

Rates Spark: Still feeling heavy for bonds

The US 10yr fell back below 4% briefly, but it took a decent bout of risk-off to force it there. There is a more natural place for the 10yr yield at above 4%, based on the forward discount for the funds rate (and that has not materially changed)



US yields are off last week's highs, but still feel under net upward pressure

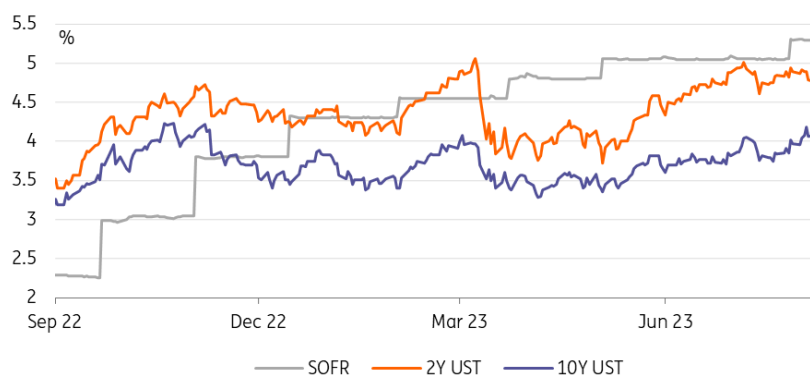
It took a bout of risk-off to briefly take the US 10yr yield back below 4%, well below the high of 4.2% seen on Friday. That was always likely to be the cleanest route to taking the US 10yr yield down. But it did not stay below 4% for long, and we remain of the opinion that the 10yr sits more naturally at above 4%, at least for now. The 10yr should trade at a 20-30bp premium to the forward discount for the funds rate low, and that's only just below 4%.

We'll also get an inflation reading on Thursday, likely confirming that US headline inflation moved back up towards 3.5%, while core inflation is finding it tough to make a material break below 5%. The point estimates here at 3.3% and 4.7% respectively on 0.2% month-on-month outcomes. These are much better than they were (the headline peaked at 9%), and the rise in the headline rate for July is just a base effect. But inflation dynamics are not yet in what could be called a comfort zone.

We also have continued supply to take down over the course of this week. The 3yr auction on Tuesday saw a good reception. It was well covered, saw a strong indirect bid (including central banks), and no tail (or technically a negative one, which is good). There is more duration to take down ahead as the 10yr and 30yr auctions are up in the coming days. The volume of supply has been upped since the last outing. It should get taken down okay.

In fact, the flow of data over the last few weeks shows good demand for the duration despite the upward pressure seen on bond yields. Had it not been for this buying, the 10yr Treasury yield could likely have attacked the previous high seen in the 4.25% area. We're still at better levels than before for buyers. But supply is also a weight to be taken down, placing upward pressure on market rates.

Off the recent peak, but we think 10Y UST sit more naturally above 4% for now



Source: Refinitiv, ING

Today's events and market view

Global growth concerns eyeing developments in China, a new bank tax in Italy, as well as rating jitters surrounding US banks all contributed to the risk-off sentiment that sparked yesterday's bull flattening.

While tomorrow's US CPI data looms large, today's calendar holds little to extend that rally. The focus could instead be on today's supply where Germany taps its 10Y benchmark for €5bn and the US Treasury later sells US\$38bn in new 10Y notes.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.