

Rates Spark: Why September looks like a good month for an ECB rate cut

The ECB's Luis de Guindos identified September as a good month for a rate cut decision as new macroeconomic projections will be in. PMIs are coming in for the US and Europe and will be watched for signs of economic weakness. As the Harris vs Trump discussion fades slightly, we gear up for some key data and corporate results in the coming days



The ECB's Guindos indicated that rates could be cut at the September meeting

ECB speaker in favour of a September rate cut decision

Euro rates found themselves lower on Tuesday, helped by dovish commentary in the morning from the European Central Bank's Luis de Guindos. He emphasised that the September meeting will have new macroeconomic projections, which will help with a rate cut decision. Later in the day, the ECB published the consumer confidence survey, which showed an improvement from -14 to -13 and reflected the gradual but fragile recovery path of the eurozone economy. As long as growth dynamics don't worsen significantly, markets will need to see less sticky inflation numbers to be fully on board with a September cut.

Market pricing now suggests a probability of around 80% for a September cut, where it has been

for much of the last few weeks. In line with Guindos' comments, we believe that September will see the first cut. But with inflation and economic data still a bit of a mixed bag, this may not be perceived as the start of a series of consecutive cuts, and the short end of the curve may therefore face some resistance to go much lower.

Weak US data maintains the downward bias for market rates

With the exception of the pandemic era, yesterday's Richmond Fed manufacturing index at -17 for July was the weakest reading since the great financial crisis. Existing home sales at 3.9m for June were also weak. The probability for a September cut is back up at 100% as a result.

The 2-year yield has broken back below 4.5%. That's some 80bp through the effective funds rate. Once we get to 100bp, the market is nailing an imminent delivery of a first cut to be followed by a sequence of rate cuts. The 10-year yield is edging back down to the 4.2% area. It went through 4.2% to the downside post the benign June CPI report. As we head towards what we and the market believe to be a rate-cutting event on 18 September, our target for both the 2-year and the 10-year yields is 4% on a three-month view, as the curve flattens out completely and prepares to build an upward sloping profile.

We're watching and monitoring the political gyrations, and they have generated talking points – but it's still a long way to November, and the macro data (and corporate results) between now and then should dominate the rates prognosis. As it is, the betting (from odds shops) is for Donald Trump to win versus Kamala Harris, even as the Democrats go through something of a renewal process post Biden's exit.

There is an FOMC meeting on 31 July, and it could be argued that a cut at that meeting could have been construed as politicking. But that's not an issue this time around, as there is no expectation for a cut from that meeting. September is far enough away to be clear of the dramatic developments of recent weeks.

Today's events and market views

PMIs for France, Germany, the UK, the US and the eurozone will be released. Consensus sees slightly improving figures for the European numbers, but the US services component is expected to come down from 55.3 to 54.8. Most focus will be on the manufacturing component of the eurozone, which at 45.8 is still deep in contractionary territory.

The UK will auction £2.25bn of 30Y Gilts. Germany has scheduled €5bn of 10Y Bunds for auction. From the US, we have a new 5Y Note totalling \$70bn.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

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