

Rates Spark: Shifting the rate cycle discount

How convinced are we that the Fed has peaked? You can never be 100% sure on this, but the odds firmly favour the view that they're done. That places rate cutting on the radar. Ahead of that, market rates tend to ease lower



Have market rates peaked in the United States? Most probably yes

The US 10yr has gapped below 4.5% in the wake of the CPI report – immediate impact effect. It did feel like Treasuries were waiting for this report before making any conclusive subsequent move having had a look below 4.5% twice and each time finding an excuse (good ones though) to get back above.

Although the headline inflation rate is now 3.2%, the caveat is that core is still at 4% (even if lower than the 4.1% expected). But the path is positive, and that's what the market rates are extrapolating.

It is still not clear that market rates should capitulate lower from here though. Tuesday's CPI report was great. But the absolute numbers mean there is still some inflation reduction work to get done.

There will be an interesting supply test next week from the 20yr auction, which will be watched following the badly tailed 30yr one last week (the main reason we gapped higher again in yields).

On the front end, the 2yr is back in the 4.85% area, having been above 5%. This is an easier sell. A big move lower is likely here. It's only a matter of when – typically it's about 3 months before an actual cut. Not quite at that point, but it will be there as a theme over the turn of the year.

Breakeven inflation has also moved lower post the number. But real yields are lower by more – by over 20bp in the 10yr (now 2.2%). Real yields are still elevated though, and reflective of macro resilience and the fiscal deficit. That's a resistance that can remain an issue for longer tenor market rates. Ongoing dis-inversion and a steeper curve ahead.

Today's events and market view

The CPI data gave the market the green light to drop the 10Y US yield back to just below 4.5%. EUR rates were pulled lower alongside, bull flattening with the 10Y Bund yield touching 2.6%. This level held twice last week, having marked the lowest yield since mid September.

Today's calendar features more data that could feed the bullish sentiment. We will get the US producer prices and we will likely also see softer retail sales data, where gasoline prices will have depressed values of sales. But as our economists point out, vehicle sales were down on the month and that credit card spending has been subdued, also pointing to a soft spending number. In the eurozone, markets will be looking at industrial production data, pointing to a worsening situation in the sector.

With a view to the risk of a government shutdown, there are signs that the Speaker's interim plan that continues government funding at current levels until early next year has some support among Democrats.

In primary government bond markets Germany will tap two 30y bonds for €2bn in total.

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