on the weaker macro backdrop again. Our longer-term view still sees the the EUR curve steepen from both ends, as curve normalisation and a rebuild of the term premium paired with foreign influences should keep more upward pressure on long-end rates.

Friday's events and market view

We will get to hear from ECB officials on both ends of the spectrum, with Nagel as a hawk and Escriva and Centeno as dovish speakers scheduled for the day.

In terms of data it will be more quiet again in the eurozone with only final CPI figures released. Main focus are the US data points, covering housing starts and building permits, as well as December industrial production.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

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